# On the 2023 remuneration committee agenda

KPMG Board Leadership Centre

**With 2023 being a year in which the majority of UK listed companies look to take their remuneration policies to shareholders for approval, executive remuneration will be high on the agenda – and in the headlines.  The economic outlook looks likely to add an additional dimension to the preparation of remuneration policies and discussions with shareholders. Remuneration committees will need to balance this economic uncertainty with the need to retain the key talent required to navigate the business through these challenging times, particularly when the ability to retain and recruit senior talent remains a challenge.**

Based on recent investor guidelines and our engagement with board members and members of remuneration committees across different industries, we have highlighted a number of areas to keep in mind as remuneration committees consider and carry out their 2023 agendas.

## Cost of living crisis

The cost of living crisis has undoubtedly been the headline from a people perspective over the large part of 2022. With inflation and interest rates still predicted to remain at unusually high levels, this will continue to feature in 2023. We have seen business respond to the impact on the workforce with different measures, including targeted pay rises for certain employee groups or advancing the normal annual pay round.

With many executive pay reviews taking place for the first time in this high-inflation environment, investors have called for restraint in executive director salary increases – not least because of the 'multiplier effect' that salary has on other variable elements of pay such as LTIP and annual bonus. Where salary increases are necessary, remuneration committees have been asked to consider increases below the rate of salary increases given to employees, given that the impact of the current economic impact on cost of living is felt much less by those on larger salaries.

## 'Windfall' gains on LTIPs

In the wake of Covid, institutional investors warned that remuneration committees would need to guard against 'windfall gains' in relation to awards granted when the share price was 'artificially' depressed.

With most LTIPs normally vesting over a 3 year period, 2023 will see a significant number of these awards vesting and renewed focus on the remuneration committee's application of discretion in this regard. It will be challenging for remuneration committees to establish what element of any gain is related to a general business improvement driven by management and what is more of a general market improvement. This will be complicated further by the prospect of a recession in 2023, which will undoubtedly have an impact on the capital markets.

Whatever decisions are made by remuneration committees, investors will expect to see sound reasoning behind any exercise of discretion articulated clearly in the remuneration report.  Investors also want to better understand the impact of any exercise of discretion, with an illustration of what payments would have been were it not for the exercise of discretion, so they can consider their response in the context of the impact on the executive team. Similarly, executives will be keen to ensure that the value they create for shareholders is reflected in their total reward.

## Continued focus on the ESG agenda

The focus on ESG has continued to gain momentum, with an increasing number of companies having an element of their long-term or short-term incentives subject to some measurement against ESG metrics. The most interesting development for 2023 seems to be the weight which investors are now putting behind this important area.

Cevian Capital, a Swedish 'activist' investor which has made material investments in a number of well-known blue chip clients  was one of the early movers in this area, but recent statements from Allianz, Amundi, LGIM and the Investment Association are clear that this will form a much greater part of investors' focus.

LGIM have gone further by announcing that from 2025 they will expect to see climate targets in all long-term incentive plans specific sectors, including automotive, banking & insurance, mining, oil & Gas, REITs, technology, telecoms and utilities. The Basel Committee he also recommended that banks consider amending their compensation policies to take into account climate risk.

The adoption of such targets will need to be more than just a 'box ticking' exercise. ESG metrics will need to be designed around the specific circumstances of each company, the rationale disclosed and, as with any performance condition, the targets should be quantifiable and appropriately stretching.

## Pensions

The end of 2022 was the deadline set by the Investment Association in the UK and a number of other key institutional investors by which pension arrangements for executives should be aligned with contribution rates for the wider firm.

If any executive director has a pension contribution above the level of the majority of the workforce, the Investment Association and others have reminded companies that they will 'red top' the remuneration policy or report (as applicable).

## Pay transparency

There are many regulations around the 'transparency of pay' including gender pay gap disclosure and the CEO pay ratio. Investors increasingly want to be assured that all companies – regardless of their size – are complying with the disclosure requirements.

## NED fees

The Investment Association in the UK have recently noted that non-executive director fees have fallen behind a level which is commensurate with the role.

It is without doubt that the role and responsibilities of non-executive directors has increased significantly over recent years and there is recognition that individuals need to be appropriately remunerated for their duties.

## Contact us

**Barrie O'Connell**
**Chair – Audit Committee Institute**
**T:** +353 21 425 4577
**E:** barrie.oconnell@kpmg.ie

**Maria Diver**
**Audit Committee Institute**
**T:** +353 87 050 4763
**E:** maria.diver@kpmg.ie