THE INVESTMENT ASSOCIATION

THE IA'S PRINCIPLES OF REMUNERATION

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About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Foreword

IA members are significant investors in UK listed companies, they want to invest in companies that deliver long-term value for their shareholders. This will lead to returns to their clients, pension and retail savers. It will also contribute to economic growth and increased prosperity for the wider economy. Executive remuneration can play an important role. When aligned with long-term company success, remuneration serves to incentivise, reward and retain executive directors that generate value, thereby promoting growth in the UK.

IA members want a competitive UK listing environment that attracts companies to list and operate in the UK. During the last year, there has been significant debate on the role, structure and approach to executive remuneration in the UK market and its impact on UK listed companies. Investment managers are balancing concerns of global competitiveness and talent retention with the expectations placed on them by successive governments' corporate governance initiatives for shareholders to vote on executive pay. As well as the requirements of their clients, with some pension funds having explicit views on the structure and quantum of remuneration in the companies in which their savings are invested. Executive pay practices have an impact on wider societal trends such as wealth disparity, and public trust in business. Investment managers are mindful of these issues when they engage and vote on executive pay.

Throughout the 2024 AGM season we have seen global companies come forward with a range of diverse proposals in terms of structure and quantum. Shareholders have generally engaged with those companies on a constructive and supportive basis which has led to shareholders supporting new proposals. Our members have been reviewing these proposals on a case-by-case basis, looking at the merits of the arguments presented by the companies and assessing whether the proposals will help to incentivise long-term performance while supporting a clear link between pay and performance.

In our letter to remuneration committee chairs in February 2024, we indicated that we would conduct a review of the IA Principles of Remuneration and guidance to reflect the evolving practices in the market and the expectations of our members, as well as to simplify them. It is clear, that some stakeholders have considered our previous Principles and guidance to be rules that must be followed. We continue to reiterate that these revised Principles are guidelines, not rules, seeking to foster good practice, alignment with investor expectations and support a competitive market environment.

The Principles do not seek to prescribe any particular remuneration structure or quantum and are intended to assist remuneration committees in making informed and responsible decisions that are consistent with the long-term interests of the company and its shareholders. This document reflects the perspectives of shareholders who acknowledge the unique circumstances of each company and the variety of remuneration frameworks that may be suitable. It encourages companies to adopt the remuneration structure most appropriate for their business, corporate strategy and performance, and to explain how this aligns with the long-term interests of the company and its shareholders. Investors will analyse the suitability of remuneration proposals on a case-by-case basis, making it crucial for remuneration committees to engage with their major shareholders to understand their views and provide clear explanations why the remuneration policy and approach is right for their business, company strategy and shareholders. IA members will continue to monitor how this flexibility is used to ensure it leads to the right results for executives, companies, shareholders and ultimately investment managers' clients.

The IA Principles of Remuneration build on the remuneration expectations set out in the UK Corporate Governance Code and so should be read in conjunction with them. These Principles were approved by the IA's Investment Committee which comprises Chief Investment Officers.

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Principles of Remuneration

OVERARCHING PRINCIPLES:

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

2. 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.

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

These overarching objectives can best be met by remuneration committees considering the following factors, collaborating with shareholders and demonstrating alignment between remuneration and value creation and protection.

REMUNERATION COMMITTEES

- Non-executive directors, particularly those serving on the remuneration committee, should oversee executive remuneration. However, the entire Board needs to be appropriately engaged in remuneration decisions. To make the best long-term decisions, the remuneration committee members, especially the chair, 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.
- Remuneration committees should have sufficient information and access to independent advice to allow them to make informed and independent decisions given the individual circumstances of the company.
- Remuneration committees should engage proactively and constructively with shareholders and other material stakeholders and take into account their views and expectations when making decisions.
- To allow shareholders and material stakeholders to understand the company's approach to remuneration, remuneration committees should disclose the key decisions taken and the reasons for those outcomes.

REMUNERATION PHILOSOPHY AND STRUCTURES

- 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, the remuneration committee should outline the mechanisms through which this long-term alignment is achieved.
- Dilution of shareholders reduces the value of end-savers' shareholdings; appropriate dilution limits should be adhered to by the company.

