

Statement by the Finnish Cabinet Committee on Economic Policy on 29 May 2007

(Translated from Finnish original)

COMPETITIVE REMUNERATION SYSTEM AT STATE-OWNED AND ASSOCIATED COMPANIES BASED ON BUILDING SHAREHOLDER VALUE

It is in the shareholders' common interest that a company has a proficient and motivated management working in line with its shareholders objectives and that it can both recruit and retain professionals needed for successful performance. Therefore, the state owner, for its part, must provide the company with opportunities to compete for professional executives and other key employees under competitive terms, while ensuring that remuneration does not lead to excesses jeopardising the targets set for remuneration schemes by the shareholder.

The composition of the board of directors, board members' proficiency and ensuring their commitment form other key elements for the shareholders. Therefore, shareholders must see to it that board compensations are commensurate with the chairman's and members' level of commitment and time spent on their duties.

Corporate ownership steering must also pay attention to the fact that the success of companies does not rest, or is not due to, solely on their management or board of directors. Considering that highly skilled and motivated staff form one of the cornerstones of business success, it is necessary to provide all staff with a fair opportunity to benefit from the company's good profit performance.

Regardless of whether the State is a sole shareholder, majority shareholder or an important minority shareholder, it has a special interest in ensuring that remuneration applying not only to the management, key staff and board members but also the staff as a whole contributes to securing and improving companies' business opportunities and competitiveness. However, it is also essential for a major shareholder that remuneration be based on results which have benefited the shareholder(s). For this reason, the Cabinet Committee on Economic Policy has adopted the following guidelines on

- Salaries and other remuneration applying to state-owned companies' management and other key employees;
- Staff remuneration; and
- Remuneration applying to members of state-owned companies' administrative bodies.

The guidelines apply to the corporate ownership steering of all companies in which the State is of the majority owner, as well as when defining the policy of the State as an owner. Whenever applicable, the State's associated companies should also follow these guidelines. Each company tending to the State's special duties must elaborate company-specific remuneration criteria, giving due consideration to the company's special duties and success in its performance.

In this statement, the Cabinet Committee on Economic Policy requires as transparent a remuneration system as possible.

1. The remuneration system applying to management and key employees is based on profitability and shareholder value growth

In the main, it is the board of directors' duty to make decisions on management remuneration. Shareholders expect the board of directors to monitor developments in remuneration practices and ensure competitive remuneration. At the same time, however, the board of directors must ensure that decisions on remuneration will not lead to exorbitant benefits under any circumstances. The underlying principle is that basic salaries must be competitive and that additional staff remuneration is based on measurable profitability and good performance. When analysing a company's performance, it is necessary to use such criteria which demonstrates the company's better performance vis-à-vis its competitors in an impartial way and which also takes account of shareholder value generated by the company.

In view of these bases and criteria:

1.1. Top management's and key staff's remuneration must be treated as a larger whole comprising a fixed basic salary, fringe benefits, performance-based bonus schemes, share-based bonus schemes and other individual terms included in the employment or service contract, such as the age of retirement and the amount of pension.

1.2. The remuneration system must, in a fair and verifiable way, be based on the company's success and the generation of growth in shareholder value. The basic salary level must be sized so as to be reasonable and all bonuses and remuneration schemes must be tied to profit performance.

1.3. When using profit-based bonuses, it is necessary to take account of the application of share-based incentive schemes in such a way that no overlapping schemes bring unreasonable benefits to the same persons. The criteria for annual bonuses and long-term (a minimum of three years) remuneration schemes must not allow for two different bonuses to be paid on the same grounds.

1.4. A profit-based bonus may not account for more than 40 per cent of the basic salary, unless there are special grounds for higher rates, for example, due to the company's strategy and targets, or competition within the industry.

