

THE

INVESTMENT

ASSOCIATION

INVESTMENT MATTERS

# The Investment Association Principles of Remuneration

**November 2017**

Registered office: The Investment Association  
Camomile Court, 23 Camomile Street, London EC3A 7LL  
The Investment Association is a company limited  
by guarantee registered in England and  
Wales. Registered number 04343737.

## FOREWORD

The Principles set 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. We believe that these Principles continue to provide a useful guide to shareholder expectations and good practice. As ever, a continued and close dialogue between companies and their shareholders is crucial.

This document is designed with a format of over-arching Principles and general Guidance. This document is predominantly for companies with a main market listing but is also relevant to companies on other public markets, such as AIM, and other entities.

Members continue to expect that, as a minimum, companies will follow the requirements relating to Remuneration in the UK's Companies Act 2006, Reporting Regulations, the UK Corporate Governance Code and the UK Listing Rules. Where companies are not subject to these regimes they should apply similar high standards.

Trelawny Williams  
Head of Corporate Finance,  
Fidelity Worldwide Investment,

Chairman of the Corporate Governance  
and Engagement Committee,  
The Investment Association

Andrew Ninian  
Director, Corporate Governance and Engagement  
The Investment Association

3 November 2017

## PRINCIPLES OF REMUNERATION

### 1. Remuneration Policies

- a. Remuneration policies should be set to promote long-term 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 success of the company and to the benefit of all its stakeholders.
- c. Non-Executive Directors, particularly those serving on the Remuneration Committee, should oversee executive remuneration. However, the Board should ensure that the company Chairman and whole Board are appropriately engaged in the remuneration setting process.
- d. Remuneration Committees need to exercise independent judgement and not be over reliant on their remuneration consultants. Members consider Non-Executive Directors should generally serve on the Remuneration Committee for at least a year before starting to chair the Committee and have sufficient skill and experience to manage the remuneration setting process.

### 2. Remuneration Structures

- a. The Remuneration Committee should select a remuneration structure which is appropriate for the specific business, and efficient and cost-effective in delivering its longer-term strategy. These Principles do not seek to prescribe or recommend any particular remuneration structure.
- b. Complexity is discouraged. Shareholders prefer simple and understandable remuneration structures.
- c. Executives and shareholders can have divergent interests, particularly in relation to time horizons and the consequences of failure or corporate underperformance. Therefore, remuneration structures should be designed to reward sustainable business performance and therefore deliver long-term value to shareholders.
- d. Given the range of business models across industry sectors, remuneration committees are encouraged to adopt the structure which is most appropriate for the implementation of their business strategy.
- e. Structures should also include provisions that allow the company, in specified circumstances, to:
  - Forfeit all or part of a bonus or long-term incentive award before it has vested and been paid ('performance adjustment' or 'malus'); and/or

- Recover sums already paid ('clawback')
- f. Executives should build up a high level of personal shareholding to ensure alignment of interests with shareholders. The shareholding should be maintained for a period after they have left the company.
- g. Dilution of shareholders through the issuing of shares to employees can represent a significant transfer of value. Dilution limits are an important shareholder protection and should be respected.

### **3. Levels of Remuneration**

- a. Undeserved remuneration undermines the efficient operation of the company and sends a disincentivising message to all staff. Excessive remuneration adversely affects its reputation and is not aligned with shareholder interests. The Board should explain why the chosen maximum remuneration level is appropriate for the company.
- b. The Board as a whole must be cognisant of the pay and conditions in the rest of the workforce, and should consider the aggregate impact of employee remuneration (including executive director remuneration) on the finances of the company, its investment and capital needs, and dividends to shareholders.
- c. Shareholders would expect the Remuneration Committee to exercise relevant discretion to avoid excessive remuneration payouts.

## GUIDANCE FOR REMUNERATION COMMITTEES

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

### SECTION A – GENERAL GUIDANCE

#### 1. Levels of Remuneration

The level 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 represent excess rent extractions. Undeserved remuneration undermines the efficient operation of the company and sends a disincentivising message to all staff. Excessive remuneration adversely affects its reputation and is not aligned with shareholder interests. 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.

Companies must consider the aggregate impact of employee remuneration on the finances of the company, its investment and capital needs, and dividends to shareholders.

The Remuneration Committee and the Board should seek specific points of reference against which the appropriateness of quantum can be outlined and judged. Useful reference points, which should help avoid unnecessary disagreements with shareholders, include:

- A stated policy that links aggregate remuneration to overall corporate performance.
- 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.
- Remuneration paid to groups of employees in the company’s workforce including the median employee and the Executive Committee, through the use of pay ratios.