LEVELS OF REMUNERATION

- Investors analyse levels of remuneration on a case-by-case basis, acknowledging that there is no one-size-fits-all approach. Remuneration committees are expected to outline why the remuneration levels and maximum opportunities are appropriate for the specific circumstances of the company and its material stakeholders, including the workforce.
- The level of remuneration needs to ensure appropriate outcomes for both shareholders and executives, whilst being able to attract, retain, and motivate talent.

Guidance for Remuneration Committees

Introduction

The purpose of this guidance is to assist remuneration committees in applying the IA's Principles of Remuneration. It seeks to foster a constructive dialogue and engagement between companies and their shareholders on executive remuneration matters and ensuring good outcomes for companies, executives, shareholders and other stakeholders. Shareholders expect that committees will choose the remuneration structure which is most appropriate for their business and which helps to deliver the company's strategy and creates value for shareholders and other material stakeholders.

The Principles and supporting guidance aim to provide a framework within which companies can design remuneration policies and practices that suit their specific needs and circumstances, while also being responsive to shareholder expectations. This guidance outlines the commonly used remuneration structures and elements of pay, and highlights shareholder expectations for each of these. It is structured to set out the significance of each element of pay to investors, the outcomes they anticipate, and their primary structural expectations. By understanding the outcomes that investors are seeking, committees can understand the views of investors, which is particularly important as it helps them align their strategies with investor expectations, especially if they choose to take a different approach.

This guidance reflects the perspectives of shareholders, IA members that invest in companies on behalf of their clients and seek investee companies to create long-term value for their shareholders. Investors acknowledge that each company is subject to different circumstances, therefore there are differing remuneration frameworks which may be appropriate. Shareholders expect companies to choose the remuneration structure that best suits their business, helps deliver their strategy and creates value for them and other material stakeholders over the long term. This guidance should not be read as a prescriptive set of rules but rather an approach which is commonly accepted as appropriate for the majority of companies. Investors will take a case-by-case approach to analysing the suitability of remuneration arrangements. Therefore, it is important for remuneration committees to engage with their major shareholders to understand their views and provide clear explanations why the remuneration policy and approach is right for their business, company strategy and shareholders.

When companies opt for an approach that diverges from these guidelines, it is of mutual benefit if the remuneration committee provides a suitably comprehensive explanation. This will allow shareholders to understand the committee's thinking as to why a more bespoke approach is appropriate, helping them recognise why shareholders should support the approach in context, and allow them to justify their support to their clients. The explanation should also outline the steps taken to mitigate any potential risks associated with this approach. Such transparency ensures that shareholders can understand and ultimately support the company's remuneration framework.

This document is predominantly for companies with a main market listing but is also relevant to companies listed on other markets, such as AIM, or private companies.

Members continue to expect that, as a minimum, they will follow the requirements relating to remuneration in the UK Companies Act 2006, reporting regulations, the UK Corporate Governance Code and the UK Listing Rules. Where companies are not subject to these regimes, they should apply similarly high standards.

Shareholder consultation

One of the tools vital for ensuring a productive dialogue between companies and shareholders is consultation. Companies are encouraged to undertake shareholder consultation when needed but 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, which the company can consider when designing and implementing its remuneration policy.

When conducting shareholder consultations, it is important for companies to provide sufficient information on their proposals and their broader approach to the remuneration strategy, so that shareholders can give informed and constructive feedback on the proposed changes and the resulting pay structure as a whole. Shareholder consultations are an opportunity to engage in open and transparent dialogue, ensuring that all perspectives are considered and valued. We recognise that this inclusive approach needs to be reciprocated by shareholders to create a constructive exchange of ideas. To facilitate a constructive dialogue, committees should seek early engagement to provide shareholders with sufficient time to consider the proposals and offer meaningful feedback.

Different shareholders may have different perspectives and preferences on remuneration matters and therefore there is no one-size-fits-all solution. This requires companies to proactively listen to shareholders, especially those who express concerns or have voted against the remuneration policy or report previously. By doing so, companies can foster a mutual understanding and trust and enhance the quality and effectiveness of their remuneration practices. It is important for committees to disclose how they have taken shareholders' views into consideration.

At the end of the consultation process, it is best practice for the remuneration committee to send a wrap-up letter to the shareholders consulted, summarising the proposals as finalised and the rationale behind them. Companies are encouraged to disclose how the consultation process was conducted, including the number of shareholders that were consulted and the resulting outcomes, in their remuneration report, highlighting the main feedback received from shareholders and how the company has responded to it. This allows all shareholders to understand how the committee's proposals have evolved.

