Willis Towers Watson

Unlock potential with effective incentive design

Long-term incentive plans in Swedish large cap companies 2017 to 2019

Performance-based pay design is one of the most fundamental and, arguably, one of the most important aspects of Executive Compensation. It encompasses a wide range of considerations - from establishing incentive objectives to selecting incentive vehicles and, ultimately, to determining incentive payouts. By presenting an overview of Swedish market practice we hope that this report can provide a helpful context for decision making and can serve as a starting point or baseline for consideration. However, while strongly believing that organisations should be aware of market practice, we would also like to recognise that market practice might not be the best fit for each organisation, and should thus not be the primary factor in compensation decisions. In fact, a converge around prevalent market practice largely eliminates an organisation's compensation program from being a competitive advantage in attracting, motivating and retaining talent.

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Chapter 1
Introduction

This report provides an overview of how the design of Long-Term Incentive (LTI) plans are developing among the largest listed companies in Sweden. This is the first Swedish LTI report Willis Towers Watson publishes that is based on publicly disclosed data.

The underlying analysis is based on companies being listed as a large cap company in January 2019. The report analyses trends from 2017 to 2019 and as this is a new report where all data has been collected this year, the list of companies is based on the large cap list of 2019 throughout all three years. Going forward, the analysis will be based on the companies being listed as a large cap company each respective year. Non-Swedish companies being listed on the Swedish large cap list has been excluded from the report as these companies typically apply non-Swedish pay practices and would not provide a representative picture of the LTI trends in Sweden.

Are you interested in comparing your company against a specific comparator group or do you have questions about the report? Give us a call or send an email and we are happy to discuss further with you.

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Chapter 2

Executive summary

The number of Swedish large cap companies offering LTI plans remain stable over the years and the typical Swedish co-investment plan is still the most common plan design type.

Over the past three years we observe an increased share of Swedish large cap companies measuring performance over one year rather than typical market practice of three years. Among performance based LTI plans, companies using two performance metrics tend to add a third performance metric. The combination of performance metrics is generally including both financial metrics and market based metrics.

Further, the number of employees eligible to participate in LTI plans is increasing over the years. Extended eligibility is one explanation to this, but we also observe companies simplifying their incentive structures, including all eligible employees in one LTI plan. Another indication of companies trying to simplify their LTI structures is that the number of participant categories decreases over the years, i.e. the differentiation between eligible employees in the LTI plans is decreasing.

The size of the LTI plans, in terms of number of shares as a percentage of total number of shares outstanding, has moderately decreased over the past three years. The majority of the share based LTI plans granted in 2019 had a plan size that was less than 0.3% of the total number of shares outstanding. The share based LTI plans are subject to shareholder approval at the Annual General Meeting ("AGM") and the financing methodologies where the company transfer the shares to the employees requires a high majority of votes for approval. An increasing number of companies seem to respond to this by including a secondary financing methodology that does not require such high majority votes for approval, in case the primary proposal does not pass the shareholder vote.

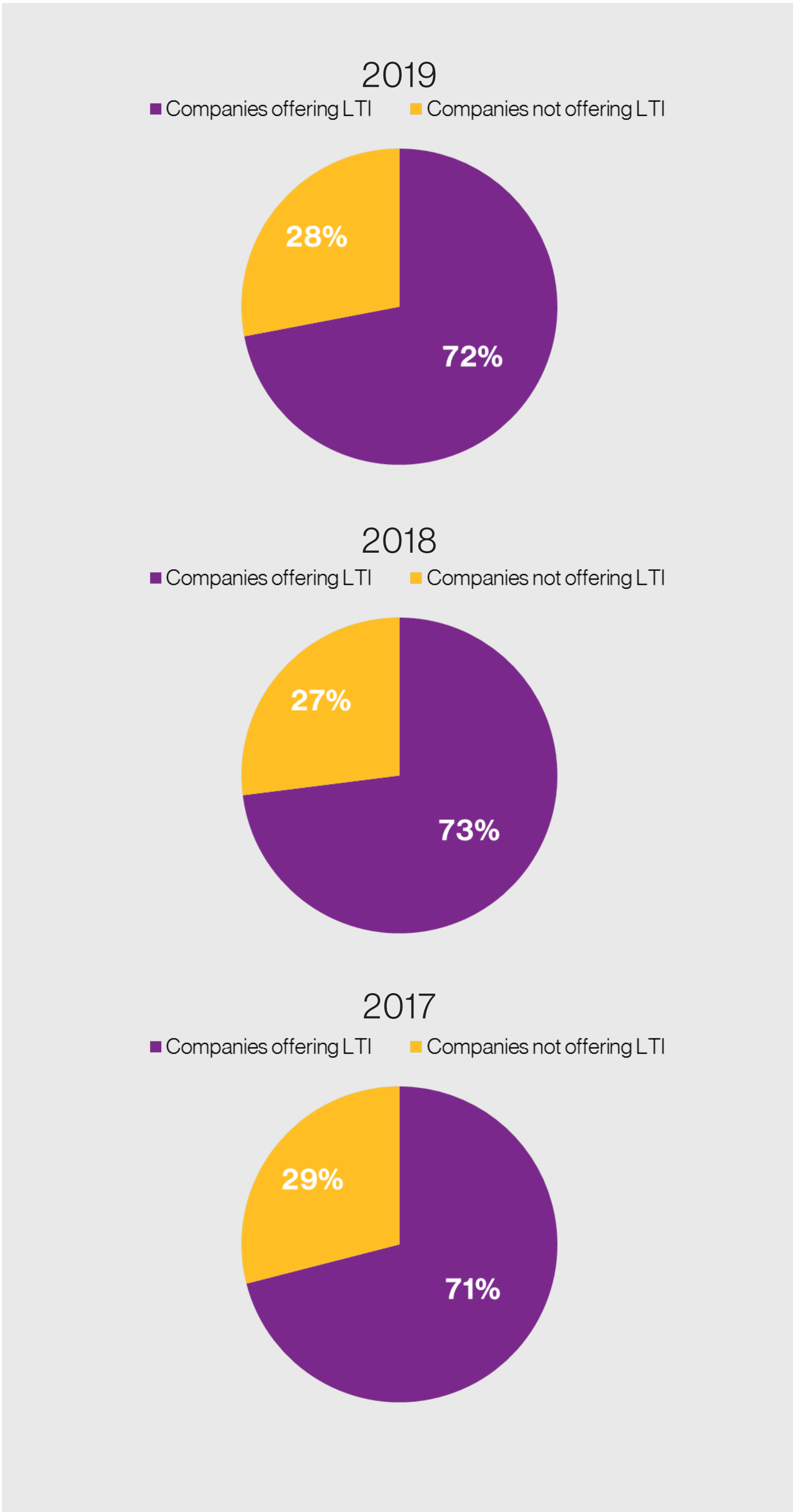
As a response to the high voting majority requirement we see a significant increase of large cap companies applying a secondary LTI financing methodology.

Chapter 3

Prevalence of long-term incentive plans

The prevalence of LTI plans among Swedish large cap companies remain stable over the last three years. Around 70% of the large cap companies operates an LTI plan where the executive team is eligible. The small fluctuations are driven by companies implementing plans rather than removing plans. However, year-on-year changes are also explained by one-time grants and new listed companies operating LTI plans.

