

THE

INVESTMENT

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INVESTMENT MATTERS

# The Investment Association Principles of Remuneration

**16 November 2020**

## THE INVESTMENT ASSOCIATION

The Investment Association champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad.

Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base.

Collectively they manage over £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. Over 40% of this is for overseas customers.

The UK asset management industry is the largest in Europe and the second largest globally. Our members hold over one third of UK Plc.

## FOREWORD

The impact of the pandemic on UK Plc will continue to reverberate for many years. How companies balance the need to reward and incentivise management whilst reflecting the experiences and expectations of employees, suppliers, shareholders and wider society will be crucial. IA members consider the Principles of Remuneration remain relevant through the pandemic, but we have supplemented the Principles with separate guidance which sets out member expectations on specific issues arising from the pandemic.

The wider stakeholder interest in remuneration shows no signs of abating and will come into sharper focus as a result of the inequalities highlighted by the pandemic. Executive remuneration is seen by some commentators as a barometer on the state of corporate governance in the UK as a whole.

The Principles are designed to give companies clarity on our members' expectations on executive remuneration. This good practice if followed will enable engagement on remuneration to be efficient and effective.

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

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## PRINCIPLES OF REMUNERATION

### 1. Remuneration Policies

- a. Remuneration policies should promote long-term value creation through transparent alignment with the agreed corporate strategy.
- b. Remuneration policies should support individual and corporate performance, encourage the sustainable long-term financial health of the business and promote sound risk management for the success of the company and to the benefit of all its stakeholders.

### 2. Remuneration Committees

- a. Non-Executive Directors, particularly those serving on the Remuneration Committee, should oversee executive remuneration. However, the entire Board should be appropriately engaged in the remuneration setting process.
- b. Remuneration Committees need to exercise independent judgement and not be over-reliant on their remuneration consultants.
- c. Members consider Non-Executive Directors should generally serve on the Remuneration Committee for at least a year before chairing the Committee and have sufficient skill and experience to manage the remuneration-setting process.
- d. Remuneration Committees must respond to a significant vote against any remuneration resolution when they appear on the IA's Public Register. Companies should seek to understand the reasons for the dissent and issue an update statement in response to the dissent. This should include the views received from shareholders and what the company has done or proposes to do in response.

### 3. Remuneration Structures

- a. The Remuneration Committee should select a remuneration structure which is appropriate for their specific business, 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. They will consider alternative remuneration structures if aligned to the company strategy.
- c. Executive directors and the company's stakeholders, including shareholders can have divergent interests, particularly in relation to time horizons and the consequences of failure or corporate underperformance. Therefore, remuneration should be designed to reward sustainable long-term business performance and better align these divergent interests.

- d. Structures should also include provisions that in specific circumstances, allow the company to:
- Forfeit or withhold 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')
- e. Executive directors should build up a significant level of personal shareholding, through personal investment and vesting of share incentives to ensure alignment of interests with shareholders. These shareholdings should be maintained for at least two years after the Director has left the company.
- f. Dilution of shareholders through the issuing of shares to employees can represent a significant transfer of value. Dilution limits should be respected.

#### **4. Levels of Remuneration**

- a) Undeserved and excessive remuneration sends a negative message to all stakeholders, including the company's workforce, and causes long term damage to the company. Shareholders expect the Remuneration Committee to ensure that the remuneration structure is appropriate.
- b) The remuneration committee should have appropriate discretion to ensure that remuneration outcomes are commensurate with company performance and are not excessive.
- c) The Board should explain why the chosen maximum remuneration level is appropriate for the company.
- d) The Board as a whole must be cognisant of the pay and conditions in the wider 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.

## 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 all stakeholders and shareholders in particular. Levels of pay that do not reflect corporate performance represent excess rent extractions. Shareholders object to levels of pay that do not respect the core principles of paying no more than is necessary and expect a clear link to sustainable long-term value creation.

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.
- 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, upper and lower quartile through the use of pay ratios.

#### 2. Executive Shareholdings and Post-Employment Shareholding Requirements

Executive directors and senior executives should build up significant holdings in their company’s shares. Executives are encouraged to purchase company shares using their own resources in order to provide evidence of their alignment with shareholders. Remuneration Committees should set out the minimum shareholding requirement the executive is expected to meet as well as, the time period in which the Executive has to achieve the requirement. The Committee should set out the consequences of an Executive not achieving the stated shareholding requirement.

