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INVESTMENT
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Dear Remuneration Committee Chair,

I am writing to outline the key changes to The Investment Association Principles of Remuneration for 2018, and to highlight the items of focus for our members for the 2018 AGM season.

2018 Review of the Principles of Remuneration

The Principles and Guidance have been reviewed given the ongoing debate surrounding executive pay as well as the Government's Corporate Governance reform initiatives, and have been updated to reflect current best practice. Following extensive changes to the Principles for 2017, the changes for 2018 are mostly incremental. The main changes are:

- Relocation benefits – members expect relocation benefits to be disclosed at the time of appointment, be in place for a limited time, and fully detailed in the Remuneration Report.
- Annual bonus – we have updated this section to reflect members' expectation that bonus targets are disclosed within twelve months of the bonus payment, and that deferral is expected for any bonus opportunity greater than 100% of salary.
- Long term incentive schemes – we have re-organised this section to give a clearer picture of members' attitudes to specific examples of schemes.

Issues to consider for 2018 AGMs

In particular, our members have asked us to re-emphasise the following aspects of the Principles:

Levels of Remuneration – Members have noted that some, predominantly large, companies have made some progress in addressing levels of pay in their 2017 Remuneration Policy renewals by reducing potential variable remuneration awards and limiting overall pay.

Investment Association members welcome the actions taken by these remuneration committees and the reductions in variable remuneration opportunity. They expect the movements made by these leading companies will be replicated across the broader market, with all companies showing restraint on any variable remuneration increases and considering whether the remuneration potential should be reduced.

Members continue to be concerned by incremental increases to variable remuneration maximums in revised Remuneration Policies which, on aggregate, lead to a substantial increase to overall remuneration. In addition, members continue to be concerned by salary increases and even "automatic" inflationary salary increases can have a significant impact on overall remuneration.

It is essential that companies adequately justify to investors the level of remuneration paid to Executives, and take into account the wider social context of executive pay, rather than looking at benchmarking alone. In the coming year, investors will be looking closely at how any increases are justified, and will expect Remuneration Committees to show restraint in relation to overall quantum.

> Pay ratios: As we highlighted in our revisions to the Principles for 2017, members now expect companies to disclose the pay ratios between the CEO and median or average employee, as well as the CEO and the Executive team, as part of justifying and explaining the levels of executive remuneration in the business. We welcome the Government's decision to require such disclosures in future and would encourage all companies to voluntarily disclose their pay ratios in 2018.

> Pensions: For a number of years, the IA and our members have highlighted the disparity between Executive Director and wider workforce pension provision. We would therefore reiterate that Executive Directors should have contribution rates at the same level as the general workforce.

Remuneration Structures – Last year, the Principles were amended to acknowledge the need for increased flexibility of remuneration structures. The Principles do not seek to promote any single remuneration structure.

During the last year, there have been a number of companies that have considered changing their remuneration structure and moving to restricted shares. Members' views on this type of remuneration structures continue to evolve. Whilst there are a number of shareholders that are unsupportive of restricted shares, there are a growing number of shareholders that will support the introduction of restricted shares for the right company, in the right circumstances.

Members are keen to support those companies who have carefully chosen a structure which is appropriate for their business and is well-justified. However, members are cautious that, in some cases, new remuneration structures are being proposed only when the current remuneration structures are not paying out to the Executives. This should not be a reason in its self to move to a restricted share model.

We note that the debate has become somewhat binary between traditional LTIP structures and Restricted Share-style plans. Members continue to encourage remuneration committees to adopt the remuneration structure which is most appropriate for the company and the implementation of their business strategy.

Shareholder Consultation – Consultation with shareholders on executive remuneration is important. However it is critical that this dialogue is meaningful and treated as a two-way process. While there have been some good examples of companies responding to shareholder feedback, the consultation process could be improved in some cases.

Members have noted that a failure to properly understand the views of shareholders has led a number of companies to withdraw their resolutions prior to the AGM. Companies who withdraw resolutions in this way should ensure that they conduct a full analysis of shareholder feedback and consult further before re-submitting their Remuneration Policies.

Pay for Performance – Our members' beneficiaries continue to seek explanations as to why they have supported the remuneration packages of investee companies; therefore, in order to justify their support, they require robust transparency on targets and structures so that the link can clearly be seen between remuneration and company performance.

In particular, the following issues are the focus of members at the present time:

> Financial Targets: As highlighted in previous years, members expect full disclosure of threshold, target and maximum performance targets, either disclosed at the time of payment of the award, or within 12 months where an explicit explanation of the commercial sensitivity has been set out.
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> Members have concerns where the metrics used to set targets for executive remuneration differ significantly or have been adjusted from headline KPI or reported numbers. If the company uses adjusted metrics for executive remuneration, they must set out why this is appropriate, and provide a breakdown of how the remuneration target has been adjusted from the headline KPI.
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> Disclosure of Personal and Strategic Performance Targets: Members expect a thorough explanation as to why personal or strategic targets have paid out, not just a description of non-financial performance indicators. Where IVIS deems there to be insufficient information on non-financial targets, members have asked IVIS to Amber Top the report.
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> Where financial metrics do not warrant a bonus payment, members will scrutinise the payment and rationale for the payment of any personal or strategic elements to ensure that such a payment is warranted.

Accountability of Remuneration Committee Chairs - The last AGM season has shown that investors are increasingly voting against the re-election of individual directors based on the decisions they make at the Remuneration Committee. Members have a range of escalation approaches in their voting policies. For example, some members vote against the Remuneration Committee Chair if they vote against a Remuneration resolution in two successive years, or if a remuneration resolution does not get majority support, some members vote against the re-election of the Remuneration Committee Chair at the next AGM.

If you need any further details on the Principles of Remuneration, please do not hesitate to contact me or one of the IVIS team (www.ivis.co.uk/contact-us).

Yours faithfully,

Andrew Ninian
Director, Stewardship and Corporate Governance