Willis Towers Watson

Perspectives

Executive Pay

Trends and Insights from Willis Towers Watson's 4th India CXO Roundtable

Per Agency theory, the agency problem arises when the agent has to choose between his/her best interests and those of the principal's, when these interests are contrary or not aligned. In an organisational context, this relationship is portrayed between the shareholders and the managers of the company. **Incentives** and **governance** are key mechanisms employed by organisations to mitigate this risk.

Willis Towers Watson's research shows that, globally, organisations are reviewing their executive pay and incentive programmes and there is continued effort from regulators and institutional investors to strengthen the alignment between executives and company stakeholders.

To discuss, debate and address some of the initiatives and trends in the area of executive pay and corporate governance, Willis Towers Watson gathered 50 top HR Leaders representing a cross section of industry, business maturity and size across Mumbai and Bengaluru.

The sessions were led by T**rey Davis, Senior Director – Executive Compensation, Asia and Australasia and Shai Ganu, Managing Director – Talent and Rewards, South Asia**. The themes that dominated the discussions included governance approaches and trends across markets, regulator and investor expectations, response from companies and proxy advisory firms, how nomination and remuneration committees are evolving, director pay trends and Willis Towers Watson recommendations.

We see continued efforts from regulators, globally, to strengthen alignment between executives and company stakeholders

Empowering shareholders through **enhanced disclosure**

Enhancing boards for **better oversight** of the company

New ways of defining and **assessing performance** and pay

Recently, SEBI guidelines were updated based on the Kotak committee recommendations. These updates include a more transparent and user-friendly disclosure format. The aim is for companies to provide easier to read, higher quality disclosure including information on how the company is performing, how the board is performing and the mid-term and long-term strategies of the company.

Regionally, disclosure rules are improving across Asia, though varyingly, led by Australia, Hong Kong and Singapore. Globally, we see changes as well. Binding votes on executive pay are becoming more common across Europe, even though not all shareholders actually want a vote on pay. With the increasing economic influence of institutional investors globally, there are increasing efforts to engage with investors on pay topics, particularly in the USA.

Strengthening corporate governance in many of these countries entails putting boards in a stronger position to effectively monitor management. For instance, India's updated SEBI guidelines require a more independent board by introducing stricter board member and committee independence guidelines. It also calls for greater focus on board member expertise and skills, to ensure that members can positively contribute and bring in diverse views and experience. The limit on number of board memberships was lowered to ensure that members have enough time to be able to perform their duties.

Similarly, we see an increasing role of independent directors in other Asian countries with more stringent definitions of "independent" and greater focus on board assessments.

New regulations also govern the tenures of non-executive directors, place greater restrictions on the combined CEO-Chairman role, and encourage (or mandate) gender diversity across Europe, while lead/presiding directors are becoming more prevalent vs. non-executive chairmen in the USA. The expanded Remuneration Committee remit in developed economies is driven by shareholder concerns around talent, pay fairness, diversity, human capital metrics (HCM) and environmental, social and governance (ESG) concerns. All these concerns can be seen as an extension of shareholders' desire to ensure each company has a sustainable, long-term strategy.

Key themes in shareholder proposals in 2019

Board Diversity

Pay Fairness

Environmental and **Social Risk**

Global proxy advisory companies such as ISS, Glass Lewis are increasingly focusing on Human Capital Metrics such as Diversity and Pay Fairness as well as Environmental and Social Risks. While most regulations (where present) with regard to board diversity generally call for mandatory female participation, many markets go beyond regulation to set voluntary goals to create a more diverse board composition with goals reaching beyond the 'mandatory' requirements.

