TUC

PensionsWatch 2014

A TUC report on directors' pensions in the UK's top companies

Executive summary

1.1 The TUC established PensionsWatch in 2003 to give a picture of occupational pensions in the UK's largest public companies, with a focus on retirement provision for top company directors. The survey draws on information from the most recent annual reports of companies in the FTSE-100 and this year considers the workplace pension arrangements of 343 executives.

1.2 Over the last few years, employees of UK companies have seen a trend towards riskier and less generous pensions. However, directors continue to receive significant retirement benefits. It is increasingly the case that directors can choose from a menu of contribution options. Nearly a third (32.7 per cent) of executives retain some form of defined benefit (DB) pension provision, which is offered by just over half of FTSE-100 companies, although most schemes are not open to future accrual. This is still a more common form of company retirement than defined contribution (DC) pension provision. Around 28 per cent of employees are in salary-related retirement schemes, according to Office for National Statistics (ONS) figures published in 2013, although there has been a steep decline in their number in recent years which is expected to continue falling.[1]

1.3 However, by far the most significant aspect of company provision of retirement benefits for directors is the cash allowance. Cash in lieu of a pension contribution is received by three directors in every five. Some companies cite the impact on pension accrual of annual and lifetime allowances, which restrict how much an individual can save in a tax privileged manner, as a reason for providing additional cash allowances to executives. A breach of the lifetime limit can trigger a tax charge of up to 55 per cent. Cash allowances are typically far larger than DC pension contributions.

1.4 Of the 100 companies analysed, 53 provide defined benefit schemes to at least one director, although in a number of cases there is no further accrual taking place.

1.5 The same number of companies provide defined contribution schemes. However fewer executives – 99 compared to 112 – participate in DC schemes compared to DB.

1.6 A striking trend is the rise of cash allowances in lieu of pension contributions as the dominant form of retirement provision at top companies. Some 219 executives, or 63.8 per cent of the total, receive cash as at least part of the company's contribution. More executives take cash in lieu of pensions than DB and DC contributions put together.

1.7 There is also a pattern of executives receiving a combination of different types of pension provision, in part due to the impact of annual and lifetime allowances which restrict the amount of tax relief an individual can receive on pension contributions. Some 64 companies offer executives at least two types of

[1] Office for National Statistics, *Pension Trends* – Chapter 7: Private Pension Scheme Membership, 2013 Edition

retirement provision. A number of executives take more than one type of pension contribution with the most common arrangement, used by 36 executives, to receive a combination of DC pension contribution and cash allowance. Three executives in the FTSE-100 are active members of DB pension schemes but also receive cash contributions.

1.8 The average accrued pension is £214,705 a year, down from £259,947 last year, perhaps reflecting the departure from the workforce of those directors who have built up significant DB entitlements.

1.9 The average accrued entitlement for the director with the largest DB pension in each company is £293,260, compared to £330,932 a year ago.

1.10 Most executives in DB schemes are able to retire on a full pension at the age of 60.

1.11 For those directors in DC schemes, the average company contribution is £87,172 a year, down from £160,380 as many companies restricted contributions to the annual limit of £50,000 for the 2013/14 tax year. The average contribution rate is 12 per cent. The average received by those with the highest contribution in each company is £108,292.

1.12 For directors receiving cash, the average company contribution is £149,493. Contribution levels are up to 50 per cent of base salary although the typical company contribution was around 16.6 per cent, reflecting the fact that provision for some executives is divided between cash and formal pension schemes. An executive with the highest cash contribution at a company typically receives £230,854, around 24.5 per cent of salary. However, many also receive other pension provision on top of this.

1.13 There has been a move towards executives receiving more than one form of pension contribution as companies and directors seek to navigate tax rules. Nearly one in five, some 19 per cent of executives, receives more than one type of pension provision. The most common arrangement of this kind is to provide an executive with both a DC pension contribution and a cash salary supplement. However, some combine DB and cash, others DB and DC and three executives are still actively accruing benefit in a DB scheme while also receiving DC contributions and a cash allowance.

1.14 At the other end of the spectrum, 13 executives receive no company contribution towards retirement benefits.

1.15 The 2014 PensionsWatch report shows that executives are increasingly being offered a menu of pension options with the majority using ostensible retirement contributions as a cash top-up to their overall pay package. These pension options are provided on significantly better terms than those available to employees.

Introduction

1.16 In 2003, the TUC initiated PensionsWatch as a way of monitoring pension provision at the UK's biggest companies, with a particular focus on executive directors. During this period there has been a significant change in the nature of pension provision in most companies, with defined benefit (DB) schemes, usually salary-related, being closed to new members of staff and, increasingly, to future accrual of benefits.