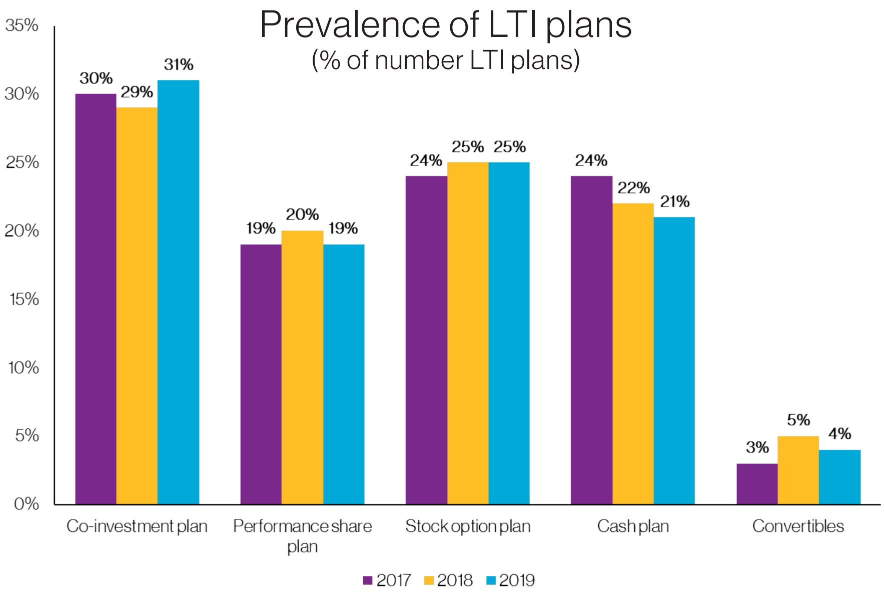
*We would expect the prevalence of LTI plans to be higher in practice due to limited disclosure requirements on cash plans. This is expected to change in connection with the implementation of the new **EU Shareholder Rights Directive (SRD)** which will require more transparent disclosure.*



Chapter 4

Long-term incentive plan design types

Co-investment plans remain the most common LTI plan design type, largely driven by the relatively high prevalence of industrial companies in the Swedish large cap list. The decreased prevalence of cash plans is explained by companies implementing new LTI plans of another design type rather than companies removing their cash plans.



Dividing the Swedish large cap companies into broad industry categories, there is a clear preference of design type within each industry. The exception being consumer goods companies where there is a wide spread of plan design types in place. Among the industrial companies, which is the largest industry group, the co-investment plan is the most common plan design type. Among real estate and financial companies there is a clear preference for stock option plans, this is expected as these are businesses where company performance is highly correlated with value creation. The majority of the technology companies have a performance share plan in place.

Co-investment plan - requires a pre-grant investment by the participant in company shares ('saving shares'). The company will then match these saving shares with performance shares (subject to fulfilment of predetermined performance criteria) and often also matching shares (only subject to remaining employed through the vesting period).

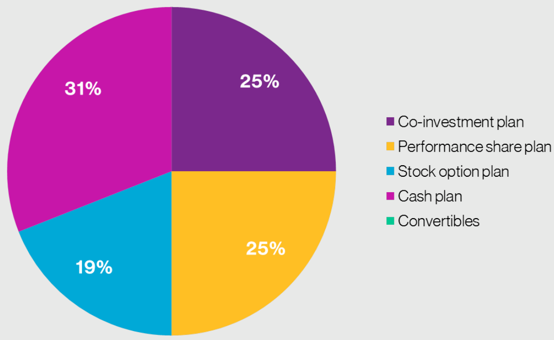
Performance share plan - no investment required by the participant, though the participant will recieve shares subject to fulfilment of certain predetermined performance criteria.

Stock option plan - includes employee stock options ("personaloptioner") and financial options ("teckningsoptioner").

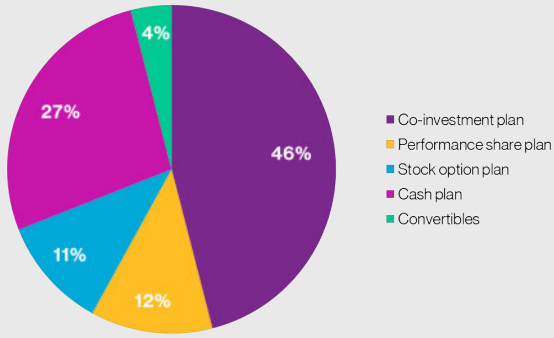
Cash plan - incentive plan exceeding one year and paid in cash. This category also includes synthetic stock options.

Convertibles - requires investment by the participant that will either be paid back in cash or converted into shares after the vesting period.

