




Operating Your Share Plans in Germany, Switzerland, and Austria and Plan Design Trends in the DACH Region


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Agenda

- **Non-DACH companies implementing share plans in DACH countries**
 - Germany
 - Switzerland
 - Austria
- **Share plans operated by companies headquartered in DACH countries**
 - Germany
 - Switzerland
 - Case Study: Novartis

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Operating Your Share Plans in Germany

- **Securities law**
- **Employment law**
- **Data protection**
- **Employee tax**
- **Social security**
- **Payroll withholding and reporting**

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Operating Your Share Plans in Germany (Legal Implications)

- **Securities law**
 - Generally no issues
- **Employment law**
 - Acquired rights (stress discretionary nature of awards)
 - Compensation on termination of employment (proper forfeiture rules)
- **Data protection**
 - EU rules

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Operating Your Share Plans in Germany (Tax Implications)

- **Employee tax**
 - Option plans - at exercise
 - Stock purchase plans - when “economic ownership” (i.e. dividend and voting rights) passes to the employee, in most cases at acquisition
 - Restricted stock (unit) plans - when “economic ownership” passes to the employee, i.e. at award or vesting, depending on the terms of the plan
- **Social security**
 - Employer and employee social security payable at the same time as income tax
- **Payroll withholding and reporting**
 - Required in the same way as for other employment income

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Operating Your Share Plans in Switzerland

- **Securities law**
- **Employment law**
- **Data protection**
- **Employee tax**
- **Social security**
- **Payroll withholding and reporting**

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Operating Your Share Plans in Switzerland (Legal Implications)

- **Securities law**
 - Generally no issues
 - Company transaction: Best Price rules in public offer
- **Employment law**
 - Acquired rights (stress discretionary nature of awards)
 - Compensation on termination of employment (proper forfeiture rules)
- **Data protection**
 - General data protection rules
 - Bank data protection if plan administered by bank

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Operating Your Share Plans in Switzerland (Tax Implications)

- **Employee Shares**
 - Taxation upon grant (ownership transfer)
 - Restriction or vesting period will not defer taxation
 - Discount on fair market value for each year of restriction
 - Tax free capital gain when shares are sold

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Operating Your Share Plans in Switzerland (Tax Implications)

- **Employee stock options (granted before 1 January 2003)**
 - Taxation upon grant on fair market value (binomial or black scholes valuation model)
 - Discount on fair market value for each year of restriction period
 - Tax free capital gain on exercise
- **Employee stock options (granted on or after 1 January 2003)**
 - Taxation upon exercise on the spread
 - Taxation upon grant still possible for tradeable options without vesting restrictions

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Operating Your Share Plans in Switzerland (Tax Implications)

- **Payroll withholding and reporting**
 - Generally for Swiss-citizens and long term permit holders only social security payroll withholding
 - For all employees who are granted options in Switzerland and exercise abroad
- **Social security requirements**
 - Follows the rules of the tax authorities
 - Social security withholding for all employees subject to Swiss social security

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Operating Your Share Plans in Austria

- **Securities law**
- **Employment law**
- **Data protection**
- **Employee tax**
- **Social security**
- **Payroll withholding and reporting**

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Operating Your Share Plans in Austria (Legal Implications)

- **Securities law**
 - Generally no issues
- **Employment law**
 - Acquired rights
 - Compensation on termination of employment
- **Data protection**
 - EU rules

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Operating Your Share Plans in Austria (Tax Implications)

- **Employee tax**
 - Option plans - at exercise (tax breaks are available provided that certain conditions are met)
 - Stock purchase plans – generally at acquisition of the shares
 - Restricted stock (unit) plans – when “economic ownership” passes to the employee, i.e. at award or vesting, depending on the terms of the plan
- **Social security**
 - Employer and employee social security payable at the same time as income tax
- **Payroll withholding and reporting**
 - Required in the same way as for other employment income

