KPN
Integrated Annual Report 2018

The power of connection

kpn

Remuneration Report

Introduction

We are committed to preserving the confidence and trust of our stakeholders by presenting the details and implementation of our remuneration policy for the Board of Management.

KPN's core values are Customer, Together and Simplicity, which form the essence of our organizational culture. Considering these core values and also being aware of the public debate surrounding the topic of executive remuneration, we strive to balance our core values and all stakeholder interests in our remuneration programs. We thereby emphasize short- and long-term value creation through pay-for-performance based on financial and non-financial targets and benchmarked competitive pay levels. This ensures a strong alignment with the company's annual performance goals and long-term value creation strategy based on addressing the needs and challenges of society.

The Remuneration Committee's (the Committee) tasks are laid down in the terms of reference of the Committee. The Committee assists the Supervisory Board with establishing, implementing and reviewing the company's remuneration policy to ensure that members of the Board of Management are compensated in consistence with that policy. The Chairman and members of the Remuneration Committee are appointed by the Supervisory Board. The Committee currently consists of Mr. Hartman (Chairman), Mr. Sickinghe, Mrs. Zuiderwijk and Mr. Haank.

Overview

Executive remuneration at a glance
A
Highlights of KPN's remuneration policy and actual remuneration

Executive remuneration policy – overview
B
In-depth insight into KPN's remuneration policy for the Board of Management and execution thereof

Supervisory Board pay policy
C
Highlights of KPN's remuneration policy for the Supervisory Board

KPN's remuneration policy; a balanced approach between long-term value creation and short-term performance

The objectives and principles of KPN's remuneration policy are based on a balanced approach between market competitive standards, the ratio between fixed- and variable pay (with a focus on long-term value creation) and the economic and social contribution of the company linked to the non-financial parameters of the variable pay.

Objectives:	Principles:
Market competitive standards:	
Attracting, motivating and retaining the necessary leadership talent	Paying at market-competitive level
Complying with best practice in corporate governance	Enhancing transparency and clarity
Supporting a work environment where inspiring leadership is the norm	Differentiating by experience and responsibility, while promoting internal fairness
Ratio base/variable pay (focus on long-term value creation):	
Driving performance based on digitalization and simplification that generates long-term sustainable and profitable growth	Paying for performance
Encouraging customer satisfaction and loyalty, agility and innovation	Rewarding a customer centric approach
Economic and social contribution:	
Creating economic value by addressing the needs and challenges of society	Balancing all stakeholder interests

› Remuneration Report

A. Executive remuneration at a glance

Considering the objectives and principles of our remuneration policy, the pay mix for executives consists of the following four elements that are further explained in this report:

Component	Form	Fixed/variable	Drivers
Base salary	Cash	Fixed	Experience and responsibility
Benefits (primarily pensions)	Funded by cash contributions	Fixed	Market-competitive standards
Short-term Incentive (STI)	Cash	Variable	Performance – assessed through annual financial and non-financial targets
Long-term Incentive (LTI)	Conditional shares	Variable	Performance – assessed through relative TSR (peer group), free cash flow, earnings per share and non-financial parameters

