



Wärtsilä Corporation Annual Report 2018

Governance

Remuneration report 2018

04

Remuneration report 2018

Dear Shareholders

This report sets out the Wärtsilä remuneration policy and report for the Board of Directors and Board of Management for 2018, and enumerates the same for the two previous years. With this policy and report, we aim to increase transparency regarding Wärtsilä's remuneration practices, and how they contribute to the business strategy and long-term interests.

Wärtsilä strives for high performance, and strong achievements are recognised and rewarded. Remuneration at Wärtsilä is guided by our 'Pay for Performance' principles. These principles are used to structure the reward approach throughout the organisation, and are designed to align employee rewards with the interests of the company and its shareholders. The remuneration policy for the President & CEO and other members of the Board of Management has been developed taking these principles into account.



We believe in a consistent approach to performance rewarding at Wärtsilä. The remuneration arrangements for the Board of Management, which also cascade down to other members of the senior management team, have operated broadly unchanged for some years.

The short-term incentive awards for the Board of Management have been consistently based on profitability (EBIT%) and cash flow targets over the past years. The expected performance criteria for profitability were set at highly ambitious levels for 2018, and increased from the previous year, while the criteria for the cash flow target was lowered. Wärtsilä's financial performance in 2018 resulted in neither the profitability nor the cash flow target thresholds being met. Therefore, no short-term incentives were awarded for the year.

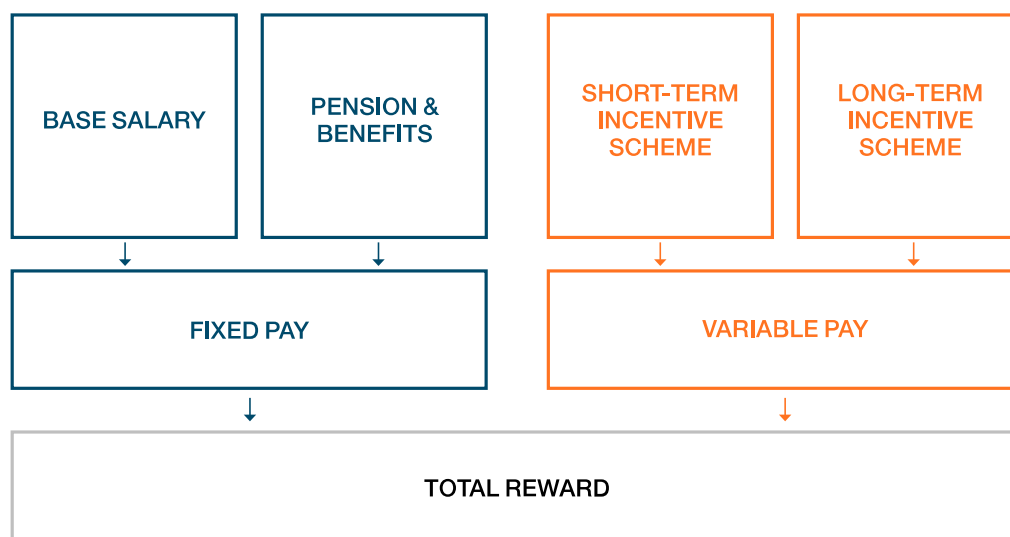
Wärtsilä's long-term incentive scheme is based on share price development, and its realisation is paid as a cash award. The 2015 scheme came to a close at the end of 2018. Due to share price performance during the performance period, there will be no pay-out for the 2015 scheme. As of 2019, the structure of the program is renewed, so that realisation is paid out in shares. With this change, our aim is to promote shareholder value creation by strengthening the alignment of senior management interests with those of Wärtsilä's shareholders.

Mikael Lilius
Chairman of the Remuneration Committee

Remuneration principles and policy for the Board of Management

Wärtsilä's rewarding principles are designed to attract, retain and motivate executives by providing compensation solutions that reward them for their performance in delivering business results.

The remuneration mix for the Board of Management consists of fixed and variable, performance related, pay. The objective is to have a good balance of rewarding elements. These comprise a fixed pay level guaranteed to be market competitive, supported by short- and long-term incentive schemes to drive company performance and to reward accordingly.



