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The Investment Association revises its remuneration principles for UK listed companies

The Investment Association has revised its remuneration principles for UK listed companies.

The revised version contains a number of welcome changes, but the main one is simply a change of tone on giving companies flexibility in applying the principles if they can justify their approach. However, quite how far companies will now use and investors actually allow that extra flexibility remains to be seen.

Introduction

The Investment Association (the "IA") publishes the fullest set of remuneration guidelines of any investor body in the UK. The principles cover investor expectations on quantum, structure and individual terms of employee share plan awards and other aspects of director remuneration in the UK.

Other bodies often follow its lead, but with some different points of emphasis. The guidelines have a long history. Many still refer to the principles as the "ABI Guidelines" from when they were published by the UK insurers membership body, but which passed custody of them to the IA a few years ago.

The principles are usually updated at this time of year to influence remuneration design and reporting for the coming year, but there was no update in 2023. This was because there was a period of general review of the UK listing infrastructure and UK shareholder expectations for London listed companies (which included remuneration expectations) and, during that, the IA undertook a fuller review than normal to play its part in that process. The changes in this year's guidelines have therefore been awaited with more anticipation than normal.

2024 Changes to Principles

While market participants perhaps expected more from the new guidelines than has actually emerged, the main changes are as follows:

Flexibility – while the remuneration principles are expressed to be guidelines, companies often complain that many investors and proxy agencies treat them as having the force of law and rigidly apply them for compliance and voting purposes, or at best set too high a bar to justify any deviation.

This in turn leads to companies often not pursuing remuneration arrangements, which they believe are appropriate for them due to their circumstances, for fear of negative comment and voting recommendations. The IA has long said in reply that it and investors have always been ready to listen to companies' arguments, but that they are often simply just not compelling.

There is now more reassurance in this version of the guidelines that flexibility will actively be considered if a good case is made for it (particularly where a company has US operations, recognising the significant differences between UK and US pay) and that blanket application of the guidelines is not always expected.

However, many companies and their advisers were looking for the IA to go further and give even more confidence to companies that the investors they represent were prepared to see more regular disapplication of the principles.

On points of detail:

Bonus deferral – deferral of annual bonuses is a significant difference between the UK, where a proportion is expected to be deferred into shares for up to three years before an annual bonus can be fully received, and the US, where full payment occurs following the end of the year.

As part of the pressure to align UK and US practice, there had been hope that the IA might change its recommendations, but the guidelines have just removed the % of salary paid out as bonus above when they expect bonuses to be deferred (it used to be 100% - now no guidance is given). They also allow companies to form a view as to when bonus deferral in shares is no longer expected because an executive already has a significant shareholding in the company.

Hybrid schemes – in the US, it is common for senior executives to receive both performance-linked and simply time-related share awards (and many give options as well as free share awards) under what are known as "hybrid arrangements". UK investors in contrast have favoured just one form of long-term incentive award and, where the company's long-term incentive arrangements move to being time-linked, not performance-linked, there should be a large reduction ("typically" 50% or more) of the value of the awards made.

Some five years ago, the IA conducted a major review of time-related awards (often called restricted share plans) but there is still concern about their use and that of hybrid schemes generally. The tone in the new guidelines is more accepting than previous years, particularly where there are US operations, though this is still not an easily accepted position. The expected five-year vesting and holding period still remains.

Dilution limits – while this aspect does not relate to individual award terms, the guidelines have always had an overall remuneration share dilution feature. This is even though, increasingly, many executive share plan arrangements are now satisfied in market purchase shares not through new issue shares. Indeed the IA also has limits on overall company share issuance generally, not just for remuneration. While the core remuneration limit remains at 10% over 10 years for all plans, this year the 5% cap on executive award share plan dilution (within the overall 10% limit) has been removed.

Many companies were defying the guidelines and operating without having this limit in their rules anyway, but if a company still has this limit in its

plans and intends to issue shares to satisfy awards, it may wish to take advantage of this relaxation at its next AGM to remove the 5% limit from its plans.

Even on the 10% cap guideline, several companies have obtained shareholder approval to go higher and this is reinforced in the guidelines where the IA say that they will listen to cases made by high-growth companies sympathetically.

Malus and clawback – the revised guidelines support the developments in the updated UK Corporate Governance Code (the "Code") which comes into force for financial years beginning on or after 1 January 2025. The new Code recommends employment contracts expressly refer to malus and clawback; more detail is provided in annual reports on a company's malus and clawback arrangements and the actual use of any arrangements.

While the guidelines do not materially add to the Code recommendations on what companies need to do, they do draw attention to what is perhaps the key change in the new Code for remuneration arrangements. This is a workstream all listed companies should have on their radar, particularly as malus and clawback arrangements in a company's share and cash plans have often developed in piecemeal fashion.

The new Code means that these should all be pulled together much as financial services companies have had to do over the last few years. The number of occasions on which an executive director has had to leave and investors have expected recovery of remuneration which means that this is not just an academic exercise either and a company could be severely embarrassed if it cannot enforce recovery.

Consultation – what is publicly disclosed in a shareholder circular or remuneration report on a company's remuneration arrangements is often the easiest part of the whole process of communicating with shareholders, as shareholder views have often been obtained through a long and much more complicated consultation process, which is hidden from public view. It is now a key part of the remuneration cycle.

In larger companies, this is often an annual process though this peaks when there is a remuneration policy vote every three years, but for all companies director remuneration can feature to some extent each year. The materials require much time and thought both on the part of companies and their investors.

The IA is keen to suggest that the consultation process is about giving information to enable investors to form their own views and listen to them rather than simply to justify the company's own position. Companies should also comment on the consultation process in the formal communication to shareholders at the end of the process.

Conclusion

Changes in the IA's remuneration guidelines are rarely dramatic from year to year, and companies normally only need address changes when they have a new policy or share plan.

However, noticing the direction of travel is important for any company. Here it does seem as if the degree of prescription that has risen in the last few years may now be falling back – in line with general listed company requirements across the piece in the UK.

For some, the test is whether the changes will make the UK compete as a listing venue and allow remuneration of overseas recruits and managers.

However, for the many smaller listed but UK focused companies, who are not in the main line of sight of proxy agencies but who still use the guidelines as a benchmark, the main change to note is definitely the more accommodating tone.

To discuss this further please contact Nicholas Stretch or Grace England.

Authors



Nicholas Stretch

Partner, London

T: +44 20 7809 2773

E: nicholas.stretch@shlegal.com



Grace England

Trainee solicitor, London

T: +44 20 7809 2498

E: grace.england@shlegal.com