

Article re the Investment Association's Principles of Remuneration 2024

Key Changes to the Investment Association's Principles of Remuneration (2024)

The Investment Association (IA) published its substantially revised Principles of Remuneration on 8 October 2024, marking a significant shift towards greater flexibility and consequently engagement with relevant stakeholders in executive remuneration structuring.

This article summarises the key changes compared to the previous version published in 2022, highlighting the overarching principles and themes, specific section changes, and the implications for UK listed companies.

Overarching Principles and Themes

The Principles of Remuneration now permit greater flexibility in the design of executive pay structures than the previous version, expressly recognising the need for companies to be flexible enough to be able to attract and retain global talent in competitive markets and indicating a move away from any perception of prescribing a “one size fits all” approach to UK executive pay.

This shift is underpinned by a strong emphasis on the need to engage comprehensively with shareholders and fully justify pay structures and decisions, to ensure alignment with the company’s long-term strategy and value creation.

The main overarching shifts in the Principles include:

1. **Simplification** – The Principles have been simplified, reducing the number of prescriptive requirements and focusing more on broader themes and objectives.
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2. **Guidance Over Rules** – The new Principles stress that they are guidelines rather than prescriptive rules, allowing companies more freedom to tailor remuneration policies to their specific circumstances, and reflecting the IA's stated intention that they are simply reflective of investor sentiment rather than dictate market practice.
3. **Room for Other Views** – A number of views on the appropriateness of specific remuneration aspects previously expressed in the Principles have been toned down, in favour of milder messaging and highlighting the risks and concerns that Remuneration Committees should be mindful of and clear with shareholders.
4. **Engagement and Disclosure** – There is a stronger emphasis on proactive and constructive engagement between Remuneration Committees and shareholders and explaining remuneration decisions, fostering mutual understanding and trust.

A summary of the key changes to specific sections of the Principles, and our thoughts on the implications of the changes for UK listed companies, is outlined below.

Changes in Specific Sections

1. Remuneration Committees

- **Expertise and Experience:** There is no longer a requirement for the chair to have served for at least a year on the Remuneration Committee before taking up the role. However the new Principles expect Remuneration Committee members, especially the chair, to have sufficient expertise and experience to fully understand the company's strategy and to have built effective relationships with other directors, management, and shareholders.
- **Independent Advice:** The requirement for Remuneration Committees to avoid over-reliance on remuneration consultants has been replaced with a recommendation for Committees to have access to independent advice to make informed decisions.
- **Engagement with Shareholders:** The specific requirement to respond to significant votes against remuneration resolutions has been replaced with general guidelines encouraging proactive and constructive engagement with shareholders.

2. Shareholder Consultation

- **Purpose of Consultation:** The revised Principles clarify that the purpose of shareholder consultation is to understand shareholder views rather than seek approval. Early engagement and transparent dialogue are emphasised.
- **Disclosure:** Companies are encouraged to disclose how shareholder feedback has been considered and to send a wrap-up letter summarising the final proposals and rationale.

3. Levels of Remuneration

- **Case-by-Case Analysis:** The new Principles focus on analysing remuneration levels on a case-by-case basis, balancing shareholder and executive expectations while attracting and retaining talent, and contain milder statements on this topic than previously.
- **Benchmarking:** The guidance warns against using benchmarking alone to justify remuneration increases, as it can create upward pressure on executive pay without regard to performance.

- **Variable Remuneration Caps:** The new guidance recommends capping variable remuneration plans, with any material increases fully justified to shareholders and subject to consultation.

6. Basic Salary, Pensions and Annual Bonuses

- **Justification for Salary Increases:** The company should explain to shareholders any decision to recruit an executive director on a higher salary than their predecessor.
- **Pension Contributions:** The guidance retains the key principles that pension contributions for executives should be aligned with those available to the workforce and that no element of variable pay should be pensionable.
- **Non-Financial Metrics for Bonuses:** The new Principles provide more flexibility for the use of non-financial metrics, such as the management of ESG risks, in annual bonuses.
- **Bonus Deferral:** If an executive director has met the shareholding guideline, shareholders may support a reduction in the level of deferral, provided that malus and clawback provisions are still applicable. The Principles no longer express an expectation of deferral where bonus opportunity exceeds 100% of salary.

7. Long Term Incentives (LTIs)

- **General Guidance:** The detailed expectations on specific structures has been replaced with broader guidance on the general terms and technical aspects of LTIs, with additional specific advice on performance share plans (PSPs), restricted share plans (RSPs), hybrid schemes, and value creation plans (VCPs).
- **Reduction of Specific Guidance:** The Principles no longer specifically address options, performance on grant schemes, all-employee schemes, matching shares, subsidiary companies and joint venture companies. Guidance on the treatment of share awards on a change of control has also been reduced and no longer mandates pro-rating of awards.
- **ESG Performance Conditions:** A new paragraph on the use of ESG performance conditions in LTIs has been included, emphasising their importance for long-term sustainability and success.

