EY Norway

Executive and Board Remuneration Report 2014
EY’s 2014 Executive and Board Remuneration Report represents commentary on the market, legislative, regulatory, governance and shareholder issues that affect executive and board remuneration. It provides an overview of remuneration trends in 2014 and outlines our views on expected changes and potential issues for 2015.

This report analyzes executive remuneration and board fee quantum and policy information for companies included in the Oslo Stock Exchange Benchmarking Index (OSEBX) as of June 2014. The analysis is based on information disclosed in the 2013 annual reports released to June 2014.

We include a discussion of the external issues we observe as influencing remuneration strategies in 2014, changes in regulations in the financial sector, the economic environment and evolving shareholder views.

We also set out key focus areas and issues which we anticipate will be of influence in 2015.

Whilst our report is not intended to constitute a benchmarking tool, we have presented our data in three different groups (CEO, CFO and other executives) to allow reflection on the most appropriate comparisons.

A more comprehensive and tailored analysis of the underlying data can be provided on request.
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The remuneration environment in 2013 was characterized by continuing economic growth.

The remuneration levels for CEOs, CFOs and Other Executives continued to increase from 2012 to 2013, with an average of 4.5%.

Generally, the quantum of executive remuneration is correlated with company market capitalization. The median total remuneration of CEOs, CFOs and Other Executives in the top 20 companies based on market capitalization was approximately twice that of the bottom 20 companies based on market capitalization.

The base salary continued to be the predominant element in the executive compensation packages. All companies but one offered a short-term incentive (STI) scheme, whereas just over half of the companies operated with a long-term incentive (LTI) scheme in 2013.

As we are now approaching the end of 2014, the positive economic environment that characterized 2013 and beginning of 2014 is discontinued as falling oil prices and turbulences in the oil sector has caused uncertainty regarding the outlook of 2015.

We anticipate an effect on the remuneration environment and expect to see lower bonus awards and reduction of LTI grants in 2015. However, due to the composition of the executive remuneration packages with high base salary levels and pension contributions defined as percentage of the base salary, the boards have limited flexibility to reduce the total salary costs in economic downturns.

Nonetheless, we will not be surprised if a negative market leads to greater scrutiny from shareholders with regards to executive remuneration combined with an expectation that remuneration levels and potential bonus awards are justified by the board of directors. Consequently we expect an increasing pressure from shareholders to demonstrate a link between performance and pay, which should be reflected in the different bonus plans for 2015. Strategically designed remuneration structures encourage improved performance and behaviors matched to a company’s desired risk profile.
Performance-based LTI plans have recently gained popularity in Norway and internationally. Many of the largest companies in Norway are partly owned by the state. The state-owned companies’ approach to LTI plans are influenced by the state’s regulations for executive remuneration, where fixed annual share grants up to 30% of base salary have up until now not been regarded as variable pay.

However, in the new guidelines for state-owned companies which are expected to be published in the beginning of 2015, we anticipate that LTI grants no longer will be regarded as fixed remuneration, but as variable pay. This will be in line with general market practice. Such a change will provide more flexibility in the way LTI plans are structured, and we expect that the state-owned companies will replace current LTI plans with performance-based LTI plans in the future.
Economic factors

Economic volatility across key global jurisdictions has impacted the stability of the Norwegian market, contributing to concerns about company performance and remuneration levels. Although the Norwegian economy has been strong in 2013, the outlook remains uncertain generally due to decreased oil price trends. A year later low oil prices has slowed down the growth, with 3% expected this year.

EY’s IPO Eye study found that IPO activity continues to increase globally with 851 IPOs raising US$186.6bn in the first nine months of 2014, a 49% increase in volume and 94% increase in proceeds compared to the same period in 2013. In Norway, 19 IPOs have been registered, raising NOK 12bn. This is 50% higher in volume compared to the same period in 2013.
The Norwegian Code of Practice for Corporate Governance

In 2014, the Norwegian Corporate Governance Board (NCGB) introduced changes in the Norwegian Code of Practice for Corporate Governance applying to executive remuneration. According to the NCGB, recommendations for 2014 share-based incentive schemes should be subject to a separate vote in the Annual General Meeting. The board of directors is required to follow the guidelines set by the shareholders regarding share-based incentives.