The ratio between fixed and variable pay

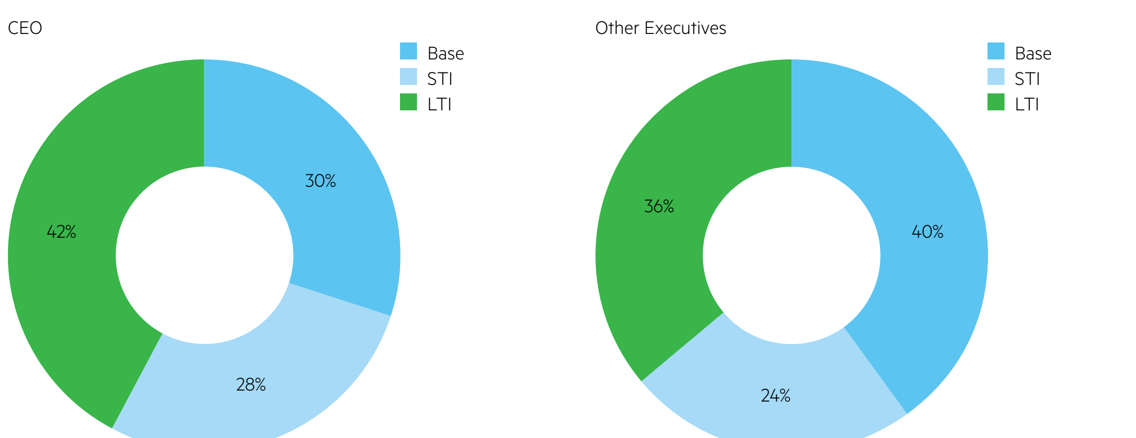
The ratio between fixed and variable pay is influenced by the extent to which targets are met. The following pie charts represent the pay mix for both the CEO and the other board members in case of an on-target performance. The different pay mix for the CEO (when compared to the other executives) reflects the outcome of the benchmark reference.

KPN's benchmarked remuneration levels

KPN's remuneration levels are benchmarked against other companies in order to ensure that KPN's total level of compensation based on the pay mix is in line with KPN's remuneration policy and objectives, as described above.

The peer employment group consists of Dutch-listed and European sector-specific companies. The advice of Korn Ferry, an independent external consultant, is used by the Committee to ensure an objective benchmark for KPN's remuneration policy and levels of remuneration.

Remuneration policy



Actual remuneration current members of the Board of Management (in thousands of EUR)
See the section 'Personnel expenses' in the Consolidated Financial Statements for full disclosure of remuneration cost under IFRS principles (also including former members).

Name	Year	Base	STI	Actual vested LTI over results in the past 3 years	Pension cost and social security	Total
Maximo Ibarra[3]	2018	657	704	-	129	1,490
Jan Kees de Jager	2018	668	382	232[1]	131	1,413
	2017	643	367	888[2]	124	2,022
Joost Farwerck	2018	625	393	214[1]	147	1,379
	2017	611	332	817[2]	144	1,904

1 Final measurement of the 2016 share grant was conducted in 2019, which leads to 42.5% vesting of the shares in April 2019. The amounts give an indication of the underlying value of the shares that will vest in April 2019 based on the closing share price of KPN at 15 February 2019 (EUR 2.72).
2 Final TSR measurement for the 2015 share grant was conducted in 2018, which led to vesting of shares in April 2018. The estimated numbers in the 2017 Remuneration Report are restated with the actual value at vesting.
3 Actual remuneration since appointment as a member of the Board of Management (18 April 2018). For transition activities and professional services prior to this Mr. Ibarra received monthly advisory fees totaling EUR 195,000 in cash, EUR 200,000 in cash subject to a 3-year retention period and EUR 200,000 in shares subject to a 4-year retention period.

Incentives aligned with strategy and sustainable performance growth

The focus of KPN's strategy is on offering the best converged smart infrastructure, focus on profitable growth segments and acceleration of simplification and digitalization. Combined with a flexible and simplified integrated network and operating model, KPN is building the Netherlands' digital highway by accelerating its FttH roll-out and modernizing its mobile network. Together, this leads to organic sustainable growth of adjusted EBITDA and free cash flow, supporting progressive dividend and deleveraging. The goals and objectives of this strategy are reflected in the short- to medium-term targets and long-term targets, which are used to compensate senior management for their performance. The performance measures also strengthen sustainable performance growth by focusing on both financial and non-financial performance indicators.

Level of variable compensation aligned with the company's risk profile

KPN aligns incentives with its long-term strategy, but it also needs to focus on short-term success in order to achieve further growth. The company's risk profile is embedded in the short-term and long-term incentive structure. The measurement of the incentive structure is assured by KPN's standards of internal financial control.

KPN's internal pay ratio

In line with the revised Dutch Corporate Governance Code, KPN takes into account the internal pay ratios within the organization when formulating the remuneration policy. In light of transparency and clarity, KPN applies a methodology to calculate the internal pay ratio that is IFRS-driven.

