Companies turn to a new, flexible form of executive pension compensation.
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The purpose of the survey is to highlight the recent changes and developments within executive pension provision. This survey and the information it contains should not be relied upon as advice from LCP or a recommendation as to the appropriateness of executives’ pension arrangements. Specific professional advice should be sought to reflect an individual executive’s/company’s circumstances.

This survey is based on legislation at August 2012.

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LCP FTSE 250 Executive Pensions Survey 2012

The LCP Executive Pensions Survey is carried out annually, alternating between FTSE 100 and FTSE 250 companies each year. This year our attention is on executives in FTSE 250 companies. We draw comparisons with the results of our last FTSE 250 Executive Pensions Survey in 2010 and also with our FTSE 100 Executive Pensions Survey in 2011.

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The Treasury has achieved its aim – in the old days executives got tax relief on pension compensation but now they are actually paying tax on it. A FTSE 250 executive who cannot shoehorn their pension savings into the new limits is paying £35,000 a year in tax.
Key findings

The cost of pensions within the average annual remuneration package of a FTSE 250 executive has fallen by one fifth from £87,000 to £68,000 since 2010.

This fall in pension compensation is due to the new tax limits on pension savings introduced in April 2011. This has forced companies to introduce more flexible forms of pension compensation, accelerating the move away from higher-value DB pension provision.

A new, flexible form of executive pension compensation dominates.

- A flexible combination of defined contribution (DC) and cash supplement is now in place for 20% of FTSE 250 executives. In 2010 this was in place for only 3% of executives.
- This is a response to the new £50,000 Annual Allowance on tax-relievable pension savings. Pension compensation is channelled into a DC arrangement until tax limits are reached, with any remaining pension compensation paid as a taxable cash supplement.

More flexibility in pension compensation increases the burden on executives to make annual decisions with their pension savings.

- 1 in 3 executives have annual pensions savings in registered pension schemes that exceed the annual allowance of £50,000. Executives who now receive cash compensation instead of making pension contributions are paying tax on that compensation.
- 1 in 3 executives with defined benefit (DB) pensions are already above the new lifetime allowance of £1.5m.
- A FTSE 250 executive is paying £35,000 each year in tax where he or she cannot fit their pension compensation into the new limits on tax relievable pension savings.
- On the other hand, executives are missing out on valuable tax relief where they are not making full use of the new allowances.

However, pensions remain a valuable remuneration component.

- The pension cost to the employer for the average FTSE 250 executive is £68,000 each year.
- Setting aside more costly DB pensions, the median level of pension compensation is 20% of basic salary.

There is a stark difference in pension compensation for FTSE 100 and FTSE 250 executives.

- The employer pension cost for the average FTSE 100 executive is three times that of his FTSE 250 peer and amounts to £225,000 per annum.
- 45% of UK-based FTSE 100 executives with DB pensions remain insulated from the new limits by receiving at least some of their pensions outside a tax-registered pension scheme. Only 6% of corresponding FTSE 250 executives with DB pensions are in the same position.
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Pensions are still an important piece of executive remuneration – but it’s a smaller and more flexible piece, with the aim of allowing each executive to use available tax reliefs.
This section sets out our analysis of pension compensation provided to FTSE 250 executives – covering cost, type and comparison with previous years.

Data in our analysis
- Our analysis covers the FTSE 250 constituents as at 30 June 2012.
- The FTSE 250 index includes the 101st to 350th largest companies with their primary listing on the London Stock Exchange.
- We have analysed published accounts with accounting years ending during 2011.
- We have considered executive directors who remained in office at the end of each company’s accounting year.
- An executive is a member of the board of directors who is also a full-time employee of the company.
- Total number of executive directors in survey: 591

Pension as a percentage of total remuneration
Pension benefits continue to form a significant part of executives’ remuneration, but the value of executive compensation has fallen markedly in our latest results. Back in 2010, pensions were £87,000 per annum of the average executive’s total remuneration. In 2012 this is down one-fifth to £68,000.

Our study reveals that the main cause of this fall is the new limit on tax-relievable pension savings introduced in April 2011. This has forced many of the companies in our survey to introduce more flexible forms of pension compensation, accelerating the move away from higher-value defined benefit pensions.
Composition of total remuneration

The bar chart below sets out an analysis by sector of the key components of executives’ total remuneration (with the number of executives in each sector given in brackets).