Executive remuneration in state-owned companies

On 24 June 2014 the Ministry of Trade and Fisheries published a new ownership report which requires state-owned companies to:

• Apply the guidelines to subsidiaries where parent company is wholly owned by the state or where the state has more than 90%
• No longer support company pension schemes which secure pension above 12 G
• Limit variable pay plans (short term incentive) to 50% of base salary

The Ministry also states that the current practice for LTI, which in many cases is treated as a fixed annual grant calculated as a portion of base salary (30%) with a three-year holding period, will be subject to evaluation in connection with the amended guidelines that are expected in the beginning of 2015.

Executive remuneration in finance institutions

On 22 August 2014 the Ministry of Finance introduced changes in the regulations for bonus schemes in the financial sector due to implementation of CRD IV. The new regulations came into effect on 1 January 2015. On 1 December the Norwegian FSA introduced new guidelines. The new regulations and guidelines will represent a tightening compared to previous regulations.

In response to regulatory changes to corporate governance frameworks, we expect that remuneration committees are becoming more active in executive remuneration decision making.

Global

• The European Commission presented a proposal for the revision of shareholders’ rights that would increase transparency and introduce a European “say on pay”.
• Legislation on the disclosure of directors pay is under consultation in the US and the EU.
• Effective at the start of 2014, listed Swiss companies began to adopt provisions in the Ordinance against excessive compensation in listed companies. Key provisions include prohibition of severance payments, annual election of board members, and annual binding vote on compensation for executives and board members.
• The regulatory environment in Asia continues to evolve globally with the primary focus on business regulation over the use of prescriptive rules on remuneration and reporting requirements. However, we are beginning to see some focus on the Financial Stability Board principles in financial services which may evolve into broader industry in some jurisdictions.
Executive remuneration: market insights

Data presented

This report presents a summary of the changes in executive remuneration for CEO, CFO and other executives in companies listed on the OSEBX list. The report is based on data presented in the companies’ annual reports. Some of the companies on the OSEBX list do not provide executive remuneration data in their annual reports and were thereby excluded from the benchmark. In total, our analysis comprises 43 companies on the OSEBX list. The analysis is based on remuneration data from 2011 until June 2014.

In the following, we highlight some of the key trends in executive remuneration, both with regards to actual remuneration levels and how the executive compensation packages are structured.

We analyze key trends in short-term incentive plans (STI), including what type of key performance indicators (KPIs) are predominantly used to measure performance. In addition, we have analyzed the companies’ long-term incentive plans (LTI) and report market practice with regards to type of LTI plans, performance measures and vesting periods.

Finally, we look at remuneration data for directors of the board, including separate analyses for chairmen and ordinary board members. We also try to pin down what we see as important issues in executive compensation in the years to come.
Remuneration levels

Market remuneration quantum

Generally, the quantum of executive remuneration is correlated with company market capitalization. Median total remuneration of CEOs, CFOs and other executives of top 20 companies based on market capitalization was approximately double that of bottom 20 companies based on market capitalization. Analysis of median remuneration levels, by segment, is included in figure 1.

Figure 1: Total remuneration of executives, by segment

<table>
<thead>
<tr>
<th>All companies (NOK’000)</th>
<th>Median</th>
<th>Salary</th>
<th>Benefits</th>
<th>Pension</th>
<th>STI bonus</th>
<th>Total remuneration*</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>3 456</td>
<td>158</td>
<td>238</td>
<td>1 373</td>
<td>6 471</td>
<td></td>
</tr>
<tr>
<td>CFO</td>
<td>2 345</td>
<td>165</td>
<td>139</td>
<td>297</td>
<td>3 274</td>
<td></td>
</tr>
<tr>
<td>Other executives</td>
<td>1 867</td>
<td>141</td>
<td>160</td>
<td>380</td>
<td>3 170</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Top 20 companies based on market cap 31.12.13 (NOK’000)</th>
<th>Median</th>
<th>Salary</th>
<th>Benefits</th>
<th>Pension</th>
<th>STI bonus</th>
<th>Total remuneration*</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>4 487</td>
<td>255</td>
<td>919</td>
<td>2 099</td>
<td>11 061</td>
<td></td>
</tr>
<tr>
<td>CFO</td>
<td>2 645</td>
<td>198</td>
<td>349</td>
<td>855</td>
<td>4 809</td>
<td></td>
</tr>
<tr>
<td>Other executives</td>
<td>2 423</td>
<td>247</td>
<td>505</td>
<td>873</td>
<td>4 575</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bottom 20 companies based on market cap 31.12.13 (NOK’000)</th>
<th>Median</th>
<th>Salary</th>
<th>Benefits</th>
<th>Pension</th>
<th>STI bonus</th>
<th>Total remuneration*</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>3 000</td>
<td>112</td>
<td>68</td>
<td>730</td>
<td>4 230</td>
<td></td>
</tr>
<tr>
<td>CFO</td>
<td>1 827</td>
<td>76</td>
<td>68</td>
<td>192</td>
<td>2 666</td>
<td></td>
</tr>
<tr>
<td>Other executives</td>
<td>1 615</td>
<td>62</td>
<td>92</td>
<td>191</td>
<td>2 213</td>
<td></td>
</tr>
</tbody>
</table>