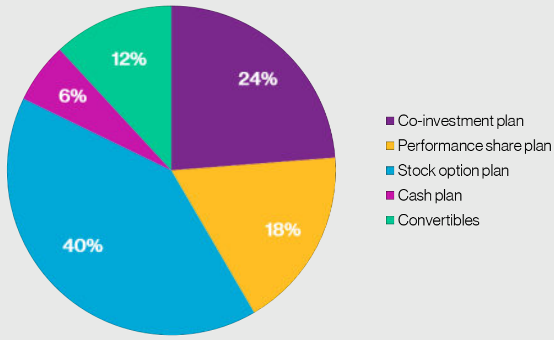
Consumer goods



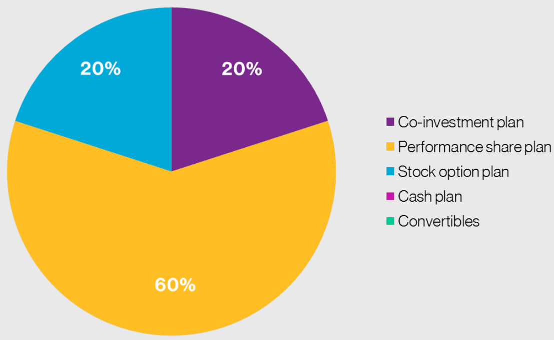
Industrials



Real estate and financials

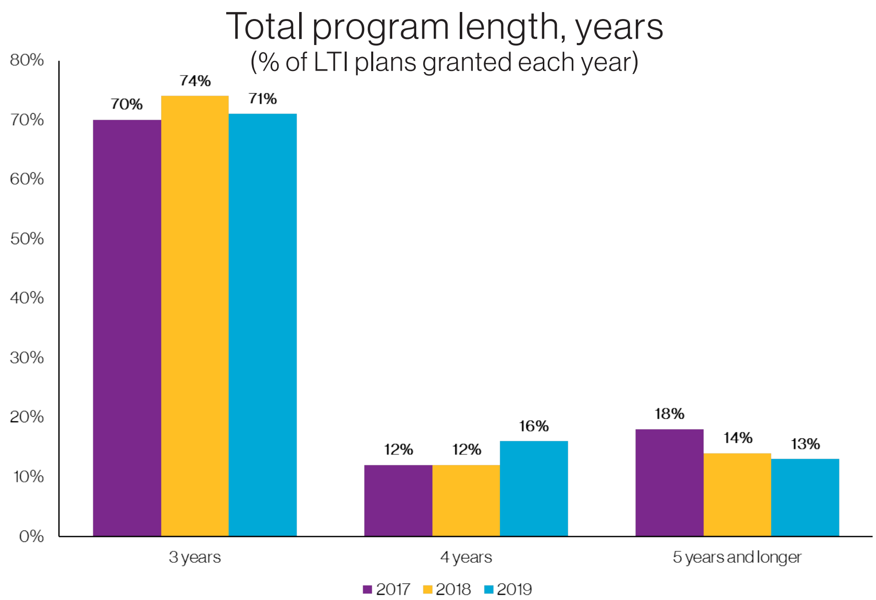


Technology

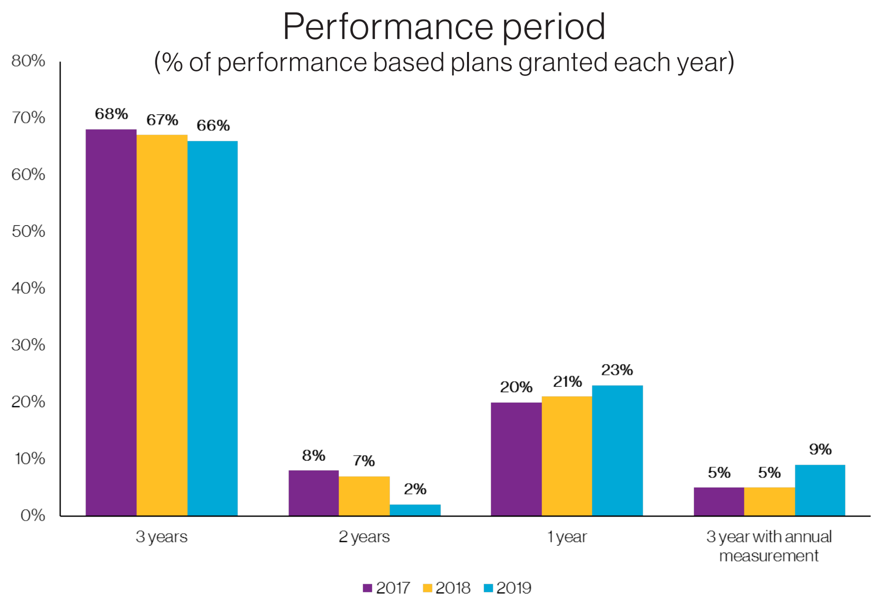


Chapter 5
Program length

Total program length includes vesting period, exercise period and any holding period if applicable. A total program length of three years remains the most prevalent approach. However, there is a decreasing trend of LTI plans with a total program length of five years or longer. This is partly driven by a lower grant frequency (e.g. triennial) among companies with long program lengths, and also companies shortening the vesting periods to three years.



Among the performance based LTI plans it is most common to measure performance over three years. However, there is an increased trend of measuring performance over one year, either as a sole one year performance period or over three years with annual measurement where one third of the LTI award is attributable to the performance in each respective year. LTI plans that measure performance over a period less than three years can be difficult to get approved by shareholders at the AGM. Especially if a large portion of the company's shareholders follow ISS voting recommendations, as ISS would typically recommend a vote against any LTI plan that measure performance over a period less than three years.

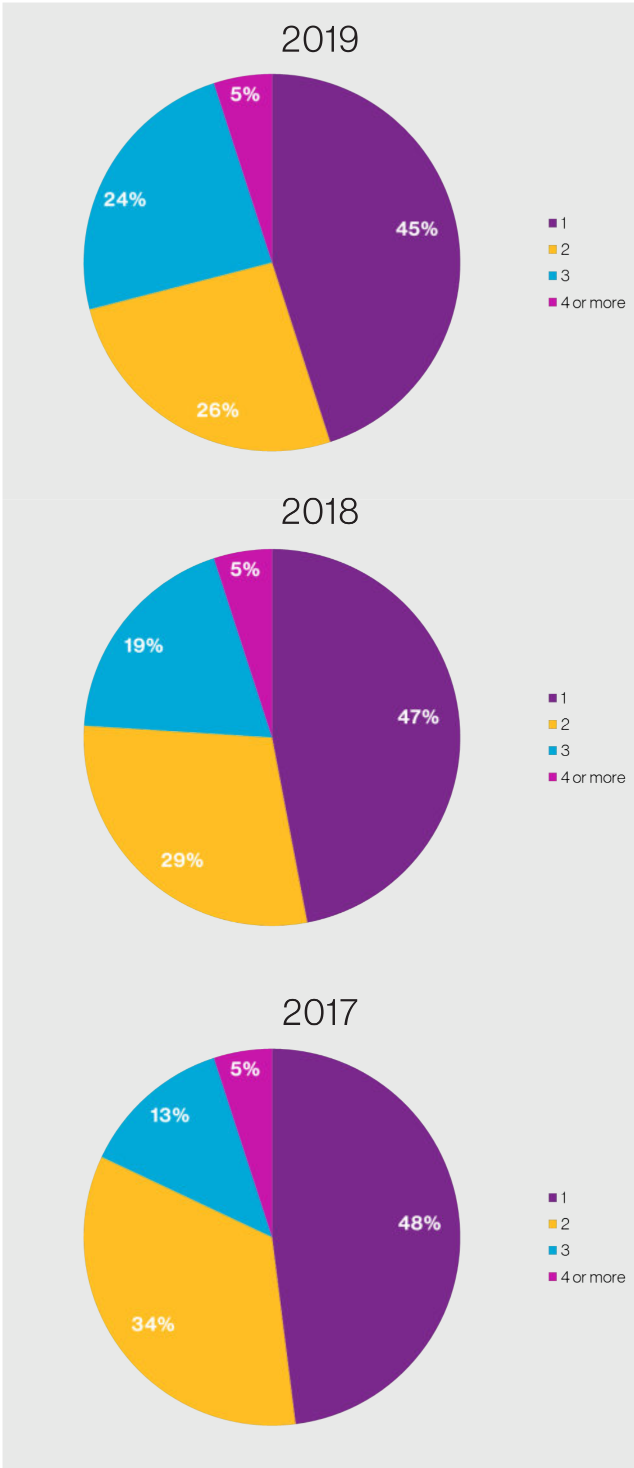


Chapter 6

Performance metrics

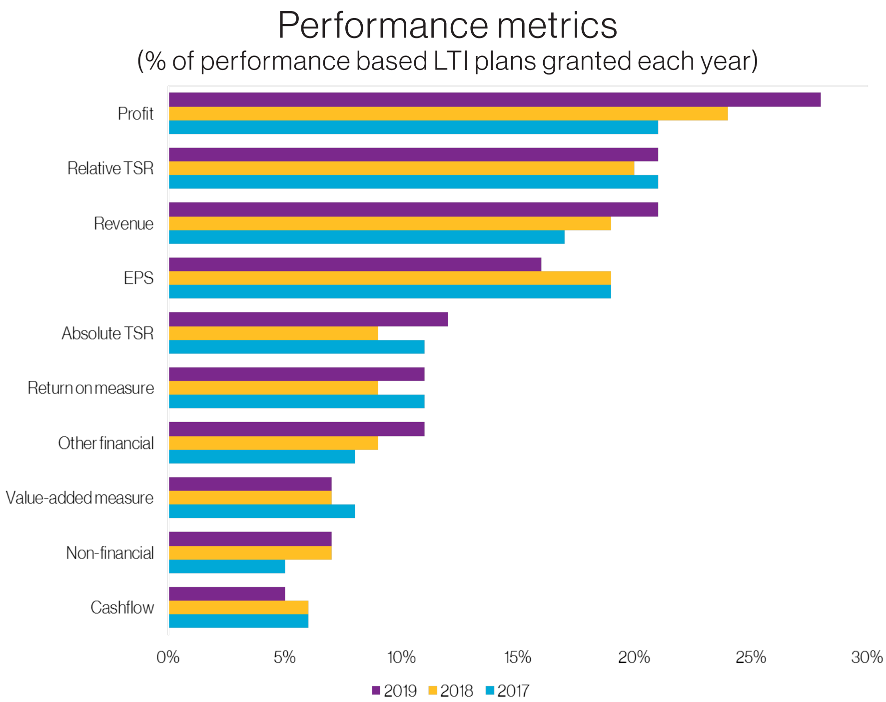
During the past three years, companies tend to move towards using three performance metrics in their LTI plan. To capture year-on-year changes the statistics are only covering companies with annual LTI grants over the three year period. If all companies were to be considered, we would see an increased portion of companies using one performance metric as newly listed companies and companies granting LTI plans on a biennial or triennial basis are inclined to use one performance metric.