Comparisons with earlier results

The composition of pension within total remuneration has changed significantly:

- Historically, pension compensation has varied markedly by sector, ranging from 6% to 34% of total remuneration in 2010.
- This year’s results show a much flatter level of pension compensation by sector, ranging from 6% to 12% of total remuneration. The trend has been to level down pension compensation across sectors for reasons that we analyse later in this report.
Pension types offered to a FTSE 250 executive

In broad order of increasing corporate risk, the types of provision are:

- no pension provision;
- an explicit cash supplement in lieu of pension;
- contributions to a DC arrangement;
- a mixture of cash and contributions to a DC arrangement;
- a mixture of DB pension and cash supplement; and
- DB pensions.

DB pensions continue to decline. Two years ago, one in three FTSE 250 executives had some DB pension as part of their remuneration. Now it is fewer than one in four. For the first time, no externally appointed executives were offered a DB pension in 2011.

However, the most significant development is the rapid growth in DC/cash compensation from 3% of executives to 20% of executives. Compensation of this type gives the executive the flexibility to optimise his or her pensions-tax allowances under the new tax regime introduced from April 2011. Remuneration committees have reacted to this change by allowing their executives to direct their employer to pay the maximum amount of tax-privileged savings into the DC arrangement and to pay any remaining contributions as a taxable salary supplement.
The attraction of DC, cash or a combination of these is confirmed in our analysis of newly-appointed executives. Our chart below showing the types of pension provision offered to external appointments during 2011 provides a good indication of trends to continue in our surveys in the future.

### Pension compensation costs to the employer

DB pension promises for FTSE 250 executives continue to be more valuable and costly to provide than other pension types.

**Cost of annual pension awarded as % of basic pay**

The cost of a DB pension has, on average, fallen from over 50% of annual basic salary in 2010 to 30% in 2012. A driver behind this fall is a switch to DC or cash pension compensation for many of the executives who had high value DB pensions in 2010. Furthermore, the cost of a DB pension in...
a year depends on the increase in salary during the year – the greater the salary increase, the greater the increase in DB pension. Salary increases over 2010/11 have tended to be lower than during 2008/09 so the cost of DB pension is lower. In addition, some companies have limited the increase in their executives’ DB pensions to ensure that their executives do not face additional tax charges.

The cost of providing other forms of pension benefit – which are generally expressed as a fixed percentage of basic salary – are similar to two years ago.

**Benchmarking of pension costs by type**

**No pension compensation**

Eight companies provide no explicit pension compensation for all of their executives. This is the same number of companies as in 2010. In total 63 executives received no explicit pension compensation, up from 50 in 2010, comprising the executives at these eight companies and one-off agreements with individual executives at other companies.

**Cash in lieu of pension**

Ten FTSE 250 companies currently offer cash in lieu of pension to all of their executives, whilst other companies offer this benefit to some of their executives. Below we set out the lower quartile, median and upper quartiles to show the range of provision for the 64 executives who received this benefit as their only form of pension provision.

<table>
<thead>
<tr>
<th>Lower quartile</th>
<th>Median</th>
<th>Upper quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>20%</td>
<td>25%</td>
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<tr>
<td>30%</td>
<td>35%</td>
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20% of basic salary continues to be a popular benchmarking choice for cash in lieu of pension.
**Main analysis**

**Defined Contribution and cash**
More than 50 companies provide a combination of DC/cash compensation to their executives. This approach is described on page 10.

**Defined Contribution pensions**
35 companies provided DC pensions to all of their executives. This is down from 55 two years ago and partly reflects that many companies now give their executives the option to have a combination of DC/cash compensation. The fall in median DC cost since 2010 suggests that companies who have switched to DC/cash are those that offer higher pension compensation.

**FTSE 250 companies with DC/cash include**
- African Barrick Gold plc
- Greene King plc
- IG Group Holdings plc
- Logica plc
- QinetiQ Group plc
- the restaurant group plc
- Spectris plc
- Stobart Group Limited
- Victrex plc
- WH Smith PLC

**FTSE 250 companies with Defined Contribution pensions include**
- Booker Group plc
- Cranswick plc
- Devro plc
- F&C Asset Management plc
- Grainger plc
- Great Portland Estates plc
- Hikma Pharmaceuticals plc
- Inmarsat plc
- Ocado Group plc
- Yule Catto & Co plc
Defined Benefit pensions

Two companies provided solely DB pensions to all of their executives throughout the year, down from ten companies two years ago. However, DB pensions continue to be a valuable benefit for 73 executives who accrued DB pensions with their current employer during 2011.

As an objective measure, and for the purpose of this report, we use each company’s own calculation of pension value as disclosed in their remuneration report to estimate the cost of the benefit earned over the year. For executives receiving only DB pension provision, the range of DB pension accrued over the year expressed as a percentage of basic salary is shown below. 2012 values are much lower reflecting lower pay rises over 2011 and steps taken by some companies to keep the value of benefit accrual below the new tax limits.