KPN's internal pay ratio is calculated as the total CEO compensation divided by the average employee compensation (total personnel expenses divided by the average number of FTEs). When calculating the pay ratio for 2018, the CEO compensation for 2018 has been recalculated on an annual basis. Consequently, KPN's calculated pay ratio in 2018 is 29 (2017: 36). For further details, see Note 5 to the Consolidated Financial Statements.

› Remuneration Report

B. Executive remuneration policy – overview

Objectives of KPN's remuneration policy

The essence of our organizational culture is aimed at delivering results. KPN's remuneration programs therefore emphasize variable pay and long-term value creation.

Sustainable performance growth

The performance measures of the short- and long-term incentive plans are aligned with sustainable performance growth. The focus is on both financial and non-financial targets in order to support creation of economic value by addressing the needs and challenges of society. Examples of such non-financial performance measures are: customer and employee satisfaction, loyalty and customer base, reputation targets and energy reduction targets. The alignment of KPN's remuneration policy with its strategic goals is reflected in the following overview.

Principles of KPN's remuneration policy

KPN's remuneration policy is guided by the following main principles:

1) Paying at market-competitive level: this is achieved through benchmarking against an employment market peer group;
2) Pay-for-performance: target remuneration aims at 30–40% of pay in base pay and 60–70% in variable pay in order to maintain a strong alignment with the company's annual financial performance goals and long-term value creation strategy;
3) Differentiating by experience and responsibility: this is achieved through alignment of the pay with the responsibilities, relevant experience, required competence and performance of individual jobholders. Consequently, there can be substantial differentials in pay levels, despite employees having similar job titles; and
4) Balancing all stakeholder interests based on a transparent remuneration policy.

These principles apply to all levels of senior management. The company's remuneration policy is compliant with the relevant legal requirements and the principles of the revised Dutch Corporate Governance Code.

Composition of employment market peer group and market assessment

To ensure the overall competitiveness of KPN's remuneration levels, these levels are benchmarked against an employment market peer group. The Committee uses one peer group consisting of Dutch-listed companies and European sector-specific companies. The following table shows the current composition of KPN's employment peer group:

Employment peer group	
AkzoNobel NV	BT Group Plc
DSM NV	Cap Gemini NV
Heineken NV	Portugal Telecom SA
Randstad Holding NV	Proximus SA
RELX NV/Plc	Swisscom AG
Royal Ahold Delhaize NV	Vodafone Group Plc
Royal Philips NV	Unilever NV/Plc

The Committee regularly reviews the peer group to ensure that its composition is still appropriate. The composition of the peer group might be adjusted as a result of mergers or other corporate activities.

Base pay

The Committee determines appropriate base pay levels taken into account the underlying principles of the remuneration policy. Each year, the Supervisory Board considers whether circumstances justify an adjustment in base pay within the market-competitive target range for individual members of the Board of Management.

Short-term incentives (STI): 70% financial and 30% non-financial targets

General

At the beginning of each year, the Supervisory Board sets financial and non-financial target ranges for the Board of Management. These ranges are based on the company's business plan. At the end of the year, the Supervisory Board reviews the company's performance against the target ranges. Members of the Board of Management are eligible for an annual cash incentive only if company performance is at or above the predetermined ranges.

Objectives: focus on both financial and non-financial targets

The objective of this STI scheme is to ensure that the Board of Management is well incentivized to achieve company performance targets in the shorter-term. Specific details on targets cannot be disclosed for performance measures, as this would require providing commercially sensitive information. The Committee uses scenario analyses to estimate the possible outcomes and decides whether a correct risk incentive is set for the members of the Board of Management with respect to the overall level of pay and pay differentials within the company.

Performance incentive zone

The target ranges for financial and operational performance comprise:

- A 'minimum' at which the minimum incentive is paid. Performance below this level is not generating a payout;
- An 'on-target' performance level at which an 'on-target' incentive is paid; and
- A 'maximum' at which the maximum incentive is paid.

