On the 2023 remuneration committee agenda

KPMG Board Leadership Centre

As boards adapt in response to the rapidly changing business and risk environment heading into 2023 driven by greater geopolitical instability, volatile markets, surging inflation, and the prospect of a global recession, remuneration committees continue to expand their oversight. In addition to the traditional remit of remuneration for the CEO and C-suite, many committees have broader responsibility for oversight of talent strategy and human capital management (HCM) issues, including employee well-being and workplace culture. This shift signals the increasing importance of these issues to the board as stakeholders, particularly shareholders, maintain a sharp focus on compensation, talent, and retention risks and their link to corporate strategy and values amid a tight labor market and economic downturn.

Based on our interactions with directors and business leaders, we highlight five issues to keep in mind as remuneration committees consider and carry out their 2023 agendas:

- Ensure that remuneration plans are properly aligned with the business strategy and focused on key drivers of performance, especially in light of a potential economic downturn and continuing volatility in the stock markets.
- Balance responsibilities for continued oversight of executive remuneration and remuneration plan design while understanding different shareholders' expectation.
- Consider whether including ESG metrics in incentive plans is right for your organisation.
- Be mindful of the impact of new and forthcoming reporting rules.

Ensure that remuneration plans are properly aligned with the business strategy and focused on key drivers of firm performance, especially in light of a potential economic downturn and continuing volatility in the stock markets.

With the risk of a global recession and continued volatility in equity markets in 2023, it is especially important that the committee consider whether the design of remuneration plans is sound and aligns the interests of executives and employees with those of investors and other stakeholders. Revisit incentive plans to ensure that they continue to provide appropriate motivational and retention goals. Do the current plans still drive the right behaviors and provide appropriate opportunity and accountability for these uncertain times? Closely examine all incentive plan metrics and payout ranges to see that they not only adequately align with the company's strategic and operational goals and shareholder interests, but also have an appropriate level of resilience to withstand future unforeseen events.

Careful consideration should be given to making any changes to existing incentive awards, especially option repricing and downward adjustments to performance metrics. Additionally, shareholders and other stakeholders heavily scrutinise changes to existing incentive awards that may be seen as unfairly benefiting executives while other employees endure cuts in wages or layoffs and shareholders lose value in their investment. This includes formal adjustments to existing metrics, as well as end-of-cycle discretionary payouts that may be perceived as offsetting low or nonexistent formulaic payouts.

Balance responsibilities for continued oversight of executive remuneration and remuneration plan design, while understanding different shareholders’ expectation.

The challenges of the last three years have led many companies to change the way they think about supporting their employees. According to KPMG Hong Kong Executive Salary Outlook 2022[1], apart from the remuneration package, candidates also pay close attention to nonmonetary, the top factors for employees considering the desirability of an employer are job satisfaction (55%), career progression and promotion (51%), and work flexibility and work-life balance (44%). Employees have unique needs, and one-size-fits-all approaches to benefit programs may leave certain employee groups wanting more.

In addition, the survey shows 14% of respondents received some form of equity-based bonus, which acts as an effective retention tool. It is imperative that remuneration committees understand how the company’s remuneration programs address the issues that employees care about. Remuneration committees can ask for information about employee benefit utilisation rates to help gauge whether the investment in these programs is having the intended outcomes in employee satisfaction and retention.

Directors benefit from being well versed in the issues of greatest concern to the company’s shareholders and other stakeholders. In addition to remuneration levels and incentive plan design, topics to consider include pay equity across the entire workforce, flexible working environment, workplace culture, and employee health and safety.

Remuneration committees can gain insight into these issues during shareholder engagement meetings.

Consider whether including ESG metrics in incentive plans is right for your organisation.

The remuneration committee continues to play an increasingly important role in the board’s oversight of ESG strategy. Governance of remuneration plans—part of the G of ESG—has always been part of the committee’s mandate, and remuneration committee chairs have been engaging directly with shareholders on remuneration related topics more frequently.

As companies continue to integrate environmental and social factors into their long-term strategy and develop metrics to track their performance, many remuneration committees have added ESG metrics to incentive remuneration plans. The Hong Kong Monetary Authority (HKMA) revised the Supervisory Policy Manual module GS-1[2] in December 2021 that sets out guidelines on key elements of climate-related risk management for authorised institutions (AIs). It is not currently a mandatory requirements, however, the HKMA would encourage AIs to integrate climate considerations into the remuneration system.

The adoption of such metrics 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. Also, it is important for companies to ensure that any ESG metrics adopted have a clear link to the company’s strategy.

[1] "Hong Kong Executive Salary Outlook 2022", KPMG Executive Search and Recruitment Services, April 2022
[2] "Supervisory Policy Manual GS -1 Climate Risk Management", HKMA, 30 December 2021

Be mindful of the impact of new and forthcoming reporting rules.

Given the remuneration committee's role in reviewing and approving the disclosure of executive remuneration and human capital information, committee members should understand how new and forthcoming reporting rules will impact the company. While these new and proposed rules impact corporate disclosures, boards can take this opportunity to guide management to continue to focus on designing remuneration plans that are in line with their pay philosophy and overall human capital strategy rather than allowing disclosure requirements to dictate policy.

In July 2022, the HKEX published the amendments on the Listing Rules relating to Share Schemes of Listed Issuers [3]. The approved amended Listing Rules have become effective on January 1, 2023.

Key amendments and requirements related to remuneration committee are outlined as below:

- Require a minimum vesting period of 12 months, unless a shorter vesting period is approved by the remuneration committee in respect of Share Grants made to Employee Participants
- Where Share Grants are made without performance targets and/or clawback mechanisms, require disclosure of an explanation by the remuneration committee as to why performance targets and/or a clawback mechanism is/are not necessary
- Require disclosure in the Corporate Governance Report of matters relating to Share Schemes reviewed and/or approved by the remuneration committee during the financial year
- Require remunerations committee's approval when there are changes to terms of share award or option granted

Remuneration committees can work closely with management and remuneration advisors to ensure there are sufficient processes and internal controls for the required disclosures to comply with the new rules.

[2] "Proposed Amendments to Listing Rules relating to Share Schemes of Listed Issuers and Housekeeping Rule Amendment", HKEX, July 2022

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