

# INVESTMENT ASSOCIATION POSITION ON EXECUTIVE DIRECTOR PENSION PROVISION – SEPTEMBER 2019

## BACKGROUND

In July 2018, the FRC published an updated UK Corporate Governance Code, which included a provision which stated:

“Only basic salary should be pensionable. The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce.”

Following its publication, the IA was asked by both Remuneration Committee Chairs and advisors as to how our members expected companies to respond to this provision.

In November 2018, the IA published its updated Principles of Remuneration which stated:

“Pension related payments should not be used as a mechanism for increasing total remuneration. The pension provision for executive directors should be in line with the general approach to the employees as a whole. The UK Corporate Governance Code states that pension contribution rates should be aligned with those available to the workforce. IA members consider this to be the rate which is given to the majority of the company’s workforce. Investors expect new executive directors or any director changing role to be appointed on this level of pension contribution. The contribution rates for incumbent executive directors should be reduced over time to the contribution rate available to the majority of the workforce, members expect this to be achieved as soon as possible. Shareholders do not expect that compensation will be awarded for this change.”

In February 2019, we announced the approach which IVIS, the IA’s corporate governance research service, will take to colour coding companies on this issue through the 2019 AGM season:

- For companies with year-ends on or after 31 December 2018, any new remuneration policy that does not explicitly state that any new executive director appointee will have their pension contribution set in line with the majority of the workforce will receive a red top on the remuneration policy
- Any new executive director appointed from 1 March 2019 whose pension contribution is above the level of the majority of the workforce will result in a red top on the remuneration report
- Any existing executive director receiving a pension contribution of 25% of salary or more will be amber topped on the remuneration report

## PROGRESS TO DATE

The IA and our members welcome the response that we have seen from companies in 2019. For new Remuneration Policy approvals and the appointment of new executive directors, we have seen the vast majority of companies appoint or commit to appoint any new executive director on a pension contribution which is equal to the level of the majority of the workforce.

We have also seen significant leadership from some executive directors, who have voluntarily reduced their pension contributions to align with the workforce, or committed to reduce them so that over time they will be aligned with the majority of the workforce level.

33 companies in the FTSE100 have made significant changes as a result of the IA's position. This includes:

- 20 FTSE 100 companies have committed that any new Director will be given a pension contribution in line with the majority of the workforce.
- 4 companies have reduced pension contributions for incumbent Directors immediately.
- 3 companies have appointed new directors with a pension contribution in line with the majority of the workforce.
- 6 have made multiple changes in this AGM season – reducing contributions for both existing and future directors

## APPROACH TO PENSION CONTRIBUTIONS IN 2020

The IA's approach in 2020 will continue to meet the underlying aim set out in our Principles of Remuneration: for pension contributions for executive directors to be aligned with those provided to the majority of the workforce. This should be immediate for any new executive director and as soon as possible for incumbent directors. Informed by this underlying aim, IA members expect the following approach from companies during 2020:

### **Disclosure of the majority of the workforce rate**

IA members request that companies disclose in their Remuneration Report the pension contribution rate which they consider to be given to the majority of the workforce. The Remuneration Committee should also explain how this rate has been derived. For example, is it an average of all employees, UK employees only, or the rate given to all new joiners? IVIS will highlight those companies that do not disclose the contribution rate for the majority of the workforce.

### **Pension contribution of all employees**

IA members consider it important for the Board, Remuneration Committee and management team to consider the pension contributions provided to all employees, not just those for the executive directors. Members have been encouraged by those companies that have stated that they are reviewing the pension contributions for all employees to ensure that they are providing an appropriate pension provision. IVIS will highlight those companies that have increased the pension contributions provided to all employees.

### **Pension contributions for new Directors**

It is now standard market practice for any new executive director or any director changing position to be appointed on the pension contribution which is aligned to the majority of the workforce rate. In 2020, IVIS will continue with its current approach:

- Any new remuneration policy that does not explicitly state that any new executive director appointed will have their pension contribution set in line with the majority of the workforce will receive a red top on the remuneration policy.
- Any new executive director or director changing role whose pension contribution is not aligned with the level of the majority of the workforce will result in a red top on the remuneration report.

### **Pension contributions for incumbent directors**

IA members welcome the leadership shown by the companies and individuals who have voluntarily reduced their pension contributions. Whilst recognising that incumbent directors have a contractual right to their current pension contributions, as outlined in our Principles of Remuneration members want to see all pension contributions reduced to the level of the majority of the workforce, as soon as possible. As such, for companies with year-ends starting on or after 31 December 2019:

- IVIS will continue to amber top the remuneration report when a director is paid a pension contribution of 25% of salary or more.
- Members expect Remuneration Committees to set out a credible action plan to reduce the pension contributions of incumbent directors to the majority of the workforce level by the end of 2022.
- Where the committee has not disclosed a credible action plan to reduce the director's pension contribution to the majority of the workforce rate by the end of 2022, IVIS will Red top the remuneration report if the pension contribution received by the executive director is 25% or more.

In most circumstances, members do not consider fixing the monetary value of pension contributions over time to be a credible action plan to bring the pension contributions in line with the majority of the workforce.

### **Defined Benefit Schemes**

We note that there are still a number of companies which provide a defined benefit pension benefit to their executive directors. We expect companies to confirm that future accrual is still open to other employees on the same terms as the executive directors. If companies do not, the remuneration report will be amber topped.

Where companies pay a cash supplement in lieu of further accrual above an earnings limit, companies should confirm that such cash supplements are also paid to other employees on an equivalent basis. Without such confirmation the remuneration report will be amber topped.