The STI is designed to strike a balance between the company's risk profile and the incentive to achieve ambitious targets. The pay-out methodology is based on a separate pay-out approach for each of the financial and non-financial targets. The Supervisory Board's ability to apply a discretionary factor ranges between 0.7 (reducing the incentive by 30%) and 1.3 (increasing the incentive by 30%). With this discretionary factor, the Supervisory Board is able to express the assessment of the overall individual performance of each member of the Board of Management. The Supervisory Board has agreed a set of non-financial KPIs with each individual member of the Board of Management. The performance based on these KPIs will be evaluated by the Committee annually and discussed with the individual board members at the end of each year. The outcome of this discussion will be used by the Supervisory Board as a reference to determine the discretionary factor.

Discretion both upwards and downwards can be applied by the Supervisory Board if the outcome of the STI scheme would produce an unfair result or if the outcome would not be considered to reflect the basic objectives and principles of pay as outlined in this section.

Actual pay-out levels

Based on the financial and non-financial targets set by the Supervisory Board, the performance (and weight) was:

- Free cash flow (35%) around maximum level.
- EBITDA (20%) around on-target level.
- Revenue (15%) around on-target level.
- Employee engagement (15%) between minimum and on-target level.
- Net Promoter Score (15%) below minimum level.

› Remuneration Report

Short-term Incentives (STI)

Component	Short-term incentives
Form of compensation	Cash
Value determination	CEO: 90% of base pay. Other members of the Board of Management: 60% of base pay
Targets	Financial targets (70% weight) typically are: › EBITDA › Free cash flow › Revenue Non-financial targets (30% weight) typically are: › various measures of customer and employee satisfaction, customer loyalty and customer base. A circuit breaker is applicable as a minimum requirement for pay-out of the STI non-financial parameters. If this minimum requirement is not achieved, the non-financial parameters of the STI will not generate a pay-out.
On-target	100% of the on-target incentive paid
Discretionary factor	A factor between 0.7, reducing the incentive by 30%, and 1.3, increasing the incentive by 30%.
Scenario maximum	Pay-out capped at 150% of the 'on-target' incentive (i.e. 135% of base salary for the CEO and 90% of base salary for the other members of the Board of Management).

Long-term incentives (LTI)

Component	Long-term share-based compensation
Form of compensation	Shares
Value determination[1]	CEO: 135% of base pay. Other members of the Board of Management: 90% of base pay.
Targets	Financial targets: › 25% based on relative TSR versus peer group › 25% on free cash flow › 25% on earnings per share Non-financial targets: › 12.5% on sustainability/environmental targets › 12.5% on stakeholder/customer targets. Vesting of non-financial targets will be subject to achieving a cumulative net profit during the vesting period of three years (i.e. qualifier for vesting).
On-target	100% of the granted shares vest.
Scenario maximum	Position 1 in TSR peer group and maximum performance of financial and non-financial targets: 200% of the shares vest.

1 Based on the average share price of the first trading day after the AGM. Dividend paid during the vesting period will be included in the value determination.

Long-term incentives (LTI): 75% financial and 25% non-financial targets

General

In addition to the base pay and the short-term annual cash incentive described above, a long-term incentive based on performance shares is used to ensure that the interests of the members of the Board of Management are aligned with those of its long-term (or prospective) shareholders and to provide an incentive for members of the Board of Management to continue their employment/service agreement relationship with the company.

The number of shares granted under this plan is based on a percentage of base pay as shown in the LTI table. The vesting methodology is based on a separate vesting approach for each of the financial and non-financial targets.
It is considered that comparing KPN's TSR with a wider group of companies (either geographically or with other industries) is not considered to be meaningful. Variations in returns would most likely be attributed largely to macro-economic events and/or sector shifts rather than to variations in management actions. Therefore, benchmarking TSR achievements relative to other, similar companies emphasizes rewarding for specific KPN performance.