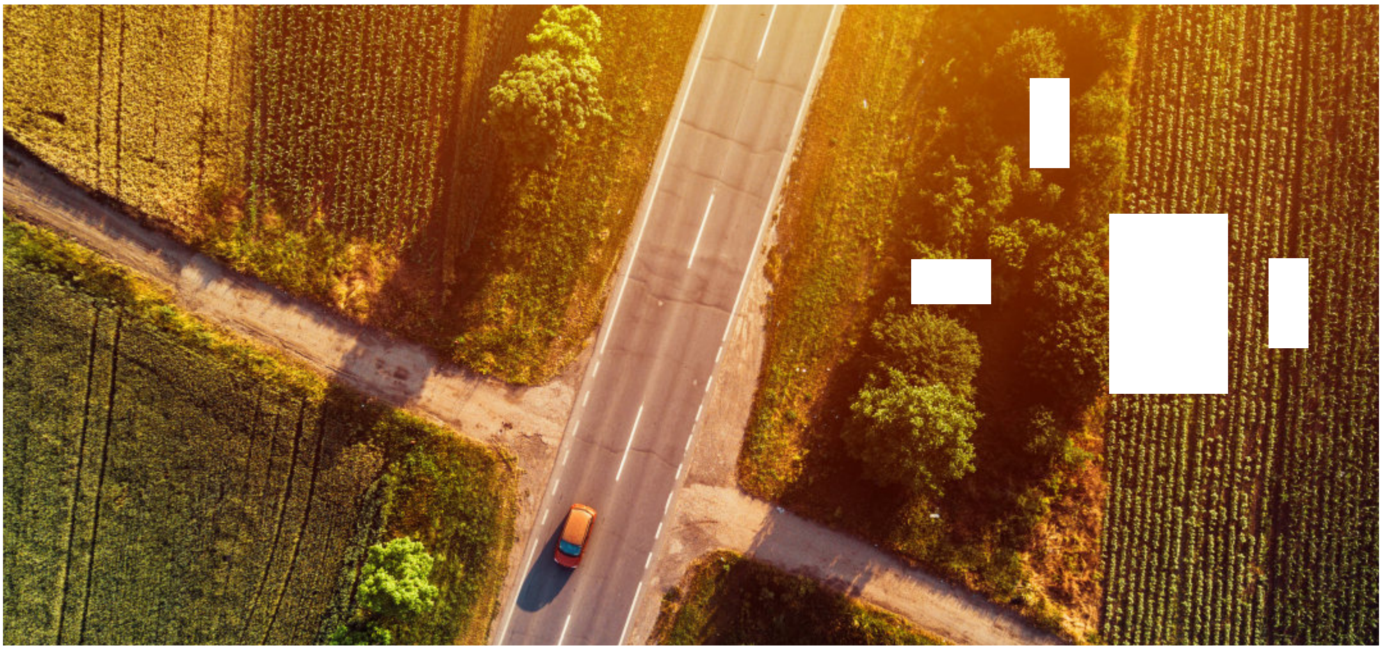
Companies using one performance metric tend to either use EPS or Total Shareholder Return.



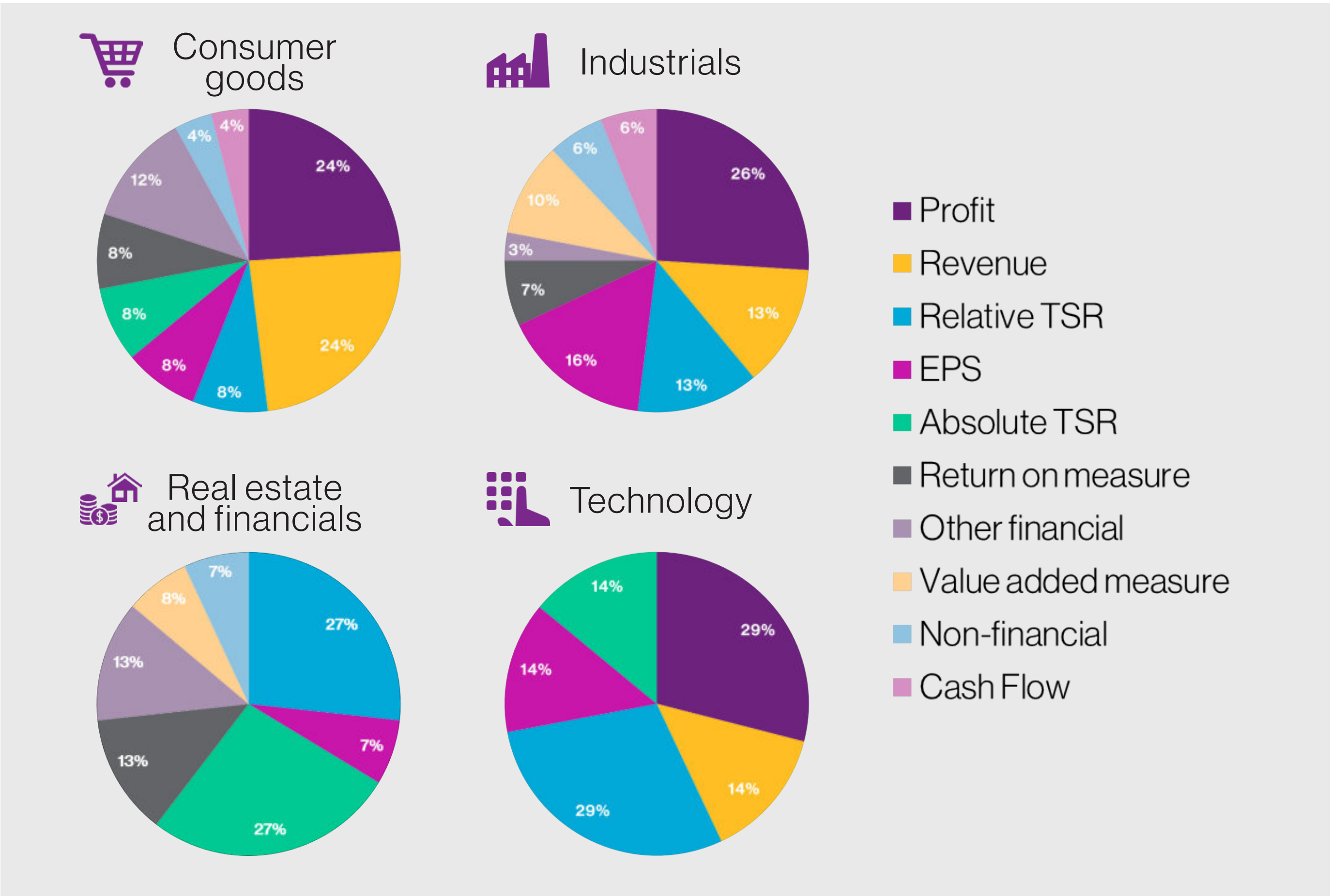
The most common performance metrics are profit, relative TSR and revenue. There is a decreased use of EPS as a performance metric as companies tend to change from EPS to one of the three most common metrics (i.e. profit, revenue or TSR).