Levels of remuneration

The level of remuneration should be appropriate for the company's circumstances, taking into account the need to attract, retain and motivate talent and implement the corporate strategy. There should be a clear link between pay and performance, reflecting:

I. the achievement of both short-term and long-term objectives, and
II. the creation of sustainable value for shareholders and material stakeholders.

Committees need to disclose potential pay levels along with a clear rationale for how they align with the company's purpose, values, and strategic goals, and how they help attract, retain and motivate talent. If the remuneration of peers and peer groups are used to justify positioning, shareholders expect that the identity and constituents of these should be disclosed, and an explanation provided as to why their selection are appropriate. If the company is deriving significant revenues from particular markets such as the US or is competing for talent globally, the committee is encouraged to set out the impact of attracting global talent on the positioning of remuneration.

The use of benchmarking on its own to justify increases in remuneration is not appropriate, as it can lead to a ratchet effect in the market. The use of median pay as a benchmark can also create upward pressure on executive pay without regard to performance.

Committees are expected to consider the company's material stakeholders when setting remuneration levels and structures, such as the workforce. Taking into account pay across the organisation is encouraged, including a detailed analysis of pay across the wider workforce as well as the pay ratios between the CEO and the average employee, and the impact of any changes in pay policies or practices on employee engagement and retention.

Variable remuneration plans should be capped, with increases fully justified to shareholders and subject to consultation, where material. Shareholders would like to see how committees have chosen the balance between short- and long-term remuneration and ensured that the remuneration structure appropriately rewards short-term performance and delivery of long-term value.

Basic salary

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 talent markets they are recruiting from, but not solely benchmarking data.

Shareholders generally expect maximum increases in basic salary for executives to be in line with those awarded to the relevant wider workforce in their locality. Where there are exceptional circumstances that warrant higher increases, such as changes in role or scope of responsibility, shareholders expect committees to provide a strong rationale that supports their decisions.

Relatively small percentage increases in basic salary can lead to significant increases in total variable remuneration, especially when variable pay is expressed as a multiple of salary. Therefore, salary increases need to be evaluated with reference to the change in maximum potential remuneration that an executive director may receive as a result of the salary increase.

When appointing new executive directors, remuneration committees should consider the salary of the relevant predecessor. If a new executive director is recruited at a higher salary than the previous incumbent, shareholders expect this to be explained. Where new executives are appointed on a salary lower than their predecessor, shareholders would prefer to see any subsequent salary increases clearly linked to performance in the role, and ideally delivered over a number of years with the proposed approach disclosed to shareholders.

Pensions

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. IA members recognise that pension rates may differ across the company and expect alignment between the executive directors' pension contributions and the pension contributions awarded to the majority of the workforce. No element of variable pay should be pensionable.

Benefits

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. Where relocation benefits are provided to a new executive director, they should be fully disclosed on appointment with a clear supporting rationale and provided for a limited period.

Annual bonus

Annual bonuses are an important mechanism for incentivising and rewarding executives for achieving specific elements of the corporate strategy for the performance year. For shareholders, the annual bonus reflects the key targets that the board deems important for the year and wants to see accomplished.

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. If qualitative targets are used, shareholders expect the committee to provide a rationale on how these targets will be measured and how they align with the interests of shareholders and other material stakeholders.

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. Targets should be clearly linked to KPIs used by the company to describe performance in their results presentations and annual report. Committees should retrospectively disclose the target ranges for each performance measure, as well as the actual performance achieved and the resulting pay-out at the end of the performance period. This will enhance transparency and accountability, and enable shareholders to assess how pay outcomes reflect the performance of the individual and the company more broadly. Where targets are deemed commercially sensitive in a given year, they should be disclosed in the next remuneration report.

An explanation of how the bonus payout reflects the stakeholder experience during the performance year is expected by shareholders. This may include, but is not limited to, the payments to shareholders, the consideration of the workforce and customer experience, and wider sustainability risks and opportunities.

Shareholders want bonus payments to be consistent with the financial and non-financial performance of the company. Shareholders expect that good performance against non-financial/strategic metrics would normally translate into financial performance of the company. Therefore, in circumstances where bonus is payable for non-financial performance only, shareholders would like to understand the committee's rationale in support of such payments, including details on how the achievement of the non-financial metrics were evidenced and how pay outcomes are justified.

