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Executive Directors' Pensions 2008

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Abstract

Employer contributions to occupational pension schemes on behalf of employees amounted to €1.4 billion in 2007 and the estimated cost of tax relief and exemption from benefit in kind taxation are €150 million and €540 million respectively. These benefits are concentrated on the top 20 per cent of earners which include executive directors of companies. As top management make little or no employee contribution for their pensions whereas other employees are generally required to do so, this paper investigates the other respects in which pension arrangements for executive directors differ from those of other employees.

Using information, mainly for 2008, from the annual accounts of 45 large Irish companies, it is found that the average annual pension contribution for an executive director amounts to nearly €24,000 compared with around €2,700 for other covered employees. Almost 40 per cent of executive directors benefitted from contributions of €50,000 or more while a quarter of them benefitted from contributions of €100,000 or more. The average pension contribution rate for executive directors is almost 31 per cent whereas the rate for the average public service worker is 20 per cent and the rate for other employees in the private sector is 8.5 per cent.

There is not enough information available on accrual rates, normal retirement age, value of accrued pension, or accrued value of individual pension funds for executive directors to reach definite conclusions. However, the limited information which is available suggests that some executive directors need only to work for half of the time other employees have to work to qualify for a full pension, that the normal retirement age may be three to five years lower than for other employees, that if the average executive director were to take immediate retirement he would have a pension 15 times greater than the income of the average single pensioner and that the average value of an executive director's pension fund amounts to nearly €4.7 million compared with €102,000 for other employees.

These comparisons indicate that there is a need for much greater equity in the arrangements for tax relief on private pension contributions. In 2009 the cap on the annual tax relieved contribution to a pension fund was reduced from €75,239 to €150,000 but the lifetime cap on the size of an individual pension fund was left unchanged at €5.418 million. Given the reduction in the cap on tax relieved contributions the cap on the size of fund should have been reduced to €1.5 million. However, neither the cap on earnings or on the size of the fund are consistent with recommendations by the OECD, and others, that tax relief on pensions should be concentrated on middle and lower income earners. Adoption of this policy would require reductions in the annual earnings limit for pension contributions to €75,000 and in the cap on the size of an individual pension fund to around €½ million.

¹ I am grateful to Jim Stewart and Tony McCashin for comments on an earlier draft and to Rosin Shortall T.D. for providing information on the cost of pension tax reliefs in 2007.

Executive Directors' Pensions 2008

Introduction

The Department of Finance (2009) has informed the Public Accounts Committee that employer contributions on behalf of employees to occupational pension schemes amounted to €1.4 billion in 2007. As these contributions are deductible as a business expense, the estimated cost of tax relief amounted to €150 million. In addition, the estimated cost of the exemption of the pension contributions from employee benefit in kind amounted to €540 million. The department provided no information on the distribution of either of these tax expenditures between executive directors of companies and other employees. However, the Covered Institution Remuneration Oversight Committee² has reported (Department of Finance, 2009, par. 5.22) that “In general, top management make little or no employee contribution for their pensions.” This is in sharp contrast to the pension arrangements for employees of these companies as they are generally required to make contributions towards their pensions throughout their working lives, just as employees in non-financial companies in the private sector and in the public sector are required to do.

The fact that top management in financial companies make little or no contribution towards their pensions compounds the inequality built into our pension system by the arrangements for giving tax reliefs on pension contributions. Hughes (2005) and Callan, Walsh and Kelly (2009), for example, have shown that most of the benefit of tax relief on pension contributions is appropriated by the top 20 per cent of earners.

In view of the belated acknowledgement by the government parties of the inequality of the tax arrangements for pensions in the Review of the Programme for Government (Fianna Fail, 2009, Green Party, 2009) it is worth asking if there are other respects in which the pension arrangements for executive directors of companies differ from those of the employees of those companies.

² Following the State's rescue of the banking system, this committee was set up by the Minister for Finance to review the remuneration packages payable to senior management and directors of financial institutions whose covered liabilities are guaranteed by the government.

Source of Pensions Information and Selection of Companies

The listing rules of the Irish Stock Exchange (2009) specify that companies must present information in tabular form on each element of each director's remuneration package by name. For defined benefit schemes the value of the increase in pension during the period under review must be stated together with the accumulated total amount in respect of the accrued benefit to which each director would be entitled on leaving service.