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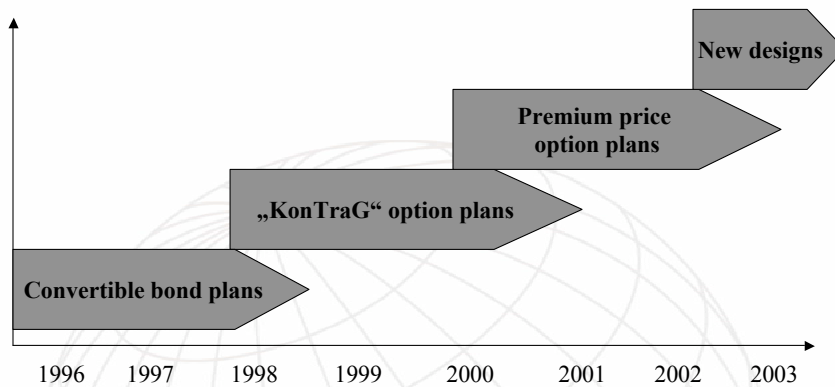
What Types of Share Plans do German Companies Currently Use?

- **Broad based plans**
 - Mostly structured as discounted stock purchase plans with holding requirement (“*Belegschaftsaktien*”)
- **Executive plans**
 - Stock option plans
 - SARs and other phantom plans
 - Convertible bonds
 - Highly bespoke designs

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Historic Development of Executive Plan Designs



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Evolution of Executive Plans

Since 1998



- Increased use of option plans (March 1998, KonTraG) as part of a value based compensation approach
- Search for a plan design that avoids adverse US GAAP implications

Since 2001



- German Corporate Governance Code and debate about disclosure
- Debate about shareholder (and stakeholder) rights
- Debate about the accounting treatment of equity plans

Since 2002/03

- Many of the plans are under water (typically granted at a premium during a period of high share prices)
- Developments of new and more varied designs in view of new HR, accounting and corporate governance considerations

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Premium Priced Option Plans

➔ Basic design

- Exercise price is higher than the market value of the stock at grant (typically between 5% and 20%)
- Court decision that premium price is in line with the legal requirement of using a performance hurdle under §193 Abs.2 Nr.4 AktG
- Mostly financed by newly issued shares

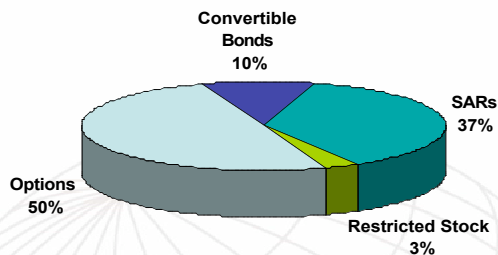
➔ Advantages and disadvantages

- Until recently avoided US GAAP issues (not any more!)
- Only beneficial if the share price performs very well, i.e. more likely to be under water
- Other performance conditions might be better suited to align the interests of management with the interests of shareholders
- Market versus non-market performance conditions under IFRS 2

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Executive Plans Operated by DAX 30 Companies



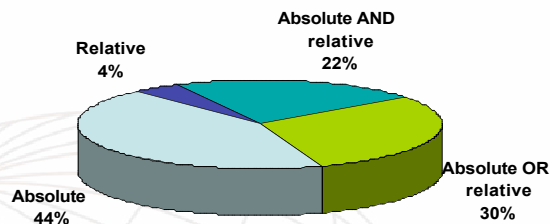
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Performance Conditions

Were always used by German companies and are required by law if newly issued shares are used

A majority of DAX 30 companies used "absolute" performance hurdles (e.g. premium price) up to 2002, many use more than one hurdle



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Main Differences between German and US/UK Option Plans

	„Typical“ German option plan	“Typical” US/UK option plan
Distribution of award volume	Appr. 10% of volume for the Board, awards more equally distributed among the Board members	Higher proportion of volume to the CEO and CFO
Vesting	Typically 2 to 4 years (average 2.5 years)	Typically 1 to 2 years (US); 3 years (UK)
Exercise price	Typically 120% of the market value of the shares at grant (premium priced)	Typically market value of the shares at grant
Additional performance conditions	If premium priced often none, otherwise generally stringent relative performance conditions	In the past typically none (US); Earnings Per Share and/or Total Shareholder Return hurdles (UK)
Disclosure	In the past typically none (collective disclosure required, individual disclosure only recommended), now requirement to "explain" if no individual disclosure	Individual disclosure required for listed companies

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Expected Future Developments

