November 2022

Top 2023 Considerations for Remuneration Committees

The Investment Association (IA) published Principles of Remuneration for 2023 along with a letter to Remuneration Committee Chairs on shareholder expectations for 2023. They frame a number of issues that IA members should regard as particularly important for Remuneration Committees to consider as they decide on 2022 remuneration outcomes and their 2023 approach.

Key Takeaways for Remuneration Committees

- Factor shareholder and stakeholder experiences into remuneration decisions and clearly communicate the approach taken.
- Consider greater restraint expected for director salary increases (recognising impact of salary increase on overall quantum) with Remuneration Committees encouraged to consider increases below the rate of salary increases given to all employees.
- Wider economic uncertainties may require wider performance ranges and use of discretion to ensure appropriate vesting outcome.
- Consideration of 2023 vesting outcomes for awards granted in 2020 and whether a reduction is appropriate to counter the impact of any windfall gains should these occur.
- Articulate the company journey to incorporate ESG metrics into variable pay and how they will evolve in future years.
- Expect ESG metrics to be linked to company strategy, quantifiable and avoiding unnecessary complexity.
- Support by investors for NEDs to be paid fees, which reflect the reality of the time commitment, complexity and skillset required for their role.
- Recommendation to vote against remuneration policy or remuneration report where executive pensions are not aligned to the majority of the workforce.

Cost of Living, Inflation and the Stakeholder Experience

There has been a recognition that most FTSE 350 companies have shown restraint and good practice through the coronavirus-19 (COVID-19) pandemic. However, given the current cost-of-living crisis, there is an expectation that Remuneration Committees will use their judgement to balance the need to appropriately incentivise executive performance while ensuring that the executive experience is commensurate with shareholders, employees, vulnerable customers and those stakeholders most affected by the cost-of-living crisis.

Against a general principle that executive salary increases should be limited to the level of inflation or all employee salary increases it is considered that additional restraint should be shown this year to recognise that the current inflationary impact disproportionately affects lower paid workers.

This additional restraint is particularly important given the leveraged nature of executive compensation. With annual bonus and long-term incentive plan (LTIP) opportunity set as a percentage of salary, any salary increases for executives will have a leveraged impact on the overall remuneration package and quantum.

The IA concludes that, “if salary increases are needed, IA members encourage Committees to consider increases below the rate of salary increases given to all employees.”

This aligns with the Institutional Shareholder Services (ISS) proposed updates to its UK Policy to set expectations that executive salary increases should be lower than those of the wider workforce.

2020 Long-Term Incentive Grants and Windfall Gains

IA guidance on shareholder expectations during the COVID-19 pandemic flagged the potential for windfall gains where the number of shares subject to an award was higher due to a significant fall in share price.

For awards made in 2020 vesting in 2023, this will be an area of focus. Remuneration Committees will be expected to consider if vesting outcomes need to be reduced and to disclose the rationale for their decision including if the decision is that it is appropriate not to make any adjustment.

This is an important issue for companies that chose not to reduce award sizes for 2020 grants but have seen a significant share price recovery.

ESG Metrics in Executive Remuneration

Expectations in relation to environmental, social and governance (ESG) factors continue to evolve at a rapid pace. In last year’s letter to Remuneration Committee chairs, the IA reflected on an expectation where a company’s long-term strategy included the management of material ESG risks or opportunities that these will be incorporated into executive remuneration structures.

It is regarded as increasingly important for companies to be able to clearly articulate the journey they are on to incorporate ESG metrics into variable pay and how they will evolve this approach in future years. The IA has reiterated its expectation that ESG metrics in executive remuneration are material, linked to company strategy, and measurable with performance disclosed.

2023 IA Principles of Remuneration

Changes to the Principles of Remuneration for 2023 are comparatively limited but there has been an update to reflect a recognition that Non-Executive Director fees have not always reflected the complexity of the role. Accordingly, investor support is expected for fees which reflect the reality of the time commitment, complexity and skillset required. This is currently important guidance for companies reviewing Non-Executive Director fees.

The 2023 Approach to Pensions

The IA position on pensions has been set out clearly in the Principles of Remuneration. Alongside a requirement that pension contributions for new directors will be aligned with the majority of the workforce has been an expectation that existing directors will be brought into line by the end of 2022.

This means that for 2023, IVIS will recommend voting against any remuneration policy or remuneration report where executive pension contributions are not aligned to the majority of the workforce.

Next Steps

Against a backdrop of global economic uncertainty, the IA laid down clear markers for Remuneration Committees to reflect on as they make decisions for 2022 remuneration outcomes and the remuneration approach for 2023 and beyond. Aon is well placed to help Remuneration Committees navigate those challenges.

Author Contact Information

Claire Morland
Partner, UK and EMEA Head of Executive Compensation, Human Capital Solutions
Aon UK
+44 7775 013141
claire.morland@aon.com

Sonia Shah
Associate Partner, UK Head of ESG, Human Capital Solutions
Aon UK
+44 2070 863766
sonia.shah@aon.com.uk

Phil Norton
Associate Partner, Head of Legal Incentives UK, Human Capital Solutions
Aon UK
+44 2070 862040
phil.norton@aon.com

Sean Carney
Partner, Human Capital Solutions
Aon UK
+44 2070 865021
scarney@aon.com

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