

Remuneration Consultants' Group

The Board's activities in 2014 and the review of the effectiveness of the Code

September 2014

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A. The RCG and its activities in 2014

Background

The Remuneration Consultants Group ('RCG') was formed in 2009 and represents the overwhelming majority of executive remuneration consultancy firms advising UK listed companies.

The aim of the RCG is the stewardship and development of a voluntary Code of Conduct (the 'Code') that clearly sets out the role of executive remuneration consultants and the professional standards by which they advise their clients where their clients are Remuneration Committees.

The inception of the Code and the RCG arose after the publishing of the final recommendations of the Walker Review in November 2009. In this review, Sir David Walker advocated that it was requisite for the executive remuneration consultancy industry to form a professional body with the oversight of a code of conduct. The objective was to provide greater clarity on the role of executive remuneration consultants and ensure that high professional standards are maintained.

The inaugural RCG Code was included as an annex to the final recommendations of the Walker Review in November 2009 and the RCG put a formal constitution in place shortly thereafter.

The Code was first reviewed in 2011 and subsequently, during the course of 2013, the Code was reviewed again and an extensive consultation process carried out. As a result, several important drafting changes were made to ensure:

- Greater clarity on the procedures and processes to manage and minimise conflicts of interest where firms provide advice on remuneration in addition to other services.
- Enhanced confidence that consultant advice is provided in a manner which encourages clients to consider pay in light of performance, business strategy and appropriate time horizons;
- Documentation of adherence to the Code and its principles (see Review of the Effectiveness of the Code – Section B for further detail).

Other key contributions included observations on the need to:

- Ensure consultants emphasise the importance of succession planning;
- Provide sound and technical training and induction for new directors who join the Remuneration Committee;
- Ensure that the consultant helps the Remuneration Committee to take investors' views into account;
- Promote the Code to other advisors who are not remuneration specialists e.g. lawyers

The RCG currently has thirteen members. The member firms are:

Aon Hewitt	Kepler Associates	PricewaterhouseCoopers
Deloitte LLP	KPMG	Strategic Remuneration
Ernst & Young	Mercer	Towers Watson
FIT Remuneration Consultants	MM&K Limited	
Hay Group	Patterson Associates	

The Board comprises an independent Chairman, two independent non-executive directors and four directors elected by the Members (who are executive compensation consultants working for the member firms).

The Board meets four times a year. The attendance record of the Board members in 2014 is summarised below.

Member	4 Mar	20 May	23 Sept	10 Dec
Martin Read (Chairman)	✓	✓	✓	-
Philippa Hird (Ind. Director)	✓	✓	✓	-
William Claxton-Smith (Ind. Director)	✓	✓	✓	-
John Lee (Director)	✗	✓	✓	-
Gordon Clark (Director)	✓	✗	✓	-
Nicki Demby (Director)	✗	✓	✗	-
Katharine Turner (Director)	✓	✗	✓	-

Where Member directors cannot attend, they are encouraged to send a representative of their firm and such representatives did attend.

During the year the Board has:

- Agreed a work plan for 2014;
- Updated the RCG's governance framework;
- Agreed the approach to, and overseen, the Review of the Effectiveness of the Code – see Section B;
- Consulted with some key stakeholders and commentators on executive pay;
- Made decisions to support the running of the RCG such as the approval of the accounts and membership fees

Note that the Member firms have also met informally on two occasions during the year - 9th June and 29th October.

During the year, no complaints have been raised with any of the Member firms or referred to the Chairman.

B. The Review of the Effectiveness of the Code

Background

The Remuneration Consultants Group (“RCG”) was formed in 2009 and represents the overwhelming majority of executive remuneration consultancy firms advising UK listed companies.

The objective

In 2011, as part of the review of the Code, the Board agreed to carry out an annual review of the effectiveness of its implementation. The evaluation process was based on self-assessment by the firms, and the Board agreed to summarise the findings of the evaluation process and make them public on the RCG website. An important aspect of this exercise has been that the Members share good ideas that will improve the effectiveness of the implementation of the Code, as well as sharing experiences on barriers to effective implementation and how these might be overcome.

The process

There were three main components of the self-assessment process. The first component was an anonymous survey of all employees engaged in executive pay consulting in the Member firms. A similar survey was run last year. The 2014 survey attracted responses from 163 individuals (equivalent to a response rate of 88% of a total of around 185 associates in all member firms combined), up from the 138 responses (a response rate of about 60%) in 2013. The survey questions and the responses can be found in Appendix A.