1.5. Share-based remuneration must be designed in such a way that the annual amount of the extra reward, paid on the basis of a long-term share-based remuneration scheme, does not exceed the beneficiary's annual basic salary, unless there are special grounds for deviation. Growth in the value of already-earned shares is in the common interest of shareholders.

1.6. It is essential that the use of the share-based remuneration lead to shareholder commitment on a long-term basis and based on sufficient holdings, thus being in the top management's and key staff's interests and consistent with those of shareholders. Share-based remuneration must be proportioned to total compensation in such a way that matters related to the company's size, line of business and risk level as well as the management's duties, special competencies and the current shareholdings of the group covered by the share-based remuneration scheme are taken into account.

1.6. Terms permitting exorbitant pension benefits and retirement under 60 years of age must not be accepted in the service contracts of managing directors and other top executives. In addition, the 60-year age limit must be reviewed in the light of the objective of raising the general retirement age.

1.7. With respect to salary payable to managing directors and other top executives during the term of notice and their severance pay, the aim must be to find solutions in line with general practices or similar (in this case, the maximum compensation should be a salary of 12 months +12 months).

2. Remunerating and incentivising management and key staff should be based on salary and share-based remuneration schemes tied to shareholding.

As a shareholder, the State does not approve of the use of stock options as remuneration schemes. International examples and the related wide-ranging debate demonstrate that stock options do not always generate a level of management commitment or ensure managerial conduct that would promote shareholder interest and increase shareholder value in the long term. Using share-based remuneration schemes must be based on justifications closely related to expectations set for the company and the development of its operations, and these schemes must be used to seek commitment based on shareholding.

The key objectives in the development of remuneration and remuneration schemes still include enhancements of their explicitness, motivational power and sustainability. Every scheme must (i) be consistent with the State's role as a shareholder, (ii) contribute to improved shareholder value and motivate staff on a long-term basis, and (iii) have reasonable terms and be predictable in a way which prevents unreasonable remuneration. The State requires boards of directors to take these aspects into consideration and to pay particular attention to the system's motivational power and the prevention of excesses.

When developing remuneration systems, special attention must be paid to the relationship between the eligible person's input and the amount of his/her remuneration. Key staff involved in share-based remuneration schemes must be able to contribute to remuneration through their personal input. However, in many cases, this is only possible for strategic management and a limited number of key employees. In addition, it is necessary to pay attention to the motivating effect required for share-based schemes, which may not be used for the sake of the remuneration level alone. For this reason, aiming to optimise the size of the target group entitled to share-based remuneration is justified.

In view of these bases and criteria applying to management and key staff remuneration,

2.1. share-based bonus schemes founded on profitability and a rise in the shareholder value are primarily used as tools of share-based rewarding. The company assumes primary responsibility for defraying the costs of remuneration and shareholders assume secondary responsibility.

2.2. Share-based remuneration schemes must include restrictions on share disposals, ensuring the beneficiaries' commitment to the company and improved shareholder value. However, these restrictions may not be unreasonable in terms of their duration or number. Shareholding corresponding to approximately one year's salary, the amount in excess of

this remaining outside the scope of the restrictions, can normally be regarded as a reasonable objective. Moreover, the disposal of shares should not be possible before a minimum of a two-year shareholding period.

2.3. The share-based remuneration schemes of unlisted companies must include redemption terms or redemption price terms ensuring the liquidation of shares after the termination of employment or as soon as the shareholding has exceeded the target level. With regard to share-based schemes, management and key staff shareholdings in companies wholly owned by the State may not reduce the State's holdings and voting rights to below 90.1 per cent.

2.4. Companies must use long-term remuneration schemes motivating beneficiaries and clearly tied to the creation of shareholder value.

3. Compensation of members of administrative bodies is primarily based on pecuniary emoluments

The Ministry of Trade and Industry has annually commissioned surveys of the compensation level and practices applying to members and chairmen of listed companies' boards of directors. With respect to supervisory boards, a similar reference group does not exist, and the compensation level must also be assessed in relation to supervisory board duties, which vary from one company to another. According to these surveys, state-owned companies' and associated companies' average compensation payable to boards of directors is at a competitive level, but it is necessary to assess board emoluments regularly in relation to the general remuneration level.

