



Association of British Insurers

ABI Principles of Remuneration

Foreword

This document sets out members' views on the role of shareholders and directors in relation to remuneration and the manner in which remuneration should be determined and structured.

The document is designed in a format of over-arching Principles, general Guidance and additional Appendices, containing further helpful guidance on the operation of incentive schemes. This document is predominantly for companies with a main market listing but is useful for companies on other public markets and for other entities too.

Members expect that as a minimum, companies will follow the requirements relating to Remuneration in the UK's Companies Act 2006, the UK Corporate Governance Code and the UK Listing Rules. Where companies are not subject to these regimes they should seek to apply similar high standards. Set out at the end of this document is Schedule A of the UK Corporate Governance Code for ease of reference.



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29th September 2011

ABI Principles of Executive Remuneration

i. The Role of Shareholders

- a. ABI members as institutional investors are interested in long-term value creation for the benefit of our ultimate clients. We have a fiduciary responsibility to our clients, who are primarily individual savers and pensioners.
- b. This responsibility involves ensuring that clients' capital is allocated efficiently and that the companies we own are well governed and run in the interests of their shareholders.
- c. As part of this, members seek to ensure that remuneration practices and policies of companies they invest in are aligned with shareholder interests and promote sustainable value creation.
- d. ABI members are committed to responsible ownership as outlined in FRC's Stewardship Code, but it is not the role of shareholders to micro-manage companies.

ii. The Role of the Board and Directors

- a. Boards of Directors are appointed by shareholders to run companies and act in their interests. They have a fiduciary duty to act in the best interests of their shareholders when determining remuneration. It is their responsibility to promote the long-term success of the company, taking into account the interests of employees, suppliers, customers, community, the environment and society.
- b. Executive directors develop and implement strategy for the company. Non-executive directors should constructively challenge and contribute to this process, scrutinise the performance of the executives, and ensure that risk management systems are robust.
- c. Non-executive directors, particularly those serving on the Remuneration Committee, should oversee executive remuneration.

iii. Remuneration Committee

- a. Shareholders look to the Remuneration Committee to protect and promote their interests in setting executive remuneration. As directors,

committee members are accountable to shareholders for the structure and quantum of remuneration.

- b. Remuneration Committees should set remuneration within the context of overall corporate performance. Structure should be aligned with strategy and agreed risk appetite, reward success fairly and avoid paying more than is necessary.
- c. Remuneration Committees should look at executive remuneration in terms of the pay policy of the company as a whole, pay and conditions elsewhere in the Group, and the overall cost to shareholders.

iv. Remuneration Policies

- a. Remuneration policies should be set so as to promote value creation through transparent alignment with the agreed corporate strategy.
- b. Remuneration policies should support performance, encourage the underlying sustainable financial health of the business and promote sound risk management for the benefit of all investors, including shareholders and creditors.
- c. Excessive or undeserved remuneration undermines the efficient operation of the company, adversely affects its reputation and is not aligned with shareholder interests.
- d. The board as a whole must consider the aggregate impact of employee remuneration on the finances of the company, its investment and capital needs, and dividends to shareholders.

v. Remuneration Structures

- a. Undue complexity should be avoided and incentive structures should have a long-term focus.
- b. Remuneration structures should be efficient and cost-effective in delivering strategy. The market environment, performance of the company and individuals, and the size and complexity of the business should be considered when determining remuneration.
- c. Executives and shareholders can have divergent interests, particularly in relation to time horizons and the consequences of failure or corporate underperformance. Remuneration structures should seek to address this.

- d. To avoid payment for failure and promote a long-term focus, remuneration structures should contain a careful balance of fixed and variable pay. They should include a high degree of deferral and measurement of performance over the long-term. Structures should also include provisions that allow the company to implement malus or claw-back arrangements.
- e. Executives should build up a high level of personal shareholding to ensure alignment of interest with shareholders.
- f. Dilution of shareholders through the issuing of shares to employees represents a significant transfer of value. Dilution limits are an important shareholder protection and should be respected.

Guidance for Remuneration Committees

The following guidance is set out to help Remuneration Committees apply the ABI Principles of Remuneration and ensure a proper level of shareholder protection.

Fixed elements of Remuneration

BASE PAY

Base pay should be set at a level which reflects the role and responsibility of the individual, whilst respecting the principle of paying no more than is necessary.

Where Remuneration Committees seek to increase base pay the reasons should be fully disclosed and justified. Salary decisions should not be taken purely on the basis of simple benchmarking against peer companies. If benchmarking is used, the aim should not solely be to match the “median” but to provide a point of reference for determining the appropriate salary for the specific job. The constant chasing of a perceived median has been a major contributor to the spiralling levels of pay.

