Plus ça change: Amendment to Principles of UK Executive Remuneration

Friday, November 13, 2015

The guidelines on executive remuneration (formerly known as the ABI guidelines) have now come under the auspices of the Investment Association ("IA"). As usual at this time of year, the guidelines (or principles, as we should now call them) have been dusted down.

The only substantive change to the principles is that long-term incentives should not pay out until at least five years after the date of award. This would still allow the usual 3-year performance period, but a further holding period of two years would have to be imposed. On this issue, the IA has followed Fidelity, which advocated minimum 5-year terms early last year.

There have been recent reports suggesting a trend towards an aggregate of five years for performance and holding periods. Although around 60% of companies have reportedly made this move, this still leaves a considerable number needing to extend their performance and/or holding periods. If a company adopts the approach of introducing a holding period after vesting in order to make up the 5-year term, it will need to decide whether or not to seek shareholder approval to amend its remuneration policy. With many companies choosing not to seek approval when introducing clawback (on the basis that this will bring it into line with investor guidelines and the change is not to the benefit of directors), it will be interesting to see how this pans out.

Further changes to the principles are likely next year, as the IA’s Executive Remuneration Working Group is expected to bring forward in the spring of 2016 its proposals to simplify executive remuneration.

The IA has sent a letter to the chairmen of remuneration committees of quoted companies to highlight this change, but also to re-emphasise certain principles about which investors have concerns:

- **salary increases**: there is continuing concern about the level and frequency of increases in directors’ salaries. Given the other benefits directors receive, investors “have a clear expectation” that increases in basic salary should be limited either to inflation or to the percentage increase given to the company’s staff as a whole, and if not, clear and explicit justification should be given;

- **bonus disclosure**: investors note that a number of companies fail to comply with the requirement in the regulations on the disclosure of directors’ remuneration to specify the measures and targets by reference to which bonuses and other incentives are paid. There is a get-out in the regulations when the targets are considered by the company to be “commercially-sensitive”, but investors want use of this to be more fully justified. If this exemption is invoked, the regulations also require “an indication given of when (if at all) the information is to be reported to the members of the company”. The letter from the IA makes it clear that investors expect targets to be disclosed retrospectively at the end of the year (presumably those relating to annual bonuses) or at a specified time in the future. The IA warns that it will
give companies with a year-end of 1 December 2015 or later who do not disclose targets or do not commit to full disclosure a “red top” and an “amber top” to those that disclose relative achievement with no commitment to disclose the actual targets;

- service contracts: notice periods of up to 12 months are still acceptable. However, investors now require new contracts to provide for equal notice from the executive and the employer and withholding of pay in lieu of notice (a PILON) in cases of an ongoing regulatory or internal investigation;

- pensions: investors expect pension contributions and arrangements to be the same for directors as for the company’s workforce as a whole;

- recruitment: “golden hello” awards should not be re-issued if there is a fall in the company’s value – investors consider that the executive and the company should bear the risk and that shielding the executive is inappropriate; and

- leaving arrangements: as previously stated, remuneration committees should take a firm line when dealing with executives who leave and full justification should be given of decisions to consider them “good leavers”.

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