- **Executive plans**
 - Redesign focussing again on relative performance conditions (in addition to, or instead of premium price) to meet corporate governance requirements and compensation / incentive objectives
 - Increased use of RS or RSU plans (due to German legal reasons generally in form of phantom plans) or deferred stock plans
 - Greater variety of plan designs
 - Increased focus on distribution of annual awards to take current share prices and likely future growth into account
- **Broad based plans**
 - Reconsideration of rolling plans out globally and/or offering wider participation among some companies
 - Greater variety of plan designs

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Share Plans Operated by Swiss Multinational Companies

- **Broad based plans**
 - Free or discounted stock plans with holding requirement (3 to 5 years)
 - Phantom shares for individuals resident in countries with security law restrictions or to avoid taxation upon grant
- **Executive plans**
 - Stock option plans (three year vesting periods)
 - Tradeable stock options taxable upon grant
 - Leveraged share plans (options for discount)

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Evolution of Equity Plans

1980



- Share plans
- Restriction period of 3 to 5 years
- 10 % tax discount for each year of restriction

1992



- First option plans implemented in Switzerland by non Swiss multinationals
- Swiss multinationals start implementing option plans in 1995
- Change of taxation from exercise to taxation at grant in 1997 (1995 in the Canton of Zurich)

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Evolution of Equity Plans

2001



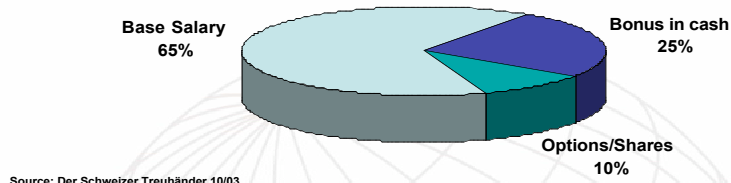
- Most international companies offer a basket of different plans
- Stock option grants no longer tax attractive due to taxation upon exercise
- Increasing number of share plans implemented instead of option plans
- Phantom plans to avoid up-front taxation

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Share Plans Operated by Swiss Multinational/listed Companies

Salary Apportionment

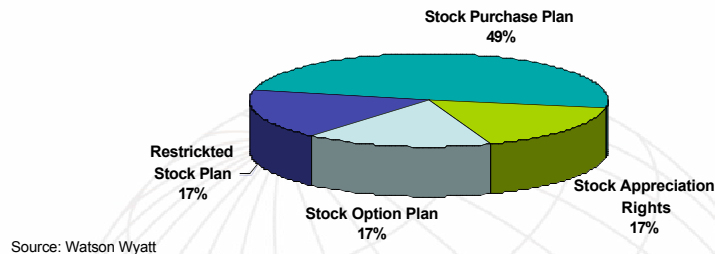


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Share Plans Operated by Swiss Multinational/listed Companies

Type of equity compensation



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Main Differences between Swiss and US/UK Option Plans

	Swiss option plan	"Typical" US/UK option plan
Distribution of award volume	Appr. 10% of volume for the Board, awards more equally distributed among the Board members	Higher proportion of volume to the CEO and CFO
Vesting	Typically 3 years	Typically 1 to 2 years (US); 3 years (UK)
Exercise price	Typically at the money at date of grant	Typically market value of the shares at grant
Type of option	Tradeable or listed stock options	Non tradeable and non listed stock options
Disclosure	In the past typically none (collective disclosure required), individual disclosure increasingly common	Individual disclosure required for listed companies

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Expected Future Developments

- **Broad based plans**
 - Share plans instead of option plans
 - Phantom plans to avoid upfront taxation of shares
- **Executive plans**
 - Share and option plans
 - Deferred plans
 - Employee can decide to invest part of his bonus in a basket of different equity plans

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Case Study: NOVARTIS

- Background on Novartis
- Plans operated by Novartis
- Our objectives
- Challenges of operating global plans in a global environment
- Current developments

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NOVARTIS in Short

- World leader in research and development of products to protect and improve health and well-being
- Created in 1996 from the merger of Ciba-Geigy and Sandoz
- Group Sales 2003: USD 24.9 billion
- Net Income 2003: USD 5.0 billion
- R & D Investment 2003: USD 3.8 billion (15.1% o.s.)
- 78,500 employees in over 140 countries