DB pensions depend upon salary, length of service and benefit scale, and there is a wide range of amounts. The DB pensions earned to date with the current employer are shown below.

£67,000

Average annual DB pension earned so far with current employer only.
**FTSE 250 versus FTSE 100 pensions**

The average annual DB pension earned so far with the current employer for FTSE 250 executives is £67,000, which is less than a third of the £210,000 annual pension earned by corresponding FTSE 100 executives.

Our 2011 Executive Pensions Survey analysed the pension arrangements of FTSE 100 executive directors. The chart below shows that the average employer cost (as a percentage of basic salary) for a FTSE 250 executive's pension is half the cost for a FTSE 100 executive.

**Cost of annual pension awarded as % of basic pay**

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**Double**

Pension cost (as % of salary) for FTSE 100 versus FTSE 250 executive.
Changes to tax relief on pension savings

- Reduced Annual Allowance
- How companies are adapting to the new tax regime
- Employer Financed Retirement Benefit Schemes
- Reduced Lifetime Allowance
- Tough decisions for executives
Pension saving in the new era of reduced tax allowances requires careful – and annual – decision-making. The executive who carries on regardless will suffer tax surprises.
Changes to tax relief on pension savings

This section details changes to tax relief on pension savings, choices made by FTSE 250 remuneration committees and the impact on their executives.

Key points of the regime now in place:

- An Annual Allowance of £50,000 on pension contributions that enjoy tax relief at the executive’s full rate of income tax.
- If pension contributions exceed £50,000 in a year, unused Annual Allowance from the three previous years may be carried forward.
- The Lifetime Allowance on tax-approved pension savings reduced from £1.8m to £1.5m in April 2012.

Reduced Annual Allowance

The Government has made changes to the Annual Allowance test for pension contributions. The Annual Allowance has reduced to £50,000 and is expected to stay at £50,000 until at least tax year 2015/16.

Contributions in a year which total more than the Annual Allowance will incur a tax charge payable upfront. “Contributions” include money purchase contributions by the executive and their employer, and, for benefits in a defined benefit scheme, the increase in the value placed on those benefits over a year.

Impact of the reduced Annual Allowance

We have assessed the impact of the reduced Annual Allowance for the 416 executives in our survey who are earning benefits in a registered (ie tax-approved) pension scheme. The chart opposite shows the HMRC value of “contributions” during 2011 for these executives. Where the value of contributions is greater than £50,000 the executive may face an additional tax charge.

Based on our analysis one in three executives have pension savings that exceeded the Annual Allowance. The consequence is that they could be taxed twice – first when they exceed the annual allowance, and again when they receive the pension during retirement. This suggests that many FTSE 250 companies and executives still need to take action to reshape their pensions savings or face unnecessary tax charges in the future.
Changes to tax relief on pension savings

This is our first survey to include company accounts published after the new pensions tax regime took effect. A large proportion of companies provided additional commentary in their pension disclosures to explain how they have changed executive pension arrangements as a direct consequence of the new tax regime.

Almost all of these FTSE 250 companies adapted to the new regime by introducing either DB/cash compensation (where DB pensions were previously provided) or DC/cash compensation.

**DB up to the Annual Allowance with cash on top**
- Balfour Beatty plc
- Electrocomponents plc
- Persimmon plc

**DC up to the Annual Allowance with cash on top**
- Aegis Group plc
- Amlin plc
- BBA Aviation plc
- Bovis Homes Group PLC
- BTG plc
- Carillion plc
- Dairy Crest Group plc
- De La Rue plc
- Dechra Pharmaceuticals PLC
- Domino Printing Sciences plc
- Drax Group plc
- Greene King plc
- Greggs plc
- IG Group Holdings plc
- Interserve Plc
- Logica plc
- Mitchell & Butlers plc
- Oxford Instruments plc
- QinetiQ Group plc
- Spectris plc
- St James’s Place plc
- Taylor Wimpey plc

How companies are adapting to the new tax regime

1 in 3 Executives with annual pension savings that exceed the Annual Allowance.
Companies who have adapted in this way have reduced the tax charges faced by their executives compared to doing nothing. Nevertheless, their executives are paying more tax than they did under the old pensions regime. We estimate that a FTSE 250 executive is paying £35,000 each year in tax where he or she cannot fit their pension compensation into the new limits on tax relieviable pension savings.