Remuneration Committees should also be aware of the multiplier effect that increases in base pay have on the overall quantum of remuneration.

PENSIONS

Pension provision can represent a considerable cost to the company and this should be recognised by the Remuneration Committee when considering total executive remuneration.

Pension related payments should not be used as a mechanism for increasing total remuneration. The pension provision for the executives should where possible be in line with the general approach to the employees as a whole.

Payments in lieu of pension scheme participation should be clearly disclosed and treated as a separate non-salary benefit. There should be informative disclosure identifying incremental value accruing to pension scheme participation and any other superannuation arrangements.

Changes in pension benefit entitlements or to transfer values reflecting significant changes in actuarial and other relevant assumptions should be fully identified and explained. Where changes to pension benefit entitlements or transfers are made at the discretion of the Remuneration Committee, these should be made clear and justification should be provided. Pensions paid on early retirement should be subject to abatement.

BENEFITS

Benefits should be fully disclosed and where significant the Remuneration Committee should view them as an integral cost of fixed remuneration.

Variable elements of remuneration

Shareholders believe that a significant proportion of executive remuneration should be performance related, and tied to the achievement of the agreed corporate strategy and long-term value creation.

No element of variable pay should be pensionable.

ANNUAL BONUSES

Annual bonuses should incentivise performance and reward achievement in line with the agreed corporate strategy.

Annual bonuses should exist to reward contribution to the business during the year above the level expected for being in receipt of a salary. They should be clearly linked to business targets, ideally through the KPIs reported in the Enhanced Business Review. Where other measures are chosen these should be explained and justified. The KPIs can be both financial and non-financial. The measurements chosen should be quantifiable and the targets chosen should be set at the start of the year. The performance measures and targets should be publicly disclosed. If the targets are considered to be commercially sensitive they should be disclosed retrospectively. Shareholders discourage the payment of annual bonuses to executive directors if the business has suffered an exceptional negative event, even if some specific targets have been met. In such circumstances shareholders should be consulted on bonus policy and any proposed payments should be carefully explained.

Shareholders believe that companies should clearly disclose and justify the performance measures chosen and the related targets. Where consideration of commercial confidentiality may prevent a fuller disclosure of specific short-term targets at the start of the performance period, shareholders expect to be informed of the main performance parameters, both corporate and personal, for the financial year being reported on.

Following payment of the bonus, shareholders will expect to see a full analysis in the Remuneration Report of the extent to which the relevant targets were actually met.

Maximum participation levels should be disclosed and any increases in the maximum from one year to the next should be explicitly justified.

Deferring a portion of the bonus into shares can create a greater alignment with shareholders. However, this should not result in an increase in the overall quantum of the bonus.

LONG-TERM INCENTIVES

Long-term incentives exist to reward the successful implementation of strategy and the creation of shareholder value over a period appropriate to the strategic objectives of the company. Shareholders have a strong and clear preference for financial metrics linked to value creation to be used in long-term incentive structures; where any metric is non-financial, it should be quantifiable, linked to value creation and disclosed. Performance measures and vesting conditions should be fully explained and be clearly linked to the achievement of appropriately challenging financial performance which will lead to enhancement of shareholder value.

Equity based long-term incentive schemes are the most effective way to align the interests of participants and shareholders.

All new incentives or any substantive changes to existing schemes should be subject to prior approval by shareholders by means of a separate and binding resolution. Any change in quantum should be fully explained and justified.

Scheme and individual participation limits must be fully disclosed in share incentive schemes.

The operation of share incentive schemes should not lead to dilution in excess of the limits acceptable to shareholders.

Windfall gains may arise if the level of share or option grants expressed as a multiple of salary is maintained after a substantial fall in the share price. Where this risk exists, grants should be scaled back.

Retesting of performance conditions is not acceptable.

Performance driven vesting criteria can incorporate a combination of absolute and relative return targets, and a linkage with shareholder returns.

Remuneration Committees should satisfy themselves that when using in isolation either comparative or absolute performance metrics the result does not produce outcomes that are not in line with the overall performance of the company, its future prospects or the experience of its shareholders over the performance period.

Alignment and outcomes

QUANTUM

Quantum of remuneration is a matter of concern to shareholders. Levels of pay that do not reflect corporate performance undermine the ability to reward success and represents excess rent extractions. It is the responsibility of the Remuneration Committee to ensure that the quantum of executive compensation is appropriate. Shareholders are likely to object to levels of pay that do not respect the core principles of paying no more than is necessary and a linkage to sustainable long-term value creation.