In order to gather this information the Irish Times list of the Top 1,000 Companies was worked through in conjunction with the listings on the Dublin and London stock exchanges to find companies operating in Ireland whose annual accounts for 2008, or in some cases 2007, were available on the internet. This search resulted in the identification of 45 financial and non-financial companies from the first 500 companies in the Irish Times list. Following the policy adopted in the preparation of the Irish Times list we have omitted companies registered here which barely trade here and whose company accounts are filed in jurisdictions outside Ireland or the UK. The list of companies included in our sample is given in Appendix 1. The great majority of them are listed on either the Dublin or London stock exchanges and all of them are companies with substantial business interests in Ireland

Type of Pension Scheme for Executive Directors

In recent years many companies have closed defined benefit (DB) schemes to new employees and replaced them with defined contribution schemes (DC). As the risk of underperformance of pension assets is borne by the employer in a DB scheme and by the employee in a DC scheme, it is important to establish if executive directors and employees have the same exposure to these risks.

Of the 45 companies for which we have pension data 32 have both DB and DC schemes for their employees, 6 have only DB schemes and 7 have only DC schemes. However, for their executive directors 21 provide DB schemes, 8 provide DC schemes, 13 provide both DB and DC and 3 companies do not specify what type of scheme they have. Publicly quoted companies are, therefore, more likely to provide DB schemes for their executive directors than for their other employees.

There are 150 executive directors in the 45 companies for which we have valid data. Of these 80, or over half, appear to be covered by DB schemes, 54, or over one-

third, appear to be covered by DC schemes, 5 are covered by DB and DC schemes while there is no information provided on the type of scheme covering the remaining 11 executive directors³. Just over 53 per cent of executive directors are, therefore, covered by DB schemes. As there were 257,303 employees in DB schemes subject to the funding standard in 2008 and 272,197 employees in DC schemes the percentage of employees covered by DB schemes was just under 49 per cent. Executive directors were, therefore, more likely than other employees to be covered by a DB scheme.

Pension Contribution for Executive Directors

The Companies Acts specify that information should be provided on the remuneration packages of executive directors. As this information includes payments of basic salary, fees or other remuneration, bonuses, benefits in kind, and contributions to pension schemes, it is possible to identify the level of pension contributions made for executive directors and to estimate what proportion of their salary companies are contributing to a pension fund on their behalf.⁴

The average contribution made to a pension scheme by companies for their executive directors in 2008 amounted to €123,882 and the median contribution was €74,000. For other employees the average contribution was around €2,700 or just over 2 per cent of the average employer contribution to executive pension plans⁵.

The 80 executive directors in DB schemes had an average pension contribution of €139,635 while the 54 directors in DC schemes had an average contribution of €92,763, or just two-thirds of the contribution for executive directors in DB schemes. These figures support the argument that the main reason why companies change to DC schemes is that it enables the company to make a significant reduction in its pension costs.

The size distribution of pension contributions for the 135 executive directors for which we have valid information is shown in Table 1. There were 13 executive directors, or nearly 10 per cent of the total, for who pension contributions of €300,000 or more were made. There were 10 executive directors, or about 7 per cent of the total

³ The phrase “appear to be” is used as many company accounts do not specify what type of scheme covers their executive directors and the type of scheme has to be inferred from other information in the accounts.

⁴ As one company provides only aggregate information for the remuneration package of its two executive directors it is assumed that each of them receives half of each component of the package.

⁵ The average employer contribution for other employees is derived from total employer contributions in 2007 of €1.4 billion and membership of funded schemes of 514,006.

Table 1: Pension Contributions for Executive Directors by Size of Contribution

Size of Contribution (€)	No. of Executive Directors	Percent	Cumulative Percent
0 – 24,999	19	14.1	14.1
25,000 – 49,999	28	20.7	34.8
50,000 – 99,999	35	25.9	60.7
100,000 -149,999	19	14.1	74.8
150,000 – 199,999	11	8.1	83.0
200,000 – 299,999	10	7.4	90.4
300,000 or more	13	9.6	100.0
Total	135	100.0	

Note: Cases where executive directors have paid pension contributions back to their companies have been omitted from our analysis but cases where companies make a cash payment because the pension fund is in excess of Revenue limits or where a company provides an additional DC pension have been included.

who had pension contributions of €200,000 to €299,999 made on their behalf. Over one-fifth of the directors, or 30 out of 135, benefited from pension contributions of €100,000 to €199,999. Just over a quarter of the executive directors, or 35, had contributions of from €50,000 to €99,999 paid into their pension funds while one-fifth received from €25,000 to €49,999. One seventh of the executive directors had pension contributions of up to €24,999 made on their behalf.

