KPMG

Remuneration committee issues

Tuesday 23 October 2018

KPMG Board Leadership Centre

Chris Barnes (KPMG Head of Reward) addressed our Board Leadership Centre FTSE350 group to explore the key areas remuneration committees are currently facing, the themes emerging from the latest AGM season and the impact of recent corporate governance changes.

Highlights of 2018 AGM season

The world of executive reward is never without its sensational eye-catching headlines, and whilst (in overall terms) the average level of support for the remuneration report and remuneration policy resolutions in 2018 remained above 90% for both FTSE100 and FTSE250 companies, there were some notable examples of shareholder dissent on both remuneration reporting and policy.

A number of businesses received a significant vote against their remuneration report with the close of season seeing one vote of nearly 80% against the report, with that remuneration committee now having to go back to shareholders for approval of their Remuneration Policy in 2019.

And this was not an isolated case – several blue chip names received at least 20% and in some cases up to 40% votes against their remuneration reports; with the advisory vote on the remuneration report resolution receiving less than 80% support at eleven FTSE100 companies. And amongst FTSE250 companies, the remuneration report resolution was defeated at two AGMs and received less than 80% support at a further fourteen shareholder meetings. (More detail around the AGM season can be found here).

Excess and inequality

Dissent on remuneration matters arose from a number of different areas, rather than one single issue; however the broad themes of 'excess and inequality' were seen to feature heavily around several of the circumstances such as:

- Pay and reward not seen as being aligned to company performance.
- Executive salary increases above the level received by the general workforce; or a higher salary being awarded to a new director compared to the predecessor in the role.
- An increase in the maximum potential pay, such as due to an increased Long Term Incentive Plan (LTIP) award or annual bonus levels.
- Value Creation Plans (VCPs) have attracted controversy for a number of years when initially introduced, and the pay-outs from them continue to grab the headlines - with one organisation withdrawing their proposals before AGM (a not-insignificant decision for a board to take) drawing attention to the question from shareholders as to whether share price itself is even a sensible measure of success for a business. Should a buoyant market itself result in reward and returns that may contradict (or at least not fully reflect) the performance of the business and the executives being incentivised?

It's also worthwhile to bear in mind that, in some circumstances, a vote against the remuneration committee can also be a systemic warning sign for discontentment more broadly with the business's direction of travel.

Where change is being seen

Simpler Restrictive Stock Plans (RSPs) have started to feature on the remuneration committee agenda – are they the latest fad or are they a genuine reaction of business (and their advisors) to complaints of complexity and potentially significant leverage seen in 'traditional' LTIPs? We expect to see interest in these plans grow over the coming months and it will be interesting to see the business rationale put forward by each investor for this.

Outside of the world of LTIPs, investors are now placing a greater emphasis on pension contributions for executives, and the use of discretion (particularly downwards) and transparency (especially relating to annual bonuses and their performance conditions) are both featuring more heavily too, in a move towards the fairness agenda.

Judgement and discretion is not always easy to apply given the many competing forces that remuneration committees are dealing with when determining their approach to pay and incentives. However, ensuring consistency with an organisation's overall strategy, culture and KPIs can be a good starting point for alignment.

Regulatory change is taking hold

The introduction of the new UK Corporate Governance Code seeks to address some of the concerns leading to the public disquiet over executive pay and reward, the role of incentives in driving behaviour and the correlation between executive pay and the experiences of the wider workforce. Key aspects impacting remuneration committees in the new Code include:

- the importance of designing remuneration policies and practices to support strategy and success
- the remuneration committee's role with respect to the pay and incentives of senior management and across the wider workforce
- the role of the board in exercising independent judgement and discretion to enable remuneration outcomes to be overridden
- a recommendation extending total vesting and holding periods for executive share awards to a minimum of five years to encourage companies to focus on longer-term outcomes in setting pay
- requirements that companies disclose what workforce engagement has taken place to explain how executive remuneration aligns with wider company pay policy
- the remuneration committee chair will have served for at least twelve months on a remuneration committee before appointment
- requirement that when 20% or more of the votes have been cast against a resolution, the company should explain - when announcing the result of the AGM vote - what action it intends to take, and provide further updates within six months and in the following year's annual report
- companies receiving 20% or more votes against a resolution will also be included in the Investment Association Public Register of companies that receive a high vote against an AGM resolution

Future developments in this area include the new upcoming disclosure around CEO pay ratios (which has actually already been observed by nearly 1 in 5 listed companies in 2018) which will give another tool to focus on what is seen as an excessive; and plans from the Labour Party around enhanced employee participation in companies (whereby businesses with more than 250 employees pay up to 10% of their shares each year into an inclusive ownership fund) gives a flavour of what alternative schools of thought may hold around the use of equity in organisations.

Private versus listed companies – a widening gap

Applying discretion towards remuneration committee approaches is more common practice in private companies where having shareholders around the board table may remove a great deal of the ambiguity faced by listed companies. Notwithstanding the lack of regulatory scrutiny potentially meaning a more flexible approach to remuneration scheme design, there is also the benefit of shareholders in a private company having a greater understanding of the business and being closer to the business objectives and performance.

It's interesting to consider whether for public listings, would a Chief Executive acting more as a business owner, with LTIP and shareholding being material to the totality of their package act as a positive driver; or conversely encourage an overly risk averse mentality?

A cohesive approach to performance

Whilst the organisations where Executive/board pay and reward closely reflects that of the wider workforce (e.g. no LTIPs, a set salary and a consistent, uniform pension contribution) may be few and far between; a robust, cohesive, company-wide approach to performance and reward may go some way towards addressing the question of 'fairness'. Employees need to feel rewarded and valued in many ways, and not just financially, to feel motivated to contribute fully to a business and its culture.

A clear transparent approach to all performance-related aspects – be that regular, honest appraisal discussions, goal-setting, benchmarking or development opportunities – can contribute positively to a robust performance management system that helps the organisation achieve its goals, whilst also motivating the workforce and creating a feeling of equality and participation.

Contact us

Chris Barnes
Partner, Head of Reward
T: +44 (0)20 7694 2738
E: chris.barnes@kpmg.co.uk

Timothy Copnell
KPMG Board Leadership Centre
T: +44 (0)20 7694 8082
E: tim.copnell@kpmg.co.uk