Fixed pay

The fixed remuneration paid to the President & CEO and to the other members of the Board of Management consists of a monthly base salary and fringe benefits. Base salaries are reviewed annually taking into account the company's and the individual's performance, and the market conditions.

The members of the Board of Management are provided private medical insurance and life insurance. They are also offered a company car benefit. Taking into consideration Wärtsilä's emphasis on environmental responsibility, hybrid or low emission cars are recommended.

The President & CEO and members of the Board of Management participate in company specific pension schemes, in addition to any statutory requirements. The nature of the supplementary pension schemes and retirement ages vary. They are generally based on the retirement scheme of the national social security system to which the person in question belongs, and are either defined benefit or defined contribution based.

Variable pay

Short-term incentive schemes

The Group operates a bonus scheme, which is implemented globally and is designed to provide incentives for achievement of and reward for delivery of the short-term business plan. The bonus is based on the Group's financial targets, business specific targets, as well as agreed team and personal targets. Around 3,000 directors and managers are covered by this scheme.

For the President & CEO and the Board of Management, the payment is based on the achievement of the company's profitability and other financial targets for the financial year, as set by the Board of Directors. The short-term incentive opportunity is capped at 100% of the annual base salary for the President & CEO, and 65% of the annual base salary for the other members of the Board of Management. Bonuses are paid in cash shortly following the year-end.

Wärtsilä's employees also participate in bonus or profit-based incentive schemes. These are applied in the majority of countries where Wärtsilä operates according to each country's legislation. Alternatively, they take the form of local bonus or profit-sharing schemes. All in all, 80% of the company's employees are covered by the Group's bonus schemes and various other performance-related incentive schemes.

Long-term incentive scheme

Around 100 senior managers, including the President & CEO and the Board of Management, participate in Wärtsilä's long-term incentive scheme.

The objective of the long-term incentive scheme is to align the interests of senior management with those of Wärtsilä's shareholders by creating a long-term equity-related interest for the participants. In so doing, this promotes shareholder value creation and drives a long-term performance culture within Wärtsilä.

The long-term incentive scheme has a three year performance period. Under the scheme, participants are awarded incentive rights. The value of an incentive right at the end of the performance period is based on the growth in value of the share price between the three month period immediately preceding the performance period and the last three months of the performance period. The end share price may include a value for part or all of the normal and extraordinary dividends paid by Wärtsilä Corporation during the performance period.

Valuation of the incentive rights:

$$\left(\text{COMPARISON SHARE PRICE} - \text{STARTING SHARE PRICE} \right) \times \text{NUMBER OF INCENTIVE RIGHTS} = \text{VALUE OF LONG-TERM INCENTIVE}$$

To ensure an appropriate level of reward, an upper limit is set for each award cycle, capping the maximum value for each incentive right. The incentive rights are paid-out in cash, but the President & CEO and the Board of Management members are expected to acquire Wärtsilä shares with 50% of the net value received until they have achieved their required share ownership level. The schemes launched as of 2019 will be paid out in shares to promote shareholder value creation by strengthening the alignment of senior management interests with those of Wärtsilä's shareholders.

Share ownership policy

Each Board of Management member is expected to accumulate and, once achieved, maintain a share ownership in Wärtsilä that at least corresponds to the individual's annual gross base salary.

Governance

The Board of Directors determines the levels and underlying principles of the fixed pay, as well as the incentive schemes for the President & CEO and other Board of Management members. The Board of Directors also decides on other possible long-term incentive schemes for senior management, unless they are by law determined by the Annual General Meeting. The Board of Management decides on bonus schemes for other directors and managers.

Remuneration of the Board of Management

Contractual terms for the President & CEO

The base salary of the President & CEO is EUR 862,200 p.a. He is entitled to participate in the short- and long-term incentives schemes according to the terms and conditions described above. The President & CEO is eligible to take retirement upon reaching the age of sixty-three (63). His pension scheme is determined according to a defined contribution based system. The retirement pension contribution is equivalent to 20% of the annual salary.

Remuneration paid to the President & CEO if dismissed by the company corresponds to 18 months' salary plus a six months' period of notice salary.