**Employer Financed Retirement Benefit Schemes (EFRBS)**

A solution to the constraints of the Annual Allowance and the Lifetime Allowance is an Employer Financed Retirement Benefits Scheme, or EFRBS. These are pension vehicles that are not registered with HMRC and so do not have the same tax advantages of HMRC registered schemes. They can, however, provide benefits that are not subject to the Annual Allowance or Lifetime Allowance charges if set up properly and unfunded (ie no contributions are made by employer or employee). Many companies first made use of EFRBS after 1989 when the Earnings Cap (ie the maximum HMRC level of pensionable earnings) was introduced.

Our equivalent survey of FTSE 100 executives showed that EFRBS have widespread use: 45% of UK based FTSE 100 executives with DB pensions received part or all of their pension via EFRBS. Conversely, only 6% of corresponding FTSE 250 executives benefit from EFRBS in this way.

**Reduced Lifetime Allowance**

The Government reduced the Lifetime Allowance from £1.8m to £1.5m with effect from 6 April 2012. The Lifetime Allowance relates to the value of the total pension fund an individual builds up across all his/her pension arrangements. If the individual draws benefits worth more than the Lifetime Allowance, then he/she will pay extra tax on the excess benefits when drawn.

One in three executives in registered DB pension schemes have total pension values to date that exceed £1.5m. Many of these executives have opted out of earning further pension in their DB scheme, making a cash pension allowance an obvious alternative form of pension compensation.
Tough decisions for executives
Our study shows that companies and executives have difficult decisions to make. The new tax regime introduces annual decision-making to avoid surprises and make full use of the tax relief allowances available.

Questions that executives are asking:
- Will I exceed the annual allowance this year?
- What options are available to mitigate a tax charge?
- Should I opt-out of the pension scheme?
- Will I exceed the lifetime allowance?
- Am I affected by the lower lifetime allowance?

LCP is helping companies and their executives by:
- Reviewing pension compensation to ensure it is in line with market practice and delivered in a practical and tax-efficient way.
- Communicating changes, and explaining the new tax regime, to executives.
- Providing seminars, one-to-one meetings, and online tax calculators to assist executives.
LCP FTSE 250 Executive Pensions Survey 2012

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LCP Pensions Tax Modeller

Helping employees understand the current and future tax consequences of their pension savings.

Changes to the limits on tax relief for pension savings are now fully in force. Many employers have made changes to pension provision. However, it is clear that employees now need ongoing support to avoid tax surprises and to make full use of the tax relief allowances available.

LCP (in partnership with Shilling Communication) have created a web-based Pensions Tax Modeller for employers wishing to help members of their defined benefit and defined contribution pension schemes. The Modeller is bespoke to each pension scheme and branded according to client wishes. It was first launched in 2010 and has supported thousands of employees since the new regime was introduced in April 2011.

What does the Pensions Tax Modeller do?
The Modeller compares current and future pension savings against the new Annual and Lifetime Allowances applicable for taxation purposes.

How does it work in practice?
Members only need to enter a few details from their most recently issued benefit statement. The Modeller then projects the scope for additional pension savings and/or the potential tax charges based on the variable scenarios chosen by the user.

Employee questions:
- Will I exceed the annual allowance this year?
- What options are available to mitigate a tax charge?
- Should I opt out of the pension scheme?
- Will I exceed the lifetime allowance?
- Am I affected by the lower lifetime allowance from April 2012?
- Do I have scope for additional pension savings in the next few years?

Additional benefits include:
- Advanced input options (such as benefits held in other pension schemes, historical contributions paid, and expected future voluntary contributions), which allow the user to assess the potential for using the “carry forward” tax facility.
- Printable pages for reference, which will include the graphs, assumptions used and all the data items that have been entered.
- A hosted secure website for which no IT involvement is required.

Pensions Tax Modeller screenshots
What if we have multiple pension schemes with different benefits?
The Modeller is highly flexible and can be easily adapted to cater for
different schemes, different benefits, and any bespoke functionality
requested.

Why now?
The change in the tax regime means regular on-going monitoring is
needed to avoid surprises in annual tax returns for employees.
The Modeller is an excellent way for employers to offer support to, and
manage questions from, employees in this challenging area.

How do I find out more?
If you would like to discuss the Pensions Tax Modeller or would like to view
a demo version, please contact Mark Jackson, Alex Whitley or Ben Adams.

The modeller is
extremely flexible and
caters for numerous
different benefit
structures. The LCP
team had a live version
up and running within
tight timescales and we
are very pleased with the
output. The modeller is
a valuable tool which
helps our employees to
understand and monitor
the options available
to them under the new
pensions tax regime.

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insurance and business analytics.