The second component was a questionnaire filled in by Practice Leaders and senior teams of the 13 member firms which attracted a 100% response rate. The aim of this has been to discover and share examples of helpful practice which may be useful across all member firms and to identify areas for improvement for better implementation of the Code.

The third component was a focus group which could be attended by one member of staff from each member firm. A total of seven members of staff from seven different member firms attended. A summary of the debate can be found below.

The major themes that emerged from the responses to the review process are summarised below.

The main findings

1) The main themes from the anonymous survey of consultants at member firms.

The survey response rate has increased significantly this year to a good level although continued improvement should be encouraged. Appendix A provides detailed results and shows the percentage responses for this year’s and last year’s survey. A summary of the responses to multiple choice questions is set out below.

- 1% of respondents were not aware that the Code existed (a decrease from 5% in 2013). However, the percentage of respondents who had read the Code decreased from 95% in 2013 to 92% in 2014.
- The majority of respondents have received training on the Code. 88% of individuals have received *formal* training and 93% have received *informal* training on the use of the Code. It should be noted that figures may be affected by the timing of the questionnaire relative to training schedules at individual member firms (it could be that new consultants in position less than a year had not received training yet due to scheduling).

- The percentage of respondents who felt they were not sufficiently knowledgeable about their clients' strategy and the impact that it has on the clients' remuneration framework decreased from 4% in 2013 to 1% in 2014.
- 90% of individuals said they are always clear whether they are working for the Remuneration Committee or for management. This has increased from 82% in 2013. The majority of the remaining 10% of respondents (8%) do not interface with clients.

Overall these findings were pleasing. All firms are encouraged to schedule training for consultants on a regular basis.

2) The main themes from the questionnaire sent to senior consultants

A questionnaire was sent to the leaders and senior teams of the executive remuneration practices at the 13 member firms and at least one submission was received from each firm. All questions asked for a written response to help the RCG better understand how the Code's provisions have been implemented by member firms and to gain insights into practices which might be helpful to other member firms. In addition, the RCG hoped to identify any barriers and problems practice leaders may have faced when implementing the Code.

The following key themes were identified:

- i) There are a variety of good practice examples of how member firms encourage adherence to the Code, including annual communications, training and assigning "compliance experts".
- ii) Training is common practice either through annual training sessions, E-learning and use of knowledge sharing platforms.
- iii) Approaches to communicating the Code externally to clients include referring to the Code on the firm's website, annual letters to the Remuneration Committee Chairman, references in all new appointment letters and proposals.

3) Outcomes from the focus group

Each Member firm was invited to nominate one attendee for the inaugural focus group this year. The purpose of this was to collect anecdotal data on the effectiveness of the Code and to look at the Code from a forward looking angle, in contrast to the backward looking surveys.

i. Effectiveness of the Code

There was consensus amongst the group that the Code formalised best practice that was already present at many of the member firms. Ultimately it hasn't changed day-to-day work substantially but is seen as a useful guide of how to formalise independence in engagement letters and encouraging annual meetings with the Remuneration Committee Chair. One member of the group highlighted the value the Code brought to demonstrating independence in pitches and proposals.

It was pointed out by some that, for more junior members of staff, it provided a very useful overview of the potential governance and ethical issues that may arise when working in the area of executive compensation where there is no formal qualification.

One participant considered the annual questionnaires and reviews of the Code a helpful reminder of its existence to consultants.

A small majority noted the Code's ability to promote the work of executive remuneration consultants externally.

ii. Linking pay with business strategy

Members of the group felt that the key requirements of the Code are supported by the recent regulatory changes, which have reinforced the scrutiny of the link between pay, strategy and performance.

iii. Using the Code to deal with conflicts of interest

The group agreed that it will always be a part of the role as a remuneration consultant to deal with the relationship between Remuneration Committee and management. One participant noted that conflicts of interest may be more likely in smaller client companies where governance is not as established and often the consultant served both the Remuneration Committee and management. Another member suggested that focussing on decisions that would be in the interests of the company can help to resolve any conflicts that arise.

iv. Training on the Code

External promotion of the Code was discussed. It was agreed that media coverage of executive remuneration may tend to be negative. However, a few participants suggested that the Board should continue to promote the good work of remuneration consultants where possible. This should include not only with the media but also shareholder, governmental and investor bodies.

