

## LENS ON:

### Investment Association Principles of Remuneration 2022

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#### November 2021

The Investment Association (IA) has today released its Principles of Remuneration for 2022, together with a letter summarising key areas of focus for IA members in the upcoming 2022 AGM Season. The covering letter serves to reinforce guidance issued to companies since the start of the pandemic and highlights the following key points:

- Consideration of the stakeholder experience in determining remuneration remains a crucial area of investor focus. Committees will need to ensure that reward outcomes are supported not only by performance outcomes but are also appropriate in the context of the experience of the company's shareholders, employees, and other stakeholders. The IA's call for companies not to pay bonuses where they have taken - but not repaid - government support remains unchanged.

**Ellason commentary:** This is an extension of the IA's published guidance on shareholder expectations on remuneration during the COVID-19 pandemic. The need for companies to consider the wider stakeholder experience when determining remuneration outcomes continues to be a priority concern for shareholders, with most companies showing the necessary sensitivity to the broader stakeholder context. Remuneration Committees will be expected to clearly disclose how they have taken this broader stakeholder context into account when determining pay outcomes for executives.

- Companies that incorporate ESG risks or goals into their long-term strategy should include performance conditions in their incentive structures which reflect this. ESG metrics should be quantifiable, have appropriately stretching targets applied, and their link to strategy should be clearly disclosed. Where companies have detailed ESG goals as part of their strategy but have not yet incorporated these into their variable pay structures, the company's intended approach for coming years should be disclosed.

**Ellason commentary:** Like many institutional investors, the IA has left it up to companies (and committees) to select and justify the most appropriate ESG measures. Recognising that embedding ESG into strategy is also a journey, the IA provides flexibility for companies who are at an early stage in the process (and have not yet incorporated ESG metrics into their remuneration structures) to explain how they intend to evolve this over time.

The Principles themselves have also received a small number of updates to reinforce recent developments in market practice and investor expectations, including:

- Executive pension contributions are expected to be fully aligned with the broader workforce by 31 December 2022. IVIS will Red Top any policy that does not state that new directors will have pensions aligned with the workforce; and will Red Top any policy where there is no clear action plan to align incumbent executive pensions with the wider workforce by the end of 2022.

**Ellason commentary:** The IA's continued ambition is for all executive pensions to be aligned to the majority of the workforce rate by the end of 2022. The IVIS Red Top will now be applied to all companies where alignment has not been achieved by the end of 2022 (previously it was only applied to those companies where the executive pension was 15% of salary or more). The IA have confirmed that, whilst early adoption is preferred, an explicit commitment that the pension will be aligned effective from 1 January 2023 onwards will be sufficient to avoid this sanction.

- Remuneration Committees must show restraint when considering the increase to any element of remuneration. Clear rationale for the increase to fixed or variable pay should be provided, with particular consideration made to the 'multiplier effect' that increasing a single element can have on the total remuneration package.

**Ellason commentary:** Increases justified by 'vague references to the market-level' are considered by IA members to have been a major contributor to spiralling levels of executive pay. Committees should be able to explain why the chosen remuneration level is appropriate for the company, exercise appropriate discretion to ensure pay-outs are commensurate with company performance and provide a compelling rationale for any significant increases.

- The Principles have been updated to reflect investor preference for companies to reduce awards at grant where share prices have fallen rather than relying on discretion when awards vest.

**Ellason commentary:** This reflects guidance issued by individual shareholders on the topic and reflects a preference for an upfront reduction in award quantum rather than a discretionary adjustment at the end of the period. The guidance has also been updated to clarify that where a Restricted Share Plan has been introduced following a substantial fall in share price, Committees should be especially mindful of the potential for windfall gains when considering the initial grant level.

- Given the increased adoption of Value Creation Plans (VCPs) over the past year, a specific section has been added clarifying investor expectations in this regard. VCPs should include an overall cap on the number of shares and the total value of awards that can be delivered to scheme participants. Given the significantly increased maximum opportunity afforded by VCPs, targets need to be substantially more stretching and sufficiently robust.

**Ellason commentary:** Investors remain wary of the introduction of VCPs given the quantum involved, but will generally consider the merits of such plans on a case-by-case basis. Committees will need to justify why the plan structure is appropriate in the specific circumstances and provide a clear rationale for the value sharing mechanisms and maximum award levels proposed.

Please do not hesitate to contact any of the Ellason team should you wish to discuss this issue further.