Where the management of material ESG risks is incorporated into the company’s strategy, targets relating to ESG risks and opportunities can be included in the annual bonus structure. They should be robust, transparent, lead to demonstratable performance and ultimately be linked to value creation.

Shareholders expect there to be long-term alignment between their interests and those of executives. One way to achieve this is to ensure that a portion of the bonus is deferred into shares supporting the achievement of shareholder guidelines and allowing the committee to apply malus or clawback provisions. A deferral policy which is aligned with the risk profile and time horizon of the business is expected by shareholders. If an executive director has met the shareholding guideline, shareholders may support a reduction in the level of deferral for the relevant director, provided that the committee still has sufficient ability to exercise malus and clawback provisions.

Shareholders are generally not supportive of performance being measured over a period less than a year or performance conditions being adjusted once set. Any adjustments to bonus target ranges or performance measures, whether due to changes in the business environment, strategic priorities, or exceptional circumstances, should be disclosed and thoroughly explained by the remuneration committee ahead of final implementation. In relation to acquisitions or disposals, performance conditions should be adjusted so that they are equally stretching.

Long term incentives

Long term incentives (LTI) in their various forms are a key component of executive remuneration, as they align the long-term interests of executives and shareholders, and provide an incentive for the delivery of the strategy and long-term value creation over a period in line with the strategic objectives of the company. Therefore, in line with the UK Corporate Governance Code, the normal performance/vesting period and holding period should be five years or more. Shareholders consider that the long-term performance or vesting period should be at least three years.

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. The committee may seek the achievement of specific performance conditions to demonstrate implementation of the strategy and long-term value creation (through performance share awards), or instead seek alignment through ownership and increasing the value of shares awarded (through restricted share awards) over the long term. In some cases, a combination might be appropriate. The company should explain why the chosen long-term incentive is appropriate for the company's individual circumstances, how it supports the implementation of the company strategy and aligns with wider workforce remuneration structures.

It is important that the remuneration committee has discretion to review the vesting outcomes of LTI awards and ensure that they are consistent with the underlying financial and share price performance of the company, individual contribution and conduct of the executive director, as well as the wider stakeholder experience. The committee should also have the ability to apply malus and clawback provisions. LTI awards should not be granted in cash or cash equivalents, as this would undermine the alignment with shareholders and the long-term focus of the scheme. If the committee includes the accrual of dividends on vested shares, investor preference is for these to be paid in shares, to further reinforce the alignment and retention objectives. If committees, consider cash payments to be appropriate they should explain how this alignment has been achieved.

When deciding the maximum grant size of LTI awards, remuneration committees should take into account the potential pay-out at target and maximum levels, as well as probability of vesting. The committee is encouraged to evaluate each year whether the grant level is suitable given the company's financial and share price performance and is expected to prevent excessive rewards from windfall gains. It may be appropriate for the committee to exercise its discretion to reduce the grant size following a significant fall in the share price between grant dates, to ensure the number of shares granted does not increase significantly year on year. Shareholders prefer discretion to be applied at the time of grant instead of relying on discretion at vesting. Where the committee did not reduce the grant size and windfall gains occur, shareholders expect remuneration committees to use discretion to ensure that vesting outcomes are not inflated and appropriate in relation to the overall company performance.

Where the management of risks and opportunities, including material ESG factors, are important for the long-term sustainability and success of any business, they should be incorporated into the company strategy and the design and assessment of LTI awards. It is important for shareholders that remuneration committees select ESG performance conditions that are relevant and material for the company's strategy and stakeholder interests, and that incentivise positive outcomes and behaviours. They should be quantifiable and appropriately stretching. The pay-out of LTI awards based on ESG criteria needs to provide demonstrable performance outcomes achieved and be commensurate with the level of value creation and risk mitigation achieved by the performance against these targets.

Shareholders are generally unsupportive of cliff-edge vesting, recognising that a small change in performance can result in large differences in pay-out. Such schemes can create unintended incentives and excessive volatility in executive remuneration and may not reflect the true performance and long-term value creation of the company. Instead, the adoption of a graduated vesting approach, where the pay-out varies in accordance with the performance level delivered, and where full vesting is reserved only for exceptional and sustained high performance is encouraged. The absolute monetary value of awards vesting for threshold performance needs to be considered to ensure it is appropriate for the level of performance achieved.