1.17 In most cases where companies have moved from DB provision to DC, they have also taken the opportunity to cut back the level of pension contribution. According to figures from financial consultancy Lane Clark & Peacock, company contributions into staff pensions have continued to fall despite the roll-out of auto-enrolment which has increased the number of employees in workplace pensions.[2]

1.18 Directors have also seen the nature of their pensions change but their entitlements remain extremely generous in most cases. In the 2003 PensionsWatch survey, the TUC found that more than two-thirds of companies were still providing DB pensions to at least some directors, although in some cases these schemes were closed to new members. Now barely half the companies, just 53, have executives in DB pension schemes, although in the majority of cases there is no future accrual.

1.19 In 2012, PensionsWatch found that for the first time only a minority of directors had some form of DB provision. Now fewer than one in three have DB entitlements with their current company.

1.20 In the wider population, ONS figures show that in 2013, 59.1 per cent of employees with workplace pensions were in DB schemes and 39.9 per cent in DC schemes.[3] However this is balance is likely to change sharply with pension auto-enrolment which is expected to bring millions more people into DC pension schemes. But, unlike employees who have often found that the company contribution to their pensions has fallen as they moved from DB to DC schemes, executives are still benefiting from high contribution levels with particularly generous terms offered to those who were previously accruing pensions in defined benefit arrangements.

1.21 Perhaps driven by restrictions on tax relief, DC pensions have proved to be of limited attractiveness to many executives and their companies. Only 28.8 per cent of executives receive a DC pension contribution and often it is limited to the annual allowance above which contributions are taxable.

1.22 The last few years have seen substantial cuts in the annual and lifetime allowance limits for pensions saving. In its first Budget in 2010, the government said it would reduce the limits to raise revenue. When introduced in 2006, the annual allowance was set at £215,000. It increased each year and reached

[2] Lane Clark & Peacock, *Accounting for Pensions 2014*

[3] Office for National Statistics, *Occupational Pension Scheme Survey 2012*

£255,000 in the 2010/2011 financial year. In April 2011 the annual allowance was reduced to £50,000. From April 2014 the annual allowance fell further to £40,000.

1.23 A further restriction is placed on the pension saving of high earners by the lifetime limit which is the maximum amount of pension saving that someone can build up over their lifetime that benefits from tax relief. Exceeding the lifetime limit can trigger a tax charge of between 25 and 55 per cent. The lifetime limit for individuals was £1.8 million in 2010/11. It has since been cut first to £1.5 million then £1.25 million for the current financial year.

1.24 Cuts to the annual and lifetime limits have been cited by the government as a way of improving its tax take that only affects the wealthiest savers. However, the willingness of many companies to supplement formal pension schemes with generous cash allowances suggests that they are seeking to ensure that the highest-paid executives are not affected by the changes.

1.25 Two clear themes emerge from this year's PensionsWatch. One is the widespread use of a cash salary supplement as all or part of an executive's company retirement provision. Some of these executives might contribute the money towards a personal pension scheme. The second is the willingness of companies to offer executives a choice of pension provision combining some or all the elements of DB, DC and cash contributions.

1.26 The pensions divide remains but what is of increasing concern is the rise of the executive with no financial interest in wider company pension arrangements. It is possible that proposed changes to pensions rules could make formal pension arrangements attractive once more to executives, at least those who are not yet pushing at annual or lifetime limits. This is because it will be easier for them to take cash lump sums from their retirement savings. However, the changes also create the impression that a pension is primarily a savings plan rather than a source of regular retirement income. This could weaken the impetus for companies to provide significant retirement contributions to staff at any level. The ongoing roll-out of auto-enrolment requires employers to provide just minimal pension contributions to employees.

Defined benefit pensions

1.27 At 53 companies in the FTSE-100 there are executives with entitlement to DB pensions. However, at most of them, executives in salary-related schemes are in a minority. Often they are deferred members. In several cases whether active or deferred members, their pension entitlement is being topped up with cash, sometimes in DC pension contributions or, more rarely, a combination of the two.

1.28 There are very few companies - Associated British Foods and energy company SSE stand out - where DB pensions remain the sole means of retirement provision for executives.

1.29 The transfer value of a pension is the amount, calculated by actuaries, which would be paid from one pension scheme to another if a director moved all their accrued benefits. Few companies now provide information on the transfer values of defined benefit pension schemes. The average disclosed transfer value is £1.1 million. The largest single transfer value disclosed was £19.2 million for Paul Walsh, the former chief executive of spirits company Diageo, who has amassed 29 years of pensionable service. This provides him with an accrued post-retirement income of £597,000 a year.

