Facing cuts

Summary

- Calls for executives' pension contributions to better align with that of their workforce have grown in recent years, due to an increased focus from the FRC, IA and government, as a matter of 'fairness'.
- As long-term investors, pension funds have been encouraged to engage with the issue, either through their fund managers or directly.
- The past year has seen a number of companies change its executive pension remuneration by levelling down its contribution levels, with some also increasing the pension contribution rates for the majority of its staff, to better achieve alignment.

Laura Blows looks at the current focus on reducing executives' retirement remuneration to better align with the pension contributions offered to their workforce, and how pension funds as shareholders can get involved

'*Top bosses earn the average annual wage in just three days'* was the news greeting people on their first Monday of the year back at work.

Splashed upon the front pages of the national press were reports that FTSE 100 chief executives starting work on 2 January 2020 would have earned above the average wage of £29,559 just three working days later, by 5pm on 6 January.

This headline-grabbing statistic, depressing for most, is just one example of the fight against 'fat-cats', LCP partner Shaun Southern says.

This focus on the growing disparity in wealth between the country's richest and poorest can be traced back to the 2008 financial crisis, Aon partner Nic Stratford adds. First, attention was drawn to 'banker bonuses', before moving onto executive pay generally, and now it's the turn of bosses' pensions to be placed under scrutiny.

Increasing focus

According to LCP research in March 2019, nearly half of FTSE 100 companies paid chief executives pension contributions, usually as cash allowances, of 25 per cent or more of their basic salary. This compares to auto-enrolment contribution levels of 8 per cent, for example.

Arguably kickstarting the focus on executives' pension provision was BlackRock. The self-described world's largest fund manager began 2017 by demanding

cuts to director pension entitlements, along with an end to high pay rises, in its letter from the company's head of investment stewardship in Europe, Amra Balic, to the bosses of over 300 companies.

The following year saw the Financial Reporting Council revise its *UK Corporate Governance Code* in July, explicitly stating that pension contribution rates for executive directors, or payments in lieu, should be aligned with those of their workforces.

In November 2018, the Investment Association (IA) sent its updated *Principle of Remuneration* to the chairs of FTSE 350 remuneration committees, setting out investor expectations on executive pay.

This was followed by the IA's Institutional Voting Information Service in February 2019, announcing it will 'red top' companies (indicating that shareholders should have serious concerns) that pay new executives pension contributions that are not in line with their staff.

Around this time politicians also got involved. In March 2019, the Business, Energy and Industrial Strategy (BEIS) Committee called for 'greater alignment' of the pension contributions of executive and employer pay, in its report, *Executive rewards: Paying for success*.

The Work and Pensions Select Committee (WPSC) also gathered evidence from a number of companies over the year, over inaction, or arguably insufficient action, to align executive pensions with that of their employees.

Executive pensions in 2019 therefore became a volatile issue during the spring AGM season and beyond.

For example, according to *Sky News*, July 2019 saw banknote printer De La Rue receive an 'amber top' alert from the IA – one below red top – on the firm's pay report after it revealed its chief executive, Martin Sutherland, had £132,000 paid into his pension pot, equating to 30 per cent of Sutherland's base salary. Food ingredients producer Tate & Lyle also received an amber top.

The year ended with Santander chief executive, Nathan Bostock, agreeing to have his pension allowance cut by £436,000 over the next two years, bringing it from a 35 per cent of salary cash lump sum in lieu of a pension, to 22 per cent this year and 9 per cent in 2021, completing all five of the largest high-street banks in 2019 agreeing to cut executive pensions.

The next two years will continue to place executive pension contributions high on shareholders' agendas. In September 2019, the IA told companies they must pay all executive directors, not just new ones, the same pension contributions as the majority of the workforce by the end of 2022 or risk being red topped.

"Companies with high executive pension payments who don't provide that plan *[to align them to the majority of the workforce]* risk facing further shareholder rebellions in their 2020 AGMs," IA director of stewardship and corporate governance, Andrew Ninian, warns.

Also, the 2020 AGM season will see the majority of listed companies bring new remuneration policies to a shareholder vote for the first time since 2017, therefore keeping executive pensions a top issue.