The cumulative distribution shows that 40 per cent of executive directors had pension contributions of €50,000 or more made on their behalf while for 25 per cent the contribution amounted to €100,000 or more.

Pension Contribution Rates for Executive Directors

Some of the companies in our sample do not provide enough information for a pension contribution rate to be calculated from the salary and pension data. Consequently, information on pension contribution rates is available for only 135 of the 150 executive directors. The average contribution rate for executive directors in 2008 was 30.6 per cent while the median was 20 per cent. The significant difference between the average and the median values is influenced by a small number of contribution rates which exceed 75 per cent of salary.

The average employer contribution rate of 30.6 per cent for executive directors in 2008 compares with 20 per cent for public service workers and 8.5 per cent for private sector employees in 2007 according to a report by Life Strategies Ltd. for the

Public Service Benchmarking Body (see Stationery Office, 2007) on the respective long-term values of public and private sector pensions.

The average contribution rate for executive directors who are members of DB schemes is 28 per cent while for executive directors who belong to DC schemes the average is 23 per cent.⁶ These contribution rates for executive directors belonging to DB and DC schemes compare with average employer contribution rates for other employees of about 11 per cent for DB schemes and 7 per cent for DC schemes according to an IAPF (2003) benefits survey and information provided by Kenny (2003)⁷. The contribution rates for executive directors for DB schemes are, therefore, two and a half times more than for other employees. The differential between executive directors and other employees is even greater for DC schemes. The contribution rate for executive directors' DC schemes is over three times greater than is being paid into DC schemes for other employees.

Table 2 shows the distribution of pension contribution rates for executive directors. Contribution rates up to 9.99 per cent were paid on behalf of about one-tenth of the executive directors. One fifth had contribution rates of from 10 to 15 per cent while almost another fifth had contribution rates of from 15 to 20 per cent. A further fifth had contribution rates of from 20 to 30 per cent while almost 30 per cent had contribution rates in excess of 30 per cent.

The cumulative percentages in Table 2 indicate that about half of the executive directors benefitted from contributions of up to 20 per cent of salary while the remaining half benefitted from contributions of more than 20 per cent.

⁶ The average contribution for DB schemes is lower than the average contribution rate for all schemes because a number of executive directors whose type of scheme is not specified have exceptionally high contribution rates.

⁷ The IAPF (2007) Pension Markets Survey carried out in 2007 does not provide enough information to enable us to estimate what the employer contribution rates are for DB and DC schemes for non-executive employees.

Table 2. Distribution of Percentage Pension Contribution Rates for Executive Directors, 2008

Contribution Rate (Per cent)	Frequency	Valid Percent	Cumulative Percent
0 – 4.99	4	3.0	3.0
5 – 9.99	9	6.7	9.7
10 – 14.99	28	20.7	30.4
15 – 19.99	25	18.5	48.9
20 – 24.99	14	10.4	59.3
25 – 29.99	15	11.1	70.4
30 – 34.99	10	7.4	77.8
35 or more	30	22.2	100.0
Total	135	100.0	

Accrual Rates for Executive Directors

In a DB scheme the accrual rate is the proportion of final salary, or average final salary over a specified period of years that someone will receive for each year they have been in the scheme. An accrual rate of $1/60^{\text{th}}$ means that a person will receive a pension worth $1/60^{\text{th}}$ of final salary for every year of pensionable service in the scheme. The normal accrual rate for private sector employees who belong to a DB scheme is $1/60^{\text{th}}$ while for public sector employees it is $1/80^{\text{th}}$ for the pension and $3/80^{\text{th}}$ for the tax free lump sum. These accrual rates mean that private sector employees with 40 years service will receive a pension equal to $2/3^{\text{rd}}$ of final salary while public sector employees will receive a pension equal to $1/2$ of final salary and a tax free lump sum equal to one and a half times final salary. Unfortunately, only four companies in our sample provide information on accrual rates for executive directors so it is not possible to say what the average accrual rate is. For seven of their executive directors it is $1/60^{\text{th}}$, or the same as for the average private sector employee covered by a DB scheme and for two of them it is $1/30^{\text{th}}$. This suggests some executive directors only need to work for 20 years rather than the usual 40 years to qualify for a pension equal to two-thirds of their salary.

