

20 October 2014

Dear Remuneration Committee Chairman,

I am writing on behalf of the Investment Management Association (IMA). Following the merger of the Investment Affairs division of the ABI with the IMA, the enlarged IMA (to be renamed The Investment Association in 2015) has assumed responsibility for guidance previously issued by the ABI.

### **2014 Review of the Principles of Remuneration**

Our Members are generally positive about how the first AGM season has progressed under the new Remuneration Regulations. With a good level of engagement between companies and investors: companies have generally listened to concerns of investors and either altered their remuneration policies in draft or provided public assurances, particularly where they were seeking overarching or unlimited discretion.

We do not consider there is a need for significant change to the Principles of Remuneration. The only change being made concerns the use of "allowances" as part of fixed pay. In general, the payment of "allowances" is inconsistent with the spirit of simplicity, clarity and pay for performance. If a Committee considers that the payment of an allowance is necessary, it should be clearly justified and explained in the context of the overall remuneration package.

### **Issues of concern to shareholders**

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

***Amounts and Gearing of variable pay*** – Investors continue to have concerns about both the overall amounts and level of gearing in variable pay. As the economy continues to recover, a number of companies have argued that the amount of variable pay should be increased. Shareholders will continue to scrutinise any such proposals very closely. In particular:

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- In normal circumstances, basic salary increases should not exceed inflation or the increase for the general workforce. The reasons for any increase greater than this should be clearly set out;
- The reasons for any increase to maximum variable pay should be clearly explained. An increase in the size of the company is not in itself a sufficient rationale.

**Threshold performance** – Members are also concerned about the absolute amounts payable for the achievement of threshold performance. Given current grant sizes of long-term incentives, even if 25% of an award vests for median or threshold performance, this can sometimes lead to vesting of substantial payments. Members look at the absolute amount paid to an executive director for threshold performance, not just the proportion of the award which vests.

**Length of performance/holding period** – The performance period for long-term incentives should be linked to the implementation of the strategy of the business and so be no less than three years and preferably longer. Committees should consider the use of additional holding periods. Whilst some have done so, shareholders encourage all companies to consider longer performance periods and/or holding periods.

**Retrospective changes to performance conditions** – IMA Members are aware that some companies are considering retrospective changes to performance conditions to take account of recent movements in exchange rates, which may have a significant impact on the outturn of profit-based performance measures. We do not support any retrospective changes to performance metrics. Shareholders are not immune to these exchange rate fluctuations and consider the management of exchange rate risk to be part of an Executive's role.

### **The last AGM season**

Members have asked us to highlight the following experiences from the last AGM season.

**Engagement process** – A number of companies received a significant negative vote, despite consulting on their proposals in draft. Shareholders consider that the remuneration engagement process could be improved:

- *Consulting or informing shareholders* – some companies say they are consulting shareholders when in actual fact they are informing them of a decision already made. Companies should be clear with shareholders if they are only notifying shareholders of a change;
- *Consult shareholders as early as possible* – Problems often arise when a company comes to investors too late to consider proposals properly and give feedback;
- *Full information* – Problems often arise if the full details of a proposal are not given during the consultation. This can include missing information on the structure of the plan or performance conditions. Additional elements or aspects of pay are also often not discussed;
- *Provide a wrap up of the consultation process* – Consultations can often run into the AGM period. It is helpful if companies send a wrap-up letter confirming that the consultation process has closed and setting out what has been decided.

**Retrospective disclosure of annual bonus targets** – The level of retrospective disclosure companies have provided on performance targets has been disappointing.

Shareholders are concerned that disclosures deteriorated under the new regulations, with a large number of companies using the “commercially sensitive” opt-out. Remuneration Committees should retrospectively disclose the performance range for annual bonus targets as well as the performance actually achieved. This is important in demonstrating the link between pay and performance.

***Public Assurances*** – A number of companies provided public assurances or further information on the operation of their Remuneration Policies ahead of the AGM. These were helpful and welcomed. Members do not expect companies to seek a re-approval of their policy at the next AGM to incorporate these assurances, but would expect details of them to be included in the next Remuneration Report.

***Disclosure of the Policy Report*** – Although not required by the Reporting Regulations, it will be helpful to shareholders if the Policy Table is disclosed in the Remuneration Report on an annual basis.

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](http://www.ivis.co.uk/contact-us)).

Yours faithfully,

Andrew Ninian

Director, Corporate Governance and Engagement