#### 2. 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 shareholding requirements and these requirements are not a substitute for performance metrics under share based plans. Shares should only count towards the executive’s shareholding guideline if vesting is not subject to any further performance or other conditions such as continued employment. Shares which are vested, but which remain subject to a holding period and/or clawback, may count towards the shareholding requirement. The use of shareholdings in hedging arrangements or as collateral for loans should be fully disclosed. Shares which are subject to future performance, holding periods, claw-back or shareholding guidelines should not be hedged or used as collateral.

Executives are encouraged to purchase company shares using their own resources in order to provide evidence of their alignment with shareholders.

Remuneration Committees should consider implementing post-employment shareholding requirements, which would require an executive to retain a proportion of their shareholding requirement for a time period after they have left the employment of the company.

### **3. 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 the market price. However, shareholders consider it inappropriate for chairmen and independent directors to receive incentive awards geared to the share price or corporate performance.

### **4. Performance Adjustment/Malus and Clawback**

As stated above, structures should include provisions that allow the company, in specified circumstances, to:

- Forfeit all or part of a bonus or long-term incentive award before it has vested and been paid ('performance adjustment' or 'malus'); and/or
- Recover sums already paid ('clawback')

Shareholders believe the circumstances in which performance adjustment and clawback can be implemented need to be agreed and documented before awards are made.

The Committee should review the circumstances in which these provisions can apply and ensure that they are appropriate for the company. In general, shareholders accept that performance adjustment will apply to a broader range of circumstances than for clawback. The circumstances should, in each case, be clearly disclosed to shareholders.

The Committee should also consider the enforcement power they have to implement each process.

### **5. 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.

Discretion should be exercised diligently and in a manner that is aligned with shareholders' interests. 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. Remuneration Committees will have to disclose the level of discretion applicable under the Policy Table.

The use of discretion should be clearly disclosed. Any discretion specific to a particular incentive scheme should be disclosed in the Remuneration Policy in addition to the plan rules.

Remuneration Committees will be held accountable for the way discretion is used.

Shareholders discourage the payment of variable remuneration 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 implementation of the remuneration policy and any proposed payments should be carefully explained.

## **6. 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.

When fulfilling relevant reporting obligations in relation to workforce pay, such as the Gender Pay Gap Reporting legislation or when publishing executive pay to employee pay ratios, shareholders expect Remuneration Committees to provide these numbers in the context of their business and fully explain why these figures are appropriate.

## **7. 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.

## **8. Contracts and Severance**

Companies should follow the Principles and Guidance contained within The Investment Association and PLSA Statement on Executive Contracts and Severance and the UK Corporate Governance Code. The Statement is available at:

[https://www.ivis.co.uk/media/5896/ABI\\_NAPF\\_Joint\\_Statement\\_14feb2008\\_2\\_v\\_5.pdf](https://www.ivis.co.uk/media/5896/ABI_NAPF_Joint_Statement_14feb2008_2_v_5.pdf)

## **9. Recruitment of Executive Directors**

When recruiting Executive Directors, companies should pay no more than is necessary and should fully justify payments to shareholders. Compensating executives for the forfeiture of awards from a previous employer should generally be on a comparable basis, taking account of performance achieved or likely to be achieved, the proportion of performance period remaining and the form of the award.

## **10. Reward for Failure**

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 should ensure that this cannot occur, both when negotiating new contracts and when agreeing any payments when contracts are terminated.

## **11. Shareholder Consultation**

There is concern from investors that shareholder consultation has focused on the minutiae of executive pay, or is treated as a validation exercise by the Remuneration Committee rather than as a process for obtaining the views of their major shareholders. Investors need to analyse a company's remuneration structure from a governance and investment perspective, taking account of the strategy of the company, and provide clear feedback.

Members agree with the Executive Remuneration Working Group that consultation needs to focus on the major strategic remuneration issues rather than the minor details of pay. Companies need to listen and respond to feedback from their shareholders, and anticipate that they may not always receive support for their proposals. Consultation does not mean that companies will gain automatic acceptance of their proposals.

As part of the consultation process, Remuneration Committees should provide details of the whole remuneration structure, not just the proposed changes, so that investors can have the whole picture of the remuneration framework.

The role of consultation should be to understand the views of shareholders, and conducting a consultation will allow remuneration committees to decide the best way to enhance their proposals. The consultation process can be improved by remuneration committees understanding the Voting Policies of the Company's largest shareholders.

Subsequent to the conclusion of the consultation process and prior to finalising details in the Remuneration Report, the Remuneration Committee should review the proposals in light of any subsequent events that occur between the consultation and the implementation of the policy, to ensure that the proposals remain appropriate.