Top three transfer values

Executive	Company	Transfer value
Paul Walsh	Diageo	£19,179,000
Steve Holliday	National Grid	£13,013,000
Philip Clarke	Tesco	£11,482,000

1.30 The highest pension accrued by an individual is the $2.1 million (£1.1 million) accumulated by Bob Dudley, chief executive of oil giant BP.

1.31 It is likely that the level of transfer values and accrued pensions will decline as the current generation of executives, who have had access to DB pension schemes and achieved long service, go into retirement. The lifetime allowance restricts the ability of younger executives to amass multi-million sums within formal pension schemes.

Top three accrued pensions

Executive	Company	Accrued pension
Bob Dudley	BP	£1,210,367
Peter Voser	Royal Dutch Shell	£909,872
Philip Clarke	Tesco	£633,000

(Peter Voser's pension is converted from Swiss francs at current rates).

1.32 In a defined benefit scheme, the accrual rate is the proportion of pay that a person receives as pension for each year that they have been in the scheme. For instance, an accrual rate of 1/60th indicates a pension worth 1/60th of a final salary, or more rarely the average salary they earned over their career at the company, for every year of pensionable service in the scheme. In line with previous years, the most common accrual rate, declared by ten companies, is 1/30ths although 1/60ths is very common and a range of other figures are used. In contrast, less generous rates of between 1/60ths and 1/80ths are used for virtually all the remaining DB schemes for employees.[4]

1.33 Not all companies declare the normal retirement age for executives. As concerns rise over the long-term funding of pensions many schemes for workers in the public and private sector are moving to a normal retirement age of 65 or higher. For those companies that provide a retirement age for executives, the most common by far is 60, although a few have moved to 62 or 65. Sometimes retirement ages for directors in the same company vary depending on when they joined the scheme.

[4] Office for National Statistics, *Pension Trends* – Chapter 6: Private Pensions, 2013 Edition

Defined contribution schemes

1.34 For those directors in DC schemes, the average company contribution is £87,172 a year, down from £160,380 as many companies restricted contributions to the annual limit of £50,000 (in the 2013/14 financial year) which benefit from tax relief. The average contribution rate is 12 per cent. The average received by those with the highest contribution in each company is £108,292, with a typical contribution rate of 17.4 per cent. The contributions received by directors are significantly down on last year, a trend likely to be due to the move towards cash payments in lieu of pension benefits as directors seek to avoid being caught by annual and lifetime contribution limits.

Top three defined contribution payments

Executive	Company	DC contribution
James Guyette	Rolls Royce	£395,000
Sam Laidlaw	Centrica	£379,000
Raffalele Jerusalmi	London Stock Exchange	£369,000

1.35 Among the highest contribution rates is that for a London Stock Exchange executive who receives 102.5 per cent of basic salary, including for contributions to compulsory state pension schemes in Italy. Executives at Centrica (owner of British Gas), engineering company GKN and Royal Mail also receive contributions equivalent to 40 per cent of their basic salary.

1.36 While the move towards cash supplements has affected the amount going into DC pension schemes, contribution rates are still more generous than those for most employees. Only in a few cases, such as airline easyJet, are contribution levels – in its case 7 per cent – the same for staff and executives. The average contribution rate for employees in DC schemes is just 6.6 per cent.[5] A common arrangement is that in place at Whitbread, owner of Costa Coffee and Premier Inn, where employees receive a 3 per cent pension contribution and executives up to 27.5 per cent.

Cash Contributions

1.37 An increasing number of executives now receive cash in lieu of at least part of their retirement provision. Indeed, only a minority do not receive any cash. FTSE-100 companies handed out a total of £32.7 million in cash allowances in lieu of pension in their last financial year. Around a quarter of those executives receiving a cash allowance get it in conjunction with another form of pension provision, such as DC pension contributions or active membership of a DB scheme.

Top three cash contributions

Executive	Company	Cash allowance
Myles Lee	CRH	£777,238
Douglas Flint	HSBC	£750,000
Antonio Horta-Osorio	Lloyds Banking Group	£549,390

[5] Office for National Statistics, *Pension Trends,* Chapter 6 – Private Pensions, 2013 Edition

(Myles Lee's allowance is converted from euros)

1.38 The biggest cash payment was received by Myles Lee who was, until the beginning of 2014, chief executive of building materials group CRH, one of Ireland's biggest companies.

