

INVESTMENT ASSOCIATION'S UPDATED GUIDANCE ON EXECUTIVE REMUNERATION

09 November 2017 | UK
Legal Briefings

The Investment Association has published an updated Principles of Remuneration for 2018.

The update will be of interest to all listed companies, who also need to keep an eye open for the upcoming revisions to the UK Corporate Governance Code, a consultation on which is expected later this month.

Important recent trends in investor views on executive pay are reflected in the updated Principles (available [here](#)) and the accompanying Letter to Remuneration Committee Chairs (available [here](#)), including:

AN INCREASING FOCUS ON HOW PAY LINKS TO PERFORMANCE

The letter to Remuneration Committee Chairs explains that investors are currently focussed on ensuring that companies provide a thorough explanation of why personal or strategic targets have been achieved (and not just providing a description of the metrics), and IA members have asked IVIS to Amber Top reports where insufficient explanation is given. Payment against personal or strategic measures will, in particular, receive scrutiny where financial metrics have not been achieved.

On a related point, the update to the Principles seems to widen, by including all incentive plans and not just bonuses, the expectation that Remuneration Committees should operate a policy that allows for non-vesting of awards if the company has suffered an exceptional negative event, even if some of the performance targets have been met. This continues to demonstrate that investors are expecting Remuneration Committees to take a more holistic view of company performance in determining whether executive pay levels are justified.

The updated Principles and Letter indicate that the specific target ranges for financial measures used in determining annual bonuses, and the extent to which the relevant targets were actually met, should be disclosed at the time of payment, or no later than 12 months thereafter where an explicit explanation of any commercial sensitivity has been set out (this period has been lowered from two years). Many companies will, however, already be compliant with this approach.

RECOGNISING THE NEED FOR INCREASED FLEXIBILITY IN CHOOSING REMUNERATION STRUCTURES

Following the Executive Remuneration Working Group's recommendation that long term remuneration needs to be simpler and more transparent, and the Government's response to its Green Paper which suggests that there should be longer holding periods, the updated Principles include a discussion of potential remuneration structures. (To see our previous bulletins on the Executive Remuneration Working Group's report please click [here](#), and on the Green Paper please click [here](#).)

The IA makes it clear that it is up to the Remuneration Committee to choose a remuneration structure that is appropriate to a company's particular business needs, fulfils its long term goals and can be justified to shareholders. Therefore, whilst the updated Principles discuss the IA's views on potential approaches, they emphasise that the IA does not recommend a particular structure.

One of the structures explored in the updated Principles is the use of restricted shares in place of performance-based LTIPs. If restricted shares are to be awarded the IA states that:

- the number of restricted shares to be awarded must be reduced by at least 50% compared to the number of shares capable of being earned under an LTIP (although we are aware that some investors require even bigger discounts);
- the restricted shares must be subject to a five year vesting and post-vesting holding period (thus matching the IA's views on the required vesting plus holding period for performance-based LTIPs); and
- that "some members" would expect a performance underpin to apply.

Notwithstanding this guidance, there remains a wide divergence of views on the use of restricted shares, and even if companies comply with these Principles it would remain to be seen whether many shareholders would be supportive.

DISCLOSURE OF PAY RATIOS

The IA repeats its call from 2017 for companies to disclose the pay ratios between the CEO and median or average employee, as well as the CEO and the Executive team, as part of justifying and explaining the levels of executive remuneration.

The IA has welcomed the Government's intention to require disclosure of pay ratios, and encourages all companies to voluntarily disclose their pay ratios in 2018.

The updated Principles also calls on companies, when fulfilling their reporting obligations on, for example, the Gender Pay Gap or employee pay ratios, to explain these figures in the context of the business and why these numbers are appropriate.

OTHER UPDATES TO THE PRINCIPLES INCLUDE:

- An expectation that any annual bonus opportunity of greater than 100% of salary will be subject to deferral. We would not expect, however, that shareholders would see this as the only circumstance in which deferrals should be applied.
- An expectation that companies should disclose any discretion specific to a particular incentive scheme both in the plan rules and in the Remuneration Policy.
- A requirement to disclose an executive's relocation benefits to shareholders when the executive is appointed (and, if the executive uses the benefits, this information is also required to be included in the Remuneration Report).

COMMENT

These updated Principles will not come as too much of a surprise to companies as they follow the same evolutionary pattern in the Working Group's Report and the Government's Green Paper (and response). The focus on disclosure obligations is also in line with the Government's long term aims in relation to corporate governance.

Companies should consider these updates, as well as keeping an eye open for the upcoming revisions to the UK Corporate Governance Code.

If you would like to discuss the IA's updated Principles and Letter to Remuneration Committee Chairs, or recent developments on executive remuneration more broadly, please get in touch.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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