On the 2025 compensation committee agenda

KPMG Board Leadership Center

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In 2025, the business environment will continue to be challenging, with increasing uncertainty and disruptions impacting companies and their employees. Emerging technologies are rapidly retooling, if not revolutionizing, business and how work gets done; changes to the regulatory environment and economic policies under the second Trump administration may fundamentally impact corporate strategies; the impact of geopolitical tensions (including trade and tariffs) may ripple across industries and workforces; and addressing the evolving expectations of investors, regulators, and employees may call for difficult decisions and trade-offs. Taken together, these and other factors are likely to make the focus on human capital and compensation strategy all the more important in the year ahead.

Drawing on insights from our interactions with directors and business leaders, we highlight five issues to keep in mind as compensation committees consider and carry out their 2025 agendas:

Ensure that the compensation strategy is optimally designed to retain and motivate talent.

Remain focused on evolving human capital management (HCM) issues when reviewing the committee's scope and composition.

Review any environmental and social metrics in incentive plans and ensure they still support the company's strategic goals and messaging.

Monitor proposed and new regulations and their potential impact on compensation strategy, incentive plan design, and disclosure practices.

Stay abreast of shareholder expectations and concerns.

Ensure that the compensation strategy is optimally designed to retain and motivate talent.

In this turbulent time, it is important to remain steadfast to the compensation committee's fundamental responsibility for overseeing effective compensation and equity incentive plans that align the interests of employees and shareholders. In times of economic and regulatory uncertainty, it can be more difficult to make key decisions related to short-term and long-term performance metrics and targets. Compensation committees may want to review the structure of these plans to consider how the company's performance on existing metrics is likely to be impacted by potential changes in the operating environment. For example, the scenario planning done when reviewing the risks and opportunities facing the business can be helpful when reviewing performance metrics and targets in incentive plans. Working with outside experts, compensation committees can help ensure that the compensation program encourages executives and other employees to make the day-to-day decisions to achieve the company's strategic goals and drive long-term shareholder value.

As always, it is important that incentive plans do not encourage unnecessary risk-taking, and to consider practices that could be deemed problematic by investors and other stakeholders, potentially resulting in negative say-on-pay votes. Many compensation committees have ongoing dialogue with their largest shareholders to share their compensation strategy and review any issues that may have been raised in prior years.

CEO and key employee retention is often an imperative in uncertain economic environments, and the compensation committee plays a key role in this regard. However, it is often challenging to design incentive plans that strike the right balance between motivation and retention. Compensation committees can work with outside consultants and the company's compensation professionals to ensure that the plans in place for the CEO, top executives, and other mission-critical employees reward those who stay with the company through these

uncertain times, while also aligning with current performance expectations. Some companies have used special, one-time retention awards for this purpose; however, these may reward for tenure rather than performance, potentially raising concerns among investors.

Remain focused on evolving human capital management (HCM) issues when reviewing the committee's scope and composition.

Many compensation committees have expanded their scope and responsibilities beyond executive compensation to include the oversight of compensation programs for all employees, and to broader talent management strategy and other human resources matters affecting the entire workforce. As of 2023, the vast majority of S&P 500 companies included at least one nontraditional compensation committee responsibility in their charter, and almost half had changed the committee name accordingly.[1] While investors have long encouraged boards to focus on broader HCM matters, the expansion of the committee's scope was accelerated as a result of the increased focus on employee health and safety during the COVID-19 pandemic, subsequent concerns about workforce well-being and mental health, and elevated attention to corporate diversity programs. These issues remain top of mind for compensation committees, but many committees face additional considerations as their companies experience calls for unionization and strikes by workers seeking higher pay in light of the inflationary pressures of the last few years and greater job security amid the proliferation of GenAI. A regular review of the committee's scope and agenda calendar can help to ensure that time is allocated to those HCM issues most relevant for the success of the business.

To that end, some boards are adding human resources expertise by appointing directors with chief human resources officer experience. While this practice is still nascent, many boards are considering adding directors with experience leading strategic human resources functions to help bring perspectives on the effectiveness of the company's talent management strategy, the ability to oversee the link between the investment in the company's workforce and firm performance, and to identify red flags in the HCM metrics reported to the board.