*In these analyses, LTI awards have not been included as the companies report on LTI awards differently. Some companies report value at grant while others report value at exercise. Hence, it is difficult to get a consistent comparison, and it was decided to only focus on STI bonus awards as this reporting is usually consistent across the companies.
Same incumbent movements in remuneration

Our analysis includes 150 executives of OSEBX list companies who filled the same role for the full 2012 and 2013.

Analyses of this population provide additional insights into underlying remuneration movements by removing the volatility created by new appointments.

The table shows the year-on-year movement of the median level of base salary and short-term bonus payments.

The percentage increase in year-on-year median base salary levels for CEOs was lower from 2012 to 2013 compared to the increase from 2011 to 2012. The year-on-year movement of short-term bonus payments for CEOs was the same throughout 2011 until 2013 and increased by 3.5% each year.

For the CFOs, the year-on-year increase in base salary was higher from 2012 to 2013 compared to from 2011 to 2012. The percentage increase in STI payments was also higher from 2012 to 2013 and increased by 2% from 2011 to 2012 the bonus payments increased by only 0.9%

Other executives saw a percentage increase in median base salary levels of 4.8% from 2012 to 2013. This was 0.7% higher compared to the increase in median base salary levels from 2011 to 2012, which was 4.1%. The STI payments, however, increased significantly from 2011 till 2012, which was above 12% while the increase slowed down to 3.2% from 2012 to 2013 and was more in coherence with the STI payments increase for CEOs and CFOs in the same period.

Figure 2: Year-on-year change in executives in companies on the OSEBX list

<table>
<thead>
<tr>
<th>OSEBX list</th>
<th>Median Salary</th>
<th>Short-term bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>3.8%</td>
<td>2.6%</td>
</tr>
<tr>
<td>CFO</td>
<td>4.1%</td>
<td>6.2%</td>
</tr>
<tr>
<td>Other executives</td>
<td>4.1%</td>
<td>4.8%</td>
</tr>
</tbody>
</table>
Remuneration mix

- In this section we have analyzed what type of compensation elements were paid to the executives in 2013 and the relative size of the various elements.

- Remuneration mix for CEOs was more heavily weighted towards annual bonus when compared to the remuneration mix for CFOs and other executives.

- The illustration of the remuneration mix demonstrates the large portion of base salary in the total remuneration package to the executives.

- This trend differs from international trends where the remuneration mix is more balanced and variable remuneration usually constitutes a larger part of the total remuneration package.

- When comparing the executives’ total remuneration in the top 20 companies to the bottom 20 companies, the annual bonus payout constitutes a larger part of the remuneration mix in the top 20 companies. The pension contributions are also significantly higher.

- One explanation could be that the top 20 companies could have more international members on their boards and more international shareholders who expect a larger part of the executives’ pay packages to be linked to company performance.

Figure 3 shows the remuneration mix for CEOs, CFOs and other executives of companies in 2013.

The executive remuneration packages for all three groups, CEO, CFO and other executives, are dominated by the base salary.
Quantum

70% of the companies with STI programs report that the maximum bonus potential for the executives is capped. The maximum bonus opportunity is usually indicated as a percentage of base salary. The majority of the companies report that the maximum bonus opportunity equals 50% of base salary. However, the market shows a wide spread from bonus payments capped at 25% of base salary up to 200%. There is no sector specific difference regarding maximum bonus pay-outs, nor any differences between companies with the highest market value compared to companies with lower market value.

Financial performance measures

- Profit/earnings was the most commonly used financial performance measure (disclosed by 37% of the companies)
- Return was also commonly used (18%)
- However, many companies do not provide details of the KPIs used in their STI plans and therefore, the figure below does not illustrate the full picture regarding market practice.

