PensionsWatch 2015

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 the 316 executive directors who sit on their boards.

1.2 Over the last few years, employees of UK companies have seen a trend towards riskier and more parsimonious pensions. While executives retained the protection of more generous and stable defined benefit pensions for longer, there is an accelerating trend for company bosses to become detached from workplace pension provision altogether and to take cash top—ups to their salaries in place of formal pension arrangements.

1.3 Executives have been insulated from the collapse in contribution rates for employees that accompanied the switch that has taken place in recent years from defined benefit pensions, where benefits are based on an employee's wages, to defined contribution, where pay-outs are down to the money put into the scheme combined with investment returns. The average pension contribution (including cash alternatives) made to executives by a FTSE-100 company is 34.1 per cent.

1.4 For the executive receiving the highest pension payment at each company, the employer contribution is more than 50 per cent of salary. This figure is influenced by executives with final salary pensions receiving contributions effectively worth several multiples of their basic salary to take account of their pay rises on promotion. The median contribution for this group is still a generous 30 per cent.

1.5 In comparison, in 2013 the rate of employer contributions received by the average active member of an occupational scheme was 12 per cent.[1]

1.6 Contribution rates to employee schemes vary substantially depending on the type of scheme an employee is in. The average employer contribution rate for private sector DB occupational pension schemes is 15.4% of salary. It is just 6.1% for DC schemes.[2]

1.7 For executives, where once contributions poured into final salary schemes, now they are increasingly going straight into their pockets. Our analysis has found that the UK's biggest listed companies are paying out £34 million a year in cash supplements to directors' salaries in lieu of contributions to formal pension schemes.

1.8 In all, 70 per cent of executives in the UK's top companies receive cash lump sums for at least part of their retirement provision. Of these the vast

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[1] Department for Work and Pensions, *Employers Pension Provision Survey 2013* (2014)

[2] Office for National Statistics, *Pension Trends – Chapter 8, Pension Contributions (2014 Edition)*

majority pocket standalone cash payments in lieu of formal pension provision although for some it was in addition to accrual in defined benefit or defined contribution schemes. These pay-puts alone are often multiples of the total pay package of a typical worker at the same company.

1.9 For decades a final salary pension, often on preferential terms, was as much an emblem of promotion to the top corporate ranks as a corner office. Such schemes provided several generations of bosses with huge pensions in retirement. Such has been the extent of change in executive pension provision that our analysis found just 52 executives continue to accrue benefits in traditional DB schemes against 149 executives who receive cash lump sums with no formal pension provision via their company.

1.10 Notably, executives are largely eschewing defined contribution (DC) pensions, the most common form of pension provided to their own employees, which leave savers potentially at the mercy of the market. These also tend to receive far lower employer contributions than defined benefit schemes. Just 41 executives, or 13 per cent, use DC schemes exclusively for their workplace retirement provision. Another 57 have DC pensions alongside another form of provision, usually cash.

1.11 Just six per cent of executives (20) receive no retirement provision at all from their companies.

1.12 This disconnection between company pension provision for the bulk of workers and those who have ultimate decision-making powers for the schemes is a matter of grave concern. It makes it less likely that schemes will be of high quality and subject to scrutiny. There is also little impetus for increased contribution rates, because pay-outs for executives have no relation to those for their workers.

Introduction

2.1 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 at most companies, with DB schemes, usually salary-related, being first closed to new members of staff and then to future accrual of benefits.

2.2 In most cases where companies have moved from DB provision to DC, they have also taken the opportunity to reduce 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.[3]

[3] Lane Clark & Peacock, *Accounting for Pensions 2015*

2.3 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 just 17 of the UK's biggest companies have executives still actively accruing benefits in DB pension schemes, although many more have deferred benefits in such schemes.

2.4 In 2012, PensionsWatch found that for the first time only a minority of directors had some form of DB provision. Now just one in six (16.4 per cent) are active members of DB schemes.

2.5 Office for National Statistics (ONS) figures show that active member of open private sector DB schemes (those which admitted new members) fell to 600,000 in 2013, from 1.4 million in 2006. Active membership of private sector DC schemes, which has been around one million since 2006, rose to 1.2 million in 2013.[4] However, many more workers are members of group personal pension schemes provided by insurance companies. This switch towards DC is expected to accelerate with the roll-out of automatic enrolment, which obliges most companies to offer workers pension contributions unless they opt out.

2.6 There remains a gulf between employer contribution rates to DB and DC schemes. ONS figures show that for private sector defined benefit schemes, the average employer contribution rate was 15.4% for employers while for DC it was 6.1%.

2.7 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. Particularly generous terms are offered to those who were previously accruing pensions in defined benefit arrangements. The average pension contribution (including cash alternatives) made to executives by a FTSE-100 company is 34.1 per cent, according to TUC analysis. For those receiving the highest employer contribution at each company, the average is 51 per cent. The median payment, which mitigates the distorting impact of large payments for a few newly promoted executives in final salary schemes, is 30 per cent, many multiples of the proportion enjoyed by employees.