Questions for compensation committees to consider include:

- Do the workforce metrics we receive provide us with a comprehensive understanding of how the company's resources are invested in the workforce, and whether those investments are generating the expected return (e.g., training and development programs)?
- Do we feel comfortable that we understand the level of employee engagement and satisfaction? Do we have a clear understanding of the level of employee turnover at various levels in the company?
- Can we assess progress toward any publicly stated goals regarding diversity targets based on the data we receive? Can we determine the success of the company's diversity, equity, and inclusion (DEI) initiatives in order to hold management accountable for diversity goals?

As companies consider how to best manage the opportunities and risks posed by emerging technologies, including GenAI, it is important for companies to be transparent about their approach to responsible implementation and use, especially if those technologies will be used to augment their workforce or to automate processes currently performed by employees. As boards consider the broader implications, compensation committees can consider the impact that GenAI and other emerging technologies will have on the company's workforce, including recruitment and retention strategies for necessary technological expertise, employee concerns about job elimination, etc.

[1] KPMG Board Leadership Center, "On the 2024 compensation committee agenda," p. 5.

Review and evaluate any environmental and social metrics in incentive plans and ensure they still support the company's strategic goals and messaging.

Environmental, social, and governance (ESG) and DEI have become extremely polarizing in the US. However, many of the issues underlying the acronyms remain integral to the responsibilities of the board—oversight of risk and opportunities facing the company. Some companies have moved away from using the terms "ESG" and/or "DEI" while continuing to ensure that their human resources practices are appropriately inclusive and aligned with operational goals to drive long-term performance.

Many influential investors and other stakeholders remain focused on holding companies accountable for publicly stated goals and targets announced previously under these programs. Additionally, various global environmental and climate-related disclosure requirements are coming into effect that will require many US companies to assess ESG-related risks and report on metrics such as greenhouse gas emissions, including the European Union's Corporate Sustainability Reporting Directive, which will come into effect in 2025.

As compensation committees review incentive plan metrics, it is important to review any ESG metrics to ensure that they are still in line with the company's strategy and reflect any changes made to the company's policies and programs. It may also be helpful to review the use of ESG metrics across the market and among the company's peers. In 2023, 74% of S&P 500 companies included ESG metrics in their executive incentive plans, up slightly from 72% in 2022 and from 57% in 2020.[2] Metrics related to HCM remain the most prevalent, with a majority (54%) of S&P 500 companies including D&I metrics in their incentive plans. This reflects a slight decrease from the 56% that had a D&I metric in 2023. HCM metrics that saw the highest increases were related to talent development and employee satisfaction. The adoption of metrics related to environmental issues increased from 35% in 2022 to 42% in 2023. The most common metrics in this category related to the company's carbon footprint, which are now part of the incentive plans at 30% of the S&P 500 companies.[3]

[2] Semler Brossy, "ESG+Incentives 2024 Report," October 10, 2024, pp. 2–3.

[3] Semler Brossy, pp. 4–5.

Monitor proposed and new regulations and their potential impact on compensation strategy, incentive plan design, and disclosure practices.

There is no shortage of regulatory changes anticipated as the second Trump administration takes office. Staying abreast of the changes relevant to compensation strategy, incentive plan design, and related disclosure practices will help compensation committees ask informed questions of management regarding compliance and policy implications for the company.

Federal Trade Commission's (FTC) noncompete agreement ban

In April 2024, the FTC implemented a final rule that prohibits employers from including noncompete clauses in employment contracts. The rule, which was slated to come into effect on September 4, 2024, was blocked by a Texas federal court judge who ruled the FTC lacked statutory authority.[4] The noncompete ban remained blocked pending two appeals.[5] However, many companies are reviewing their use of noncompete agreements since the FTC may still address them on a case-by-case basis and is considering appealing the decision.[6] In addition, California enacted laws prohibiting noncompete clauses that came into effect on January 1, 2024, and other states may be considering taking similar action.[7]

Clawback policies

Companies listed on the New York Stock Exchange and Nasdaq were required by December 1, 2023, to adopt clawback policies under which incentive compensation already paid to executives or former executives had to be returned in cases where such incentive payouts were affected by material and nonmaterial financial restatements.[8] Some investors and proxy advisors encouraged companies to adopt more comprehensive clawback policies. A review of clawback policies at 401 of the S&P 500 companies having implemented such policies in the 12 months to May 2024 found that most went beyond the SEC mandate. Almost 50% had policies with two or more triggers, such as "actions deemed harmful or inappropriate" or "crimes committed by executives."[9] As detailed on p. 8, shareholder proposals related to clawbacks were the second most prevalent compensation-related proposal submitted during the 2024 proxy season.