Shares should only count towards the executive’s shareholding requirement if vesting is not subject to any further performance conditions. Unvested shares, which are not subject to a further performance condition, can count to the shareholding requirement on a net of tax basis. Shares which have vested, but which remain subject to a holding period and/or clawback, may count towards the shareholding requirement. For example, deferred shares awarded under annual bonus schemes can count to the shareholding requirement on a net-of-tax basis. Shares vested from a long-term incentive award, but still in the holding period can also be used to meet 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 requirements should not be hedged or used as collateral.

The UK Corporate Governance Code states that Remuneration Committees should develop a policy on post-employment shareholding requirements, which would require an executive to retain a proportion of their shareholding for a time period after they have left the employment of the company.

IA members consider the post-employment shareholding requirement should apply for at least two years at a level equal to the lower of the shareholding requirement immediately prior to departure or the actual shareholding on departure. The Remuneration Committee should state the structures or processes it has in place to ensure the continued enforcement of the post-employment shareholding requirement, particularly after a Director has left the Company. This may require the establishment of employee ownership trusts or nominee accounts for the shares to be held in. Shareholders expect these post-employment shareholding requirements to be established for all new executive directors and for existing executive directors at the earliest opportunity and at a minimum by the company's next policy vote.

### **3. Non-Executive Shareholding**

Shareholders encourage non-executive directors to own shares in the company. Chairs and non-executives may receive part of their fees in shares bought at the market price. However, shareholders consider it inappropriate for chairs and independent directors to receive incentive awards geared to the share price or corporate performance.

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

Remuneration structures should include provisions that in specified circumstances allow the company to:

- Forfeit or withholding 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 current market standard triggers for malus and clawback are gross misconduct or misstatement of results. These two events are likely to be rare, and when they do occur, it may be challenging to prove the individual culpability of directors. In order to give clawback the necessary power to make post-hoc adjustments when the performance that determined the award comes into question, remuneration committees should establish a more substantial list of specific circumstances in which the malus and clawback provisions could be used. This will vary by company, but the FRC's Board Effectiveness guidance states circumstances might include payments based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure. The circumstances should, in each case, be clearly disclosed to shareholders.

The Committee should also consider the enforcement power they have available to them to implement each process. In order to help the enforcement of clawback, it is important that the terms are clearly set out and accepted by the executive director. Companies should require executives to sign forms of acceptance at the time of grant in order to set the expectations for malus and clawback applying to

that award and setting out how and when it may be applied. It is also very important that the documentation for the LTIP and bonus rules, the remuneration policy and employee contracts are all consistent. Any communication around the payment of bonuses or LTIPs should also be consistent with and not contradict the malus and clawback provisions. Remuneration Committees should develop clear processes for assessing executives against either malus and clawback criteria or how they will exercise discretionary clawback. Demonstration of process and evidence of decision-making is very important in the event that clawback is contested.

## **5. Discretion**

Discretion can help Remuneration Committees 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 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 particular ones that impact on stakeholders including the company's workforce. For example, if there has been a significant health and safety failure or a poor outcome for clients. In such circumstances, shareholders should be consulted on implementation of the remuneration policy and any proposed payments should be carefully explained.

Remuneration Committees will be held accountable for the way discretion is used. As with malus and clawback provisions, the remuneration committee should ensure that the committee has sufficient legal power and that all documentationsuitably reflects the ability for the committee to exercise discretion.

Discretion should be exercised diligently and in a manner that is aligned with shareholders' interests. Discretion should only be exercised within the previously agreed policy 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. It is now a requirement for remuneration committee chairs to disclose any instances of discretion being employed in their Annual Statement in the Remuneration Report. It would be helpful for remuneration committee chairs to affirm if no discretion has been used in the year under review. Any discretion specific to a particular incentive scheme should be disclosed in the Remuneration Policy in addition to the plan rules.

Remuneration Committees should consider introducing discretion into their incentive schemes to limit vesting outcomes if a specific monetary value is exceeded. IA members consider it appropriate for individual Remuneration Committees to decide on the level at which such a discretion would be suitable for their company and how it would be implemented on an individual basis.

## **6. Pay for Employees below Board Level**

Under the UK Corporate Governance Code, the Remuneration Committee are required to "review workforce remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration."

The Committee has a role in determining pay of senior management. 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 complying with relevant reporting obligations in relation to workforce pay, such as the Gender Pay Gap Reporting or executive to employee pay ratios, shareholders expect Boards and Remuneration Committees to fully explain why these figures are appropriate and disclose any actions the committee or company intends to take to rectify them.