The year has already begun with *Sky News* reporting that the IA issued a 'red top' to WH Smith for its group chief executive, Carl Cowling, receiving a pension contribution of 12.5 per cent of his salary, due to this percentage not being in line with the company's average worker.

So, with AGM season this spring just around the corner, why should pension funds as investors take notice of executive pension pay?

Pension funds' role

Commenting at the time on the PLSA's January *AGM Review* report, its policy lead for investment and stewardship, Caroline Escott, said: "As long-term investors, pension funds are ideally placed to encourage companies to behave in a way that ensures sustainable business success."

Dalriada Trustees professional trustee, Judith Fish, highlights how the BEIS committee stated that the primary responsibility for ensuring change with executive pay rest with asset owners, such as pension funds, as they invest for the long term. "The behaviour of institutional investors is likely to be monitored to determine the extent that they get 'on board' with this," she warns.

"Providing directors with the same pension contributions as the rest of the workforce is fundamentally an issue of fairness," Ninian summarises.

Independent thinktank, the High Pay Centre, describes CEO pay as the "canary in the coalmine", indicating poor corporate governance and higher business risk.

"One of the most prominent trends that has gained traction is ESG. So far there has been much focus on E *[environment]*, but less on S *[social]* and G *[governance]*. Executive pensions are now about the G. Executive pay is one of the most prominent indications of the need to improve governance. Governance is now beginning to get the right level of focus, but this always should have had more attention, especially following the collapse of Carillon," Aries Insight director, Ian Neale, says.

LCP partner, Gordon Watchorn, recommends pension funds make use of their fiduciary managers to critique executive pay as part of their ESG remit.

The IA states that pension funds "can play an important role", with some conducting direct engagement with companies. Others will communicate their expectations of companies on key issues like executive pay through their fund managers, or participate in collaborative engagement with companies.

"Knowing this issue is of direct concern to the end owners of capital is helpful to incentivise change within companies," it adds.

In addition, Stratford recommends pension funds compare the rate of average pension contributions for the workforce with the plans for the executives' pension remuneration, "to see if what the company proposes seems reasonable to achieve alignment by 2022".

According to Escott, the PLSA is very keen to emphasise that individual accountability is vital. "If you as an investor have an issue with an executive's pension contributions, then there are a number of things you can do; you can vote against the board, or the remuneration report, or vote against the person responsible, such as the chair of the remuneration committee or even the chair of the board."

Engagement

Yet not all investors are necessarily keen on this subject. According to the High Pay Centre, in May 2019, investors "are not interested in tackling inequality and excessive executive pay". It stated that between 2014 and 2018, every single FTSE 100 company pay policy put to AGMs was approved by shareholders, and only 11 per cent of pay-related resolutions attracted significant dissent levels of over 20 per cent.

However, the PLSA's *AGM Review* report in January found that executive remuneration levels remained a key concern for pension schemes as shareholders over the past year.

So far, the response from executives has not been unanimous wild joy at this increased scrutiny of their pension arrangements either.

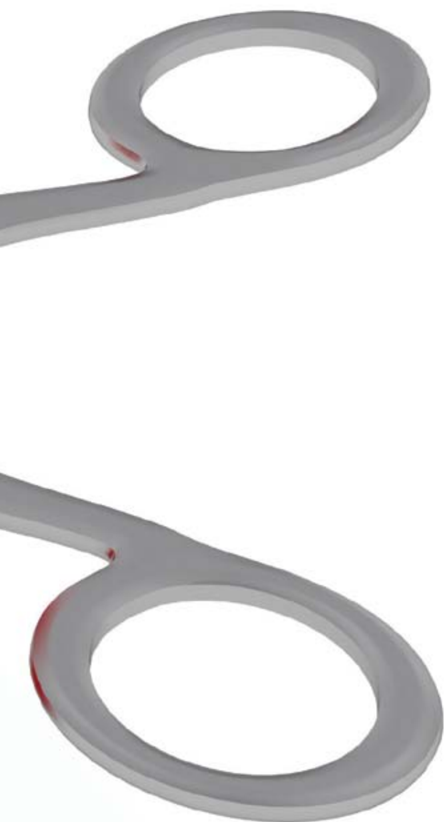
For instance, outsourcing firm G4S refused to answer questions from the WPSC and BEIS committee in May 2019 about its policy of paying 15 per cent pension contribution to new executive directors and 25 per cent to existing directors. However, G4S remuneration committee chair, John Daly, said the company had made "significant changes" to its remuneration policy over the past year, which were "well received by shareholders".

