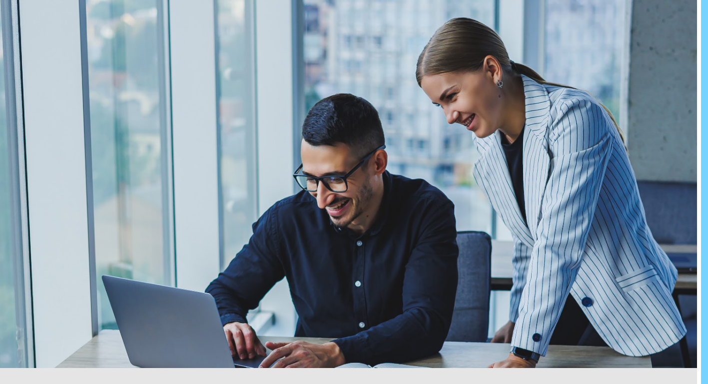
The Investment Association's Principles of Remuneration 2025

October 2024

Principles of Remuneration 2025

In October 2024 The Investment Association (IA) published its long awaited update to the Principles of Remuneration (Principles).

The update marks a significant development in the Principles and there are several important changes that UK listed companies should be aware of, particularly as the annual reporting season is fast approaching.



The updated guidance is based on three overarching principles:

Remuneration policies should promote long term value creation through transparent alignment with the board's agreed corporate strategy.

01

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 benefit of material stakeholders.

02

Remuneration policies should seek to deliver remuneration levels which are clearly linked to company performance.

03

Overview

The updated Principles follow the IA's letter to Remuneration Committee Chairs on 23 February 2024, and signals a change in the IA's thinking to reflect the competitive landscape in the UK and evolving investor expectations.

The Principles do not seek to prescribe any particular remuneration structure or quantum and are intended to assist in the making of informed and responsible decisions that are consistent with the long term interests of the company and its shareholders.

The language used in the updated Principles moves away from a prescriptive tone towards more nuanced, flexible language. This encourages companies to shape their remuneration approach to align with their own journey, market and strategic objectives.

Indeed, the Principles recognise that a "one size fits all" approach is not appropriate. This in turn places an emphasis on the need for companies to provide clear rationale for their decisions.

Simplicity and alignment of pay outcomes with wider shareholder outcomes and companies' long term strategy remains key.

A clear link between pay and performance remains a central theme.

The updated Principles encourage a proactive, constructive and transparent approach for shareholder engagement on changes under consideration, and emphasise the importance of early dialogue with investors to allow time for feedback.

The Principles refer to situations where a company is "deriving significant revenue from particular markets such as the US or competing for talent globally", which allows companies to consider how competitive their pay is in comparison to pay in other markets internationally.

Given this, it is expected that this year's round of remuneration policies may see additional investor and press scrutiny.

Remuneration Philosophy & Structure

Remuneration Committee

The Principles recommend that non-executive directors, particularly those serving on the Remuneration Committee, should oversee executive remuneration. However, the entire Board as well as the Remuneration Committee members, are expected to have sufficient expertise and experience of the company to fully understand its strategy, and have built effective relationships with other directors, management and shareholders.

There is a shift to a more practical approach in the engagement with stakeholders and no longer a specific reference to the requirement for the Committee to respond to a significant vote (>20%) against any remuneration resolution which would place them on the IA's Public Register.

Remuneration Committees should have sufficient information and access to independent advice in order to allow them to make informed and independent decisions given the individual circumstances of the company. They should engage proactively and constructively with shareholders and other material stakeholders and take into account their views and expectations when making decisions.

The Remuneration Committee should select a remuneration structure which is appropriate for the company's circumstances and business and focuses on delivering its longer-term strategy.

Simplicity is encouraged. An effective remuneration structure promotes a clear line of sight between individual and company performance and remuneration outcomes. Long-term alignment between executives and shareholders is important.

Shareholder Consultation

Companies are encouraged to undertake shareholder consultation, especially before making any material strategic remuneration decisions, such as introducing new incentive schemes, substantially changing performance metrics or materially increasing remuneration levels. The purpose of shareholder consultation is not to seek approval or endorsement, but to understand the views and expectations of shareholders for the business.

Shareholder consultations are an opportunity to engage in open and transparent dialogue, ensuring that all perspectives are considered and valued.

The process is expected to be disclosed in the remuneration report and companies are encouraged to disclose in their remuneration report how the consultation process was conducted, including the number of shareholders that were consulted and the resulting outcomes.