The most frequent financial performance measure in 2013 was profit (37%).
Non-financial performance measures

- 67% of the companies report that they have non-financial performance metrics in their annual bonus plan.

- The percentage of companies with non-financial performance metrics is slightly higher for companies in the top 20 than companies in the bottom 20 (76% versus 57%).

- Individual performance metrics were the most frequent measures, business plan/strategy the second most popular non-financial performance metric, and health, safety and environment (HSE) the third.

- Other disclosed non-financial measures included customer service targets and operating targets.

Figure 6: Use of non-financial performance metrics in annual bonus plans.

Figure 7 shows the most prevalent non-financial measures in 2013.

The most frequent non-financial performance measure in 2013 was people measures (45%).

45%
Companies with LTI plans

Just over 50% of the companies in our analysis operate with a long-term incentive plan. However, this includes companies in the financial sector which according to legislation on executive remuneration in financial institutions cannot operate with traditional LTI programs. Instead, variable pay models in the financial service industry are typical STI bonus plans with deferred payment mechanisms.

If companies in the finance sector are not included in the statistics, the actual number of companies that have LTI plans increases to 64%.

“Internationally, companies have started to replace old share option plans with performance-based plans as they are becoming more popular. EY expects this trend to come to Norway as well and we are already witnessing companies in the Norwegian market change from non-performance-based to performance-based plans.”

According to our sector analysis (figure 8), a higher percentage of companies in the health sector (100%), followed by the energy (63%) and industry sector (63%), have LTI plans compared to other sectors.

Figure 8 shows the sectors with the highest percentage of companies with LTI plans

Point of View

LTI grants are not reported consistently by the companies. Some report the value of the LTI at grant while others report the value at the date of exercise. This inconsistency in reporting makes it difficult to compare the value of the LTI granted to the executive management.

Best practice in Norway and internationally suggests that the reporting of LTI should be made at grant.
LTI in state-owned vs. not state-owned companies

The landscape of LTI plans can be split into companies with state ownership and companies without state ownership. Companies with state ownership should follow the state’s regulations for executive pay in state-owned companies. According to these guidelines, LTI shall be defined as fixed remuneration and not variable pay. The executives will receive annual fixed LTI grants (a few companies require that the company had a positive EBIT the previous year in order for LTI to be granted) which will have to be invested in company shares and kept for a period of three years. The shares will be transferred to the executives after the three-year vesting period, on the condition that the executive is employed by the company at that time.

In companies with no state ownership, LTI is defined as a variable long-term incentive plan. Different types of LTI plans are employed and one can roughly differentiate between performance-based and non-performance-based LTI plans.

In performance-based plans, pay-out depends on whether pre-defined performance goals have been achieved during a vesting period, usually three years. In non-performance-based plans payout is solely dependent on share price development. Traditional share option programs are in the latter category, as these usually have no other conditions for exercise other than that the share price has increased sufficiently during the vesting period, so that the options are “in-the-money”.

Figure 9 illustrates the difference between LTI plans in state-owned companies versus companies with no state ownership.
Long-term incentive policy

Type of plan
26% of the companies that had LTI plans in 2013, had performance-based LTI plans, while 74% had non-performance-based plans.

Figure 10 shows the percentage of companies with performance-based LTI plans vs. non-performance-based LTI plans.

Performance metrics
Not all companies with performance-based LTI plans report on performance measures for executives. However, amongst the ones that do, relative performance measures such as relative total shareholder return (TSR), are the most common.

Vesting period
Of the companies which report the number of years' vesting period in their LTI plans, 75% have a three-year vesting period while 25% have a four-year vesting period.

Figure 12 shows the percentage of companies which had three-year and four-year vesting period.

The most common vesting period for LTI plans is three years (used by 75% of the companies).
Board fees: market insights
Analyses of board fee levels

This section contains analyses of non-executive director (NED) fee policy information. Analyses were undertaken for chairman and NED. Below, the median and average level for all companies on the OSEBX list is reported, as well as the median and average level for the top 20 and bottom 20 companies.