The most common combination of performance metrics among companies using two metrics is profit and revenue, where profit tend to be more heavily weighted. This is naturally driven by large cap companies being more mature in their life cycle, hence a larger emphasis on profitability than growth.





Dividing the Swedish large cap companies into four broad industries, profit is still the most common performance metric across industries, except for the real estate and financial industry. These companies tend to have a large emphasis on value creation, thus TSR has a high prevalence among real estate and financial companies. Beside profit metrics, revenue is most common among consumer goods companies, EPS is most common among industrial companies and relative TSR is most common among technology companies.

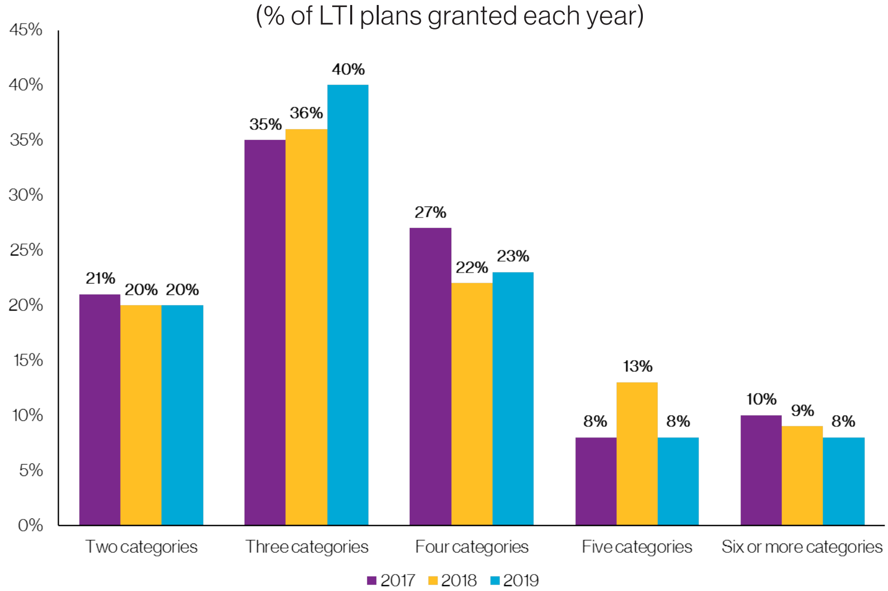


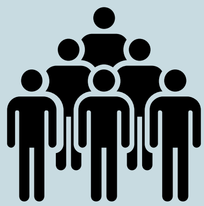
Chapter 7
Eligibility

LTI plans are generally targeting a smaller group of employees, the top executives. However, the eligibility seem to be increasing over the years when looking at number of eligible people against number of employees. This is partly driven by extended eligibility, but also by companies simplifying their incentive structure by combining different LTI plans into one (one LTI plan for top executives and one LTI plan for the broader group of employees combined to one plan). The number of companies that target all employees tend to remain stable over the years, in 2019 there were six Swedish large cap companies offering all of their employees to participate in the LTI plan.

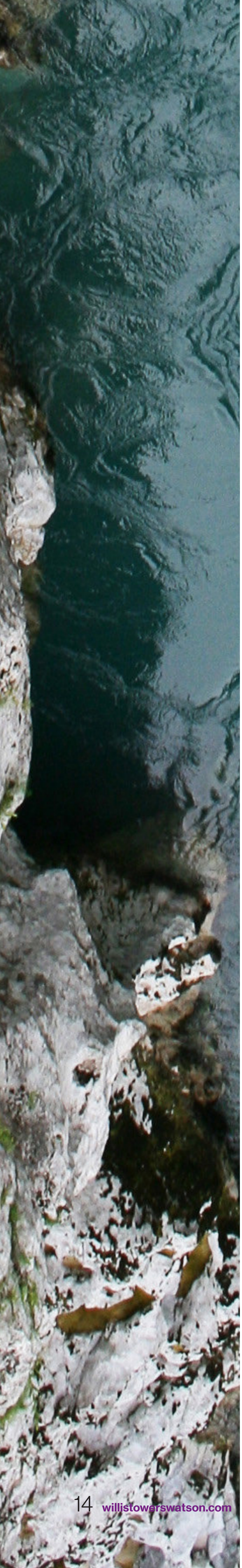
Number of participants (% of employees)	2017	2018	2019
Upper quartile	3,49%	3,91%	5,07%
Median	1,04%	1,35%	1,72%
Lower quartile	0,50%	0,57%	0,67%
Number of companies offering all employees to participate in the LTI plan	5	5	6

Number of participant categories
(% of LTI plans granted each year)





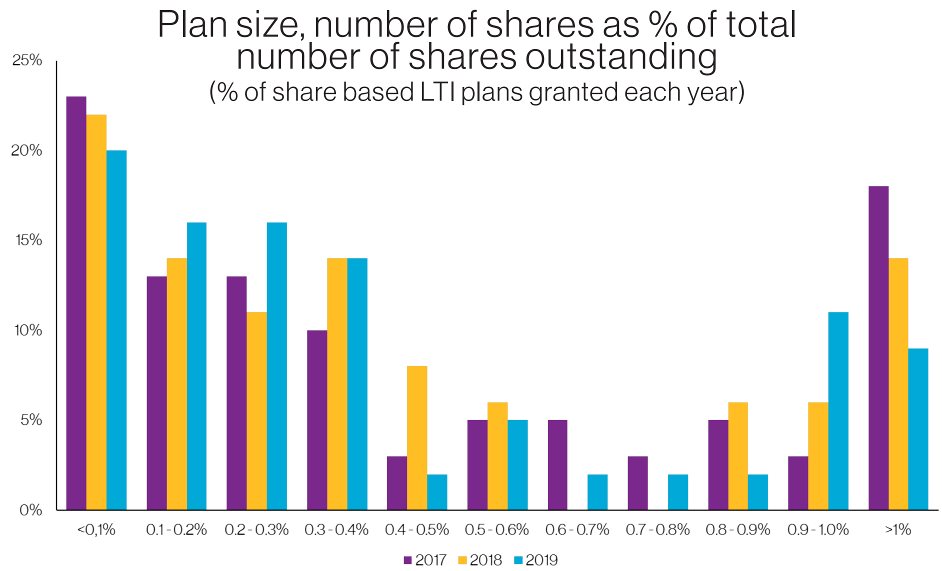
Companies typically divide the eligible employees in different categories where the grant sizes are differentiated on other factors than salary (e.g. number of shares, percentage of salary etc.). CEO is typically in a separate category, which means that companies with two categories generally covers the CEO and the management team. However, companies with a wider eligibility than the top executives often decrease the differentiation by reducing the number of categories.



Chapter 8
Plan size

The graph shows the portion of shares that may be used in a company's LTI plan. The majority of the share based LTI plans is expected to use less than 0.3% of total number of shares outstanding. Most companies estimating to use above one percent of the total number of shares outstanding do not grant LTI plans on an annual basis and they tend to have a broad group of employees eligible to participate in the LTI plan.

ISS and some institutional investors prefer dilution to be capped around 1%.