One participant suggested that information on the Code could be included as part of on-boarding for new Remuneration Committee members alongside the UK Corporate Governance Code and schedule 8.

Another suggested that private equity firms should be made aware of the Code so that they are able to help companies preparing to list to understand how to work with Remuneration Consultants.

v. Increasing the membership

It was considered whether other professions that may be required to make decisions about executive compensation should sign up to the Code (e.g. lawyers, actuaries). It was also discussed whether internal executive remuneration specialists should be encouraged to sign up to the Code. Individual rather than company membership was also discussed but felt by many not to be appropriate at this time.

C. Recommendations

Reminder of recommendations from 2013 review

The 2013 review specifically highlighted three points for the RCG Members and the Board to act on:

1. All Member firms should be asked to continue to ensure that the Code forms part of the induction and that employees are trained in the use of the Code at least annually thereafter and also seek advice from their line managers;
2. Some form of mandatory training and/or guidance should be required on at least an annual basis and Member firms should (where applicable) make their line managers responsible for this and hold individuals accountable for attendance at these sessions;
3. Member firms should be more proactive as and when they observe apparent breaches of the Code.

In response to point 3, an amendment to the Code was proposed and implemented during 2013 to support this.

Recommendations from 2014 review

Based on the major themes that came out of the 2014 review, it is clear that more work still needs to be done in regards to points 1 and 2 above. This may always be the case, although members have been shown to be increasingly aware of the Code and the majority have introduced formal training.

Therefore, taking the above into account together with findings from the 2014 review the following recommendations are being made to RCG members:

1. Internal promotion of the Code - All Member firms should be asked to continue to ensure that the Code forms part of the induction and that employees are trained in the use of the Code at least annually thereafter;
2. External promotion of the Code - All Member firms should include the requirements of the Code as part of on-boarding for new Remuneration Committee members and a summary page of the key points of the Code should be circulated internally and externally as part of proposals and training;
3. Extending the use of the Code - Member firms should promote the requirements of the Code as best practice for smaller companies, those preparing to list and private equity firms who may have limited experience of dealing with Remuneration Consultants.

RCG Code of Conduct Consultation – Survey of Consultants

Total responses: 163 (138 in 2013 survey). Statistics shown in brackets represent the 2013 survey results.

Question 1: How many years of executive pay consulting experience do you have?

Answer Options	Response Percentage	Response Count
a. 0-3 years	25.8% (36.2%)	42 (50)
b. 3-6 years	21.5% (14.5%)	35 (20)
c. 6-9 years	13.5% (13.8%)	22 (19)
d. 9+ years	39.3% (35.5%)	64 (49)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 2: Prior to this survey, were you aware that a Code of Conduct governing the activities of remuneration consultancies existed?

Answer Options	Response Percentage	Response Count
a. Yes	98.8% (94.9%)	161 (131)
b. No	1.2% (5.1%)	2 (7)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 3: Have you read the Code of Conduct?

Answer Options	Response Percentage	Response Count
a. Yes	92.0% (94.9%)	150 (131)
b. No	8.0% (5.1%)	13 (7)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 4: How much *formal* training (e.g. induction, webcasts, lunch and learns) have you had on the use of the Code?

Answer Options	Response Percentage	Response Count
a. A lot	31.9% (34.1%)	52 (47)
b. A little	55.8% (60.1%)	91 (83)
c. None	12.3% (5.8%)	20 (8)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 5: How much *informal* training (e.g. discussions with other consultants, references in work) have you had on the use of the Code?

Answer Options	Response Percentage	Response Count
a. A lot	31.9% (29.0%)	52 (40)
b. A little	61.3% (65.2%)	100 (90)
c. None	6.7% (5.8%)	11 (8)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 6: How often is the Code discussed in your work?

Answer Options	Response Percentage	Response Count
a. Frequently	40.5% (44.2%)	66 (61)
b. Infrequently	47.2% (42.0%)	77 (58)
c. Very rarely	8.6% (12.3%)	14 (17)
d. Never	2.5% (0.7%)	4 (1)
e. Not applicable	1.2% (0.7%)	2 (1)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 7: Does your quality assurance (QA) process take the Code into account?