The integrity and credibility of the scheme are compromised if there are retrospective changes or retesting of performance or vesting conditions and these are not supported by shareholders. The exception may be where there are unique corporate events, which require targets to be adjusted to ensure they remain appropriately stretching. In such cases engagement with shareholders is expected.

Performance share plans

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 remuneration committee needs to explain clearly the performance measures and vesting conditions chosen for each award, and how they are clearly linked to the achievement of appropriately challenging financial and strategic performance targets that will enhance shareholder value.

Shareholders expect PSP awards to be subject to challenging and transparent performance conditions that reflect the company's strategic objectives. The performance period should be at least three years, and there should be a further holding period of at least two years after vesting, to ensure alignment with the long-term interests of the company and its shareholders and material stakeholders.

Performance criteria need to reflect the performance of the business as a whole and be applied consistently across the measurement periods. Relative and absolute performance metrics which produce outcomes that are in line with the overall performance of the company, its future prospects and the experience of shareholders and other stakeholders over the performance period are encouraged.

If Total Shareholder Return (TSR) is used as a performance measure, the calculation of starting and finishing values for TSR should be made by reference to an average share price over an appropriate and well-defined period of time at the beginning and end of the performance period. TSR should be measured on a consistent basis. Comparator groups which are appropriate for the company and its industry, and clearly disclosed and explained by the committee are crucial for shareholders as this helps ensure that the benchmarks used for executive remuneration are relevant and fair.

Committees are also cautioned that share buybacks can impact earnings per share (EPS), and shareholders expect their impact be excluded from the calculation of performance. Like all performance conditions, EPS performance should reflect the underlying performance of the business, so committees should take a consistent approach to exceptional items and accounting charges that may distort the underlying performance of the company. Members expect the impact of share buybacks and other capital management decisions to be taken into account when determining whether a performance measurement has been satisfied.

No vesting should occur below median performance for relative measures. Full vesting requires the achievement of stretching performance that reflects exceptional and sustainable value creation. Sliding scales are encouraged to ensure that there is a smooth progression of pay-out between threshold and maximum performance levels, and that the incentive schedules are robust and aligned with shareholders' interests.

Committees should prospectively disclose the target ranges for each performance measure to shareholders, as well as the actual performance achieved and the resulting pay-out at the end of the performance period. This will enhance transparency and accountability and enable shareholders to assess the alignment of pay and performance.

Restricted share plans

Restricted Share Plans (RSPs) are an alternative form of long-term incentive that grant shares to executives subject to continued employment, rather than performance conditions. RSPs can provide a simpler and transparent way of aligning executive interests with shareholders, but they also pose some challenges and risks in terms of ensuring appropriate pay-for-performance outcomes and avoiding excessive rewards for mediocre results. Committees need to provide the rationale and consider the implications of introducing an RSP and consult with shareholders. Committees need to justify their choice of incentive structure and demonstrate how it supports the delivery of the company's strategy, consistently with its culture and long-term success. Shareholders assess the introduction or continuation of RSPs on a case-by-case basis, considering the following factors:

- The level of discount applied to the size of the awards, compared to the previous or alternative performance share plan - Shareholders expect committees to recognise that RSPs have a more certain outcome and a lower risk profile for executives than performance shares and therefore not grant awards of equivalent face value. Shareholders consider that a significant reduction in the award size is expected, typically a discount of 50%, however, depending on the company's circumstances and the performance measures used in the previous plan a different discount rate may be considered appropriate.
- Use of underpins – To ensure shares do not vest in circumstances of significant underperformance or as a result of events that put at risk shareholder returns over the long term, the inclusion of minimum performance underpins are welcomed. The application of discretion is expected to ensure that there is no reward for failure. On vesting, shareholders expect committees to disclose if the underpins have been met and therefore the level of vesting achieved.
- Annual vesting of restricted shares is generally not supported by shareholders.

Hybrid schemes

Some companies may opt for 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. Shareholders expect committees to explain why the hybrid model is preferred over a single structure.