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Plans Operated by NOVARTIS

Novartis Stock Option Plan

- Annual grant of stock options based on agreed performance vs. annual objectives
- ROW: tradeable options with 2 years cliff vesting; exercise period 7 years
- USA: non-tradeable options with 3 years cliff vesting; exercise period 7 years
- Coverage: 10% of all employees

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Plans Operated by NOVARTIS

Long-Term Performance Plan

- Incentive plan for senior executives (top tier) in 12 countries
- Annual grant process
- Payout in Novartis shares based on 3 year strategic plan EVA achievement
- Focus on shareholder value created by the Division or Business Unit

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Plans Operated by NOVARTIS

Leveraged Stock Savings Plan

- Optional stock savings plan with annual choice process
- Employee may convert up to the annual cash incentive amount in an equivalent share amount
- Company matches the number of shares at 50% or 100% after 3 or 5 years vesting
- Coverage: all associates in Switzerland, UK and for select top tier executives

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Our Objectives

Novartis compensation principles place strong focus on long-term, equity based programs which are designed to

- attract, retain and motivate high caliber key talents
- support a performance oriented culture allowing high performers to achieve superior rewards
- align executives, management and associates to create sustainable shareholder value
- encourage decision making that will result in long-term rewards
- total individual compensation at target performance level is aimed at the median of comparable companies of our industries

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Challenges of Operating Global Plans in a Global Environment

- Legal/regulatory hurdles
- Securities laws
- Cultural differences and perceptions
- Taxation: corporate and personal income tax
- Communication: Complexity of design
- Language
- Stock market environment
- Cost of administration and compliance

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Current Developments

- Taking into consideration stock market environment, the fact that participants may have different needs, different perspectives towards risk and be at different stages as to financial planning we made the following enhancements to our option program:
- February 2004 - introduction of tradable options in the USA
- February 2004 - introduction of "Choice Model" worldwide, incl. the USA:
associates can choose between receiving their award in
 - A) 100 % tradable options
 - B) 50 % tradable options and 50 % Restricted Stock or Restricted Stock Units (depending on country)
 - C) 100 % Restricted Stock or Restricted Stock Units

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Current Developments

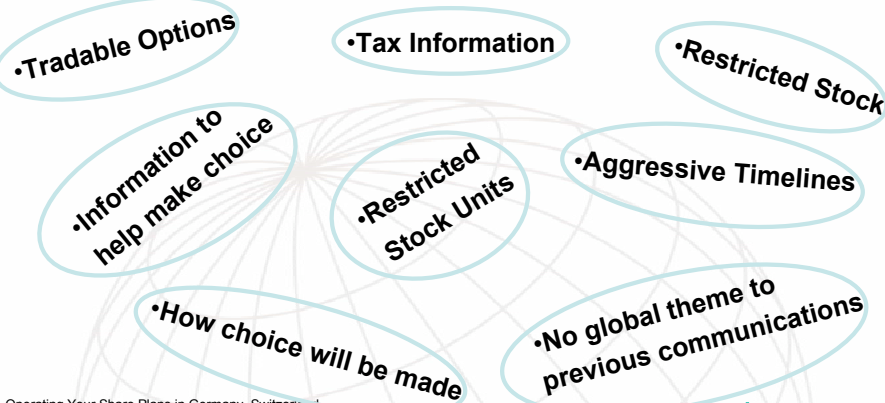
- Stock Options offer greater upside potential whereas Restricted Stock/Restricted Stock Unit offers better downside protection
- Restricted Stock bears voting and dividend rights and vests after 3 years
- Restricted Stock Units have no voting and dividend rights; after three year vesting period they convert automatically in Novartis shares
- Choice model covers 65 countries with a total of approx. 8,000 participants
- 23 countries are under the Restricted Stock Plan and 42 countries under the Restricted Stock Unit Plan.

