SLAUGHTER AND MAY/

CLIENT BRIEFING

OCTOBER 2024

THE IA'S UPDATED PRINCIPLES OF REMUNERATION

QUICK LINKS

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On 8 October 2024, the Investment Association ('IA') issued an update to its existing Principles of Remuneration (the 'Principles'). The update re-iterated that the Principles are not prescriptive rules, but guidelines seeking to foster good practice and alignment with investor expectations. Therefore, companies can diverge from the Principles as required, in favour of bespoke remuneration frameworks which are better suited to their unique business needs. The IA recommend that a comprehensive explanation is provided to shareholders for any divergence.

ENGAGEMENT WITH SHAREHOLDERS

Throughout, the Principles encourage companies to adopt a remuneration framework which is most appropriate to their business and to explain to shareholders how the framework aligns with the long-term interests of the company. Shareholder consultations are recommended when a company is proposing material changes, such as implementing a new share plan or substantially changing performance metrics. The Principles have clarified the purpose of these discussions, which is not to seek approval from shareholders, but to provide both the company and shareholders with a forum for transparent two-way dialogue on remuneration issues. At the end of the process the remuneration committee should send a letter to consulted shareholders outlining its final proposals and the rationale behind them. Remuneration committees are encouraged to describe this consultation process in their remuneration report, to allow all shareholders to understand how the company's proposals have evolved in light of shareholder feedback.

BENCHMARKING

The Principles promote remuneration policies which clearly link pay to performance and are accompanied by a clear rationale as to how they align with the company's goals and talent requirements. The IA continues to consider that the use of benchmarking on its own to justify increases in remuneration is not appropriate, as it can lead to a ratchet effect in the market. The Principles now also explicitly state that shareholders expect the identity of benchmark comparators to be disclosed with an explanation of their selection.

HYBRID PLANS

Building on the IA's letter update published on 23 February 2024, the Principles recognise that 'hybrid' LTIPs may be suitable for certain companies, in particular those which have a significant US footprint and/or compete for global executive talent. Hybrid plans consist of: (i) a performance share component, and (ii) a restricted share component, which is subject to ongoing service but not stretching performance conditions. While the restricted share component should be discounted to reflect its certainty, the 'typical' 50% discount may not be appropriate in all circumstances, depending on company circumstances and the performance measures being replaced. Significantly, the IA Principles state that the vesting period of hybrid plans should be at least five years, with no accelerated vesting or early release (subject to a clear explanation for any different approach). This is a significant contrast to the US executive pay landscape, in which annual vesting of restricted shares is routine.

DILUTION LIMITS

The IA relaxed its guidelines on dilution limits by removing the 5% dilution limit for discretionary incentives – although in most cases we expect companies would also need shareholder approval to amend their existing plan rules to remove this cap. In addition, the overall dilution limit of 10% of issued ordinary share capital in any rolling 10-year period can now be increased with shareholder approval in exceptional circumstances, such as a high growth company that has recently listed on the stock exchange. We would expect this to be of most interest to smaller companies.

ANNUAL BONUSES AND SHARE OWNERSHIP

The IA Principles now state that mandatory deferral periods for annual bonuses can be reduced if the remuneration committee determine that the executive has met share ownership guidelines and malus and clawback provisions apply. The benchmark for setting executive share ownership guidelines should be the same as the long-term incentive grant size.

MALUS AND CLAWBACK

The guidance around malus and clawback, a continuing area of focus, confirms that shareholders expect triggers to be disclosed, in line with the new requirements of the 2024 UK Corporate Governance Code, and reminds remuneration committees that executives need to agree to these provisions to ensure enforceability.

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