Where hybrid schemes are used, shareholders believe that it is appropriate that they follow the same guidance as a standalone PSP or RSP, as outlined above. Shareholders expect the RSP portion of the hybrid scheme to be discounted to reflect the lower risk and higher certainty involved, and encourage the committee to explain the rationale and methodology for determining the discount rate. The vesting period for a hybrid scheme is expected to be at least five years, with no accelerated vesting or early release of shares, subject to a clear explanation of any different approach.

Value creation plans

Another type of long-term incentive arrangement that some companies have adopted or considered is a value creation plan (VCP), which awards executives a proportion of value created above a threshold level of return. VCPs aim to align executive remuneration with ambitious strategic goals and significant value creation for shareholders and material stakeholders. However, VCPs also pose several challenges and risks, such as the potential for significant pay-outs, dilution of existing shareholders, and reduced flexibility to adapt to changing circumstances. Therefore, committees are encouraged to exercise caution and diligence when designing and implementing a VCP. The adoption of a VCP may face scepticism and resistance from some investors. Therefore, committees are advised to engage early and constructively in consultation and communication with investors and material stakeholders to address their concerns and expectations regarding the VCP. Committees will need to provide clear and comprehensive disclosure and explanation of the VCP, including its rationale, design, performance targets, caps, dilution, and alignment with the company's strategy, culture, and long-term success. Committees should seek to ensure that they address the following key issues:

- It is expected that the adoption of a VCP be accompanied by a compelling rationale and a thorough assessment of the alternatives. Shareholders consider it appropriate that a VCP only be used when it is clearly aligned with the company's strategy, culture, and long-term objectives, and when it reflects the specific circumstances and opportunities of the company.
- Shareholders expect committees to impose an overall monetary cap as well as one on the number and value of shares and awards that can be granted under a VCP and provide a clear and robust explanation as to why the cap is appropriate and reasonable.
- A VCP needs to reward exceptional performance that creates substantial and sustainable value for shareholders and material stakeholders over at least a five-year period. Therefore, the performance targets under a VCP are required to be challenging, demanding and reflect the company's strategic vision and aspirations. Measurable, transparent, and verifiable performance targets are expected. Committees are expected to disclose the performance targets and the rationale behind them, including how they align with the company's long-term interests and values.
- A VCP can have a significant impact on the company's share capital and ownership structure, especially if the performance targets are met or exceeded. Therefore, committees need to carefully assess and monitor the potential dilution and shareholding implications of a VCP.

Technical conditions for long-term incentives

All long-term incentive awards should be priced at the mid-market price of the company's shares at the time of grant, unless otherwise specified in the scheme rules or agreed with shareholders.

Awards for executive directors should normally be granted within a 42-day window following the announcement of the company's results or other exceptional events that may affect the share price (excluding all-employee share plans).

Re-pricing or re-testing of awards in the event of a fall in the share price or a failure to meet vesting conditions, undermines the link between pay and performance and reduce the alignment with shareholders' interests. Therefore, shareholders will not accept the re-pricing of awards or re-testing of performance conditions.

Shareholders expect the life of any long-term incentive scheme not to exceed 10 years from the date of shareholder approval, unless renewed by shareholders (excluding all-employee share plans).

The use of new shares dilutes existing shareholders and therefore reduces their value, which has a direct impact on pension and retail savers. Therefore, appropriate dilution limits for the company should be adhered to.

Where ordinary shares are issued, the number of new shares issued, or treasury shares re-issued under all the company's share schemes should not exceed 10% of the issued ordinary share capital (adjusted for share issuance and cancellation) in any rolling 10-year period.

Exceptional cases may arise for high growth companies that have recently listed on the stock exchange and need to incentivise their key employees with share-based rewards. In such cases, committees may seek shareholder approval for higher dilution limits. Committees will have to disclose the rationale and expected timeline for aligning with the standard dilution limits.

Employee share ownership trusts (ESOTs) are vehicles that allow companies to acquire and hold shares in their company to be used for employee share schemes. However, committees are expected to limit the use of ESOTs to no more than 5% of the issued ordinary share capital of the company, unless they have obtained shareholder approval for a higher percentage. Shareholders also expect that committees ensure that ESOTs are not used as an anti-takeover device by preventing the trust from voting the shares held by it or by applying the same voting policy as the majority of shareholders. Shareholders welcome committees to disclose the existence and purpose of any ESOTs, as well as the number and proportion of shares held by them and how they are voted.