Board of Management's total remuneration in 2018

TEUR

	Salary and short-term benefits	Supplementary pension contributions	Short-term incentives ¹	Long-term incentives ²	Total
Board of Management					
Jaakko Eskola, President & CEO	862 (785)	170 (156)	239 (295)	1 696 (410)	2 967 (1 645)
Pierpaolo Barbone, President, Services and Deputy to the CEO	384 (425)	107 (88)	56 (105)	848 (410)	1 396 (1 028)
Other members of the Board of Management	2 263 (2 162)	368 (493)	480 (441)	4 452 (1 587)	7 563 (4 863)

¹ Relates to the annual bonus for 2017 performance, which was paid in 2018.

² Relates to the 2015-2017 long-term incentive cycle, which was paid in 2018.

Short-term incentive schemes

The Board of Management's performance target structure for the short-term incentives is described in the table below. A sliding scale of targets was set for each measure.

PRESIDENT & CEO	Group EBIT % (2/3)		Group Cash Flow from operating activities (1/3)
BUSINESS ROLES	Group EBIT % (1/3)	Respective business targets (1/3)	Group Cash Flow from operating activities (1/3)
OTHER CORPORATE ROLES	Group EBIT % (2/3)		Group Cash Flow from operating activities (1/3)

Short-term incentive for 2018 performance

The above performance measures and weightings apply to the annual bonus for 2018 performance.

Performance against the group targets was as follows:

MEASURE	PERFORMANCE OUTCOME
Group EBIT %	Below threshold
Group Cash Flow from operating activities	Below threshold

As the performance outcomes were below the target thresholds, no bonuses were paid out.

Short-term incentive for 2019 performance

There are no proposed changes to the operation of the short-term incentive plan for 2019. The performance measures, weightings, and maximum limits will be the same as those applying in 2018.

Historical development of performance outcome

The performance measures and weightings have remained consistent during the past years. Actual performance against the group targets during 2016-2017 is shown below.

MEASURE	PERFORMANCE OUTCOME	
	2016	2017
Group EBIT %	Between threshold and target	Between threshold and target
Group Cash Flow from operating activities	Between target and maximum	Between target and maximum
The bonus paid out on average (of the maximum)	President & CEO: 50% Board of Management: 50%	President & CEO: 31% Board of Management: 35%

Long-term incentive schemes

The table below sets out details of the realised and outstanding awards under Wärtsilä's long-term incentive scheme. The scheme applies to Wärtsilä's senior management, consisting of approximately 100 directors, including the Board of Management. The value delivered is based on the share price development during the three-year performance period. The values reflect the share split effective March 2018.

Performance period	2016-2018	2017-2019	2018-2020
Number of incentive rights granted (on 31.12.2018)	4 857 000	5 490 000	4 845 000
Starting share price, EUR	15.82	16.19	22.58
Measurement period for comparison share price	Q4 2018 + 100% of dividends paid	Q4 2019 + 100% of dividends paid	Q4 2020 + 100% of dividends paid
Maximum value per incentive right, EUR	4.61	6.07	8.47
Final comparison share price, EUR	15.79	-	-
Final value per incentive right, EUR	0.00	-	-
Scheme payment date	February 2019	February 2020	February 2021

* The share issue without payment (share split) approved by Wärtsilä Corporation's Annual General Meeting on 8 March 2018 increased the total number of Wärtsilä shares to 591 723 390. The figures in the above table have been restated accordingly.

The incentive rights are paid-out in cash, but the President & CEO and the Board of Management members are expected to acquire Wärtsilä shares with 50% of the net value received until they have achieved their required share ownership level.

In January 2019, the Board of Directors decided on the long-term incentive plan for 2019-2021. The structure was renewed so that reward will be paid out in shares, in order to better promote shareholder value creation by strengthening the alignment of senior management interests with those of Wärtsilä's shareholders. The incentive scheme 2019 comprises 6,542,000 incentive rights. It is based on the share price development during a three-year period, with a starting share price of EUR 16.76. The reward cannot exceed EUR 6.56 per incentive right and it takes into account 100% of dividends paid out during the performance period and reinvested in the Company's shares. The 2019 scheme will be due for payment in February 2022.