Pay transparency regulations

The Salary Transparency Act (H.R. 1599), introduced in March 2023 to the US House of Representatives, seeks to mandate the internal and external disclosure of wages, wage ranges, and other compensation elements of employment opportunities. At the same time, the Pay Equity for All Act of 2023 (H.R. 1600) was introduced, seeking to prohibit employers from taking into account a candidate's wage history when determining their compensation. While these bills have not yet made it any further, several states have enacted pay transparency laws, starting with California in 2018, and a prohibition on asking for pay histories is even more widespread. The European Union's Pay Transparency Directive, designed to address pay

[4] Alisa Nickel Ehrlich and Nicci Warr, "FTC Ban on Worker Non-Competes Halted by Federal Court," August 21, 2024.

[5] David J. Clark, "Two Appeals to Determine Fate of FTC's Noncompete Ban," Epstein Becker Green, October 31, 2024.

[6] Courtney Vinopal, "Legislative lowdown: Federal judge strikes down FTC noncompete ban," HR Brew, August 28, 2024.

[7] Robert A. Atkins, et al., "California Non-Compete Laws Takes Effect," Paul Weiss Rifkind Wharton & Garrison LLP, January 26, 2024.

[8] KPMG LLP, "Answers to issuers' clawback implementation questions," Hot Topic, September 2024.

[9] Frederic Lee, "Boards Implement Wide-Reaching CEO Clawback Policies," Agenda, September 13, 2024.

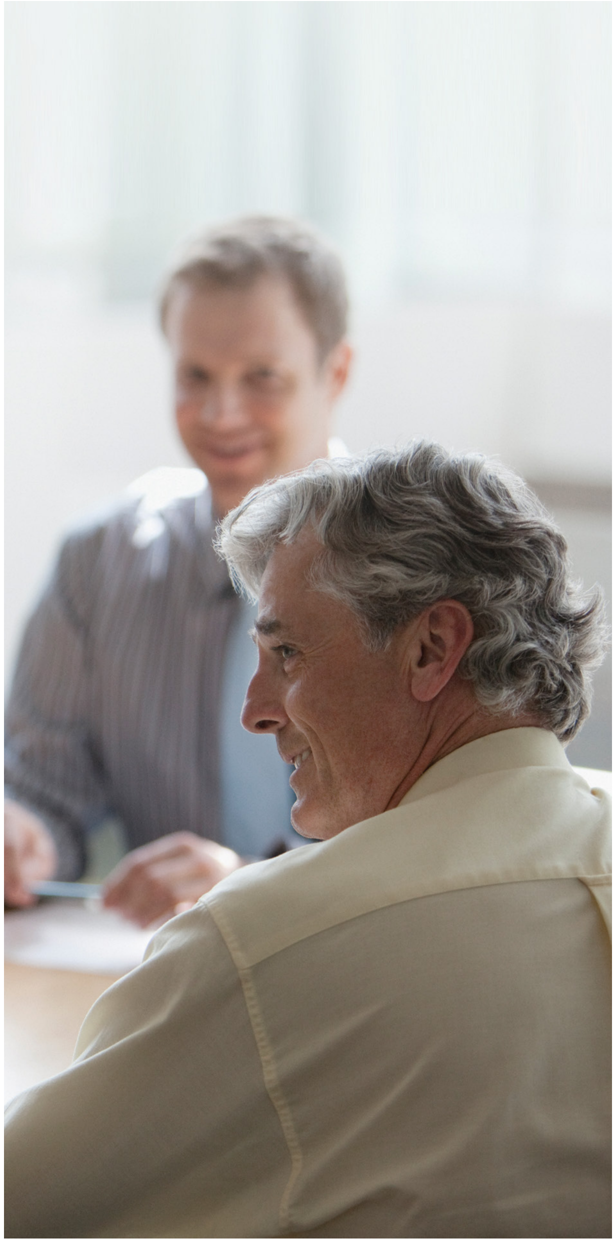
discrimination and the gender pay gap, not only requires disclosure of salaries but also requires companies to address their gender pay gap if it exceeds 5%. Adopted in 2023, EU member states have until 2026 to transpose the directive into national legislation. Compensation committees are encouraged to work with their general counsel's office to ensure compliance with these regulations as noncompliance can expose the organization to fines and/or civil lawsuits.