## **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 reputational risks from 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 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 impacts company stakeholders, can result in excessive payments to departing directors. Boards should ensure that this cannot occur, both when negotiating new contracts and when agreeing any payments when contracts are terminated.

## **11. Leaver provisions**

Payments made to departing directors for payment in lieu of notice should only consist of contractual entitlements and be limited to salary, pensions and any benefits and reflect the length of the notice period. Members expect that the notice period should commence immediately when a decision has been made that an executive has resigned, or the board has decided that that an individual is leaving the company. Annual Bonus payments should only be paid to good leavers and deferred bonuses should continue to be settled in shares on the normal deferral schedule. Companies should disclose if a Director is a good or bad leaver and the reasons for the company giving the Director that status.

## **12.Shareholder Consultation**

There is concern that shareholder consultation is being treated as a validation exercise by some Remuneration Committees rather than as a process for obtaining and understanding the views of the company's major shareholders.

Members believe that consultation needs to focus on the major strategic remuneration issues rather than the minor details of pay. However, companies should be satisfied that they have been transparent enough that the final proposals do not contain any surprises. They should provide details of the whole remuneration structure, not just the proposed changes, so that investors are provided with a complete picture and sufficient information to make an informed voting decision.

Companies should listen and respond to feedback from their shareholders to enhance their proposals. Companies should anticipate that they may not always receive support for their proposals. Consultation does not mean that companies will gain acceptance of their proposals. The consultation process can be improved by Remuneration Committees understanding the Voting Policies of the Company's largest shareholders. The IA's Institutional Voting Information Service (IVIS) assists IA members during the consultation process helping members to identify the key changes and areas where further information or clarifications are required. IA members support the IA being included in the company's consultations to aid members with their own analysis.

At the conclusion of the consultation process it is helpful for Remuneration Committees to send those shareholders consulted a letter wrapping-up the consultation and setting out the final approach which the Committee will be taking. 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.

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

Effective remuneration planning 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 for doing so should be fully disclosed, justified and aligned to increases awarded to the wider workforce.

Salary decisions should not be taken solely on the basis of comparisons against peer companies. 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 related payments should not be used as a mechanism for increasing total remuneration. The UK Corporate Governance Code states that pension contribution rates should be aligned with those available to the workforce. IA members consider this to be the rate which is given to the majority of the company's workforce. Investors expect new executive directors or any director changing role to be appointed on this level of pension contribution. The contribution rates for incumbent executive directors should be aligned over time to the contribution rate available to the majority of the workforce, members expect this to be achieved as soon as possible. Shareholders do not expect that compensation will be awarded for this change.

Where the pension contributions for incumbent directors are above the majority of the workforce rate, members expect Remuneration Committees to set out a credible action plan to align the pension contributions of incumbent directors to the majority of the workforce rate by the end of 2022.

Members expect that companies disclose in their Remuneration Report the pension contribution rate which they consider to be given to the majority of the workforce. The Remuneration Committee should also explain how this rate has been derived. For example, is it an average of all employees, UK employees only, or the rate given to all new joiners.

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 clearly disclosed, and a justification should be provided. Pensions paid on early retirement should be subject to abatement.

No element of variable pay or allowances should be pensionable.

### **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 should be 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 the 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 variable remuneration structure. Shareholders prefer simple remuneration structures.

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

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, through the financial and strategic KPIs reported in the Strategic Report. Where other measures are chosen, these should be explained and justified.

The impact of material Environmental, Social and Governance risks on the long-term value of companies is becoming increasingly apparent. As a result, a greater number of companies are incorporating the management of material ESG risks and opportunities into their long term strategy. In these cases, it is appropriate that Remuneration Committees consider the management of these material ESG risks as performance conditions in the company’s variable remuneration. As with any other performance condition, it is imperative they are clearly linked to the implementation of the company’s strategy.

IA members have noted the increasing use of strategic targets and/or personal objectives in annual

bonuses. Shareholders continue to expect that financial metrics will comprise the significant majority of the overall bonus. Where personal objectives are used companies should demonstrate how they link to long term value creation and should not be for actions which could be classed as “doing the day job”.

All measurements must be quantifiable. They should be clearly disclosed and defined with the targets set at the start of the year. Any adjustments made to the metrics as set out in the company’s accounts should be clearly explained and the impact 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 and disclosure of achievements which have led to the payment of these elements. The weightings, achievement and outcomes of personal and strategic objectives should be disclosed separately.

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.

Where financial metrics do not warrant a bonus payment, members will scrutinise the payment and rationale for the payment of any personal or strategic elements to ensure that such a payment is warranted.