Remuneration Committees should respond to a significant vote against their remuneration report or policy (more than 20% of the votes against). Companies should seek to understand the reasons for the dissent, publish their explanation of the reasons and outline what the Board and Remuneration Committee are doing to address the dissent.

## **12. Special Awards and ex-gratia Payments**

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. If such awards are made, the Remuneration Committee must justify them.

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

Shareholders do not support the practice of paying transaction related bonuses.

## SECTION B - FIXED REMUNERATION

### 1. 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.

### 2. 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 executives should be in line with the general approach to the employees as a whole. Any differences in pension contribution rates for executives and the general workforce should be disclosed and justified to shareholders. Where there isn't a clear justification, members expect the company to explain how they intend to reduce the disparity.

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.

### **3. Benefits**

Benefits should be fully disclosed and, where significant, viewed as an integral component of fixed remuneration.

Any benefits relating to the relocation of an executive should be disclosed at the time of appointment. Where these benefits are deemed necessary, they should be in place for a limited period, which is disclosed to shareholders. Each element of any relocation benefits should be detailed in the Remuneration Report.

### **4. “Allowances” as part of Fixed Pay**

Members consider that, in general, the use of allowances as part of fixed pay goes against 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 within the context of the overall remuneration package.

## SECTION C – VARIABLE REMUNERATION

These Principles do not seek to prescribe or recommend any particular remuneration structure. Remuneration structures should be designed so as to reward the delivery of sustainable value to shareholders over the long-term.

Shareholders prefer simple remuneration structures. Given the range of business models across industry sectors, remuneration committees are encouraged to adopt the structure which is most appropriate for the implementation of their business strategy.

Remuneration committees may consider non-financial performance criteria in variable remuneration, for example relating to environmental, social and governance (ESG) objectives, or to particular operational objectives. ESG measures should only be used if they are material to the business and quantifiable. In each case, the link to strategy and method of performance measurement should be clearly explained.

No element of variable pay should be pensionable.

Depending on the type of remuneration structure which is chosen by the Remuneration Committee, we have set out below a number of considerations for each type of structure.

### 1. Annual Bonuses

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

Annual bonuses 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 Strategic Report. Where other measures are chosen, these should be explained and justified. The KPIs can be both financial and non-financial.

The measurements chosen must be quantifiable and the targets set at the start of the year.

Companies should clearly disclose and justify the performance measures chosen and the related targets. The definition of any performance measure should be clearly disclosed. Any adjustments made to the metrics as set out in the company's accounts should be clearly explained and the impact of the adjustment on the outcome disclosed.

Where consideration of commercial sensitivities 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, companies should provide a full analysis of the performance relative to the targets in the Remuneration Report. This includes the specific target ranges (threshold, target and maximum) for financial measures and the extent to which the relevant targets were actually met. For personal or strategic objectives, investors expect a detailed rationale for the payment of these elements. It is expected that bonus targets are disclosed no later than twelve months following the

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

Deferring a portion of the bonus into shares is expected for bonus opportunity of greater than 100% of salary. However, this should not result in an increase in the overall quantum of the bonus.

Discretion should be retained to ensure that a payment that is inappropriate in all the company's circumstances is not made. Companies should disclose the range of discretion which can be applied to bonus awards.

Where companies consider a recalibration of their remuneration policy towards annual performance periods instead of long term performance, shareholders would expect to see a significant reduction in maximum potential given the increased certainty of measuring performance over one year rather than three years.

## **2. Long-Term Incentives**

### **i. General**

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

The performance period should be clearly linked to the timing of the implementation of the strategy of the business, which should be no less than three years and shareholders would generally prefer longer. The use of additional holding periods is now commonly expected by investors, so that in total the performance and holding period should cover a period of at least five years.

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.

### **ii. Particular Types of Scheme**

The Remuneration Committee should select a remuneration structure which is appropriate for the specific business, and efficient and cost-effective in delivering its longer-term strategy. The selection of a scheme should be well justified to shareholders.

These Principles do not seek to prescribe or recommend any particular remuneration structure. Below are the views of investors on some of the common structures in the market:

### ***a) Long Term Incentive Plans (LTIPs)***

If an LTIP-style structure is used, performance conditions should be carefully chosen, so they are suitable for measurement over a long period of time (see below for further comments on setting performance conditions).

Threshold vesting amounts, reflecting expected performance, should not be significant by comparison with annual base salary. Full vesting should reflect exceptional performance and so be dependent on achievement of significantly greater value creation than that applicable to threshold vesting.

Sliding scales and graduated vesting profiles 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'.

### ***b) Matching schemes***

Any matching shares allocated will be considered by shareholders as part of the quantum of total remuneration. The performance conditions should be appropriate to the total amount potentially to be received, including matching shares. Matching schemes in addition to other long term incentives may add unnecessary complexity.

