PAY IN UK LISTED COMPANIES: INVESTMENT ASSOCIATION PAY EXPECTATIONS FOR 2022 PUBLISHED

The Investment Association ('IA') has published its Principles of Remuneration for 2022 along with a letter for Remuneration Committee ('RemCo') Chairs highlighting its key priorities.

The impact of Covid-19 remains a focus, with the IA acknowledging the leadership that RemCos and executives have shown in responding to the pandemic. Disclosure, pay increases and linking ESG measures to remuneration structures also continue to be hot topics for investors.

Here's a summary of the key points for UK listed companies (further detail can be accessed here).

Covid-19

Consideration of the wider stakeholder experience when determining pay outcomes will continue to be a key investor expectation as the pandemic evolves. In particular, companies that have taken and not repaid government support are reminded that they should show restraint in making pay decisions and are not expected to award bonuses. The IA has also confirmed that its additional guidance on Covid-19 remains effective for the upcoming AGM season.

Environmental, Social and Governance ('ESG') issues

Where companies incorporate ESG risks into their long-term strategy, the IA expects these factors to be reflected in pay structures and performance conditions. Companies are reminded that ESG metrics should be quantifiable and clearly linked to company strategy, with the rationale for the selected ESG metrics and targets disclosed. The IA recognises, however, that incorporating ESG into strategy and pay structures will take time. Where companies have incorporated ESG into their long-term strategy but have not yet reflected them in their pay structures, an explanation will be needed on the approach they intend to take in the future.

Restricted Share Plans ('RSPs') and Value Creation Plans ('VCPs')

Given the increase in use of RSPs and VCPs it is not surprising that the IA has issued further guidance in this area:

The IA has previously been clear that where a company is moving from an LTIP to a RSP a discount rate of at least 50% of the normal grant level is appropriate. However, where there is a risk of a windfall gain, this discount may be insufficient if there has been a substantial fall in the share price since the last LTIP grant. In such circumstances, companies should scale back awards further at the time of grant.

As VCPs are not considered 'standard' arrangements and should only be used where they are appropriate to the specific circumstances of the company, a clear rationale for their adoption should be provided for investors. VCPs should also have an overall cap on shares and the total value of awards. Given the significantly increased maximum opportunity under a VCP, targets need to be substantially more stretching and sufficiently robust. A clear rationale will also be needed as to why the performance targets and percentage of any value created above a predetermined hurdle rate are appropriate.

Pay increases

Investors continue to closely scrutinise how increases to salary or variable pay are justified and expect RemCos to show restraint in relation to overall quantum. Any potential increases to the level of salary in particular should be considered in tandem with the effect this will have more broadly, as increases in salary are likely to have a ‘multiplier effect’ on the overall level of remuneration.

Where any increases for executives are above those for the wider workforce, RemCos will need to explain the background to this and justify that decision. The IA is clear on this topic that justifying an increase solely on the basis that it reflects market norms or benchmarking is not appropriate.

Windfall gains

The IA Principles have been updated to reflect investor preference for RemCos to reduce awards at the time of grant in circumstances where share prices have fallen and windfall gains are an issue, rather than relying on discretion when awards vest.

Pensions

As previously set out by the IA, contribution rates for incumbent executive directors should be aligned to the contribution rate available to the majority of the workforce, by 31 December 2022.

As was the case for 2021, where a directors' remuneration policy does not state that new directors will have pensions aligned with the workforce or where there is no credible action plan in place to align executive pensions with the workforce, IVIS will 'red top' the remuneration report.

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CC Comment

The updates to the IA Principles should not hold many surprises for most UK listed companies.

As was the case for 2021, the complexity and uncertainty of Covid-19 remains a focus with the clear expectation that investors will continue to look closely at annual disclosures. In particular RemCos will be expected to clearly set out how they have taken the broader shareholder and stakeholder context into consideration when making their pay decisions. Any increases to executives salary or variable remuneration will also need careful thought and a clear rationale. As has been the case throughout the pandemic, any serious deviations from the IA Principles in this regard will likely expose a company to public censure.

Windfall gains remain an area of scrutiny. The clear steer towards scaling back awards at the time of grant in order to deal with a fall in share price, rather than relying on a more general discretion when awards vest, will likely be a notable change. Companies throughout the pandemic have typically emphasised the importance of RemCo discretion on vesting in dealing with any such windfall gains and may want to revisit that approach.

Given global events like the pandemic, climate emergency, economic uncertainty and social justice issues it also comes as no surprise that investors remain focussed on ESG. The flexibility in relation to embedding ESG factors into pay will be welcome, with the IA (as with other investor bodies) stopping short of a more prescriptive or 'one size fits all' approach. For more information on this topic, our global guide to ESG and pay can be found here.

Companies will also welcome the additional guidance on VCPs, given general shareholder scepticism and scrutiny of these plans. For any companies seeking to adopt VCPs, a robust justification and clear rationale tied back to the specific circumstances of the company will be crucial to get shareholders over the line.

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