
Remuneration Policy

Introduction

Please find below the remuneration policy applicable to the Board of Management as adopted by the 2004 General Meeting of Shareholders and amended by the 2005 General Meeting of Shareholders.

The remuneration policy in general

The objective of the remuneration policy for members of the Board of Management is in line with that for Philips Executives throughout the Philips Group: to focus them on improving the performance of Koninklijke Philips Electronics N.V. (the 'Company') and enhancing the value of the Philips Group, to motivate and retain them, and to be able to attract other highly qualified executives to enter into Philips' service, when required.

In determining the remuneration policy, the Remuneration Committee ensures that a competitive remuneration package for Board-level executive talent is maintained and benchmarked with other multinational companies operating in global markets. The main focus – and the strongest weight in this benchmark – is on companies with headquarters based in Europe. Total individual compensation is aimed at the median of comparable companies in the general industry. For that purpose, benchmark research is carried out each year on a great number of Dutch companies (among others Shell, Unilever and Akzo Nobel), other European companies (e.g. Siemens, Nokia, STM and Alcatel), and over ten global multinational companies (e.g. IBM, Intel and Motorola) of comparable size, complexity and international scope in the general industry. Additional market data on hundreds of companies in the general industry is provided by a number of independent external expert advisers.

Deviations on elements of this remuneration policy, when deemed necessary in the interests of the Company in extraordinary circumstances, will be disclosed in good time prior to the appointment of the individual.

In order to link executive remuneration to the Company's performance, the remuneration package includes a significant variable part in the form of an annual cash bonus incentive and a long-term incentive in the form of restricted shares and stock options



Features of the remuneration for members of the Board of Management

Base salary

Base salaries are based on a function-related salary system and are in line with market developments shown by the benchmark research and the additional market studies. When first appointed, an individual Board member's base salary will usually be below the maximum function-related salary. Normally (and subject to the decision by the Supervisory Board) the base salary will reach the maximum function-related salary level over a maximum 3-year period from appointment. The annual review date for the base salary is April 1. Adjustment of individual salaries by the Supervisory Board is influenced by the (annual) adjustment, if any, of the function-related salary levels and the progress to the (maximum) function-related salary level if this level has not yet been reached. The individual salary levels are shown in the Annual Report.

Annual Incentive (bonus)

Each year, a variable cash incentive (Annual Incentive) can be earned, based on factors such as the achievement of specific targets. These targets are set at a challenging level, taking into account general trends in the relevant markets, and are partly (as from 2004: 80%) linked to the financial results of the Philips Group and partly (as from 2004: 20%) to the set team targets based on the areas of responsibility monitored by the individual members of the Board of Management. The Annual Incentive criteria are 1) the financial indicators of the Company: net income and cash flow, and 2) team targets. The related targets for the members of the Board of Management are determined annually at the beginning of the year by the Remuneration Committee on behalf of the Supervisory Board and hence are linked to the Company's financial performance, as well as to the team targets. The financial targets, based on US GAAP financial measures, pursue value creation as the main business objective.

The on-target Annual Incentive percentage is set at 60% of base salary for members of the Board of Management and 80% of the base salary for the President/CEO, and the maximum Annual Incentive achievable is 90% of the annual base salary and for the President/CEO 120% of the annual base salary. In exceptional circumstances, the Remuneration Committee may decide to increase this percentage by 20% (resulting in an Annual Incentive percentage of 108% and 144% for the President/CEO). The Annual Incentive pay-out in any year relates to the achievements of the preceding financial year versus agreed targets.

Long-Term Incentive Plan (LTIP)

For many years Philips has operated a long-term incentive plan, which has served to align the interests of the participating employees with the shareholders' interests and to attract, motivate and retain participating employees. In 2003, the General Meeting of Shareholders approved the current Long-Term Incentive Plan, consisting of a mix of restricted shares and stock options, which will be continued in 2004 and beyond. This approval of the shareholders meeting included the approval of a pool of up to 12 million stock options and 4 million restricted shares based on a Philips Total Shareholder Return (TSR) multiplier – determined from year to year and explained in the 2003 shareholders meeting – of 1.1 (excluding 20% premium shares). This pool may be granted yearly to the members of the Board of Management, the other members of the Group Management Committee, Executives and other key employees. Grants can also be used for one-off situations, for example in the event of initial grants to new employees and additional grants in the event of promotion. The Supervisory Board now proposes to the General Meeting of Shareholders to allocate 2.5% of the annual pool as a maximum number to be granted to members and, if applicable, to future new members of the Board of Management

on an annual basis. The actual number of stock options and restricted shares that will be granted to the members of the Board of Management will be determined by the Supervisory Board. This number depends on the achievement of the set team targets based on the areas of responsibility monitored by the individual members of the Board of Management and on the share performance of Philips at grant date relative to a peer group of companies, or on the circumstances of the case in the event of new members of the Board of Management or in the event of promotion.

Pensions

The final-pay pensions of members of the Board of Management are funded by the Stichting Philips Pensioenfonds (the 'Philips Pension Fund') of the Netherlands. The conditions contained in the by-laws and the regulations of the Philips Pension Fund apply, with the proviso that the pensionable age – from the point of view of pension accrual – has been set at 60. The final-pay pension plan equals that of other Dutch senior Philips Executives. If the employment agreement of members of the Board of Management continues after the age of 60, the pension payments are postponed accordingly, as provided for in the Philips Pension Fund by-laws and regulations. As the retirement age is different from the date of commencement of the state pension, the pension scheme provides for a bridging payment in order to compensate for the adverse effect. The Board of Management members' own contribution comprises 4% of EUR 63,024 (annually set by the pension fund) and 6% of the difference between the gross pensionable salary minus a deductible part (the so-called "franchise") and the above-mentioned amount of EUR 63,024. A different arrangement resulting in additional pension benefits may apply in some cases as a result of past policies.

Additional arrangements

In addition to the main conditions of employment, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and relocation allowances, medical insurance, accident insurance and company car arrangements, are broadly in line with those for Philips Executives in the Netherlands. In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips Executives in the Netherlands. They also benefit from coverage under the Company's Directors and Officers (D&O) policies. The Company's policy forbids personal loans to members of the Board of Management.

Contracts of employment

Members of the Board of Management have a contract of employment with the Company. The form of contract used for members of the Board of Management is in line with the standard form used for other Philips Executives. As of 1 August 2003 for newly appointed members of the Board of Management the term of the contract is, in accordance with the Articles of Association of the Company, set at 4 years, and if the Company terminates the contract of employment the maximum severance payment is in principle limited to one year of base salary in line with the Dutch Corporate Governance Code. The main elements of the contract of a newly appointed member of the Board of Management shall be made public no later than at the time of issuance of the notice convening the General Meeting of Shareholders in which a proposal for appointment of a member of the Board of Management is placed on the agenda.