2.8 Often the cash pay-out to an executive is directly related to the level of contribution the company was making to their previous DB scheme. This can lead to a two-tier structure on many company boards with longstanding directors receiving the highest cash pay-outs in lieu of pension.

2.9 Payments also vary by sector. Financial services companies are often particularly generous in the proportions of salary paid out in pension allowances with contribution rates as high as 50 per cent not unusual.

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[4] Office for National Statistics, *Occupational Pension Scheme Survey 2013*

2.10 DC pensions continue to be of limited attractiveness to many executives (and the remuneration committees that decide their reward). Fewer than one in three executives receives any form of DC provision, with half of these receiving it in combination with a cash top-up. The average DC contribution was a relatively small £75,772. The average contribution rate was 13.4 per cent.

2.11 However, full analysis of the situation is hindered because not all companies disclose in those situations where executives have the choice between cash, DC pension contributions or a combination of the two, what precise combination they opted for.

2.12 A factor in executives' retirement provision is the increasing restriction on how much top earners can contribute to a pension without a tax penalty. The last few years have seen substantial cuts in the annual and lifetime limits for pensions saving.

2.13 When introduced in 2006, the annual allowance was set at £215,000. It increased each year and reached £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. Further restrictions on the annual allowance available to those earning more than £150,000 a year are due to be implemented from April 2016.

2.14 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. It will fall to £1 million from April 2016.

2.15 These limits could be subject to further change after the government launched a consultation process on changes to pension tax relief that closes at the end of September 2015.

2.16 While some companies assist directors by establishing unorthodox pension schemes that mitigate the impact of these tax limits, others have decided to supplement formal pension provision with generous cash allowances to ensure that the highest-paid executives are not affected by the changes.

2.17 Such is the dramatic nature of the shift that the number of executives receiving any sort of cash payment (in combination or not with other forms of provision) now stands at 222 out of 316. In comparison 52 are accruing DB entitlements and 98 are making contributions to DC schemes.

2.18 Many are combining forms of pension provision in a pick'n'mix of executive pay perks. Some 53 are combining DC and cash; 18 are topping up their DB entitlements with cash; two are amassing both DC and DB benefits; and two DB, DC and cash.

2.19 The clear theme of this year's PensionsWatch is the increased detachment of executives from the pension provision available to the rest of their workforce. Executives have not moved with their workers from high quality DB to typically inferior DC provision. Instead, many have plumped for cash top-ups to their pay at proportions far in excess of those available to the typical worker.

2.20 This plays a role in the maintaining the gulf between executive pay and those of their workers that has expanded in recent years.

2.21 It also suggests that the impetus for improvements to the quality of workplace pension schemes is limited because a declining number of those around boardroom tables have interests in them.

2.22 This detachment undermines the impetus for companies to make improvements on the minimal contributions required under auto-enrolment because for many of those at the very top of business, pension provision has become a cash sweetener to spend today rather than deferred pay that provides the primary means of making financial preparations for old age.

Cash contributions

3.1 Seven in ten top executives receive cash for at least part of their retirement provision, TUC analysis has found. FTSE-100 companies handed out £33.9 million in cash allowances in lieu of pension in their last financial year. This was up 3.6 per cent from the £32.7 million awarded in the previous year.

3.2 Around a third of those who receive cash are also participating in a pension scheme, such as DC pension or active membership of a DB scheme.

Top three cash contributions

Richard Solomons	IHG	£3.2 million
Douglas Flint	HSBC	£750,000
Antonio Horta Osorio	Lloyds Banking Group	£556,890

3.3 The biggest cash payment was received by Richard Solomons, chief executive of InterContinental Hotels Group, who in the last financial year was handed cash to in lieu of future entitlements from a DB scheme. This meant he was handed a cash supplement equivalent to 419 per cent of his basic salary.

3.4 Lloyds Banking Group chief executive Antonio Horta Osorio receives a cash contribution of £556,890, an allowance worth 50 per cent of his basic salary. This is in line with some other executives at financial institutions, such as Douglas Flint at HSBC. However, Mr Horta Osorio also received last year a DB pension contribution worth £712,000 to replace a pension he gave up when he joined from his previous employer as well as a payment into a DC scheme.

3.5 Among those who get the largest cash payment at each company, the average cash haul is £255,4612. This compares to an average of £230, 854 found in PensionsWatch 2014.

3.6 The average cash payment in lieu of pension at a FTSE-100 company is £152,926, some 29.3 per cent of salary. This is ahead of the £149,143 recorded in last year's PensionsWatch.

