23 February 2024

Dear Remuneration Committee Chair,

RE: Investment Association Principles of Remuneration

This letter is to provide an update on the IA's Principles of Remuneration and emerging views on the issues which are likely to be important to IA members during the 2024 AGM season.

The IA's Principles of Remuneration are not rules, but guidelines that aim to foster good practice and align with investor expectations. They are designed to be flexible and adaptable to the unique circumstances of individual companies. Companies should choose the remuneration structure most appropriate for their business, strategy and choose the remuneration approach which the directors consider will deliver business performance and long term returns to shareholders.

In the last year, there has been considerable debate on the competitiveness of the UK listing environment and UK remuneration practices. IA members want a competitive UK listing environment that attracts appropriate companies to list and operate in the UK. As a fundamental principle, to support higher potential pay levels, there needs to be clear alignment between pay and performance.

We appreciate the valuable feedback we received from Remuneration Committees and companies during 2023 including those that contributed to our roundtables in September. IA members are committed to working collaboratively with Remuneration Committees to achieve the right remuneration structures for companies, executives, stakeholders, shareholders and ultimately pension savers and the wider UK economy. Given the views we have heard, we are conducting a more fundamental review of the Principles of Remuneration which will be published later in 2024, reflecting the evolving member expectations on remuneration and feedback from companies. In the interim we set out the issues we will be considering during the review and main themes for 2024.

Review of 2023

Looking back on the 2023 AGM season, members recognise that Remuneration Committees responded effectively to investor expectations particularly on the Cost-of-Living crisis and windfall gains.

Shareholders were supportive of the approach that companies took to the inflationary environment focusing salary budgets on lower paid employees and recognising the impact of significant salary increases on total remuneration for executives. There was strong alignment between shareholders and committees on these issues, with remuneration reports providing detailed information on the how all employees were treated, which generally led to good support from shareholders on remuneration reports in 2023, with the number of pay resolutions receiving significant dissent falling by 18% compared to 2022. Whilst inflation has fallen significantly in the last year, it is still relatively high, so investors would expect companies to remain cautious in 2024, being clear as to how they have considered salary increases for executives in the context of all-employee salary increases, the impact on total remuneration for the executives and putting executive remuneration in the context of the stakeholder experience.

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Similarly, members observed Remuneration Committees considering the treatment of LTIP grants made at the onset of the pandemic. During the year, Remuneration Committees provided appropriate disclosures and rationales for how they considered if there had been windfall gains and, when appropriate, members noted that discretion was used to reduce vesting outcomes.

Competitiveness of UK remuneration practices

During 2023, there has been considerable debate on the competitiveness of remuneration in the UK and the impact of investor expectations on remuneration in the UK compared to other jurisdictions.

Our members are determined to ensure that the UK is a competitive place to list and remain listed as well as to do business, this will bring benefits to our members, their clients and ultimately the UK economy. Therefore, they welcome the debate and are keen to understand the key issues which need to be considered. Shareholders expect a clear link between pay and performance and want executives to be paid for delivering returns to shareholders, but companies and asset managers do not operate in isolation. There are a number of competing pressures which need to be considered when discussing UK remuneration practices.

Through successive corporate governance initiatives there has been a clear expectation from Government that shareholders play a role in policing executive pay. This has led to shareholders receiving more detailed disclosures and voting rights with an anticipation that they will ensure a stronger link between executive pay and company performance. Added to this, asset managers are managing investments on behalf of their end-clients that include individual savers and pension funds. Whilst focused on long term returns of their funds, executive remuneration attracts interest from pension funds and they have explicit views on the structure and quantum of remuneration in the companies in which their savings are invested. In some cases, these expectations are continuing to evolve, with some asset owners are becoming more vocal on their hopes especially relating to fair remuneration, in work poverty and social inequalities. This creates debate between pension funds and their asset managers. There are also increasing number of international investors in the UK, which is leading to a diverse range of differing expectations on remuneration. There are also wider stakeholder perspectives such as those of the company employees, public and political sentiment, often influenced by the media which need to be considered.

In September 2023, the IA met with nearly 100 companies in the FTSE 350 to discuss our Principles of Remuneration and their views on the competitiveness of remuneration in the UK. It is clear from these conversations that there is no consensus on the one single issue which needs to be resolved to improve the competitiveness of UK remuneration. Instead, three themes were highlighted by companies:

- **Need to increase pay opportunities through LTIP grant levels** - some companies highlighted the challenges in attracting US executives and compete in the US market, particularly for the UK's largest companies and those that have a significant US presence or revenues. They felt there was a need for more flexibility to offer higher LTIP awards to create a competitive remuneration structure.
- **Use of Hybrid schemes** – some companies want to use hybrid schemes which incorporate both performance and restricted shares, these global companies are able to use such schemes in the US and other jurisdictions and feel such structures should be used for their executives.
- **Requirements in the UK Corporate Governance Code reduce the perceived value of remuneration** – the UK Corporate Governance Code has introduced a number of requirements which extend the long-term perspective of directors through remuneration such as increased holding periods, shareholding guidelines, post-employment shareholding guidelines and malus and clawback. Individually, they are accepted as a means to increase the long-term alignment of executives and shareholders but in aggregate there is a view from some companies that the perceived impact on the value of remuneration received is disproportionate.

We understand that a small number of companies are currently consulting with their shareholders on the impact of these issues and shareholders are willing to consider proposals on quantum and hybrid schemes given the individual circumstances of these companies. Investors will assess proposed changes 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.

A Review of the IA Principles of Remuneration

The IA's Principles of Remuneration are principles, not rules. They set out the important issues which investors consider when evaluating a company's remuneration structure but also allow companies to understand the approach which is most likely to receive support from shareholders. Companies should choose the remuneration structure most appropriate for their business, strategy and choose the remuneration approach which the directors consider will deliver business performance and long term returns to shareholders. This should be achieved through engagement with shareholders so there is a good understanding by shareholders how this alignment is achieved. Underpinning this is the first principle:

"Remuneration policies should promote long-term value creation through transparent alignment with the agreed corporate strategy."

During our engagement with companies, companies stated that they valued the Principles of Remuneration, which are helpful for companies as they provided the aggregate views of shareholders and set appropriate expectations for companies. There has been continuity of the Principles over many years, which helped companies plan and respond to them. However, companies raised that the guidance which underpins the Principles can be simplified to remove prescription and duplication of the UK Corporate Governance Code.

In light of the feedback, we received from companies and the evolving views of our members on quantum and hybrid schemes we will be updating the Principles of Remuneration in 2024 to simplify them, ensure that they are supporting a competitive market and delivering the right outcomes for both shareholders and their underlying clients. We will ensure that current market practice and expectations of our members lead to the evolution of the Principles, rather than the Principles dictating market practice. We will keep Remuneration Committees updated on our progress.

Priorities for 2024 AGM season

We anticipate these productive conversations on remuneration practices in the UK to be a key focus for 2024, as well as how Remuneration Committees are adapting to the inflationary environment. In addition, in the current market environment committees should demonstrate how the remuneration outcomes are appropriate given the performance achieved during the year, as well as how the committee has set targets for 2024.

We are optimistic that the 2024 AGM season will be a productive and constructive one, as we continue to work together to ensure that remuneration policies and practices are aligned with the long-term interests of shareholders and their underlying clients. If you need any further details on the Principles of Remuneration, please do not hesitate to contact me or one of the IVIS team.

Yours faithfully,

Andrew Ninian
Director, Stewardship, Risk and Tax