Share ownership

Board of Management's share ownership in Wärtsilä on 31 December 2018

Board of Management	No. of shares
Jaakko Eskola	41 739
Change in 2018	33 258
Pierpaolo Barbone	21 831
Change in 2018	14 554
Arjen Berends	0
Change in 2018	0
Päivi Castrén	14 799
Change in 2018	9 866
Kari Hietanen	15 633
Change in 2018	10 422
Roger Holm	11 796
Change in 2018	11 796
Atte Palomäki	14 493
Change in 2018	9 662
Marco Ryan	0
Change in 2018	0
Marco Wirén	20 184
Change in 2018	15 279

* The changes in holdings reflect the increased number of shares resulting from the share issue without payment (share split), which was approved by the Annual General Meeting on 8 March 2018.

Evaluation

The Board of Directors monitors the Group's short- and long-term incentive schemes and evaluates the achievement of the targets on which they are based. The incentive schemes for 2018 were found to be well balanced and in accordance with market practices. The Board of Directors was satisfied that the payout outcome was appropriate given the company's performance.

Remuneration of the Board of Directors

The Annual General Meeting decides annually on the fees to be paid to the members of the Board of Directors for one term of office at a time.

The Annual General Meeting approved the following fees to the members of the Board of Directors for 2018:

- to the ordinary members EUR 70,000/year
- to the deputy chairman EUR 105,000/year
- to the chairman EUR 140,000/year

Approximately 40% of the annual fee is paid in Wärtsilä shares. In addition, each member will be paid EUR 750 per board meeting attended, the chairman's meeting fee being double this amount. Further, the Chairman of the Audit Committee will receive a fixed fee of EUR 20,000 and each member of the Committee a fixed fee of EUR 10,000 for the term; the Chairman of the Remuneration Committee will receive a fixed fee of EUR 10,000 and each member of the Committee a fixed fee of EUR 5,000 for the term; and the Chairman of the Nomination Committee will receive a fixed fee of EUR 8,000 and each member of the Committee a fixed fee of EUR 4,000 for the term. The members of Wärtsilä's Board of Directors were paid altogether EUR 718 thousand for the financial period that ended on 31 December 2018. The Board's members were not covered by the company's incentive schemes.

Fees paid to the Board of Directors

TEUR	Attendance fees		Yearly fees		Total	
Board of Directors	2018	2017	2018	2017	2018	2017
Mikael Lilius, Chairman	35	21	140	132	175	153
Tom Johnstone, Deputy Chairman	14	9	105	99	119	108
Maarit Aarni-Sirviö	26	12	70	66	96	78
Kaj-Gustaf Bergh	12	8	70	66	82	74
Karin Falk	8	5	70	66	78	71
Johan Forssell	12	6	70	66	82	72
Risto Murto	24	13	70	66	94	79
Markus Rauramo	33	15	70	66	103	81

Fees paid in Wärtsilä shares in 2018

Board of Directors	No. of shares
Mikael Lilius, Chairman	3 183
Tom Johnstone, Deputy Chairman	2 387
Maarit Aarni-Sirviö	1 591
Kaj-Gustaf Bergh	1 591
Karin Falk	1 591
Johan Forssell	1 591
Risto Murto	1 591
Markus Rauramo	1 591

Board of Directors' share ownership in Wärtsilä on 31 December 2018

Board of Directors	No. of shares
Mikael Lilius, Chairman	61 260
Change in 2018	41 901
Tom Johnstone, Deputy Chairman	8 594
Change in 2018	6 525
Maarit Aarni-Sirviö	32 437
Change in 2018	22 155
Kaj-Gustaf Bergh	30 103
Change in 2018	20 599
Karin Falk	3 007
Change in 2018	2 535
Johan Forssell	3 007
Change in 2018	2 535
Risto Murto	8 947
Change in 2018	6 495
Markus Rauramo	16 609
Change in 2018	11 603

* The changes in holdings reflect the increased number of shares resulting from the share issue without payment (share split), which was approved by the Annual General Meeting on 8 March 2018.