1.39 Lloyds Banking Group chief executive Antonio Horta-Osorio receives a cash contribution of £549,390 as just one element of his pension arrangement which included a £732,000 pension buy-out which went into a DB scheme (to compensate him for pension benefits sacrificed when he left his previous employer Santander) and an £18,170 contribution to a DC pension scheme.

1.40 The typical cash contribution to executive remuneration in lieu of pension is 16.6 per cent of basic salary, or more than £149,493 each. However, the biggest cash recipient at each company receives on average 24.5 per cent of salary or £230,854. CRH provided Myles Lee with a cash allowance of 83.1 per cent of salary while executives at Lloyds Banking Group, HSBC and engineering company Meggitt receive 50 per cent.

1.41 Even pension providers often opt for cash payments in lieu of pension contributions. Standard Life provides cash allowances to all executives, while at Prudential six executives receive cash for at least part of their retirement compensation.

1.42 Companies pay a range of proportions of salaries as cash in lieu of pension. Among those getting the highest cash allowance at each company, the most common percentage of salary paid as a cash allowance is 30 per cent. At ITV, cash allowances increased to 25 per cent of base salary for both its executives from 1 October 2013 when previously it contributed 9 per cent for its chief executive and 15 per cent for its finance director. However, in some companies contributions are falling. At Vodafone, executives have seen their pension allowances fall from 30 per cent to 24 per cent.

1.43 Often the highest cash payments are not received by the highest earner, who is typically the chief executive. Instead, in many cases the payments go to other longstanding staff members who were previously accruing DB entitlements but have been affected by scheme closures or annual and lifetime limits.

Different combinations of provision

1.44 There is also a pattern of executives receiving a combination of different types of pension provision, in part due to the impact of annual and lifetime limits, which cap how much tax relief an individual can receive on retirement savings. Some 64 companies in the FTSE-100 provide at least two types of retirement contribution.

1.45 A number of executives take more than one type of pension contribution with the most popular option, used by 36 executives, a combination of DC pension contribution and cash allowance. Some 20 directors are active members of DB schemes who also receive cash contributions. Three executives are receiving DB, DC and cash contributions.

1.46 At a number of companies, such as property companies British Land and Hammerson, broadcaster BSkyB and mining firm Rio Tinto, executives receive a contribution into a pension scheme up to the annual limit. Above the limit, cash is provided in lieu of a pension contribution.

1.47 Elsewhere, executives are often offered a choice of how they want their contribution made. For instance at Centrica, executives get a pension contribution of 40 per cent of salary but can choose whether to have it paid into a DC pension or as a cash allowance.

No pension contribution

1.48 Some 13 executives receive no pension contribution at all, according to the latest annual reports from their companies, although these individuals still benefit from extremely preferential wider remuneration packages.

1.49 Some have had a policy of providing no pension contribution to any executive including gold mine operator Randgold, engineering company Weir Group and retailer Sports Direct.

1.50 At others one or more directors receive no payment, often those who have lengthy service with the company and who would be expected to have amassed pension entitlements that take them to the lifetime limit. These include Aberdeen Asset Management's chief executive Martin Gilbert.

Conclusion

1.51 PensionsWatch continues to demonstrate that the retirement packages provided to directors of major companies are much better than those available to their staff.

1.52 There remains a lack of transparency in many companies' disclosures about executive pension provision. Transfer value declarations are increasingly rare and some companies also do not provide details of executives' accrued DB pensions. A number of companies do not provide a breakdown between cash and DC allocations of executives' pension allowances, reducing the usefulness of the disclosure in an era when executives are increasingly offered a menu of retirement benefit options.

1.53 While directors have been affected by the move away from DB pension provision, they have been compensated with large DC contributions or cash payments in lieu of salary.

1.54 Those who continue to build up DB pension entitlements benefit from generous accrual rates and the ability to retire on a full pension at 60.

1.55 This year's survey shows that executives are increasingly benefiting from a lavish menu of retirement provision with the ability to choose their preferred balance between payments into pension schemes.

1.56 The risk is that if executive pension contributions are merely a way of topping up a salary, this could undermine corporate commitment to decent pension provision for the wider workforce. In particular, it might prevent companies looking at more effective and innovative means of providing decent retirement incomes for employees such as utilising powers contained in the current Pension Schemes Bill allowing the establishment of collective defined contribution pensions.

1.57 Meanwhile, pension auto-enrolment, which has been gradually rolled-out since 2012 presents a significant opportunity to ensure that millions of workers receive a decent income in retirement. However, this will only happen if contribution rates, particularly from the employer, are increased. The disengagement of many executives from formal workplace pensions saving on their own behalf risks this opportunity being overlooked.