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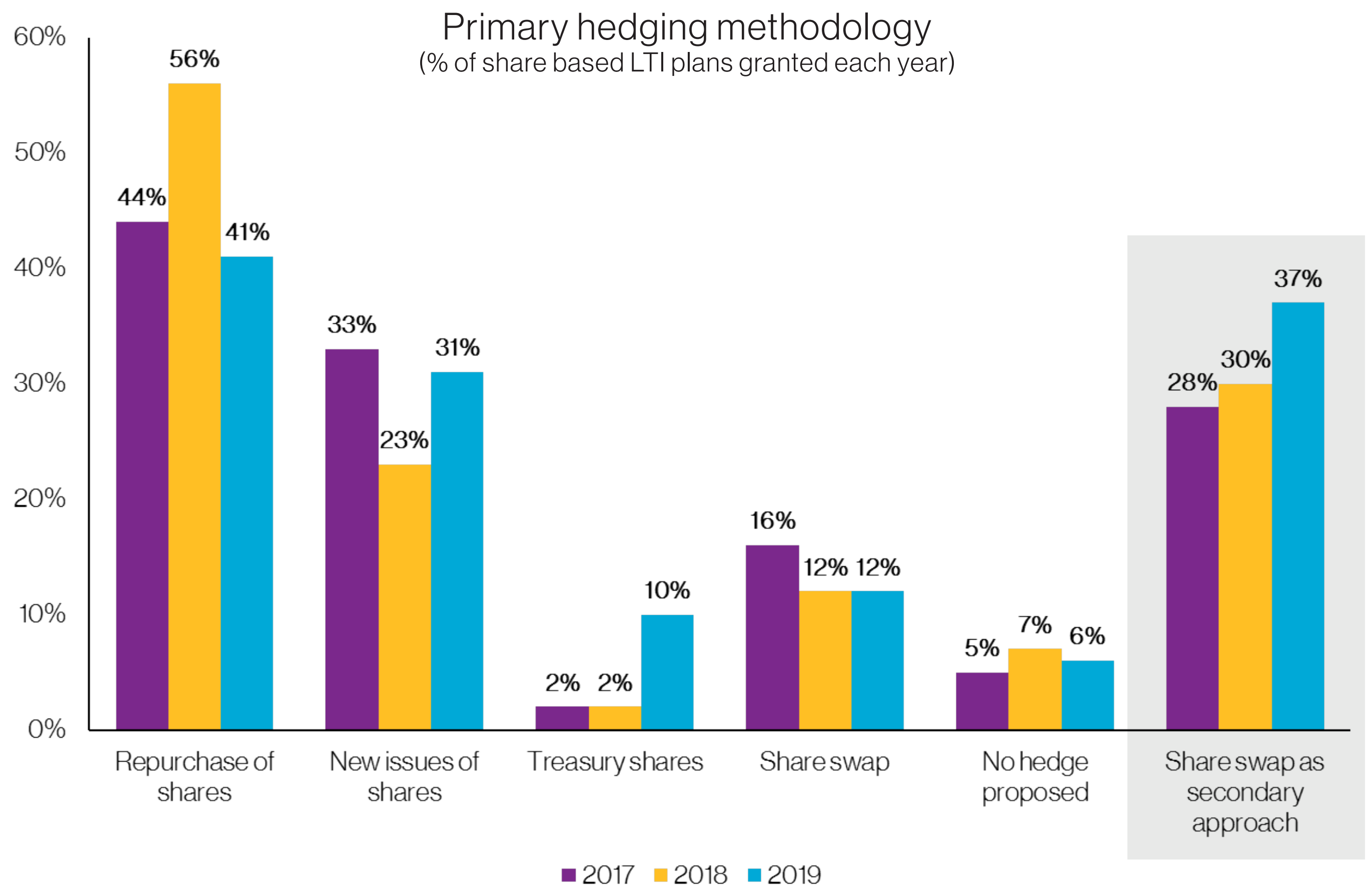
Chapter 9

Financing of share based LTI plans

In order to deliver shares to LTI plan participants, the company need to get the shareholders' approval on how the company will secure the delivery. The most commonly used way to secure share delivery is to repurchase shares, which results in a cash cost. The second most common way is to issue new shares, thus diltuing the shareholder value rather than using cash.

In recent years there is an increase in the number of companies including a share swap as a secondary financing alternative for the LTI plan proposed at the AGM. The reason for including a secondary financing alternative is to have coverage for a situation where the primary financing alternative does not pass the AGM vote. A share swap is more costly to the company but does not require as high voting majority at the AGM.



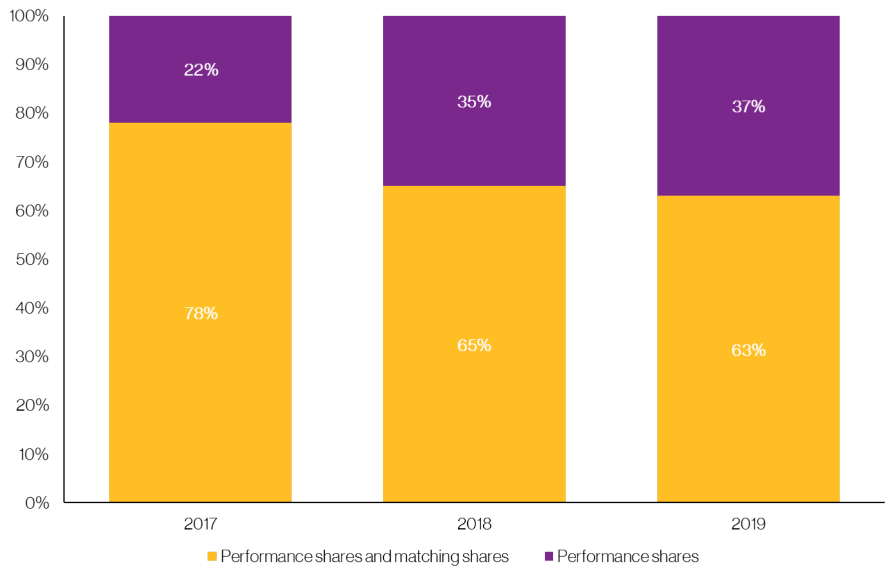
Chapter 10
Co-investment plans

The most common LTI plan design type is a co-investment plan where the participants are required to purchase company shares in order to be eligible for matching of performance shares and in some plans also matching shares. However, there is a decreasing amount of companies that are matching the investment with matching shares (i.e. shares that are subject to employment and not performance conditions). While the prevalence of matching shares is decreasing, there is a trend of increased use of a TSR underpin for matching shares. This means that matching shares are subject to a TSR performance condition requiring the company's TSR to be positive during the vesting period (in addition to remain employed during the vesting period). Companies removing the matching shares tend to compensate for this by increasing the potential amount of performance shares by at least the same amount as the matching shares removed.