Long-term alignment between executives and shareholders

In this section, we set out several elements that help to create long-term alignment between executives and shareholders. The UK Corporate Governance Code currently requires committees to implement each of them. If the committee considers that one element is not appropriate for the company, it is expected to explain how the equivalent goal is achieved through other mechanisms.

Shareholding guidelines

One of the key aspects of long-term alignment of executives with shareholders is the in-role and post-employment shareholding guidelines. These guidelines ensure that the executives have a significant stake in the company and are incentivised to deliver value creation over time. Shareholding and post-employment shareholding guidelines are effective and reasonable in aligning the interests of the executives with those of the shareholders and promoting a long-term perspective on the company's performance and strategy. The main expectations of the shareholding and post-employment shareholding guidelines are as follows:

- The committee sets a minimum shareholding requirement for each executive and a specific time period in which to achieve that requirement. Shareholders generally consider the long-term incentive grant size as a suitable benchmark for the minimum shareholding requirement.
- The committee is also expected to set out the consequences of not achieving or maintaining the minimum shareholding requirement, such as withholding or reducing future grants of long-term incentives, or deferring a portion of the annual bonus into shares until the requirement is met.
- Under the shareholding requirement, the committee should only count shares that are owned outright or vested without further performance conditions or underpins. This can include shares that are subject to a pre-exercise holding period, as they are exposed to the same market risk as other shares.
- Shareholders support the UK Corporate Governance Code requirement to develop a formal policy for post-employment shareholdings. Shareholders consider that executives retain the minimum shareholding requirement or, if lower, the shareholding on departure for two years after leaving the company, as this ensures that the executives remain accountable for the outcomes of the decisions and actions taken during their tenure.
- The committee should ensure the enforceability of the post-employment shareholding requirements by incorporating them into the service contracts or the terms and conditions of the long-term incentives, or trusts in which they are held.

Malus and clawback

Another important mechanism for long-term alignment is the malus and clawback provisions, which allow the committee to recover remuneration that was paid inappropriately or based on inaccurate or misleading information.

The UK Corporate Governance Code includes an expectation for malus and clawback provisions to be in place and the disclosure of the triggers when they can be applied. For shareholders, it is vital to know the triggers for using malus and clawback, and for them to be clearly stated and suitable for the specific conditions of the company. In order to ensure that remuneration committees can enforce malus and clawback provision efficiently, they should consider the following:

- Defining the triggers and having the executives agree to them,
- Ensuring that all documents (including contracts, remuneration policy, bonus and plan rules) are consistent and contain the triggers,
- Communicating with participants in line with the provision of the terms,
- Documenting the process and decision making so that the committee’s approach to enforcement is clearly laid out.

Discretion

Shareholders want to ensure that remuneration outcomes are appropriate given the company and individual performance. Exercising discretion when assessing executive performance and determining remuneration outcomes is an important role of the committee. Discretion allows the committee to take the broader context and the long-term interests of the company, its shareholders and material stakeholders into account and to avoid rewarding or penalising executives for factors beyond their control or influence.

Shareholders recognise that discretion should be applied in a balanced and consistent manner, and that it can have both positive and negative implications for executive remuneration. Positive discretion can be used to reward exceptional achievements or contributions that are not captured by the predefined performance measures or targets, while negative discretion can be used to adjust remuneration outcomes downwards if they do not reflect the underlying performance of the company or the individual, or if there are significant adverse events.

The committee is encouraged to evaluate the use of discretion on a case-by-case basis, taking into account the specific company circumstances and rationale for each decision. The committee is also encouraged to consult with shareholders and other material stakeholders as appropriate, especially in cases where the exercise of discretion may have a material impact on the remuneration outcomes or the perception of the company's governance and reputation. Shareholders welcome the disclosure of the process, rationale, implementation and impact of discretion in a clear and transparent manner in the Directors' Remuneration Report, and an explanation how the use of discretion aligns with the company's remuneration policy and principles.

The committee will also need to ensure that it has the legal authority and contractual provisions to apply discretion. Shareholders expect that any use of discretion respect the limits of the remuneration policy and does not exceed the maximum levels of remuneration that have been approved by the shareholders. The committee is encouraged to monitor the frequency and magnitude of the use of discretion, and review the effectiveness and appropriateness of the discretion framework on a regular basis.

