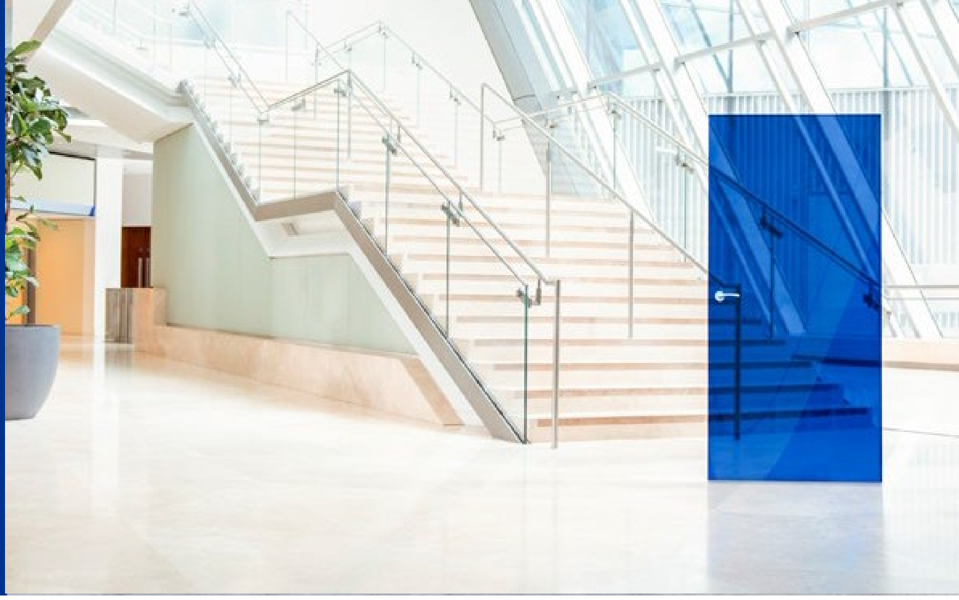
On the 2022 remuneration committee agenda

KPMG Board Leadership Centre



Executive compensation has been under intense scrutiny over the past two years and the heightened scrutiny is unlikely to lessen in a post-pandemic world. 2021 has been a record year for the number of shareholder and investor revolts, therefore, as businesses and economies start to recover, remuneration committees will have to carefully look at their policies and decisions around remuneration with the continuing focus on restraint but also the impact of pay on the wider workforce.

Based on recent actions within the market and our engagement with board members and members of remuneration committees across different industries, we have highlighted seven areas to keep in mind as remuneration committees consider and carry out their 2022 agendas.

Prominence of the Environment, Social and Governance (ESG) agenda

ESG is now a critical consideration for businesses and continues to be high on the agenda of remuneration committees. With the majority of companies now implementing an ESG strategy, it is a primary concern for business leaders as to how they will drive dynamic change in this space. Investors, regulators, employees, customers and other stakeholders will therefore hold clear expectations of how management interests have been aligned to ESG strategies and how they will be incentivised to bring those to fruition.

Linking executive pay and ESG metrics is a continuing conversation with an increasing number of companies having implemented some form of ESG metric into their long- term incentive. With the majority of proxy advisors and investors encouraging the inclusion ESG related performance measures, the question now is, how do you set targets? Below are talking points for boards and remuneration committees:

— Prioritise. Whilst undoubtedly any board will be looking to achieve all elements of their ESG strategy, it is useful to prioritise which areas will be a key focus in the next 3-5 years. This helps to provide milestones for achievement particularly where the objectives are very long term, such as climate related strategies.

— Materiality. Many of the measures we are seeing introduced into long or short term incentives have a relatively low weighting. However, materiality reflects the importance of the chosen ESG metric and therefore a low percentage rating may not convey the importance.

— Culture. How can the wider workforce also be incentivised? Bringing a collaborative approach and linking together the focus of the executives with that of the wider workforce, will not only reinforce a refreshed corporate culture, but also drive performance.

Inclusion, Diversity and Social Equality (IDSE)

Th IDSE agenda continues to be a crucial consideration and is very much front of mind, due to continuing social and political events. In order to further enhance the board diversity, HKEX has revised the CG Code and relevant Listing Rules which have strengthened the relevant requirements to promote diversity. The amendment are listed as follows:

— Single gender board will not be considered as diverse board

— Companies are required to conduct annual review on board diversity

— Disclosure must be made on gender ratios in the workforce

These targets are designed to provide a 'positive benchmark', but will mean that boards will need to take affirmative and clear action to improve board diversity.

From a pay perspective, remuneration committees and organisations should continue to review the composition of the total reward package and consider if there are constituent parts which may discourage the promotion of individuals from minority groups.

IDSE is part of the broader ESG agenda and therefore should become part of the performance-based targets linked to executive pay, as discussed above.

Expanded remit of remuneration committees

In the wake of COVID-19, remuneration committees have had to apply sound judgement on executive pay impacted by the pandemic and should continue to do so in terms of exercising restraint and addressing potential windfall gains or losses.

Monitoring executive pay levels, determining appropriate bonus outcomes and appropriate basis for long-term incentive (LTI) grants during this period of economic recovery will continue to be a focus, however, we are also seeing a growing need to ensure that these decisions are linked to wider workforce pay and people strategies.

Again, this can be linked to the rise of ESG strategies and the need to have effective change management in terms of corporate culture becoming more focused on a fully inclusive environment and employee engagement and wellbeing.

It is also important in terms of ensuring a strong succession strategy and ensuring that pay policies are encouraging strong career development for a diverse workforce.

Innovative incentive arrangements

The debate around more innovative incentive ideas continues to develop and has only been enhanced by the need for fresh thinking on delivering executive compensation and long term incentives.

The market has been actively discussing the gaining momentum over Restricted Share Plans (RSPs), but these continue to have a mixed reception from investors.

However, with more companies having a renewed purpose and focusing on creating long-term sustainable business models, this will see an increased focus on the need for a more balanced view in terms of performance conditions (i.e. financial vs non-financial) and also a more behavioural focused reward philosophy.

Furthermore, the HKEX revised the CG code (for implementation in 2022) which introduced a new recommended best practice that issuers generally should not grant equity-based remuneration (e.g. share options or grants) with performance-related elements to INEDs as this may lead to bias in their decision-making and compromise their objectivity and independence.

Reputational dangers and the fairness agenda

Excessive executive pay would not send the right message to potential investors and the public. In particular, public and investors would be more sensitive on such topic than usual given with the tough time that we are experiencing. Whilst the reputational impact of executive pay issues may not be immediately quantified, the remuneration committee and other key officers will spend significant amount of time on issues which are not core to the business itself.

The fairness agenda is not a new topic, but its importance continues to increase and shows the need for continued restraint to be shown in respect of executive pay, but also the growing remit the remuneration committee has to ensure that its pay decisions are reflective of the pay philosophy applied to all employees.

Therefore, again in line with the ESG focus which should be embedded into all areas of a company's operations and outlook, remuneration committees will need to continue to apply a greater focus on social equality and the levelling of pay, with more value being placed on performance across the board and a flatter pay curve effectively 'levelling-up' the wider employee population.

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