Remuneration report 2020

Introduction

This remuneration report provides an outline of how the guidelines for executive remuneration of AB Volvo, adopted by the Annual General Meeting in June 2020 (the "remuneration policy"), have been implemented in 2020. The report also provides details on the remuneration of AB Volvo's President and CEO and Deputy CEO.

The report has been prepared in compliance with the Swedish Companies Act and the Remuneration Rules issued by the Swedish Corporate Governance Board.

Further information on executive remuneration is available in note 27 in the Volvo Group's annual and sustainability report for 2020 (the "annual and sustainability report 2020").

Information on the work of the Remuneration Committee of the AB Volvo Board of Directors in 2020 is set out in the corporate governance report, which is available on p. 172-187 in the annual and sustainability report 2020.

Remuneration of the Board of Directors is not covered by this report. Such remuneration is resolved annually by the Annual General Meeting and disclosed in note 27 in the annual and sustainability report 2020.

2020 summary

AB Volvo had a record year in 2019 and a strong financial position entering into 2020. The targets for the long-term and short-term incentive programs for 2019 were achieved. However, when the pandemic hit, the company acted early and decisively to manage those unprecedented circumstances: The President and CEO, the Deputy CEO and the other executive managers decided voluntarily to reduce their salary in 2020 for part of the year. The Board of Directors decided as a precautionary measure to revoke the proposal to the Annual General Meeting to pay dividend for 2019, which was confirmed by the Annual General Meeting in June 2020. Thereby, in accordance with the condition that long-term incentive is payable only if the Annual General Meeting decides on dividend to shareholders, the long-term incentive for 2019 was nullified despite the targets being achieved. As for the long-term incentive and short-term incentive programs for 2020, the initial targets set were deemed irrelevant by the Board of Directors, due to the crisis' profound effects on the Group and the economy at large. Hence, the targets were changed. The new, revised targets for 2020 have partly been met. Performance for the year was strong as reflected in a share price that increased 23.5%, comparing the share price as per end of 2020 with share price as per end of 2019. The Board of Directors finds the outcome of the incentive programs 2020 reasonable taking into consideration the financial development of the company during a challenging year with significantly reduced revenue.

Overall performance in 2020

An update on the overall performance of the Group and AB Volvo is provided in the statement of the President and CEO, Martin Lundstedt, and in the Group Performance section of the annual report, available on p. 6-7 and p. 40-171 in the annual and sustainability report 2020.

Overview of the application of the remuneration policy in 2020

Remuneration of the Volvo Group executive management shall be on market terms and shall consist of the following components: fixed cash salary, variable remuneration, pension benefits and other benefits. The current remuneration policy, adopted by the Annual General Meeting 2020, can be found in note 27 in the annual and sustainability report 2020.

The company has complied with the applicable remuneration policy during the year. No compensation has been provided or promised to the President and CEO, Deputy CEO or other executive managers that constitutes a deviation or derogation from the remuneration policy.

The auditor's report regarding whether the company has complied with the policy is available on the Group's website: www.volvogroup.com. No remuneration has been reclaimed.

Consideration of shareholder views

During 2020, the Remuneration Committee and the Board of Directors have consulted with shareholders individually and collectively and have followed up on comments and questions received from shareholders in connection with the Annual General Meeting in June and otherwise during the year.

The Remuneration Committee and the Board have for 2021 and onwards decided to propose a change to the pension commitments of the company to its President and CEO, Deputy CEO and other executive managers employed in Sweden. This proposed change aims to simplify the pension commitments and bring them more in line with the prevailing pension schemes for similar individuals in the Swedish market, without materially altering the remuneration from an economical perspective. The change is conditional upon the acceptance by affected parties as well as approval of an adjustment of the remuneration policy to be resolved on by the Annual General Meeting in 2021. The full proposal for the updated remuneration policy is set out in the notice to the meeting, and is also available on the Group's website, www.volvogroup.com.

In response to queries and comments from some shareholders on the Group's long-term incentive program, the Remuneration Committee and the Board have also decided to further clarify the rationale and mechanics of the program, as follows.

- The current long-term incentive plan was introduced in 2016. Under this plan, the Board resolves each year whether to offer a long-term incentive program or not and on specific performance targets that are to apply. Programs have been implemented each year since plan inception, with each program comprising approximately 300 top executives of the Group.