3.7 Many financial services companies, including Barclays, Standard Life, Royal Bank of Scotland and HSBC, paid retirement contributions to all its executives entirely in cash. They might have been expected to encourage the use of the pensions products that many of them sell.

3.8 The highest proportions being paid are often also by financial services companies with HSBC handing all its executives cash allowances worth 50 per cent of salary (amounting to a total of nearly £2.1 million for the four executives). Meanwhile, Barclays chief executive Antony Jenkins and Standard Life head David Nish each received a 33 per cent cash allowance.

3.9 It has become common for a two-tier structure to apply to executive cash payments as those who were previously in DB schemes are often allocated large cash allowances when their membership ends. G4S is a typical example of this. Grahame Gibson, an executive who was previously accruing benefits in the company's DB scheme, received 40 per cent cash in lieu of pension contribution while other executives received between 20 and 25 per cent.

Defined benefit

4.1 An executive enrolled in a lucrative DB scheme is an increasing rarity in corporate Britain but is not yet completely extinct. At just 17 FTSE-100 companies are executives actively accruing benefits although at a number of other firms executives have deferred DB pension entitlement.

4.2 Meanwhile, only four FTSE-100 companies provide any form of defined benefit pension provision to new recruits. These are Diageo, Johnson Matthey, Wm Morrison and Tesco, although the latter plans to close this to future accrual

4.3 In all, 52 executives are actively saving in DB schemes, of whom 22 also have this topped up with other forms of provision by their companies, most typically cash.

4.4 Associated British Foods, Coca-Cola Hellenic, Diageo and Royal Dutch Shell are the only companies where DB pensions remain the sole means of retirement provision for executives.

4.5 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. Disclosure of pension transfer values is now sporadic in the annual reports of top UK listed companies making the aggregate DB pension wealth of UK executives impossible to calculate. However, the £13.7

million amassed by outgoing Tesco chief executive Philip Clarke, who spent his career at the grocer, stands out for its large size.

Top three accrued pensions

Ben van Beurden	Royal Dutch Shell	£ 852,716
Ian King	BAE Systems	£794,973
Andrew Witty	GlaxoSmithKline	£684,331

4.6 The highest accrued pension identified in the FTSE-100 is the £852, 716 (€1.2 million) secured by Ben van Beurden of Royal Dutch Shell, who is a 30-year veteran of the oil giant.

4.7 It is likely that the level of transfer values and accrued pensions will decline as the last of the generation of executives who built up entitlements over long service, go into retirement. The lifetime limit restricts the ability of younger executives to amass multi-million sums within formal pension schemes.

4.8 In a defined benefit scheme, the accrual rate is the proportion of pay that 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 sometimes the average of the 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 seven companies is 1/30ths. A rate of 1/60ths is also widespread.

4.9 Of those companies that disclosed retirement ages for executive pension schemes, 60 was the most common. This contrasts where many schemes in the public and pirate sectors are moving to a normal retirement age of 65 or higher due to concerns over the long-term funding of schemes.

Defined contribution

5.1 For those directors in DC schemes, the average company contribution is £65,447, another year-on-year fall. This is down from £87,172 a year ago and £160,380 two years ago.

5.2 This is in part due to the £40,000 annual limit on contributions without amassing tax penalties. The average contribution rate is 13.4 per cent.

5.3 The average received by those with the highest contribution in each company is £75,772 (down from £108,292), with a typical contribution rate of 15.4 per cent.

Top three DC contributions

Sam Laidlaw	Centrica	£418,000
James Guyette	Rolls-Royce	£349,000
Raffaele Jerusalmi	London Stock Exchange	£310,000

5.4 The same trio of executives top the DC rankings for PensionsWatch 2015 as last year. This year Sam Laidlaw, chief executive of Centrica heads the list, as the recipient of a £418,000 payment.

5.5 While the amount going into DC pension schemes has fallen as executives have moved towards cash supplements for tax or personal reasons, it should be noted that contribution rates are still more generous for directors than for most employees. In only a few cases, such as insurer Admiral or airline easyJet, do contribution levels apply for staff and executives.

No pension contribution

6.1 Some 20 executives receive no pension contribution, according to the latest annual reports from their companies. This is up from 13 the previous year, although it should be noted that these individuals still benefit from extremely generous wider remuneration packages.

6.2 A few companies have a policy of providing no pension contribution to any executive including gold mine operator Randgold and retailer Sports Direct.

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

Conclusion

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

7.2 There remains a lack of transparency in many companies' disclosures about executive pension provision. Transfer value declarations for DB are increasingly rare. 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.

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

7.4 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.

7.5 But for many the concept of amassing deferred pay in retirement savings no longer applies. Instead money that would previously been earmarked for a pension is added as a cash supplement to their salary.

7.6 The risk is that if ostensible pension contributions are merely a way of topping up executive pay, 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 Pension Schemes Act 2015 allowing the establishment of collective defined contribution pensions.

7.7 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.