Recruitment of new directors and leaver provisions

One of the key responsibilities of the remuneration committee is to determine the pay for new directors in line with the remuneration policy approved at that time by shareholders. They are also responsible for agreeing the remuneration for departing directors. The committee needs to consider the following issues setting the pay for new and departing directors:

- Salary of new joiners is expected to be commensurate with their skills and experience, while taking into account the remuneration of the previous incumbent. The committee is encouraged to not automatically match or increase upon the salary of the predecessor, but rather consider the role and the individual circumstances of the new joiner. Shareholders will assess this on a case-by-case basis.
- The committee needs to take into account the prevailing market conditions, the company's performance and strategy, and the expectations of material stakeholders.
- Shareholders recognise the desirability of executives being compensated for forfeiting previous awards from their former employer on no more than a like-for-like basis. The committee needs to ensure that the replacement awards are subject to similar terms and conditions, and that they reflect the present value, vesting periods and performance expectations of the forfeited awards. Shareholders expect the committee to disclose the details and rationale of the replacement awards to shareholders.
- Notice periods for executives should be of one year or less. Notice periods should start immediately on the date of resignation or termination, and not be delayed or extended for any reason.

- The committee should provide clear and unambiguous definitions of good and other leavers.
- Good leavers are usually termed those that leave for retirement, death, disability, or ill-health, redundancy, or change of control. Other leavers may be those executives who leave the company due to misconduct, poor performance, breach of contract or voluntary resignation. The committee needs to disclose the terms and conditions of these provisions to shareholders.
- Shareholders expect that the committee focuses on fixed pay for leavers, such as salary, pension and benefits, and avoid making any discretionary payments or enhancements. The committee is expected to ensure that any payments are subject to mitigation or clawback, where applicable, to recover any overpayments or adjust for any misstatements or misconduct.
- Bonus and LTI awards should be paid to good leavers only, subject to the original performance and vesting conditions and the pro-rating for the time served. The committee is encouraged to disclose the rationale and justification for the treatment of leavers and the number of awards vesting or forfeited.
- Shareholders prefer that the structure of leavers variable remuneration be maintained, to retain the alignment with shareholders and the long-term focus of the company.
- Other leavers should not receive any payments beyond their contractual entitlements and would usually forfeit all their unvested and deferred awards.
- No leaver provisions should reward poor performance or failure. The committee is expected to ensure that any payments made to leavers are consistent with the performance outcomes and the value delivered to shareholders. The committee is expected to avoid making any payments that may damage the reputation of the company or undermine the trust of stakeholders.

Special awards

Special awards or ex-gratia payments, which are granted outside the normal parameters of the remuneration policy, may be perceived as undermining the link between pay and performance and creating a culture of entitlement or reward for failure. Therefore, companies should adhere to the following principles when considering special awards or ex-gratia payments:

- Shareholders consider that special awards are not needed if the remuneration policy is well designed and aligned with the company's strategy and performance. Companies should avoid making discretionary adjustments or exceptions that could compromise the integrity and credibility of the policy.
- Exceptional circumstances, such as turnaround situations, may justify the use of special awards. In such cases, the remuneration committee is strongly encouraged to clearly explain the rationale and objectives of the award, and how it supports the long-term interests of the company and its shareholders. The committee is also encouraged to ensure that the award is reasonable and proportionate, and that it is subject to appropriate performance conditions and clawback provisions.
- Shareholders, especially major ones, welcome the opportunity to engage with the committee to give feedback on proposed terms and conditions of a special award, if it believes that one is appropriate and necessary. The committee is expected to disclose the outcome of the consultation process and the views of the shareholders in the remuneration report.

Non-executive director fees and shareholdings

One of the key aspects of good governance is to ensure that independent non-executive directors (NEDs) are adequately compensated for their contribution to the board. Independent NEDs are expected to receive fair remuneration that reflects their time commitment, the complexity of the role and the experience that they bring to the board. Boards should clearly disclose the time commitment which NEDs are expected to fulfil, and their fee should be commensurate to this commitment.

Moreover, shareholders encourage independent NEDs to align their interests with those of shareholders by owning shares in the company. A portion of the director fee could be paid in shares purchased at market rates.

The UK Corporate Governance Code explicitly states that NEDs should not participate in share option or performance-related pay schemes as it would impinge upon their independence and objectivity.

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