- The objective of the long-term incentive program is to drive long-term value creation and align the interests of the participants, including the President and CEO and the Deputy CEO, with those of shareholders. To achieve this, the long-term incentive program operates on a four year cycle. It has a performance based annual award, which, after tax, is entirely invested in Volvo shares with a mandatory lock-in period of three years. In this way, all participants will build up a shareholding in the company and have a vested interest over the longer term development in the value of the shares. Value to the participants can only be realized after four years (unless termination of employment, upon which the holding requirement is lifted) and is determined by a combination of both operating performance and share price performance.

- In addition to the three-year lock-in period that apply to all participants, the company has also adopted share ownership guidelines specifically for the executive management of the Group. Under these guidelines, the President and CEO needs to build up a position in series B-shares of

AB Volvo that will have a value of two annual base salaries (before tax) and the Deputy CEO is required to hold series B-shares in the company to a value of one annual base salary. The President and CEO's current holding of B-shares amounts to 191,884 B-shares as per 25 February 2021, and the Deputy CEO's holding amounts to 73,825 B-shares as of the same time. Both holdings are in excess of the holding requirement.

- The initial award under the long-term incentive program is based on annual performance periods and targets, established by the Board. A longer term performance period for this component of the long-term incentive was considered, but due to the significant cyclicality in the commercial vehicle industry, where demand fluctuates substantially from one year to next, it is inherently difficult to forecast several years out. Consequently, the Board deem it difficult to set viable performance targets that are to be met several years into the future. Furthermore, share price is perceived to be a good measure of long-term performance as it reflects performance and outlook, as well as changing conditions experienced by shareholders. The Remuneration Committee and the Board therefore consider the one-year performance period, in combination with the three-year lock-in period for the acquired shares, as a good set-up to drive long-term value creation and to align participants' interest to the long-term shareholder return.

- The metrics used for performance targets under the long-term incentive program, e.g. operating income, operating cash flow or return on capital employed are disclosed for each program. The specific targets and ranges for such metrics are considered proprietary, as disclosure of these could indirectly serve as profit guidance, which the Group does not give. However, the awards granted to Group management under each program are described in note 27 of the annual and sustainability report of the Group for each subsequent year. During the five years the current long-term incentive program has been in place, the average pay-out has been 53.1% of maximum possible award to the President and CEO and to the Deputy CEO. The Board believes the current structure of the long-term incentive program has contributed to drive the substantial earnings and profitability improvement that the Group has demonstrated over the last several years, while at the same time the challenging performance targets have resulted in a balanced pay-out to the top executives.

- Possible awards under the program are subject to the maximum caps set out in the applicable remuneration policy. For the President and CEO the maximum award is 100 per cent of the base salary, and for the Deputy CEO the maximum award is 80 per cent of the base salary. There will be no payout under the long-term incentive program if the Annual General Meeting that is held in the year following the performance year, decides not to distribute any dividends to the shareholders.

- In summary, the four-year cycle of the long-term incentive program has worked well. The Board is of the view that the structure of the long-term incentive program is simple and provide meaningful line of sight for the participants. Further, it is deemed that it provides for early and growing personal shareholding, encouraging a long-term outlook. It avoids the pitfalls of long-term financial targeting in an uncertain environment, and aligns well with shareholder interests and experience.

<u>Table – Total remuneration of the President and CEO and Deputy CEO (amounts in SEK)</u>

The table below sets out total remuneration to AB Volvo's President and CEO and Deputy CEO during 2020. The fixed salaries for the President and CEO and Deputy CEO 2020 are lower than previous year as both decided to lower their salaries during part of the year due to the extraordinary situation as a result of the Covid-19 pandemic. Also, there was no award under the long-term incentive program for performance year 2019, consistent with decision at the Annual General Meeting in June 2020 not to distribute any dividends to the shareholders. This loss of opportunity was final for all participants, including the CEO and Deputy CEO, and no part of an award that otherwise could have been payable under that program can be recovered later on.