The non-financial parameters set are based on energy reduction and a reputation dashboard. See the relevant sections of this Integrated Annual Report for detailed information about energy reduction and reputation. The performance period of the LTI plan is set at three years. Vesting is, in principle, also subject to the condition that the member of the Board of Management has not resigned within three years of the date of the initial grant. The Committee uses scenario analysis to estimate the possible outcomes of the value of the shares vesting in coming years and decides whether a correct risk incentive is set for the members of the Board of Management with respect to the overall level of pay and pay differentials within the company.

See Note 5 to the Consolidated Financial Statements for a further description and valuation of the option and share plans.

Performance-measuring and peer group performance

The following table provides an overview of KPN's performance peer group to determine KPN's relative shareholder return for LTI plans.

Companies included in the peer group

BT Group Plc	Tele2 AB
Deutsche Telekom AG	Telekom Austria AG
Orange Belgium SA	Telia Company AB
Orange SA	Vodafone Group Plc
Proximus SA	Swisscom AG
Telenor ASA[1]	KPN NV

1) In 2018 TDC was delisted. Telenor replaced TDC group for the 2018 grant and possible future grants. For grants of previous years that have not yet vested, TDC will remain in the peer group and its TSR performance after delisting will be adjusted with the average TSR performance of the TSR peer companies (i.e. the so-called "synthetic approach").

Position	Vesting schedule	Position	Vesting schedule
Position 1	200%	Position 5	100%
Position 2	175%	Position 6	75%
Position 3	150%	Position 7 and below	No vesting
Position 4	125%		

The table above provides the vesting schedules of the TSR part in the LTI plans. Please note that the peer group used for relative TSR reflects the relevant competitive market in which KPN competes for investor preference. As such, it is different from the employment market peer group, which is used to determine competitive pay levels for the CEO and other members of the Board of Management. The peer group may be adjusted if an individual company no longer qualifies as a relevant peer company. The vesting schedule for financial and non-financial targets other than TSR is: threshold performance 25%, on-target performance 100% and maximum 200%.

Performance incentive zone

In line with the design of KPN's LTI plan, the target performance ranges for vesting of the LTI plan comprise a threshold below which no shares vest, an on-target performance level at which shares vest at on-target and a maximum at which the shares vest at the maximum level.

Once vested, the shares will have to be held for a minimum period of two years. An exception to this rule is made for shares that are sold to cover income tax obligations in relation to the vested shares typically the value taxed as income equals the number of shares vested multiplied by the share price at the time of vesting. An external remuneration consultant calculates the end-of-year TSR peer group position and the number of shares vested based on this target, and makes certain that calculations are performed objectively and independently. The TSR is calculated based on the three-month average share price at the start and end of the performance period.

Discretion both upwards and downwards can be applied by the Supervisory Board if the outcome of the LTI incentive scheme would produce an unfair result or if the outcome would not be considered to reflect the basic objectives and principles of pay as outlined in this section.

The LTI plan rules contain a change of control clause, which provides for immediate vesting at 100% (irrespective of the actual performance at that moment, whether higher or lower) and lifting of the blocked period normally applicable, to enable the member of the Board of Management to dispose of their shares in the situation of a change of control. The immediate vesting at 100% will be pro rata for the time passed in the plan during the vesting period of three years. (i.e. 1/3 in year one, 2/3 in year two, full in year three).

Actual pay-out levels

	Weighting	Outcome	Vesting percentage
TSR	25%	0%	0%
EPS	25%	0%	0%
FCF	25%	0%	0%
Energy	12.5%	140%	17.5%
Reputation	12.5%	200%	25%
Total vesting			**42.5%**

The LTI plan 2016 vests in April 2019 and the final TSR measurement for this share grant was conducted mid-February 2019. The targets for the LTI plan 2016 were set at the grant date in April 2016.

Remuneration Report

The vesting of the LTI plan 2016 is based on the strong performance of the non-financial targets based on sustainability and reputation (both with a weight of 12.5%). According to DJSI and CDP, KPN is recognized as one of the world's most sustainable telecom companies. This is reflected in a strong performance of the sustainability target during the vesting period 2016-2018 based on energy consumption. The vesting of 140% for this part of the LTI plan 2016 was the result of additional energy savings in our networks, data centers and offices despite an exponential increase in the volume of our IT services. The strong upward movement of KPN's reputation as concluded by the Reputation Institute (the leading international organization devoted to advancing knowledge about corporate reputations) improved further during the vesting period 2016-2018 and resulted in a vesting of 200% for this part of the LTI plan 2016.

