CLIFFORD CHANCE

Incentives News

November 2015

Updated IA Remuneration principles - Headlines

The Investment Association (IA) published its updated Principles of Remuneration yesterday, together with its annual letter to remuneration committee chairmen highlighting areas of concern for shareholders. There is little substantive change to the principles themselves but a number of points of note for UK listed plcs in the letter, particularly ahead of AGM season.

Here are the headlines….

PRINCIPLES

There are two substantive changes to the principles:

1. **LTIP holding periods**

   There has been a change of emphasis on LTIP holding periods. Instead of remuneration committees "considering" the use of post-vesting holding periods, the principles now state that holding periods are expected by investors.

   Following Fidelity's lead, the IA states that the total vesting and holding period "should" be **at least 5 years**. (This is already the case for the majority of FTSE 350 companies, certainly for executive directors).

2. **Bonus target disclosure**

   The IA notes in its letter that retrospective disclosure of bonus targets in directors' remuneration reports (**DRR**) has improved but remains concerned that some companies are relying on the blanket of "commercial sensitivity" to avoid or delay disclosure.

   The 2015 principles are more explicit than the 2014 principles on the extent to which companies can rely on the commercial sensitivity argument.

   Whilst the 2014 principles simply stated that reliance on commercial sensitivity should be exceptional and justified, the 2015 principles require companies to explain to shareholders (a) the circumstances justifying non-disclosure on grounds of commercial sensitivity and (b) when disclosure will take place in future.

   Failure to fully disclose bonus targets or commit to full disclosure at a specified time is likely to lead to a **Red Top** of the DRR or an **Amber Top** if no disclosure date is given. This applies to companies with year ends on or after **1 December 2015**.

LETTER

The letter sets out areas which the IA says its members have asked be re-emphasised to companies:

1. **Salary increases**

   Investors are concerned by the level and frequency of salary increases, especially those above inflation. The IA notes an increasing number of investors are of the opinion that executive directors should not receive any regular salary increases.

   Salary increases will continue to be scrutinised and companies should have a "clear and explicit rationale" for any increase to director and senior executive salaries.

2. **Joiners and leavers**

   Remuneration arrangements for new joiners and leavers at senior levels have long been a source of concern for investors.

For new joiners, there will be continued scrutiny of recruitment and buyout awards and there is particular concern about any attempt to re-grant or re-price recruitment awards where a company has fallen in value.

In relation to leavers, the IA reiterates that remuneration committees must take a robust approach when making decisions on remuneration for leavers, particularly where they deem someone to be a good leaver who would not automatically fall into that category.

Companies should also give a "**full justification**" of why they consider someone should be a good leaver. This will give rise to some interesting debates for remuneration committees on the leaver treatment of executives who either resign or leave by mutual agreement.

3. **Service contracts**

The IA notes that the majority of members remain in favour of **12 month notice** periods. They are though keen to see the **same notice period** for both the company and the director.

One point of interest for any companies putting in new director contracts is that the IA expects **new contracts** to allow companies to withhold PILON payments during any regulatory or disciplinary investigation.

4. **Pensions**

Members are concerned by large pension increases for directors and want to see simpler arrangements which are more in line with those of other employees.

Looking ahead to **2016**, the IA trailed that its recently formed Executive Remuneration Working Group is currently working on proposals for "**a radical simplification of executive pay**" which are expected to be published in spring 2016.

Any questions?

Please get in touch with your regular Incentives team contact if you would like to discuss.

Contacts

Sonia Gilbert
+44 20 7006 2041

Liz Pierson
+44 20 7006 2817