In fulfilling this responsibility, the Remuneration Committee should seek specific points of reference against which the appropriateness of quantum can be judged. Useful reference points, which should help avoid unnecessary disagreements with shareholders, include:

- A stated policy that links aggregate remuneration to overall corporate performance. High pay for exceptional performance is consistent with this approach.
- The remuneration policy of the company as a whole. Remuneration Committees should assess the appropriateness of changes in the quantum of executive remuneration in the context of the company overall, including changes in employee remuneration more broadly.
- A relevant and fairly constructed peer universe. It is undesirable simply to use “median” pay as a benchmark since this, if used broadly, can lead to ratcheted increases in remuneration.

It is unacceptable that poor performance by senior executives, which detracts from the value of an enterprise and threatens the livelihood of employees, can result in excessive payments to departing directors. Payment for failure cannot be tolerated. Boards have a responsibility to ensure that this cannot occur both when negotiating new contracts and when agreeing any payments when contracts are terminated.

EXECUTIVE SHAREHOLDINGS

Executive directors and senior executives should build up significant shareholdings in companies. Unvested share based incentives should not be allowed to count towards the holding requirements and these requirements are not a substitute for performance metrics under share based plans.

NON-EXECUTIVE SHAREHOLDING

Shareholders encourage non-executive directors to own shares in the company. Chairmen and non-executives may receive part of their fees in shares bought at market price. However, shareholders consider it inappropriate for chairmen and independent directors to receive incentive awards geared to the share price or corporate performance that would impair their ability to provide impartial oversight and advice.

DISCRETION

Discretion can help Remuneration Committees to ensure that the outcomes of executive pay schemes properly reflect overall corporate performance and the experience of the shareholders in terms of value creation.

Shareholders expect that discretion should be exercised diligently and in a manner that is aligned with shareholders' interests.

The use of discretion should be clearly disclosed. Remuneration Committees will be held accountable for the way discretion is used.

Discretion should only be exercised within the previously agreed boundaries and maxima. If these are exceeded then shareholders will consider excessive payments to be ex gratia in nature.

SPECIAL AWARDS AND EX GRATIA PAYMENTS

Special or one-off awards are not generally favoured. Effective remuneration planning involving a balance of short and long term plans, carefully selected and calibrated performance measures and targets, and annual grants, should make exceptional awards unnecessary. A need for special grants, particularly for continuing management, indicates poor planning by the Remuneration Committee. Special awards may be acceptable when, for example, a new team is brought in to turn around a company. When such awards are made the Remuneration Committee must justify them.

Experience has shown that retention awards for main board directors rarely work. Retention concerns on their own are not sufficient grounds for remuneration to increase.

Shareholders are not supportive of the practice of paying transaction related bonuses.

CLAWBACK AND MALUS

The inclusion of clawback and malus provisions in scheme designs and executive contracts is a recognised way to prevent executives receiving rewards that are undeserved.

Shareholders expect to see such provisions included in relevant arrangements and for them to be enforced when appropriate.

PAY FOR EMPLOYEES BELOW BOARD LEVEL

The Remuneration Committee should be cognisant of pay and conditions elsewhere in the Group and take them into account when determining executive remuneration.

The Committee may have a role in determining pay or having oversight of remuneration at below board level. This is of particular relevance where the levels of remuneration or the risks associated with the activities involved are material to the Group's overall performance.

TAXATION

Remuneration committees should not seek to make changes to any element of executive remuneration to compensate participants for changes in their personal tax status.

Remuneration structures that seek to increase tax efficiency should not result in additional costs to the company or an increase in its own tax bill. Remuneration Committees should be aware of the potential damage to the company's and shareholders' reputation from implementing such schemes.

CONTRACTS AND SEVERANCE

Companies should follow the Principles and Guidance contained within the ABI and NAPF Statement on Executive Contracts and Severance and the UK Corporate Governance Code. The Statement is available at: <http://www.ivis.co.uk/ExecutiveContractsAndSeverance.aspx>

Appendix 1 – Additional Guidance

The following guidance may help remuneration committees when implementing remuneration policies and structures.

PERFORMANCE CONDITIONS AND VESTING

Remuneration Committees should choose performance criteria that are linked to long-term value creation.

The definition and calculation of any performance measurement should be clearly disclosed.

It should fully reflect the performance of the business as a whole and should be applied consistently across measurement periods.