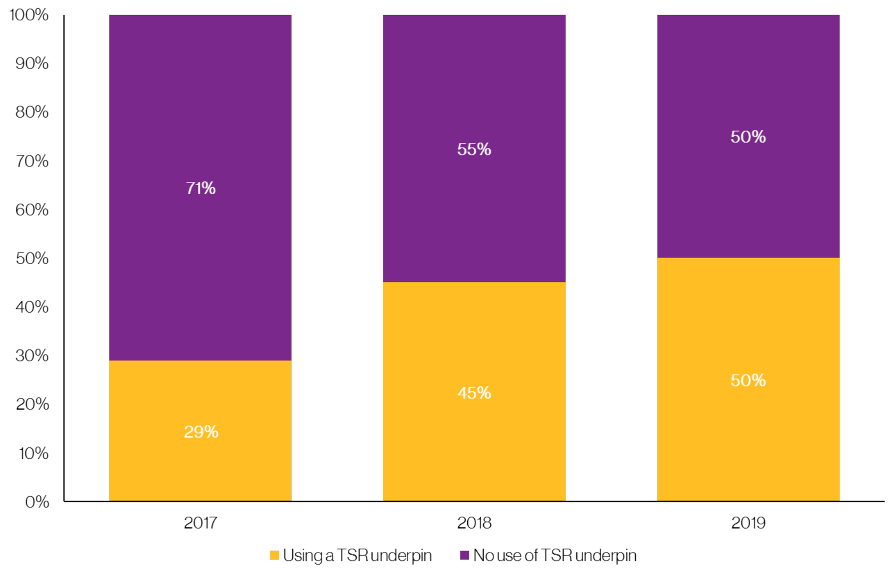
Performance shares - vesting is conditional upon remaining employed through the vesting period and fulfilling certain performance criteria.

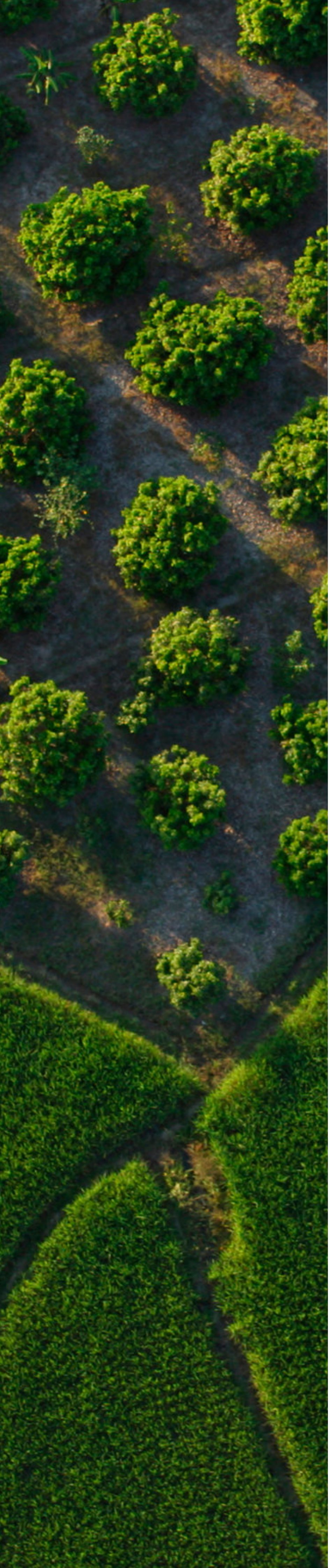
Matching shares - vesting is conditional upon remaining employed through the vesting period.

Plan vehicles
(% of co-investment plans)



TSR underpin prevalence for matching shares
(% of co-investment plans with matching shares)





Companies defining the possible investment size as a number of shares or a fixed amount tend to differentiate this size between different participant categories. However, companies defining the investment size as a percentage of salary usually quote the same percentage level over all participant categories, differentiation is then fulfilled by the varying salary levels. Most commonly, an investment size of 10% of base salary is used for all participants.

Number of matching shares per saving share is usually the same for all participant categories, i.e. no differentiation. The matching ratio is as lowest one matching share per four saving shares and as highest one matching share per one saving share. Looking at the performance shares the matching ratio is normally differentiated between the participant categories.

Number of performance shares per one saving share	CEO	Management Team	Tier 3	Tier 4
Upper quartile	6,8	5,8	5,0	3,0
Median	5,5	5,0	4,0	3,0
Lower quartile	2,5	2,3	2,0	2,0

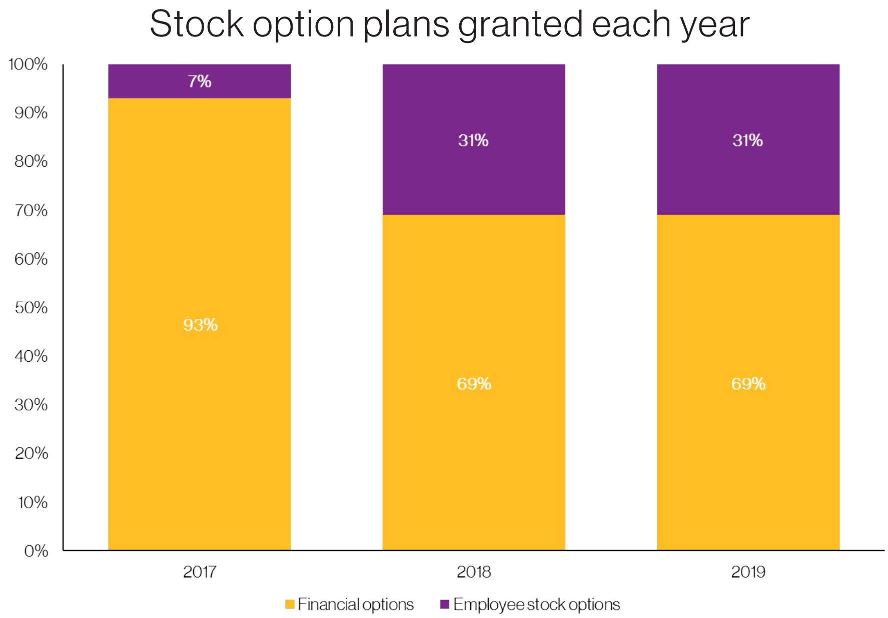
Considering co-investment plans where the investment requirement is defined as a percentage of base salary, the table below illustrates the differentiation between participant categories (besides base salary differentiation). Using the CEO LTI award value as a base of 100%, the median management team would have an award value of 83% of the CEO value.

LTI award value	CEO	Management Team	Tier 3	Tier 4
Upper quartile	100%	94%	79%	56%
Median	100%	83%	61%	45%
Lower quartile	100%	69%	42%	34%

Due to shareholder pressure and regulation we observe significant design change trends to increase the value at risk for participants. This is a trend we expect more companies to adhere to over the coming years.

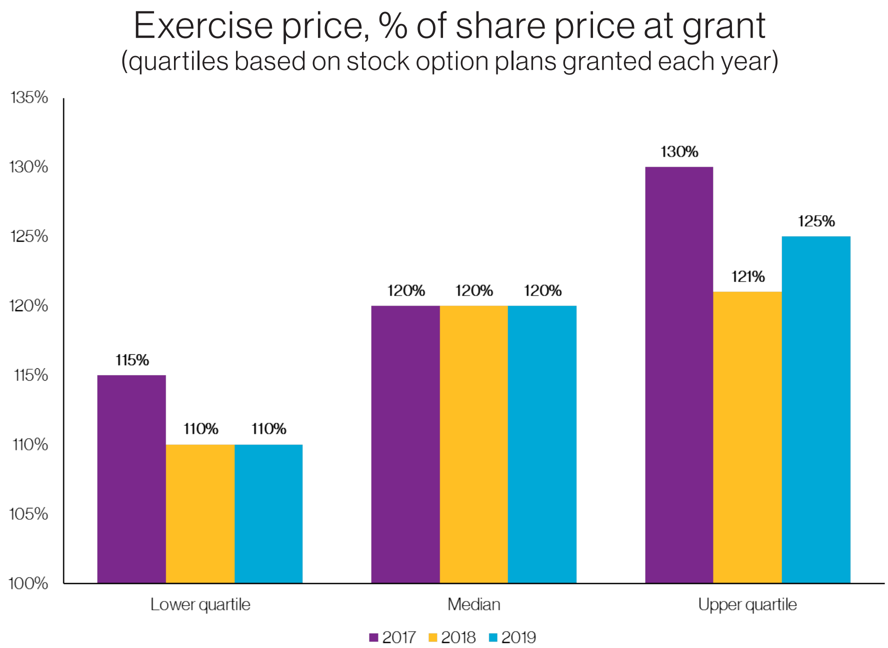
Chapter 11
Stock option plans

Stock option plans include both employee stock options ("personaloptioner") and financial options ("teckningsoptioner"). The vast majority of the stock option plans consist of financial option plans. A few companies have changed to employee stock options or added employee stock options as a second LTI vehicle over the years. A couple of newly listed companies have implemented both types of stock option plans.