Name of individual and position	Financial year	Fixed remuneration *		Variable remuneration *		Pension expense *****	Total remuneration	Proportion fixed/variable remuneration out of total remuneration
		Fixed salary	Other benefits**	One-year variable (STI)***	Multi-year variable (LTI)****			
Martin Lundstedt, President and CEO	2020	14,518	252	10,721	10,721	7,715	43,926	Fixed: 44.7% Variable: 55.3%
Jan Gurander, Deputy CEO	2020	7,871	92	4,648	4,648	4,049	21,308	Fixed: 50,3% Variable: 49,7%

All amounts in thousands of SEK (TSEK)

* The President and CEO and the Deputy CEO have only received remuneration from AB Volvo, and not from any other Volvo Group company. Neither the President and CEO nor the Deputy CEO has received any extraordinary remuneration (remuneration that under the remuneration policy may be awarded under extraordinary circumstances).

** This includes for both individuals a company car benefit and medical benefits; for the President and CEO it also includes a housing benefit until June 30, 2020 and certain transport related items.

*** See below (*Compliance with the remuneration policy and application of performance criteria*) for a further description of terms and performance targets

**** As value to the participants is not available until the fourth year of the program and is based on a combination of both operating performance and share price performance, the LTI program is reported as multi-year variable for purpose of this table. There will be no payout under this LTI program if the Annual General Meeting in 2021 decides not to distribute any dividends to the shareholders

***** For the President and CEO, the pension expense consists of 4,864 TSEK related to fixed salary, and 2,851 TSEK related to variable salary. For the Deputy CEO, the pension expense consists of 2,744 TSEK related to fixed salary, and 1,305 TSEK related to variable salary.

Compliance with the remuneration policy and application of performance criteria

A prerequisite for the successful implementation of the Group's business strategy and safeguarding of its long-term interests, including its sustainability, is that it is able to recruit and retain qualified personnel. To this end, it is necessary that AB Volvo offers competitive remuneration. The Board of Directors and the Remuneration Committee work flexibly and focused to align the remunerations with the overall targets of the company at every given time. In this work, performance criteria are developed stepwise over time, to drive the development of the Group and further increase alignment with shareholders' interests. Total remuneration of the President and CEO and the Deputy CEO during 2020 has complied with the remuneration policy.

In the beginning of 2020, targets on operating income and operating cash flow were established for the short-term incentive program, and targets on operating income and return on operating capital employed was established for the long-term incentive program. However, the outbreak of the Covid19-crisis followed shortly after the establishment of these measurements and targets, and with the crisis' profound effects on the Group and the economy at large, it quickly became clear that these measurements and targets were principally irrelevant. The programs were therefore launched with revised measurements and targets. During 2020, both the short-term incentive and long-term incentive program measured performance on the adjusted operating income margin of the Volvo Group as well as operating cash flow performance for the Industrial Operation part of the Group. The Board of Directors decided that this was the best performance measure in order to focus the top executives, including the President and CEO and the Deputy CEO, on maintaining a solid profitability and to preserve cash through the Covid19-crisis.

Performance on adjusted operating income margin was measured against a range with a minimum and maximum for the financial period and a linear payout in the range. Performance on operating cash flow for the Industrial Operation part of the Group was applied as a threshold condition, where the performance target had to be reached for any award at all to be made under the programs. Adjusted operating margin for the Group in 2020 came out at 70.3%, and cash flow came out in excess of the target.

For the President and CEO the above resulted in a payout of 70.3% of his annual base salary for the short-term incentive as well as for the long-term incentive program. For the Deputy CEO this resulted in a payout of 56.3% of his annual base salary for the short-term incentive as well as for the long-term incentive program.

More information can be found in note 27 in the annual and sustainability report 2020.

<u>Derogations and deviations from the remuneration policy</u>

During 2020 no derogations or deviations have taken place from the remuneration policy or the procedure for determining remuneration under the policy.

<u>Comparative information on the change of remuneration and company performance</u>

Table: remuneration and company performance in 2020

	RFY 2020
President and CEO remuneration (TSEK)	43 926
Deputy CEO remuneration (TSEK)	21 308
Group Operating Income (MSEK)	27 484
Operating Cash Flow in industrial operations MSEK)	18 545
Average remuneration on a full time equivalent basis of employees (excl. executive management) of the parent company (TSEK)	1 478

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