<table>
<thead>
<tr>
<th>Total</th>
<th>Chairman fee</th>
<th>NED base fee</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
<td>481</td>
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<tr>
<td></td>
<td>Average</td>
<td>568</td>
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</table>

<table>
<thead>
<tr>
<th>Top 20 companies</th>
<th>Chairman fee</th>
<th>NED base fee</th>
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</thead>
<tbody>
<tr>
<td>Median</td>
<td>561</td>
<td>283</td>
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<td>Average</td>
<td>544</td>
<td>332</td>
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<thead>
<tr>
<th>Bottom 20 companies</th>
<th>Chairman fee</th>
<th>NED base fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>407</td>
<td>268</td>
</tr>
<tr>
<td>Average</td>
<td>587</td>
<td>246</td>
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</tbody>
</table>

Number of non-executive directors

The number of non-executive directors on the main board increases slightly in line with market capitalization. The median number of non-executive directors in the top 20 companies is six compared to four in the bottom 20 companies.

<table>
<thead>
<tr>
<th>Total</th>
<th>Number of NEDs</th>
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<tbody>
<tr>
<td></td>
<td>Median</td>
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<td></td>
<td>Average</td>
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<tr>
<td>Top 20 companies</td>
<td>Median</td>
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<td></td>
<td>Average</td>
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<tr>
<td>Bottom 20 companies</td>
<td>Median</td>
</tr>
<tr>
<td></td>
<td>Average</td>
</tr>
</tbody>
</table>
Anticipated trends and issues for 2015
2015: Anticipated trends

2015: Discontinuation of positive economic environment due to falling oil prices

New business strategy for slower economic growth
Organizations will have to adapt to the new economic environment. If profitability is challenged, cost saving and efficiency initiatives might rise. Potential of downsizing and low or no increase in remuneration levels.

Organizations are likely to respond with a re-evaluation of the reward strategy in the organization.
• Underwater equity grants may lead to negative incentive effects which need to be addressed.
• Focus on variable pay elements which motivate executives. Stronger link of strategic business issues with annual and long-term incentive performance metrics.
• Greater scrutiny from shareholders regarding executive remuneration levels.
Continued regulatory changes and investor pressures

**Challenge**

**Complex stakeholder environment**
The increasingly complex stakeholder mix of global shareholders, regulators and public perception.

**Shareholder and regulatory pressure to increase transparency and simplification**
There is heightened pressure from shareholder and regulatory bodies to disclose remuneration levels and demonstrate the link between performance with pay.

**Remuneration related trends**

**Organizations will need to demonstrate that headline and overall performance are aligned with pay mechanisms by:**

- Balancing business needs (to attract, retain and incentivise talent) with corporate governance guidelines (on pay) to focus on promoting the long term
- Ensuring pay schemes reflect the organization’s risk profile
- Adapting to the changing corporate governance environment influenced by the financial services sector (e.g., long-term incentives as a means to align with shareholders or as a means to recoup pay such as through clawback and malus features)
- Ensuring shareholders are engaged and considered
- Considering tax consequences of ‘negative earnings’ and global legal landscape.

Somewhat conflicting guidance from stakeholders may slow adoption and place focus more on ‘explanation’ than compliance as a practical solution.

**Increased simplicity in reward design to increase transparency and line of sight by:**

- Replacing multiple LTI plans with a single program and eliminate matching arrangements
- Reducing perception of rewarding twice for the same performance by using differentiated metrics
- Increasing innovation in bonus deferral programs
- Extending vesting and holding periods (e.g., three-year vesting plus two-year holding)
- Greater adoption of shareholding requirements
- Ensuring targets are sufficiently stretching
- Enhancing disclosure on the use and rationale for discretion.

The increased requirements have created an environment that may prioritize compliance ahead of business needs. Further, a potential unintended consequence of greater pay transparency is increasing levels of pay.
EY Executive Compensation and Reward Advisory team

What we do
The Executive Compensation & Reward Advisory team at EY advises Remuneration Committee and management teams on solutions tailored to each organization and fit for purpose in an increasingly global marketplace.

By implementing our philosophy of ‘best fit’ versus ‘best practice’, we ensure the development of a company’s remuneration solutions are led by business imperatives and consider the risk-remuneration relationship. We are sensitive to the applicable regulatory environment, stakeholder interests and corporate objectives.

Our reward professionals have deep technical and commercial experience and can guide you through these complex issues in order to develop remuneration solutions that meet your commercial need.

We have established relationships with companies, regulatory bodies and shareholder advisory groups. We remain at the forefront of thought leadership on the latest remuneration trends and emerging practices.
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About EY

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