The setting of a premium exercise price is not a substitute for performance conditions in accordance with this Guidance

Total Shareholder Return (TSR) relative to a relevant index or peer group is one of a number of generally acceptable performance criteria. However, Remuneration Committees should satisfy themselves prior to vesting that the recorded TSR or other criterion is a genuine reflection of the company's underlying financial performance, and explain their reasoning.

The calculation of starting and finishing values for TSR should be made by reference to average share prices over a short period of time at the beginning and end of the performance period. Lengthy averaging periods should be avoided. Where TSR is used as a performance criterion and the chosen comparator group includes companies listed in overseas markets, it is essential that TSR be measured on a consistent basis. The standard approach should be for a common currency to be used. Where there are compelling grounds for the calculation to be based on local currency TSR of comparator group companies, then the reasons for choosing this approach should be fully explained.

Threshold vesting amounts should not be significant by comparison to annual base salary. Furthermore, award structures with a marked 'cliff-edge' vesting profile are considered inappropriate, particularly where there may be clustering of performance outcomes around the average.

Full vesting should be dependent upon achievement of significantly greater value creation than that applicable to threshold vesting.

Sliding scales are a useful way of ensuring that performance conditions are genuinely challenging. They generally provide a better motivator for improving corporate performance than a 'single hurdle'.

Comparator groups used for performance purposes should be both relevant and representative. Where only a small number of companies are used for a comparator group, Remuneration Committees should satisfy themselves that the comparative performance will not result in arbitrary outcomes. Awards should not vest for less than median performance.

COST

The primary information that should be disclosed includes:

- The potential value of awards due to individual scheme participants on full vesting. This should be expressed by reference to the face value of shares or shares under option at point of grant, and expressed as a multiple of base salary.
- The maximum dilution which may arise through the issue of shares to satisfy entitlements.

MEASUREMENT OF THE PERFORMANCE PRE-GRANT

Shareholders expect that future performance should govern the vesting of options or share awards. Measuring performance achieved prior to the point of grant is generally not considered a suitable alternative.

CHANGE OF CONTROL PROVISIONS

Scheme rules should state that there will be no automatic waiving of performance conditions either in the event of a change of control or where subsisting options and awards are 'rolled over' in the event of a capital reconstruction, and/or the early termination of the participant's employment. Remuneration Committees should use best endeavours to provide meaningful disclosure that quantifies the aggregate payments arising on a change of control.

In the event of a change of control, the key determinant of the level of awards vesting should be underlying financial performance. Also, any such early vesting as a consequence of a change of control should be on a time pro-rata basis i.e. taking into account the vesting period that has elapsed at the time of change of control. Remuneration Committees should satisfy themselves that the measured performance provides genuine evidence of underlying financial achievement over any shorter time period. They should explain their reasoning in the Remuneration Report or other relevant documentation sent to shareholders.

PRICING AND TIMING OF AWARDS

The price at which shares are issued under a scheme should not be less than the mid market price (or similar formula) immediately preceding grant of the shares under the scheme.

Options granted under executive (discretionary) schemes should not be granted at a discount to the prevailing mid-market price.

Repricing or surrender and regrant of awards or 'underwater' share options is not appropriate.

The rules of a scheme should provide that share or option awards should normally be granted within a 42 day period following the publication of the company's results.

LIFE OF SCHEMES AND INCENTIVE AWARDS

No awards should be made beyond the life of the scheme approved on adoption by shareholders, which should not exceed 10 years.

Shares and options should not vest or be exercisable within three years from the date of grant. In addition, options should not be exercisable more than 10 years from the date of grant.

Where individuals choose to terminate their employment before the end of the service period, or in the event that employment is terminated for cause, any unvested options or conditional share-based award should normally lapse.

In other circumstances of cessation of employment¹, it is to be expected that some portion of the award will vest, to the extent of the service period that has been completed but subject to the achievement of relevant performance criteria. In general the originally stipulated performance measurement period should continue to apply. However, where in the opinion of the Remuneration Committee, early vesting is appropriate, or where it is otherwise necessary², awards should vest by reference to performance criteria achieved over the period to date.

Where options vest, in the event of death or cessation of employment of the option holder or where a company is taken over (except where arrangements are made for a switch to options of the offeror company), or where they have already vested at the time of such event, they must be exercised (or lapse) within 12 months. Where the performance measurement period applicable to an option extends beyond the

¹ Such circumstances may include disability, ill health, redundancy, retirement or analogous reasons for departure of a 'good leaver' nature.