During the vesting period 2016-2018 KPN's results on free cash flow (weight 25%) and earnings per share (weight 25%) performed below the minimum of the applicable bandwidth and therefore do not contribute to the vesting of the LTI plan 2016. KPN's TSR performance (weight 25%) during the vesting period resulted in a 8th relative position in terms of TSR performance in the peer group of European telecommunications companies and this outcome is below the minimum position for generating a vesting for this part of the plan.

Claw-back clause

The Supervisory Board has the discretionary authority to recover variable pay awarded on the basis of incorrect financial or other data.

Benefits and others

Pensions

Members of the Board of Management are eligible for a defined contribution pension plan with a contribution based on the fiscal defined contribution table that corresponds to a retirement age of 68, an annual accrual rate of 1.875% and a pension accrual capped at EUR 105,075 base pay. Board members receive a fixed gross allowance equal to the associated pension contribution paid by the company prior to 2015 for the base pay part above the capped amount.

Additional arrangements

The additional arrangements, such as a housing allowance, life insurance coverage, expense allowances, use of smart phones and company car provisions needed for the execution of their roles, are broadly in line with other companies of similar size and complexity, as well as with market practice.

Loans

Company policy does not allow loans or guarantees to be granted to members of the Board of Management.

Terms of employment

Members of the Board of Management have a service agreement for a definite period of time. All members of the Board are appointed for a period of four years, which is in line with the requirements of the Dutch Corporate Governance Code.

Severance arrangements

Severance payments for the CEO and current members of the Board of Management are aligned with the revised Dutch Corporate Governance Code and equal one-year base pay. Such payments also apply if a member of the Board of Management terminates his agreement with the company as a consequence of change of control over the company, subject to specific conditions applicable thereto.

Share ownership guidelines

The members of the Board of Management are encouraged to acquire company shares equal to one times the annual fixed compensation for members of the Board of Management, excluding the CEO, and two times the annual fixed compensation for the CEO. Retained vested shares as part of the LTI plan will be included in the share ownership guideline.

Outlook for 2019

The current remuneration policy was reviewed in 2018. Based on the outcome of this review, some adjustments to the current remuneration policy will be presented for approval to the AGM of Shareholders in April 2019. The details of the proposed adjustments in the remuneration policy will be included in the notes to the agenda for this meeting.

C. Supervisory Board pay policy

The Committee is responsible for reviewing and, if appropriate, recommending changes to the pay of the Supervisory Board. Any recommended changes to Supervisory Board pay must be submitted to the AGM of Shareholders for approval. Members receive an additional fee if a meeting is held in a country other than the member's country of residence. Shareholdings in the company held by Supervisory Board members serve as a long-term investment in the company and help to align their interest with those of KPN's other shareholders. No Supervisory Board member is granted shares as a form of pay. As a policy, the company does not provide loans or guarantees to its Supervisory Board members.

The table below shows the pay-out to Supervisory Board Members and fixed committee fees on an annual basis.

Amounts in EUR	**Annual fees**
Chairman Supervisory Board	100,000
Vice-Chairman of the Supervisory Board	70,000
Member Supervisory Board	60,000
Chairman Audit Committee	20,000
Member Audit Committee	10,000
Chairman Strategy & Organization Committee	12,500
Member Strategy & Organization Committee	7,500
Chairman Remuneration Committee	10,000
Member Remuneration Committee	5,000
Chairman Nominating & Corporate Governance Committee	10,000
Member Nominating & Corporate Governance Committee	5,000

See Note 5 to the Consolidated Financial Statements (Personnel expense) for details on actual remuneration of the Supervisory Board.

Peter F. Hartman (Chairman of the Remuneration Committee)
Duco W. Sickinghe
Claudia J.G. Zuiderwijk
Derk J. Haank