The 2019 BEIS report had criticised Lloyds Bank and HSBC for "seeking to flout the spirit" of the FRC's and IA's remuneration principles regarding pension contribution rates, by offering "substantial" alternative pensions advantages to their chief executives, to compensate for the alignment of pensions contributions.

This is a concern of Fish, who says that, while the trustee firm supports calls for executive pensions to be aligned with the majority of the workforce, it is worried that "if the company exec's pensions are reduced, they will just get the reward in other ways".

Potentially highlighting this was Standard Chartered's 2019 remuneration policy, which saw executives receive 20 per cent of 'total' salary, down from 40 per cent of salary, with new directors receiving 10 per cent of total salary. (Total salary includes all fixed elements of remuneration – going against the *UK Corporate Governance Code*, as the code says pension contributions should be expressed as a percentage of basic salary, LCP states). Other staff receive 10 per cent of salary as pension contributions.

Commenting at the time, LCP said



by decreasing the headline number, Standard Chartered seemingly responded to pressure to align pension contributions for executives with that of their workforce, but in practice, the amount received would stay broadly the same, giving the example of CEO, Bill Winters, receiving a pension allowance of £474,000 in 2019, compared to £460,000 in 2018.

Having been called on by the WPSC, Winters reportedly described picking on individual pension arrangements as "immature and unhelpful".

But in November 2019, Winters agreed for his pension allowance to be cut from 20 per cent to 10 per cent, taking effect at the start of 2020 and bringing his pension in line with that of his workforce. The firm's group chief financial officer also took a 50 per cent pension cut, from £294,000 to £147,000.

"A number of companies proactively reduced executive pension entitlement, to 'head off' investor dissent"

Impact

Whether the cuts are being made with good grace or not, significant change is being made. The PLSA's January report noted that a number of companies proactively reduced executive pension entitlement, to 'head off' investor dissent.

The IA states that in the past year, 36 companies committed to any new director being given a pension contribution in line with the majority of the workforce. Twelve companies, including HSBC, BHP and British American Tobacco, have reduced pension rates for incumbent directors immediately, and 10 companies, including RBS and Aviva, have already appointed new directors with pension contributions in line with the majority of their staff's.

Last month saw incoming Sainsbury's chief executive, Simon Roberts, set to receive 7.5 per cent of his base salary as an annual pension allowance; a marked contrast to the outgoing executive's 30 per cent contribution when took the role in 2014.

Meeting in the middle?

But it is not just the levelling down of executive pensions that is occurring to achieve workforce pension contribution alignment.

For instance, following on from BEIS' concerns regarding Lloyds' executive pension arrangements, its executives were questioned in front of the WPSC in June 2019.

That year, Lloyds' chief executive, António Horta-Osório's pension was cut from 46 per cent to 33 per cent of salary.

In November, Lloyds confirmed that Horta-Osório will take a further pension cut, from 33 per cent, to 15 per cent of base salary for 2020. Staff pension contributions are also expected to rise from a maximum of 13 per cent to 15 per cent of base salary this year.

Meanwhile, Barclays was reported in December 2019 to be considering increasing its employee pension contributions from 10 per cent to 12.5 per cent. In 2019, Barclays chief executive received a £396,000 cash lump sum in place of pension provision, equivalent to 34 per cent of salary. This year he will take a £200,000 cut, bringing his pension payment to around 17 per cent of salary.

Is this the emergence of a broader trend, that of executives' increasing interest with their staff's pension contributions, as well as their own?

Possibly so, according to the IA. "We are particularly pleased that some companies have used this shareholder scrutiny as an opportunity to assess whether their broader workforce contribution rates are appropriate," Ninian says.

While the focus is on executive pension arrangements, aligning them to the majority of employees, Southern wonders about the 'middle tier', such as managers and directors, which sit between the CEOs and the main workforce. "If bosses contributions have to significantly reduce, will they reduce the other tiers accordingly, effectively creating one uniform pension contribution rate?", he asks.

Whatever may happen, one thing's for sure; the year is likely to carry on as it began, with executive pay continuing to hit the headlines.

Written by Laura Blows