THE
INVESTMENT
ASSOCIATION
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Dear Remuneration Committee Chair,

I am writing to outline the key changes to The Investment Association's Principles of Remuneration for 2019, and to highlight the items of focus for our members for the 2019 AGM season. The Principles set out Investment Association member's views on remuneration.

The 2019 review of the Principles of Remuneration took place against a backdrop of new remuneration provisions in the UK Corporate Governance Code and following an AGM season, which saw increasing dissent on remuneration resolutions in the FTSE 100. The political and media focus on executive remuneration continues to grow with the forthcoming implementation of new remuneration reporting requirements and an ongoing BEIS Select Committee inquiry into Fair Pay.

IA members are concerned that some companies are still not understanding or responding to the views of their shareholders on remuneration. Members feel frustrated that they have no option but to vote against a company's remuneration proposals as the Committee has failed to take account of their views or tried to argue "exceptional circumstances", which are rarely the case.

2019 Review of the Principles of Remuneration

The Principles have been updated to be clearer and sharper. We have also updated specific areas in line with the new UK Corporate Governance Code and developing best practice:

Malus and Clawback: the Principles have been updated to be clearer on investors' expectations of the enforcement processes companies should have in place to implement clawback and malus provisions. The new Principles require Remuneration Committees to consider the most appropriate trigger events for the individual company.

Shareholding requirements and post-employment holding periods: the Principles have been updated to outline which shares can count towards the shareholding guidelines and the expectation of investors on post-employment holding periods.

Pensions - The UK Corporate Governance Code states that pension contribution rates should be aligned with those available to the workforce. IA members consider this to be the contribution rate given to the majority of the company's workforce. Investors expect new executive directors and directors changing roles to be appointed on this pension contribution level. The pension contributions for current executive directors should be reduced over time to equal the rate received by the majority of the workforce. Shareholders expect that no compensation will be awarded for this change.

Restricted shares: the Principles provide an update on investor expectations for those companies seeking to introduce a restricted share scheme. A majority of members are willing to consider the introduction of restricted shares. Their support is clearly dependent on the strategic rationale for restricted shares at that company as well as other conditions being in place.

Leaver provisions: the Principles have been updated to reflect member expectations and current best practice.

<u>Issues to consider for 2019 AGMs</u>

In particular, our members have asked us to re-emphasise the following aspects of the Principles:

Investor and Remuneration Committee relations - As outlined above, members are concerned that some Remuneration Committees have been unresponsive to investor concerns or argue that they are operating in exceptional circumstances. In these cases, investors have felt their only option is to vote against the remuneration resolutions. Whilst recognising the difficulty of balancing the competing demands of executives and investors, members feel that too often Remuneration Committees are overly considerate of the management perspective, often at the expense of their shareholder's views.

This year's AGM season has also seen a dramatic increase in the number of individual directors receiving a significant level of dissent. This is for a number of reasons but includes accountability for the decisions made by individuals as members of the remuneration committee. IA members are increasingly voting against remuneration committee chairs and individual members of the committee where they feel that the committee's decisions have failed to meet investor expectations.

Executive remuneration is a growing reputational issue for companies, individual Remuneration Committee members and now the executive directors who receive the remuneration in question. Executive and Non-Executive Directors can no longer rely solely on the contractual nature of a remuneration payment, investors and wider stakeholders are looking to directors to consider the issue of fairness. As the new UK Corporate Governance Code and pay ratio reporting requirements demonstrate, the company's approach to all employee pay is an important factor. Remuneration committees should ensure that they consider the wider employee pay context when taking their executive remuneration decisions.

Shareholder Engagement - Members are concerned that some companies treat shareholder consultation as a validation exercise by the Remuneration Committees rather than as a process for obtaining the views of their major shareholders. Consultations should focus on major strategic remuneration issues rather than the minor details of pay. However, companies should be satisfied that they have been transparent enough that the final proposals do not contain any surprises. They should provide details of the complete remuneration structure, not just the proposed changes, so that investors have the full picture.

New Reporting Requirements - The new reporting requirements come into force from 1 January 2019, with most companies being legally required to report against them in their 2020 Annual Reports. The IA supported the introduction of pay ratios and has requested companies disclose them for a number of years. Given that the methodology for calculation of pay ratios is now clear, we would encourage all companies to report their pay ratios in 2019. Members encourage all companies to adopt option A as this method of calculation is considered the most statistically robust.

The IA and our members also support the GC100 and Investor Group Remuneration Reporting Guidance which is in the process of being updated. We would encourage all companies to also follow this guidance.

Levels of Remuneration – It is essential that companies adequately justify to investors the level of remuneration paid to Executives. In the coming year, investors will continue to look closely at how any increases are justified, and will expect Remuneration Committees to show restraint in relation to overall quantum.

Members continue to be concerned by incremental increases to both fixed pay and variable pay opportunity which, on aggregate, can lead to substantial increases in overall remuneration.

Pay for Performance – Our members' clients, ordinary pension savers continue to seek explanations as to why remuneration pay-outs are supported. In order to justify their support, they require robust transparency on financial and non-financial targets so that the link between pay and performance can clearly be seen.

If you need any further details on the Principles of Remuneration, please do not hesitate to contact me or one of the IVIS team (www.ivis.co.uk/contact-us).

Yours faithfully,

Andrew Ninian
Director, Stewardship and Corporate Governance