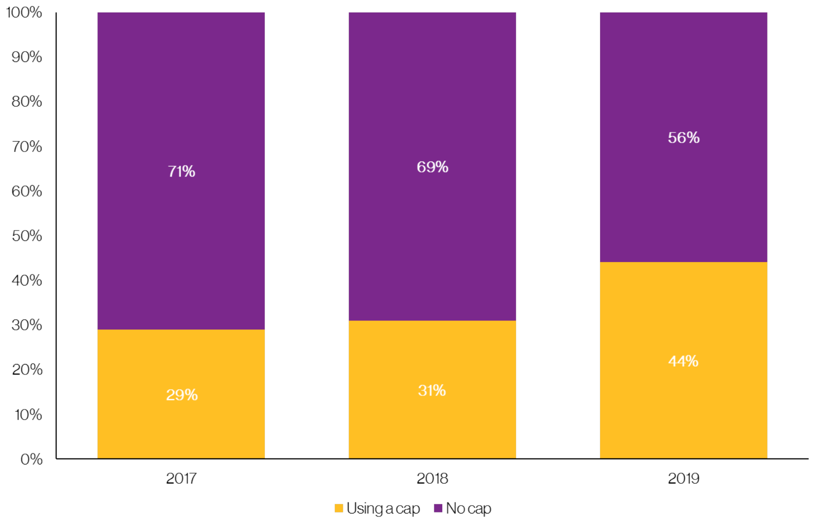


The exercise price as percentage of the share price at grant has remained stable over the years and is typically set at 120%. Companies that do change the exercise price tend to lower it, which could be the result of an expected impending market downturn. Among the Swedish large cap companies, lower exercise prices are generally applied within employee stock option plans while the higher exercise prices are generally applied in financial option plans.

The exercise price can further be defined as a relative measure rather than a fixed percentage of the share price at grant. This is typically applied among real estate companies where the exercise price is not determined at grant, but rather determined at the end of the vesting period depending on the development of a real estate index. Such option feature capture the company's performance relative the industry's performance.

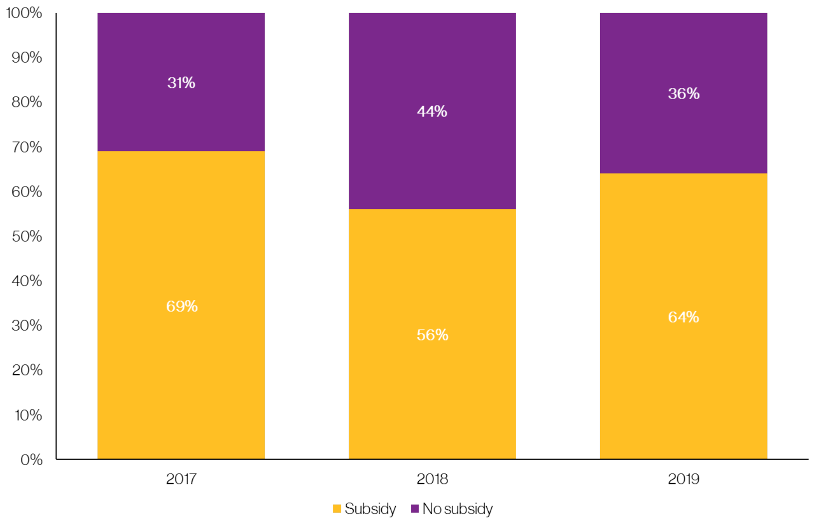


Companies using an exercise cap in stock option plans
(% of stock option plans granted each year)



Options usually comes with a high upside potential. However, this upside can be limited by adding a cap to the option (i.e. the maximum gain per option is capped at a certain level). This is increasingly being applied in stock option plans among Swedish large cap companies, although the majority of the stock option plans are still not accompanied with a cap.

Prevalence of subsidy in financial option plans
(% of financial option plans granted each year)



In financial option plans participants are required to purchase the options at market value. Companies can choose to subsidize the participants' purchase cost fully or partly (e.g. to encourage participation). The majority of companies granting financial options subsidize the participants' purchase cost fully or partly. The drop in 2018 is mostly explained by a lower amount of financial option plans granted, and not by companies removing the subsidy (one company removed the subsidy in 2018). The subsidy is generally paid after a certain time period (e.g. after the vesting period ends) for retention purposes.

Companies subsidising the participants' purchase cost tend to move towards an upfront payment rather than a delayed payment. This is usually accompanied with a repayment clause which applies if the employee leaves the company within a certain time period.

Appendix I
Swedish large cap companies

Below is the Swedish large cap companies as of January 2019 and which industry these have been categorized within. Certain companies have been excluded from the analysis in this report due to being considered non-Swedish and hence not applying typical Swedish market practice when it comes to LTI plan design. One company was delisted in 2019 and has therefore also been excluded from the analysis in this report.

Consumer goods	Industrials	Real estate and financials	Technology	Excluded due to non-Swedish practice	Excluded due to delisting
AAK	Addtech	Atrium Ljungberg	Elekta	ABB	Ahlsell
Arjo	Alfa Laval	Avanza Bank	Ericsson	Ahlstrom-Munksjö	
Attendo	ASSA ABLOY	Bonava	Hexagon	Arion Banki	
Axfood	Atlas Copco	Castellum	Modern Times Group	AstraZeneca	
Betsson	Beijer Ref	Fabege	Tele2	Autoliv	
Dometic Group	BillerudKorsnäs	Fast. Balder	Telia Company	Fenix Outdoor	
Electrolux	Boliden	Handelsbanken		Lundin Mining Corporation	
Essity	Bravida	Hemfosa Fastigheter		Millicom Int. Cellular	
Evolution Gaming Group	Epiroc	Hufvudstaden		Oriflame	
Getinge	HEXPOL	Industrivärden		Stora Enso	
Hennes & Mauritz	Holmen	Intrum		Tieto	
Husqvarna	Indutrade	Investor		Veoneer	
ICA Gruppen	Lifco	JM			
Kindred Group	Loomis	Kinnevik			
NetEnt	Lundin Petroleum	Klövern			
Nobia	Munters Group	Kungsleden			
Pandox	NCC	Latour			
Swedish Match	NIBE Industrier	Lundbergföretagen			
Sobi	Nolato	Nordea Bank			
Thule	Peab	Nyfosa			
Vitrolife	SAAB	Ratos			
	Sandvik	Resurs Holding			
	SCA	Sagax			
	Securitas	SEB			
	Skanska	Swedbank			
	SKF	Wallenstam			
	SSAB	Wihlborgs Fastigheter			
	Sweco				
	Trelleborg				
	Volvo				
	ÅF				

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