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Communicating the Choices

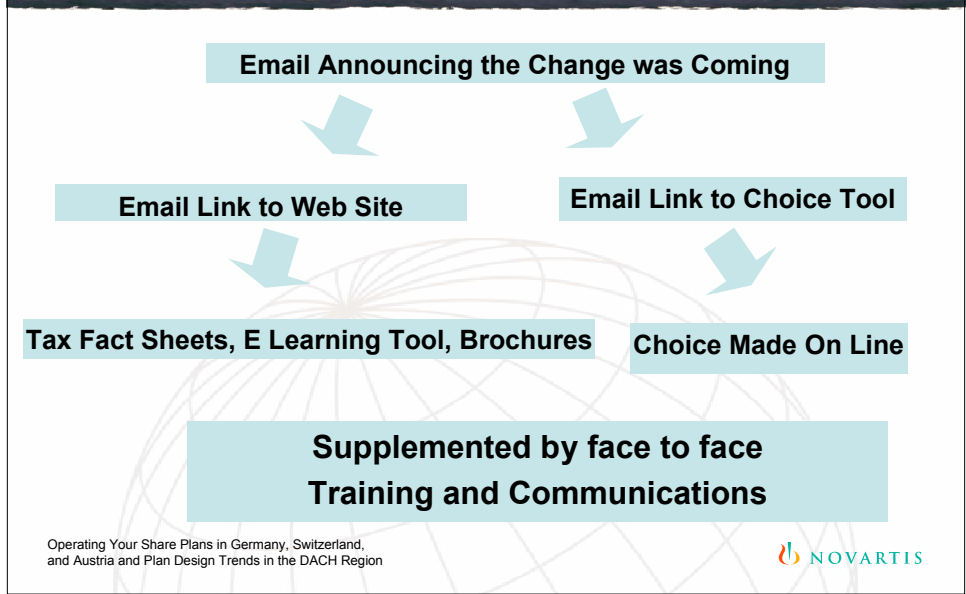
Early Realisation that Communication was key to success



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Electronic Communication



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Current Developments

- Generally, the enhanced stock program offering the flexibility of choices is well accepted and understood.
- Introduction of tradeable options in USA/Canada needs particular communication and education effort/focus
- **Choices made in Switzerland**

- A. 100 % tradeable options:	53.0 %
- B. 50 % tradeable options / 50 % Restricted Stock:	25.0 %
- C. 100 % Restricted Stock	21.0 %
Total:	<u>66 % options and 34 % Restricted Stock</u>

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Current Developments

- **Choices made in Germany**
 - A. 100 % tradable options: 44.0 %
 - B. 50 % tradable options / 50 % RSU: 24.0 %
 - C. 100 % Restricted Stock Units (RSU): 32.0 %
 - Total: **51 % options and 49 % Restricted Stock Units**
- **Choices made in Austria**
 - A. 100 % tradable options: 29.0 %
 - B. 50 % tradable options / 50 % RSU: 29.0 %
 - C. 100 % Restricted Stock Units (RSU): 42.0 %
 - Total: **31 % options and 69 % Restricted Stock Units**

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Select 2004: Participants' Choices

Countries	100% Options	50% Options/ 50% RS or RSU	100% RS/RSU	Weighted Option/RS or RSU
Basel (RS)	53%	25%	21%	66%/34%
French Cross Border	43%	34%	26%	57%/43%
German Cross Border	43%	30%	28%	57%/43%
Germany (RSU)	44%	24%	32%	51%/49%
France (RSU)	28%	14%	58%	45%/55%
Italy (RSU)	23%	11%	66%	16%/84%
Spain (RSU)	63%	17%	21%	72%/28%
UK (RS)	74%	20%	6%	87%/13%
Japan (RSU)	43%	16%	41%	50%/50%
Austria (RSU)	29%	29%	42%	31%/69%
Mexico (RS)	60%	18%	22%	73%/27%
Brazil (RS)	77%	13%	10%	81%/19%
Total Rest of World	53%	22%	25%	57%/43%
CEGs USA	37%	28%	35%	46%/54%

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Current Developments

Tax Matrix for Enhanced Stock Award "Select"

	Options	Restricted Stock	Restricted Stock Units
Switzerland	at grant, based on tax ruling (discounted Black-Scholes value)	at grant; discount for years of restriction	n.a.
Germany	at exercise (sale), ordinary income tax rate on FMV option	n.a.	at vesting, i.e. delivery of shares on FMV share; capital gain if share sold prior to 1 year holding
Austria	at vesting on FMV option ordinary income rate Sale of option < 1 yr after vesting: capital gain tax	n.a.	at vesting, i.e. delivery of shares on FMV share; capital gain if share sold prior to 1 year holding

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Any Questions?

Thank You

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