Answer Options	Response Percentage	Response Count
a. A lot	60.1% (56.5%)	98 (78)
b. A little	36.8% (39.1%)	60 (54)
c. None	3.1% (4.3%)	5 (6)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 8: To what degree do you think the Code influences practices and behaviours in your firm?

Answer Options	Response Percentage	Response Count
a. Significantly for the better	23.9% (18.8%)	39 (26)
b. A little for the better	45.4% (52.9%)	74 (73)
c. No change and improvements still needed	1.8% (2.2%)	3 (3)
d. No issues which needed to be addressed	22.1% (18.1%)	36 (25)
e. No view	6.7% (8.0%)	11 (11)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 9: In general, does your firm now have regular one-to-one meetings with client Remuneration Committee chairmen without management present?

Answer Options	Response Percentage	Response Count
a. Yes - at least annually	64.0% (66.4%)	103 (89)

b. Yes - less often than annually	8.1% (7.5%)	13 (10)
c. No	0.6% (0.7%)	1 (1)
d. Don't know	27.3% (25.4%)	44 (34)
	<i>answered question</i>	161
	<i>skipped question</i>	2

Question 10: How knowledgeable are you on your client's strategy and the impact that has on its remuneration framework?

Answer Options	Response Percentage	Response Count
a. Very comfortable	45.6% (46.0%)	73 (63)
b. Comfortable	41.3% (35.0%)	66 (48)
c. Uncomfortable	1.3% (3.6%)	2 (5)
d. Not applicable	11.9% (15.3%)	19 (21)
	<i>answered question</i>	160
	<i>skipped question</i>	3

Question 11: How comfortable are you in challenging the views of management at Remuneration Committee meetings?

Answer Options	Response Percentage	Response Count
a. Very comfortable	28.2% (36.2%)	46 (50)
b. Comfortable	32.5% (22.5%)	53 (31)
c. Uncomfortable	1.2% (0.7%)	2 (1)
d. Not applicable	35.6% (35.5%)	58 (49)
e. It depends (please say more)	2.5% (5.1%)	4 (7)
	<i>answered question</i>	163
	<i>skipped question</i>	0

Question 12: When you are working for a client, are you always clear for whom you are doing the work and whether it is for the Remuneration Committee or for management?

Answer Options	Response Percentage	Response Count
a. Yes	90.0% (81.5%)	144 (110)
b. No	1.9% (2.2%)	3 (3)
c. Do not interface with clients	8.1% (16.3%)	13 (22)
	<i>answered question</i>	160
	<i>skipped question</i>	3

Question 13: How do you think the Code and its implementation could be improved?

Answer Options	Response Count
	33

Respondents suggested the following:

- *Form a networking group to discuss issues relevant to remuneration and educate more junior members of the profession;*
- *Make adherence to the Code compulsory for member firms and introduce a penalty for failure to comply;*
- *Incorporate into the code an obligation to meet the Remuneration Committee Chair as part of the formal contracting process;*
- *Shorten the Code and simplify the language;*
- *More effective communication to media;*
- *Introduce templates for assessing the performance of the consultant;*
- *Encourage more engagement from Remuneration Committee Chairs;*
- *Improve efficiency and consistency of training for consultants by setting up online training produced by the RCG;*
- *Continue to maintain the profile of the Code as there remain a limited number of executives at new clients who remain inexperienced as to the expectations of the Code;*
- *Include a series of case studies as the Code is a little abstract;*
- *Require a link to the Code to be provided in Directors' Remuneration Reports where the Code is referenced.*

Question 14: Do you have any other comments?

Answer Options

Response

Count

28

One respondent suggested setting up protocols within internal reward functions along the same lines as the RCG. The hope would be that having the backing of an external body to refer to would help individuals resist inappropriate internal pressures. Another proposed requiring consultants to advise companies to disclose total fees paid to remuneration committee consultants, the fees for remuneration services to management, for other consulting, audit and other services, as well as services to the company's pension fund(s). Many respondents queried the need to meet four times a year. One of the respondents noted that behaviour should reflect the Code rather than having to always reference it. Another of the respondents suggested introducing consequences for use of another consultancy's pay data without the proper authorisation.