Instead of conventional pecuniary emolument, many listed companies have adopted procedures, whereby board compensation is partly paid either as company shares (the share-based bonus model) or is tied, as an incentive, to the company's share price performance. Neither does the State approve of option schemes as a form of compensation for members of administrative bodies. However, the share-based compensation model recommended by the company's other institutional shareholders may also be in line with the interests of the State as an owner whenever it contributes to highlighting the role of the board of directors in ensuring the company's long-term development and greater shareholder value. The State has no motive to lead the way in this issue, but as the share-based compensation model continues to become more common, it must be considered an alternative model for state-owned companies and the State's associated companies. In this case too, the adoption of the share-based compensation model must be assessed separately for each company, taking all company-specific factors carefully into account.

In view of these bases and aspects applying to compensation payable to members of administrative bodies,

3.1. Compensation payable to chairmen and members of the boards of directors of state-owned companies and the State's associated companies must remain commensurate with that of competitors. As a general rule, board emoluments are paid in cash.

3.2. State-owned companies and the State's associated companies may, for special reasons, apply share-based compensation to board members, if this form of compensation

becomes standard practice in typical, competing companies. Option schemes for boards of directors should not be applied.

3.3. Compensation payable to chairmen and members of supervisory boards must primarily be assessed on the basis of their tasks.

4. The benefits of success belong to all staff

Staff must have a fair opportunity to benefit from the company's success. The companies' performance-based remuneration and bonus schemes must guarantee their staff a fair share of good results. In the remuneration of the staff, the main rewarding tools are result-based bonuses and staff funds.

In view of these bases and aspects:

4.1. Remunerating employees based on company profitability and results must extend to all staff in the manner considered by each company. These remuneration tools comprise performance-based bonuses and staff funds, and performance-based bonuses channelled into these funds can also be used to buy the company's shares traded on the stock exchange.

5. Transparent remuneration and disclosure of important information

Rewarding is primarily a means to ensure recruitment of good and skilled management and staff, as well as their commitment to the company. At the same time, rewarding is a signal to the investors of how the company's owners have invested in the management, Board of Directors and staff. It is important for both shareholders and potential investors to be capable of assessing whether the remuneration system in place is appropriate and proportionate to the company's success. As a result of the State's involvement as a shareholder, a requirement for greater openness than usual pertains to the remuneration system because it is necessary to guarantee the controllability of the shareholder.

Considering that long-term remuneration schemes based on the value of shares are of special importance to shareholders, it is advisable for listed companies to disclose their adoption even when there are no statutory disclosure requirements in this respect.

In order to achieve the necessary degree of openness, the company is required to disclose – either in its printed annual report, or in default of such a report, in some other, appropriate way – relevant information on its remuneration system. In addition, the State as a shareholder will ensure that this information regarding state-owned companies can be found via one web address.

The web pages on ownership steering will provide direct links to the web pages of listed state-owned and associated companies. Information regarding unlisted companies must be available via one web address, covering at least the following information available in a sufficiently readable form:

5.1. Company name and the State's shareholding and votes

5.2. The Article of the Line of Business appearing in the Articles of Association.

5.3. The income statement, or the summarised income statement, and the balance sheet for the previous financial year.

5.4. The managing director's name, total remuneration paid during the previous calendar year, and a description of his/her remuneration components.

5.5. Information on the size of the board of directors and of any group of key staff, as well as on compensation schemes applying to them.

5.6. The name of the chairman, vice-chairman and members of the board of directors, and their total remuneration, including the criteria for its determination.

5.7. Information on performance-based and profit-based bonuses, staff funds and any other remuneration mechanisms within the remuneration system applying to other staff.