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On the remuneration committee agenda

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KPMG Board Leadership Centre

Chris Barnes and Andy Johnson lead KPMG's Reward and Executive Compensation practice in the UK. Working with listed, private and family-owned businesses, they keep them up to speed with the challenging remuneration landscape. Pensions, post-employment holding periods and discretion in rewards are among the current hot topics they covered at the FTSE350 remuneration committee breakfast, where a series of polling questions were also used to spark the debate.

The correlation between company performance and executive remuneration and incentives has long attracted intense shareholder scrutiny and public commentary. Revisions to the Corporate Governance Code in 2018 sought to firm up the responsibilities of the remuneration committee in reviewing, not just overseeing, workforce remuneration, policies and alignment with corporate culture and strategy.

Now that the 2019 AGM season is mostly over, next on the horizon for many FTSE350 companies is the three-yearly voting cycle on remuneration policies. Pensions as reward; post-employment holding periods, and discretion in rewards are high on the agenda. The environment remains challenging as do the role of chairing or sitting on a remuneration committee.

The role of pensions in executive pay

"The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce." The UK Corporate Governance Code, July 2018.

Companies must set out a credible plan to pay all executive directors the same pension contributions as the majority of their workforce by the end of 2022 or face further shareholder dissent, according to guidance recently issued by the Investment Association. Those companies that pay existing directors more than 25 percent of salary as a pension contribution will receive a 'red top' warning and will likely see reputational consequences too.

Such is the pressure from shareholders on fairness for all, that one-third of companies in the FTSE100 have made significant changes to their executives' pension contributions. For incoming directors, or those changing roles, many companies are already paying pension contributions in line with the rest of the workforce.

Andrew Ninian, director of Stewardship and Corporate Governance at the Investment Association, expects companies to begin tapering down pension contributions now. Certainly, the investment community will favour a staggered or immediate reduction. Some companies, instead of reducing director contributions, are even raising the rate of contributions to the wider employee population to enhance lifetime savings.

In a poll at the breakfast, remuneration committee members were split on the importance of pensions in executive remuneration. For 43 percent, pensions are 'largely' irrelevant in the context of overall quantum of reward and tax legislation, while the equivalent number responded they are a 'somewhat important' part of the remuneration package, although relevance is waning.

The emerging debate, perhaps, is how companies might otherwise fill the gap left by declining pension contributions or accept this is not an area worth straying into.

Post-employment holding periods

"The remuneration committee should develop a formal policy for post-employment shareholding requirements, encompassing both unvested and vested shares," The UK Corporate Governance Code, July 2018.

By remaining invested, directors are tied into the on-going viability of the business and are obliged to consider succession planning when they exit. It is a move that aligns outgoing director interests with shareholder interests and encourages a longer-term view.

When polled, 65 percent of guests at the breakfast responded that post-employment holding periods are only ‘somewhat effective’ at driving long-term strategic decision-making. Just 10 percent consider them very effective, while 26 percent say they are not effective at all.

“In financial services,” explained one guest, *“holding periods can run into double figures before the reward is even released.”* Another said, *“I’ve never seen a CEO change behaviour based on shareholding.”* Whether extensions to post-employment holding periods will deliver greater sustainability is yet to convince remuneration committee members.

Exercising discretion

“Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes. They should also include provisions that would enable the company to recover and/or withhold sums or share awards and specify the circumstances in which it would be appropriate to do so.” The UK Corporate Governance Code, July 2018

The revised Code strengthens the remuneration committee’s ability to exercise discretion, upwards or downwards, in respect of directors’ remuneration. It is designed to ensure that remuneration properly reflects overall corporate performance and value creation and aligns with shareholders’ interests.

Even where directors meet their targets, shareholders want companies to apply proper judgement, override formulaic outcomes and adjust remuneration according to whatever is happening within the business. They should determine, for instance, whether a bonus is payable if other factors are causing negative pressure on share price.

The Code also requires greater disclosure of how discretion is exercised in determining vesting outcomes and consistency between employee and shareholder communications.

For 30 percent of attendees at the breakfast, corporate financial performance is the primary reason for exercising discretion. Individual performance was cited by 26 percent. *“Above inflation salary increases, unless adopted across the entire organisation, will raise questions and redtops,”* remarked one attendee.

Dates to watch out for...

The new Corporate Governance Code applies to accounting periods beginning on or after 1 January 2019.

Many directors’ remuneration policies must be voted on and approved during the 2020 AGM season. Will yours be among them?

Our Reward team hold a forum twice a year. The next event will be held on Thursday 5th December 2019 (08:30-10:00) at Number Twenty, where highlights from our 2019 survey of Executive Remuneration in FTSE 350 companies with be presented. If you are interested, please contact the Board Leadership Centre team to reserve your space.

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