HCM disclosures

The SEC's Fall 2024 Regulatory Agenda listed proposed amendments to require companies to disclose additional details on specific human capital metrics in Form 10-K. However, SEC rulemaking priorities may change under a new chair in 2025. The SEC Investor Advisory Committee's Investor-as-Owner Subcommittee recommended that the SEC's final rule include disclosures regarding the number of employees broken down between full-time, part-time, and contingent worker categories; turnover rate; total cost of the workforce broken down by employee category; and demographic data on the workforce for investors to evaluate the company's efforts to attract and retain new talent and evaluate those efforts.

Insider trading arrangements and related disclosures

In December 2022, the SEC released new rules governing the structure and disclosure of insider trading arrangements, also known as 10b5-1 plans. Under these rules, company insiders will no longer be able to implement overlapping trading plans and will be limited to one single-trade plan for each 12-month period. Companies will also have to provide additional details on policies and procedures around these plans in Form 10-Q and Form 10-K filings and in annual disclosures under Item 402(x) of Regulation S-K. The narrative insider disclosures and quantitative amounts in the disclosures will also have to be machine readable (i.e., with XBRL tags). Compensation committee members can work with their compensation advisors to ensure these plans are properly structured and disclosed.



Stay abreast of shareholder expectations and concerns.

In addition to engagement with the company's largest shareholders, insights into shareholder concerns and expectations can also be gained from the outcomes of recent proxy season votes. A review of the results of management say-on-pay (MSOP) proposals—including an analysis of reasons for lack of support and of compensation- and human capital-related shareholder proposals from the most recent proxy season—can provide compensation committees insights into current expectations regarding compensation and human capital matters.

Average support for MSOP proposals was slightly higher at S&P 500 companies in 2024 compared to 2023. The average support for such proposals voted on at S&P 500 companies in the first half of 2024 averaged 90%, compared to 88% in the same period in 2023. The lowest average support (87%) was seen among technology companies and the highest (93%) in the energy/utilities sector. The 2024 proxy season also saw the lowest number of failed MSOP votes in 10 years. Only three S&P 500 companies (all in either the technology or industrial sectors) saw their MSOPs receive less than 50% support. All of the 11 S&P 500 companies that failed their MSOP votes in 2023 received majority support this year,[10] indicating that changes were likely made to compensation practices in response to the shareholder concerns that led to negative votes in the prior year.

A review of the reasons proxy advisor Institutional Shareholder Services (ISS) recommended against MSOPs can provide compensation committees with insights into what may be areas of concern for shareholders. This year, ISS recommended against fewer MSOPs at S&P 500 companies: 34 in the first half of 2024 compared to 42 during the same period in 2023. Almost all negative recommendations were due to concerns about a lack of pay-for-performance, such as misalignment between CEO pay and shareholder return, or for above-target payouts. Other concerns related to insufficient disclosure regarding performance goals, lack of compensation committee communication and responsiveness, and severance/change-in-control arrangements.[11]

The number of compensation-related shareholder proposals (60) that went to vote during the first half of 2024 was slightly lower than in 2023 (71), likely due to the fact that more proposals were excluded through the no-action process. The majority of these proposals—which were all filed by one shareholder proponent—requested that companies implement a shareholder approval requirement for severance packages totaling more than 2.99 times an executive's salary and target bonus. Even though support for these proposals dropped significantly in 2024 to an average of 15%,[12] compensation committees should be aware of continued shareholder scrutiny of change-in-control agreements, especially those that have a single trigger feature.

The second most common compensation-related proposals focused on clawback policies. Although both the New York Stock Exchange and Nasdaq now require listed companies to adopt clawback policies, as noted on p. 6, the number of proposals increased from 4 in the first half of 2023 to 12 in the same period in 2024. These proposals seek to have the recovery of executive compensation expanded from misconduct or willful misconduct to more general "conduct or negligence." Average support for these proposals dropped from 42% in 2023 to 17% in 2024.[13] However, it remains important for compensation committees to understand investor expectations regarding clawback policies and review them regularly to ensure they strike the right balance between responsiveness, accountability, and competitiveness.

[10] Sullivan & Cromwell, "2024 Proxy Season Review: Part 2: Compensation-Related Matters," September 5, 2024, p. 1.

[11] Sullivan & Cromwell, "2024 Proxy Season Review: Part 2," p. 2.

[12] Sullivan & Cromwell, "2024 Proxy Season Review: Part 1: Rule 14a-8 Shareholder Proposals," August 13, 2024, pp. 26–27.

[13] Sullivan & Cromwell, "2024 Proxy Season Review: Part 1, p. 27.

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