(i) Restricted Share Plans (RSPs)

- **General Approach:** The Principles no longer detail examples of when RSPs may be appropriate, and instead provide general guidance on what Remuneration Committees are advised to consider and do if an RSP is contemplated.
- **Flexibility in Discount Rates:** The new Principles allow for flexibility in discount rates for RSPs, stating that a discount rate other than the typical 50% may be appropriate in certain circumstances.
- **Annual Vesting:** The guidance now states that annual vesting of restricted shares is generally not supported by shareholders.

(ii) Hybrid Schemes

- **Recognition of Hybrid Schemes:** A new section recognises the importance of hybrid schemes, usually a combination of performance shares and restricted shares, in companies that have a significant US footprint or are competing for global talent.
- **Vesting Period:** The vesting period for a hybrid scheme is expected to be at least five years, with no accelerated vesting or early release of shares.

(iii) Value Creation Plans (VCPs)

- **Neutral Stance:** The new guidance takes a more neutral stance on VCPs, acknowledging their increasing acceptance while advising caution and diligence if one is contemplated. Early engagement with investors and material stakeholders is recommended, and the Principles set out key considerations for Remuneration Committees to consider.
- **Performance Period:** A VCP must reward the creation of substantial value over at least a five-year period.

8. Malus and Clawback

- **Alignment with UK Corporate Governance Code:** The malus and clawback provisions have been aligned with the updated 2024 UK Corporate Governance Code, and retain general recommendations for defined triggers, consistent and effective contractual documentation, clear communication and documentation of enforcement processes.

9. Discretion

- **Case-by-Case Basis:** The new Principles no longer refer to discretion being used in a manner directly aligned with shareholders' interests, and now encourage discretion to be contemplated on a case-by-case basis, taking into consideration shareholders, material stakeholders and specific company circumstances. The guidance emphasises that discretion can have both positive and negative implications for executive remuneration, and should avoid rewarding or penalising executives for factors beyond their control or influence. The guidance newly contemplates the exercise of upwards discretion being potentially appropriate in some cases, rather than only downward discretion.

10. Grant Process, Dilution Limits, Shareholding Guidelines and Special Awards

- **Pricing of Shares:** Issued shares should be priced "at" the mid-market price at the time of grant, rather than "not-less than" the mid-market price.
- **42-Day Grant Window:** The 42-day window for granting share awards now only applies to executive directors, excluding all-employee share plans.
- **Higher Dilution Limits:** The new Principles envisage that Remuneration Committees may seek shareholder approval for dilution limits higher than 10% for discretionary and all-employee share schemes in exceptional cases, such as recently listed high-growth companies. The 5% dilution limit previously applicable discretionary executive schemes has been removed.
- **Shareholding guidelines:** The Principles confirm the IA's view that the amount of the annual LTIP award is an appropriate level for the minimum shareholding requirement, and provide some examples of consequences that may be applied where the requirement is not met.
- **Special Awards:** The new Principles tone down statements in this area, providing points for consideration when making special awards and encouraging a well-designed remuneration policy that eliminates the need for such awards and engagement with shareholders when such an award is proposed.

Implications for UK Listed Companies

The Principles have been revised in response to calls from various companies and investors in recent years to permit listed companies greater flexibility to design remuneration policies that align with their specific circumstances and strategic goals. This shift is supported by a greater focus on constructive engagement and collaboration with shareholders, encouraging a more transparent and constructive dialogue, which in turn aims to create an environment in which companies can safely and confidently design and implement their tailored executive pay structures and decisions with the support of their shareholders.

The overall objective behind the revisions is to enable companies to be better positioned to attract and retain global talent, particularly in competitive markets like the US, while ensuring that remuneration structures are aligned with long-term value creation and shareholder interests. Certain specific changes, such as the new guidance on hybrid share schemes and the relaxation of guidance on dilution limits, bring UK pay practices closer to US practices, and the changes have been made in the context of a wider review of the UK's competitiveness in the global market by public and private bodies.

However, the increased flexibility also places a greater responsibility on Remuneration Committees to justify their decisions and engage effectively with shareholders. Companies that can successfully navigate this landscape and gain shareholder support for their proposals will benefit from the new Principles, while those that fail to do so may face challenges in implementing their desired remuneration policies.

Overall, the revised Principles represent a positive step towards a more dynamic and responsive approach to executive remuneration, reflecting the evolving needs and expectations of companies, shareholders and other stakeholders. The change also presents an opportunity for listed companies – particularly those who will soon be due to seek reapproval of their remuneration policies – to consider more objectively whether their current pay structures could benefit from a review and a fresh approach, setting the scene for potentially more diverse discussions and proposals around executive pay in the forthcoming annual reporting seasons.

If you would like to discuss the changes to the Principles and the implications for your company, please contact [Kathy Granby](#) or another member of the Lewis Silkin Reward & Incentives team.