### ***c) Option schemes***

Dividends should not be paid or accrue in the period prior to exercise, as the shares are not owned by the participant.

### ***d) Performance on grant schemes***

If the Remuneration Committee considers a performance on grant scheme to be appropriate:

- It should be accompanied with genuinely long holding periods and significant shareholding requirements;
- There should be clear disclosure (in advance) of the performance required, and achieved, to justify grants;
- Given the increased certainty of payments, members expect a significant discount to be applied than under long term incentive schemes that are subject to future long-term performance.
- The use of a measurable financial performance underpin over the holding period should be considered.

### ***e) Restricted Share Awards***

Issues to consider in relation to restricted share awards are:

- The Discount – If moving from a LTIP to restricted share model, the Remuneration Committee should consider the appropriate discount to award levels to reflect restricted shares have more certain outcomes. Members believe that the discount rate for moving from the LTIP to restricted share awards should be a minimum of 50%, Grant levels should be held at this level in future and not gradually increase over time.
- Vesting Periods – The total vesting and post-vesting holding period should be at least five years. The grant of restricted shares should be accompanied with significant shareholding requirements.
- Underpin – Some members expect that restricted share awards should be subject to an appropriate underpin.

Members have stated that companies that have demonstrated a history of sensible approach to remuneration and have established a relationship of trust with its investors are more likely to get acceptance for such a scheme.

### **iii. Performance Conditions**

The widely differing nature of business models and industry characteristics means that the appropriate performance measures and conditions for different companies may vary significantly. Performance measures and vesting conditions should be fully explained and clearly linked to the achievement of appropriately challenging financial performance which will enhance shareholder value.

Whilst other considerations may apply in particular circumstances, for example, restructuring, shareholders will expect that remuneration policies and structures will normally be consistent with the following criteria:

- Shareholders have a clear preference for financial measures linked to value creation. Performance criteria should be linked to the Company's long-term strategy and targets reflect an appropriate balance between the shorter- and longer-term.
- Remuneration Committees will need to consider, and explain, appropriate performance criteria in the light of the specific business characteristics of the group in question. Performance criteria should fully reflect the performance of the business as a whole and should be applied consistently across measurement periods.
- The definition of any performance measurement should be clearly disclosed. Any adjustments to reported metrics should be clearly explained and the impact on the outcome detailed. Members expect the impact of share buy backs and other capital management decisions to be taken into account when determining whether a performance measurement has been satisfied.
- Retesting of performance conditions is not acceptable.
- Remuneration Committees should ensure 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.

- Comparator groups used for performance purposes should be both relevant and representative. Where only a small number of companies is 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.
- Where operational measurements are used, they would generally be expected:
  - To include, subject to business strategy, one or more measures relating to overall business volume or growth
  - To include one or more measures relating to business efficiency or profitability
  - To avoid the risk of providing an implicit incentive to take undue operational or financial risks or, in particular, to adopt an unduly risky capital structure.
- Where Total Shareholder Return (TSR) relative to a relevant index or peer group is used, 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.
- Where appropriate, Remuneration Committees should take account of The Investment Association Long Term Reporting Guidelines: <https://ivis.co.uk/media/12519/Long-Term-Reporting-Guidance.pdf>

#### **iv. Vesting**

Threshold vesting amounts, reflecting expected performance, should not be significant by comparison with annual base salary.

Awards' structures with a marked 'cliff edge' vesting profile are considered inappropriate. Full vesting should reflect exceptional performance and so be dependent on achievement of significantly greater value creation than that applicable to threshold vesting.

#### **v. Grant Size**

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. Similarly, where a fixed number of shares are used, the number of shares awarded should be reviewed to ensure windfall gains do not arise where the share price has increased.

In all cases, the Remuneration Committee should review each year, if the grant level is appropriate given the company's financial and share price performance.

## **vi. 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.

## **vii. 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. Shareholders would prefer that, in the event of a change of control, outstanding awards due to Directors are rolled over into equivalent awards in the successor entity.

## **viii. 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.

Re-pricing or surrender and re-grant 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 immediately following the end of the closed period under Market Abuse Regulation (EU) 596/2014.

## **ix. 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 ten years from the date of grant.

Where individuals choose to terminate their employment before the end of the service period, or they are considered a "bad leaver", 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 employment<sup>1</sup>, some portion of the award may 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 necessary<sup>2</sup>, 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 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.

## **x. Dilution**

---

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

<sup>2</sup> 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.

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. 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.

## **xi. 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 be made only 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.

## **xii. 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.

## **xiii. All-Employee Schemes**

All-Employee schemes, such as SAYE schemes and Share Incentive Plans (SIPs) 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.