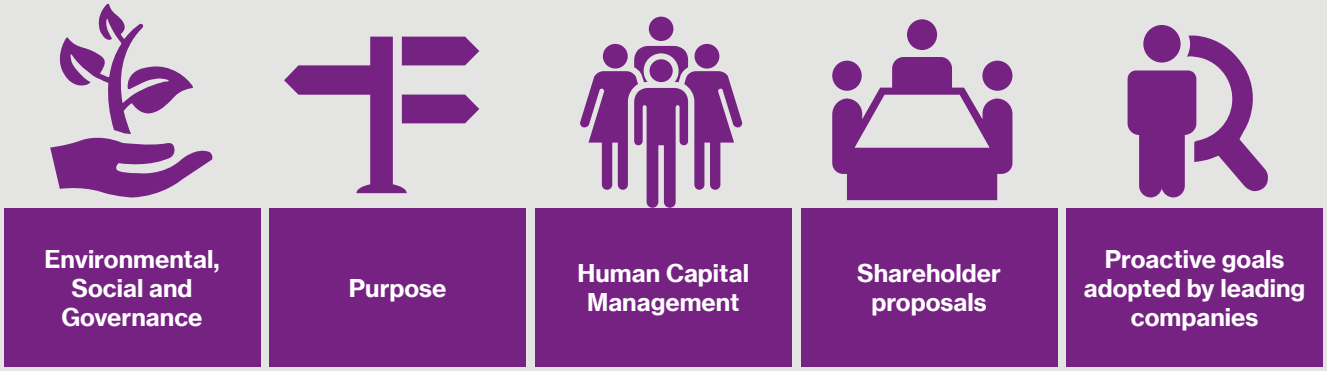
For example, in the USA, institutional investors have allied with companies to create coalitions such as the '30% Club' which asks for 30% of the Board to consist of women directors. In the UK, the Lord Davies report commissioned by the UK government recommended a voluntary target of 33% female representation by 2020 for FTSE350 companies.

As companies adopt these diversity goals, they also need to acknowledge that 'participation' must be supported with 'inclusion', by providing a culture where participants are free to speak and have equal authority to act.

Increased investor focus on ESG (environmental, social and governance) issues is driving remuneration committees to expand their role to include reviews of how compensation and HR policies and plans impact business risk and talent management. A higher sense of responsibility is driving remuneration committees to relook at their charter and executive pay policies and to review company and executive performance in light of new ESG goals as well.

Remuneration Committees' traditional focus has been on C-suite executives, but the remit is being expanded to include broader employee populations to ensure proper board oversight of succession planning, diversity and inclusion efforts, management training and development efforts, retirement and health benefits, and broader employee incentive arrangements.

Key external factors which are driving remuneration committees to relook at their charters



Companies are also rethinking ways to effectively design pay to meet business needs and stakeholder expectations

As organisations are relooking at 'incentive design' with a fresh lens, managing pay in a global economy comes with it's own challenges. Determining LTI grants remains a challenge for international LTI awards as exporting parent company practices may over or under compensate as compared to local market practice. Also, Parent company designs may not be aligned with local norms. On the other hand, differences in design and levels across countries may weaken desired behaviours and internal equity.

While there is a wide use of non-financial performance metrics and use of discretion in settling annual and long-term incentive awards in Asia, there is an increasing number of performance metrics being introduced in LTI plans in the USA.

Although the pay levels in Asia are rising, most still lag behind major global markets. Pay-at-risk is increasing to varying degrees across the Asian region, but still with markedly less emphasis on total variable pay compared to North America for CEOs.

There's no single lens for effectively evaluating executive compensation. Instead, we found that high-performing companies take a range of approaches and differentiate their executive compensation programmes, especially through their long-term incentives design. Some of the key takeaways and recommendations from the session were:

- **Tailor your pay programmes to your company's specific strategy and execution**
- **Consider revising and expanding Remuneration Committee terms of reference**
- **Monitor performance targets and ranges in light of changing economic expectations**
- **Examine pay mix, variability and role of discretion in pay programmes**
- **Ensure decisions are based on high-quality compensation benchmark data**
- **Update outside director remuneration to reflect expanded role, prominence**
- **Monitor investor interest in HCM and ESG issues**

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