Deferring a portion of the entire 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. Investors expect any dividends accrued on deferred bonuses to be paid in shares.

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 schemes are an effective way to align the interests of participants and shareholders. Generally, members do not support the payment of long-term incentive schemes in cash or cash equivalents other than to settle tax. Investors expect any dividends accruing on vested shares to be paid in shares.

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.

Share incentives should have clearly disclosed participation limits, both on an individual basis and in aggregate (scheme limits).

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, efficient and cost-effective in creating sustainable long-term value. 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 common structures:

### ***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).

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 expected by investors, so that in total the performance and holding period should cover a period of at least five years.

Threshold vesting amounts, reflecting expected performance, should not be significant in comparison with annual base salary. Full vesting should reflect exceptional performance and should be dependent on the achievement of significantly greater value creation than that required for 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 that could be potentially 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:

#### **Strategic Rationale**

Investors assess proposed restricted share schemes on a case-by-case basis, paying particular attention to the context of the company and the rationale articulated when deciding on the appropriateness for a particular company. For example:

- Sector factors, like the impact of commodity pricing or a cyclical business model, could make a restricted share schemes appropriate.
- Turnaround situations could be appropriate context for the use of a restricted share scheme.

#### **Discretion & Underpin**

It is vital for Remuneration Committees to have the ability to exercise discretion on vesting outcomes. This will allow the Remuneration Committee to guard against payment for failure. Committees should confirm they have reviewed the vesting outcomes and should provide an explanation as to why a level of pay-out is appropriate, and how such a decision was reached. Some shareholders have expressed a preference for a quantitative underpin to be achieved prior to any award vesting.

#### **Vesting and holding periods**

Investors are largely agreed that the preferred vesting period for restricted share schemes is at least five years. In addition, the company's shareholding requirement should be significant and require a post-retirement shareholding requirement of at least two years.

#### **Previous approach of the company to remuneration**

In deciding on whether to support the introduction of a restricted share scheme, investors will factor in a company's previous approach to remuneration. In particular, they will compare the previous pay-out levels to historic company performance and reflect on the level of trust they have with the Remuneration Committee when assessing any proposals.

Members may be suspicious of new proposals in cases where the existing remuneration framework was considered to be delivering appropriate outcomes or where new remuneration structures are being proposed only when the current remuneration structures are not paying out to executives.

## **Discount**

If a company is moving from an LTIP to a restricted share model, the Remuneration Committee should consider the appropriate discount to award levels. This is to reflect that restricted shares have more certain outcomes. Members believe that the discount rate for moving from the LTIP to restricted share awards should be at least 50% and grant levels should be held at this level in future and not gradually increase over time.

The exact level of discount should take account of the individual company factors, such as levels of existing remuneration potential, and other features of the restricted share scheme proposed.

### **iii. Performance Conditions**

Performance measures and vesting conditions should be fully explained and clearly linked to the achievement of appropriately challenging financial and strategic performance which will enhance shareholder value.

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

- Financial measures linked to value creation. Performance criteria should be linked to the Company's long-term strategy, this includes when environmental, social and governance performance targets are chosen.
- 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 or retrospective changes to 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 shareholders and other stakeholders 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 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.

Award structures with a marked 'cliff edge' vesting profile are considered inappropriate. Full vesting should reflect exceptional performance and should 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. Therefore, following such a share price fall, 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.

## **x. Leaver Provisions**

Where individuals choose to terminate their employment, 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. Shareholders expect bad leaver would not receive annual bonus payments. Individuals that do not meet the good leaver criteria

should be treated as a “bad leaver”.

In other circumstances of cessation of employment, where the individual is considered a good leaver this may include disability, ill health, redundancy, or retirement, some portion of the award may vest, to the extent the service period has been completed, but subject to the achievement of relevant performance criteria. The originally stipulated performance measurement period should continue to apply. Where in the opinion of the Remuneration Committee, early vesting is appropriate, or where it is otherwise necessary, such as death, takeover or sale of the company or business, awards should vest by reference to performance criteria achieved over the period to date.

Investors expect that deferred bonus and long-term incentive awards should continue to be settled in shares and subject to the appropriate performance and holding periods. If it is the expectation of the Remuneration Committee that the individual leaving will retire and thus will be treated as a good leaver, the committee should have appropriate mitigation clauses in case any individual goes on to take further executive role.

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.

## **xi. 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. 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.

## **xii. 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.

### **xiii. 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.

### **xiv. 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.