RCG Code of Conduct Consultation – Questionnaire for Senior Consultants

A questionnaire was sent to the leaders and senior teams of the executive remuneration practices at the 13 member firms and at least one submission was received from each firm. All questions asked for a written response to help the RCG better understand how the Code's provisions have been implemented by member firms and to gain insights into practices which might be helpful to other member firms. In addition, the RCG hoped to identify any barriers and problems practice leaders may have faced when implementing the Code.

i. Encouraging adherence to the Code

Examples of good practice that emerged include:

- a. Annual and induction training sessions including setting up an E-Learning platform;
- b. Annual update letters to all members of staff;
- c. Building in a review of strategy and corporate objectives at the beginning of an engagement;
- d. Aligning the precepts of the Code with pre-existing internal Codes; and
- e. Assigning a specialist 'compliance' expert or team that are on-hand to answer any questions.

ii. Approach to training

Different approaches to training were described. Some make training and reading the Code a formal part of induction.

Only two responses did not specifically refer to formal training / group sessions with consultants. Techniques employed include:

- a. Formal or informal training at least annually;
- b. Specific E-Learning training; and
- c. Circulating the Code to employees or making it available on shared IT platforms or in one case, providing best practice guidance along with a copy of the Code and making it mandatory for consultants to sign off receipt and compliance.

iii. Communicating the Code

The various methods used by member firms to communicate the Code externally to clients include:

- a. Asking clients to refer to the Code in their Directors' Remuneration Reports;
- b. Referring to the Code in proposals;
- c. Referring to the Code in standard terms of business or adjusting terms to be aligned with the Code;
- d. Sending annual letters of independence;
- e. Referring to the Code on their company website;
- f. Referring to the Code in all new appointment letters; and
- g. Referring to compliance of the Code and membership to the RCG in all marketing materials, trends reports and thought leadership papers.

To communicate the Code internally member firms do the following:

- a. Involve the firm's internal risk team in monitoring the code; and
- b. Circulate information about the Code to all consultants within the firm.

Based on the disclosures published in 2014 so far, 97% of the FTSE 100 companies name a member of the RCG as one of their advisers (and 93% of the FTSE mid-250 (excluding investment trusts). Data has not been collected on the frequency of references to the Code in the Remuneration Reports of the FTSE 350, though 55% of the FTSE 350 referred to the Code in 2013.

iv. **Commercial arrangements**

Most firms ensure that engagement letters prepared at the outset of an assignment clarify roles and responsibilities under the Code.

v. **Additional steps to ensure the Code is adhered to**

Steps taken by individual firms to ensure effective implementation of the Code which may prove useful for all member firms include:

- a. Discussions on sensitive issues or conflicts of interest with senior colleagues or the Chairman of the Remuneration Committee;
- b. Regular quality audits;
- c. Formal clarity on ownership of papers for Remuneration Committee meetings;
- d. Active induction on the code for Remuneration Committee Chairmen;
- e. Including adherence to the Code in performance goals; and
- f. End of project reviews in light of the Code.

vi. **Barriers to implementation**

Some firms mentioned that they now see no significant barriers to implementing the Code. That said, comments on current barriers included the following:

- a. A lack of interest from clients, either because they would rather discuss effective ways of working than a set of rules or they do not see the value in annual meetings;
- b. A lack of interest from consultants as they believe their personal and firm standards already comply with the standards of the Code;
- c. Pressures to cross-sell;
- d. Difficulty of dealing with unforeseen changes once the scope has been agreed; and
- e. Use of inappropriate comparator groups.

vii. **Useful techniques to support implementation**

Several points were highlighted – see Appendix B – including regular reviews of adherence, E-Learning training, annual meetings with the chair, training sessions, referring to the Code in engagement letters and talking about the Code as a part of ordinary business.

viii. **Using the Code to demonstrate advice is independent and objective**

Many firms mention that they were already doing this as part of their usual business activities. Others mentioned the change in disclosure requirements has resulted in many more DRRs referencing the Code. One encourages Remuneration Committees to include an annual review of consultants in their Terms of Reference. Also mentioned were recommendations that clients communicate their knowledge and adherence to the Code in consultation with shareholders.

ix. **Complaints and breaches of the Code**

None were reported by any firm.

x. **Other comments**

One firm mentioned that the rising profile of the Code has meant that it is becoming a tool for measuring independence. However, others mention that the Code may be a victim of its own success with clients becoming less interested in attending regular meetings about the Code. It was suggested that the Code could include a requirement for a formal handover between consultants should a mandate end.