² Such circumstances may include death and also occasions such as takeover of the company or sale or transfer of the business undertaking where awards are not being rolled over into equivalent awards in the successor entity or new employer.

point of cessation of employment options must be exercised within 12 months of vesting following the end of the performance measurement period.

Any shares or options that a company may grant in exchange for those released under the schemes of acquired companies should normally be taken into account for the purposes of dilution and individual participation limits determined in accordance with this Guidance.

JOINT VENTURE COMPANIES AND SUBSIDIARY COMPANIES

Shareholders generally consider it undesirable for options and other share-based incentives to be granted over the share capital of a joint venture company.

Discretionary grants over shares of a subsidiary company should only be made in exceptional circumstances. Where companies can justify doing so in terms of contribution to overall value creation, shareholders may consider exceptions subject to the following:

- Participation in subsidiary company schemes is restricted to those whose time is fully allocated to that subsidiary. Parent company directors should not participate in such schemes.
- There is full disclosure of the accounting treatment used when recognising the cost of option or share awards.
- Grants of options or share awards are subject to appropriately challenging performance criteria.
- Dilution limits relating to the subsidiary company should be disclosed in the context of parent company dilution limits.
- The methodology for valuing the subsidiary company shares and in the case of option awards the measurement of volatility of those shares should be disclosed. The party responsible for the valuation process should also be disclosed.
- Any entitlement or obligation to convert subsidiary company shares to parent company shares should be disclosed.

Shareholders may consider further exceptions where the condition of exercise is subject to flotation or sale of the subsidiary company. In such circumstances, grants should be conditional so that vesting is dependent on a return on investment that exceeds the cost of capital and that the market value of the shares at date of grant is subject to external validation.

Exceptions will apply in the case of an overseas subsidiary company where required by local legislation, or in circumstances where at least 25% of the ordinary share capital of the subsidiary company is listed and held outside the group.

DILUTION

The rules of a scheme must provide that commitments to issue new shares or re-issue treasury shares, when aggregated with awards under all of the company's other schemes, must not exceed 10% of the issued ordinary share capital (adjusted for share issuance and cancellation) in any rolling 10 year period. Remuneration Committees should ensure that appropriate policies regarding flow-rates exist in order to spread the potential issue of new shares over the life of relevant schemes in order to ensure the limit is not breached.

Commitments to issue new shares or re-issue treasury shares under executive (discretionary) schemes should not exceed 5% of the issued ordinary share capital of the company (adjusted for share issuance and cancellation) in any rolling 10 year period. This may be exceeded where vesting is dependent on the achievement of significantly more stretching performance criteria. The implicit dilution commitment should always be provided for at point of grant even where, as in the case of share-settled share appreciation rights, it is recognised that only a proportion of shares may in practice be used.

ESOTs AND ALL-EMPLOYEE SCHEMES

Employee Share Ownership Trusts - ESOTs

ESOTs should not hold more shares at any one time than would be required in practice to match their outstanding liabilities, nor should they be used as an anti-takeover or similar device. Furthermore an ESOT's deed should provide that any unvested shares held in the ESOT shall not be voted at shareholder meetings. The prior approval of shareholders should be obtained before 5% or more of a company's share capital at any one time may be held within ESOTs.

Where companies have provided for an ESOT to be used to meet scheme requirements, they should disclose the number of shares held by the ESOT in order to assist shareholders with their evaluation of the overall use of shares for remuneration purposes. The company should explain its strategy in this regard.

All-Employee Schemes

All-Employee schemes, such as SAYE schemes and Share Incentive Plans (SIPs) - (formerly known as AESOPs), should operate within an appropriate best practice framework. If newly issued shares are utilised, the overall dilution limits for share schemes should be complied with. The Guidance relating to timing of grants (except for pre-determined regular appropriation of shares under SIPs) applies.

Appendix 2 – Schedule A of the UK Corporate Governance Code³

SCHEDULE A THE DESIGN OF PERFORMANCE-RELATED REMUNERATION FOR EXECUTIVE DIRECTORS

The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to promote the long-term success of the company. Upper limits should be set and disclosed. There may be a case for part payment in shares to be held for a significant period.

The remuneration committee should consider whether the directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme.

Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities.

Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or, at least, form part of a well considered overall plan incorporating existing schemes. The total potentially available rewards should not be excessive.

Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives, including non-financial performance metrics where appropriate. Remuneration incentives should be compatible with risk policies and systems.

Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block. Consideration should be given to the use of provisions that permit the company to reclaim variable components in exceptional circumstances of misstatement or misconduct.

In general, only basic salary should be pensionable. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.

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