Further detail on Remuneration Packages

Levels of Remuneration

Basic salary is a core element of executive remuneration. Investors expect the basic salary of an executive to be reflective of the experience of the individual, responsibilities of the role and size and complexity of the company. Committees need to justify their salary decisions based on the global talent markets they are recruiting from, but not solely benchmarking data. If peer group benchmarking is used to justify any quantum changes, the identity and constituents of the peers should be disclosed.

Any new recruits with a higher salary than previous job holder would require explanation.

As set out in the UK Corporate Governance Code, pension contributions or payments in lieu of pension for executives should be aligned with those available to the workforce. The provision of additional benefits such as health and life insurance are an integral part of fixed remuneration. All benefits should be fully disclosed and explained.

A clear link between base salary and performance is still of significant importance, however, the report contains specific reference to where an organisation has a specific market presence in other regions, such as the US or where they are competing for talent globally.

Shareholders expect bonuses to be paid for demonstrable performance, based on robust, quantifiable targets that reflect the company's performance and implementation of the strategy. The rationale for the selection of performance metrics, including any strategic key performance indicators (KPIs), needs to be disclosed by the committee, with an explanation of how it relates to value creation.

The new Principles remove the deferral requirements for any STI that is above 100% salary. It also allows more flexibility to use non-financial measures and qualitative targets provided clear rationales for how these are measures and aligned with shareholder and material stakeholder interests are given.

Share plans

Shareholders need to understand the philosophy that the Remuneration Committee adopts towards long term incentivisation and how that approach supports the implementation of the strategy and value creation.

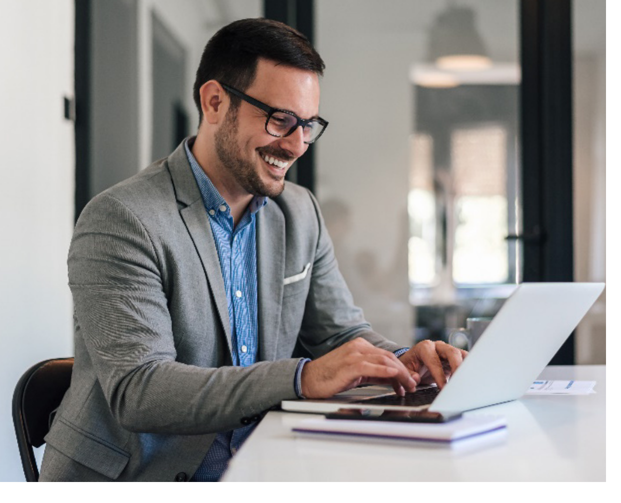
Performance Share Plan (PSP)

The design and structure of the Performance Share Plan (PSP) should be appropriate for the company's long-term strategy and reflect its specific circumstances.

The guidelines specifically mention that share buyback impacts should be excluded from the valuation of Earnings Per Share (EPS) when setting and assessing the performance.

Restricted Share Plan (RSP)

Shareholders continue to expect a discount when switching from PSP to RSP, however with a 'softening' discount ratio. In the previous guideline shareholders expect 'at least' 50% discount whereas in the new guideline this is positioned as 'typically a discount of 50%'.



Further detail on Remuneration Packages (cont.)

Hybrid Scheme

The new guideline allows a Hybrid Scheme – which is typically a combination of performance shares and restricted shares (but could also be a combination of other short or long-term incentives). Shareholders recognise that hybrid schemes are sometimes used by companies that have a significant US footprint and/or compete for global talent and would expect committees to explain why the hybrid model is preferred over a single structure.

The guideline states that companies moving from a single plan to the Hybrid Scheme should consider the discount guidance provided for moving from PSP to RSP (i.e. typically at 50%). The vesting period is expected to be at least five years with no accelerated vesting or early release.

Value Creation Plans (VCP's)

Remuneration Committees continue to be encouraged to exercise caution and diligence when designing and implementing a VCP. Early engagement and constructive consultation is advised for companies considering introducing a VCP. The guidelines state that the VCP needs to reward exceptional performance that creates substantial and sustainable value for shareholders and material stakeholders over at least a five-year period.

Dilution

The 5% dilution over **10 years** has been removed after a long time, although the **10% dilution** in **10 years** still remains, the guidance does state exceptions may be considered but this may be challenged by individual shareholders.

The guideline also introduced a **5%** limit of the issued ordinary share capital for any Employee Share Ownership Trusts (ESOTs).

Malus, Clawback & Discretion

There is an increased emphasis on Malus and Clawback and the use of Discretion. When exercising discretion, the Remuneration Committees are expected to consider broader contexts, and the long term interests of the company, its shareholders and material stakeholders. In addition, positive discretion is allowed to avoid penalising executives for factors beyond their control or influence.

