INVESTMENT ASSOCIATION: UPDATED PRINCIPLES OF REMUNERATION ARE HERE!

The long-awaited IA principles of remuneration were published on 8 October 2024. As previewed in their letter to RemCo Chairs earlier this year, the IA have followed through on their promise to simplify the principles, with more emphasis on companies having the freedom to adopt remuneration policies and structures appropriate for them.

There are now 3 overarching, simplified principles, and a new emphasis on linking pay to performance. These are still supported by a re-structured guidance section.

We have summarised the key themes and changes below.

1. Key themes

a) **Guidance not rules:** Emphasis on the principles being guidance, 'not prescriptive rules' and focus throughout on the need to balance shareholder expectations with flexibility to pay appropriate remuneration that allows a company to attract, retain and motivate talent.

b) **Flexibility:** particular provisions have been softened and allow for more **flexibility provided that the company can explain why their different approach still satisfies the rationale.**

For example: the discount for a time-based award (RSP), as compared to a performance-based award: 50% is now just a 'typical' discount as opposed to minimum discount.

c) **Market practice:** updated to reflect current market practice.

For example: new section on hybrid plans, a recognition of the impact of the US market on pay levels and old sections on matching shares, joint ventures, option valuation deleted.

d) **Disclosure and shareholder engagement:** for flexibility to work, shareholders must engage so IA has included more expectations on when and what a company should disclose and engage. There is a repeated focus on disclosing sufficient, quality information in good time to shareholders.

For example, companies should engage with shareholders before discretion is exercised and disclose details on any consultation process.

2. Specific areas – some key changes include:

a) **Timing of grant and life of plan:** the 42-day grant restriction is now explicitly limited to grants to executive directors and excludes all-employee plans and the ten-year limit on a plan life now excludes all-employee plans.

b) **Bonus deferral:** if an executive director has met their shareholding guideline, there can be a reduction in level of deferral, as long as malus and clawback still apply.

c) **Dilution limits:** the 5% limit for new shares issued in a rolling 10-year period for discretionary plans has been deleted but the 10% limit remains, although there is an acknowledgement that there may be an exception for high growth companies.

d) **Shareholding guidelines:** long-term incentive grant size is now specifically drawn out as being the suitable benchmark for the minimum shareholding requirement.

Comment:

There has been a debate running in the market for some time now on balancing shareholder expectation with a need for more flexibility and managing the disparity in pay between executives and the wider workforce. As we have flagged before here, genuine concerns exist around recruitment and retention of chief executives of international businesses, where the talent pool is small and competition from non-UK companies is significant.

Updating the principles to balance all of this was always going to be a difficult task for the IA. They appear to have been very conscious of this debate, and the changes made to the principles demonstrate how investor sentiment towards executive pay in UK listed companies is evolving, recognising that the UK needs to be an attractive place to list and work, particularly compared to the US.

Overall, the IA have made good progress to reflect this balance, with the increased focus on flexibility and engagement. The changes made are not as seismic as some were perhaps hoping as there are still several prescriptive provisions, but the softening of these provisions and the introduction of more flexibility should be viewed as a positive.

For the 2025 AGM season, companies must be prepared to engage with shareholders early and transparently if they want shareholder support on any non-standard arrangements and shareholders must make time to listen.

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