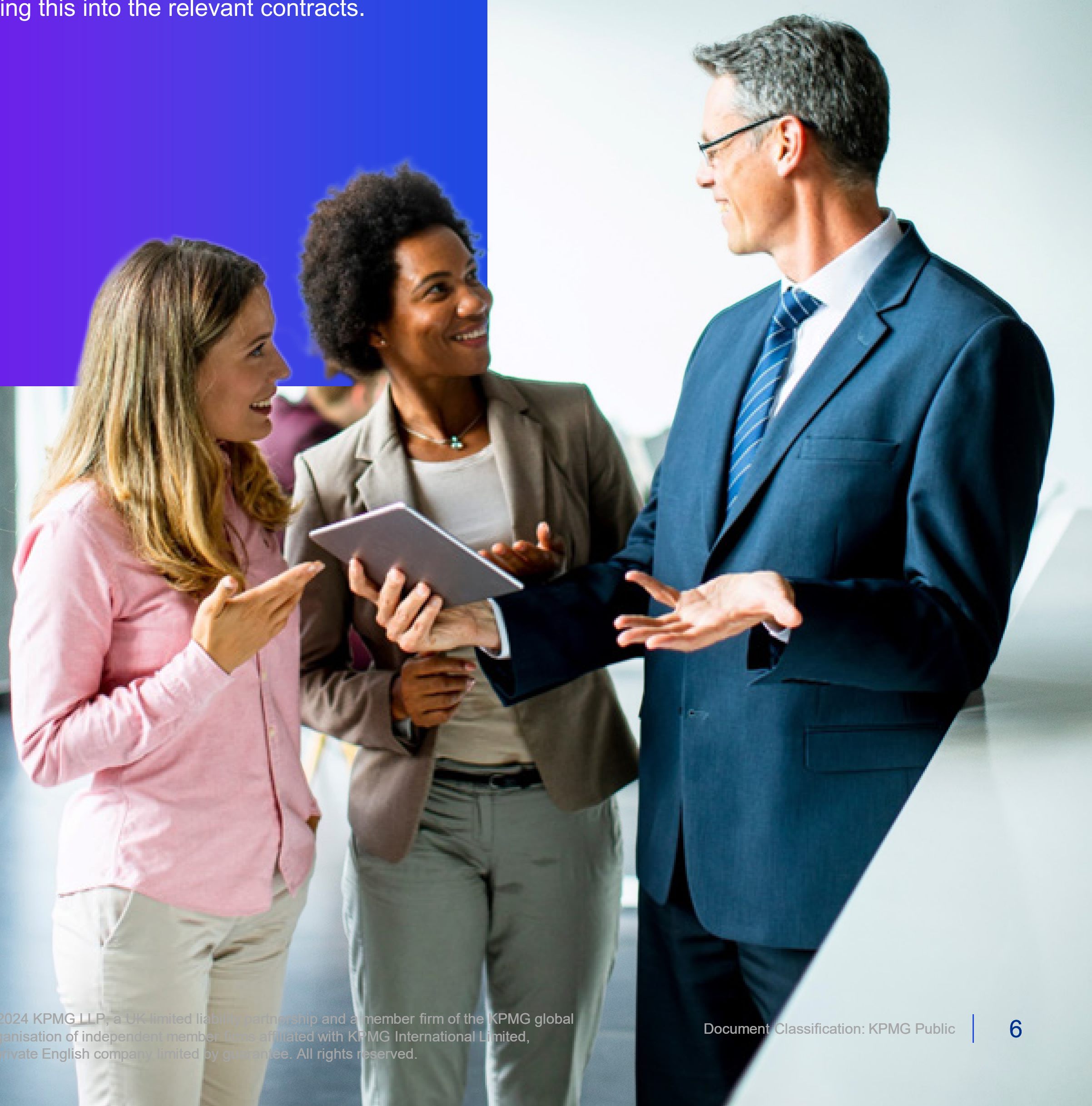
Use of ESG Measures

Where ESG measures are used in LTI, they should align to the ESG measures in incorporated in the company strategy. These measures should be quantifiable and appropriately stretching. The pay out of any LTI based on ESG criteria needs to provide demonstrable performance outcome achieved and value creation.

Shareholding Guidelines

The guidelines states that the minimum shareholder requirement should be aligned to the LTI grant size.

The guideline supports the UK Corporate Governance Code requirement to develop a formal policy for post employment shareholding. The committee should ensure the enforceability by incorporating this into the relevant contracts.



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- Pay structuring and benchmarking
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- Legal, regulatory and pay governance
- Design, implementation and on-going operation of incentive plans
- Corporate transactions
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