Normal Retirement Age

The normal retirement age for employees who joined the public service before 2004 was 60 but it was increased to 65 for those joining after 2004. For private sector employees the normal retirement age is 65. Only two companies (Diageo and

Greencore) appear to report the normal retirement age for their executive directors. For Diageo Ireland the normal retirement age is 62 while in Greencore it is 60 for three of their four executive directors and 50 for their chief executive officer. This suggests that the normal retirement age for some executive directors could be three to five years lower than for the average private sector employee but more information would be required before any definite conclusions could be drawn.

Value of Accrued Pension

Companies are supposed to provide information in their annual accounts on the value of the pension which their executive directors have accrued to date and to which they would be entitled if they retired at the end of 2008. However, this information is provided only for 50 of the executive directors in our sample. It shows that the average company pension to which they would be entitled if they retired now amounts to €179,340. CSO figures for 2006 show that single pensioners received social benefits amounting to €12,421 (see Central Statistics Office, 2008). These social benefits include old age social welfare benefits, occupational/personal pensions, family/children related allowances, housing allowances, and other social transfers including unemployment benefit. Executive directors are, of course, also entitled to the State pension. Taking this into account it appears that if the average executive director were to retire now he (for very few are women) would have a pension over 15 times greater than the average single pensioner.

There is information in the company accounts for 2008 on the accrued value of nine executive directors' pension funds. It indicates that the average value of their accrued pension fund was €4,659,222. This compares with an average fund value of around €102,000 for other employees⁸.

The largest pension fund amounted to €1.7 million while the smallest amounted to €387,000. Before 2006, when a cap was introduced, there was no limit on the size of pension fund that could be accumulated on behalf of an individual. The way was left open, therefore, for about 6,000 individuals to accumulate an average pension fund of somewhat less than a quarter of a million euro, for two unnamed individuals to accumulate pension funds which were subsidized by the taxpayer of around €100 million (see Department of Finance, 2006) and for the Irish Nationwide Building society to report in its accounts for 2008 that on 12 January 2007 pension

⁸ The average fund value for other employees is derived by dividing the value of all pension funds in 2008 (€54 billion) by the number of members of funded DB and DC schemes (529,500).

obligations to its Chief Executive Officer, Mr. Michael Fingleton, were settled by transferring €27.6 million outside the control of the group.

Executive Directors Salaries

As already noted company accounts are obliged to provide details of different components of compensation for executive directors. These components include information on salaries and the total remuneration package.⁹ As Hughes and Nolan (2009) have shown that pension contributions and salaries are positively related this feature of compensation arrangements for executive directors provides a context within which to understand why pensions for higher earners are so favourable and why there is so much “dead weight” in providing tax reliefs for the higher paid. It is useful, therefore, to consider how much executive directors are paid on average and what is the size distribution of their salaries.

The average salary for an executive director in 2008 amounted to €422,771. This compares with average earnings of employees of €35,750 based on National Employment Survey data for October 2007. The average salary for an executive director is strongly influenced by a number of very large salaries payable to their chief executives by the six companies shown in Table 3. The salary for this select group of chief executives ranges from just over €1 million for Independent News & Media to nearly €1.5 million for CRH. We can take account of the influence of exceptionally large salaries on the overall average by identifying the median salary. This figure identifies the mid-point of the distribution of salaries and shows that half of the executive directors received a salary greater than the median and half received a salary less than the median. The median salary for the 150 executive directors amounted to €359,254 or about 85 per cent of the mean salary.

The distribution of executive director salaries by salary range is shown in Table 4. Half of the executive directors received salaries ranging from €¹/₄ million to €¹/₂ million while over one-fifth of them had salaries ranging from €¹/₂ million to €³/₄ million. Nearly one-tenth of them received salaries in excess of €³/₄ million while only 3 per cent had salaries of less than €100,000. The cumulative distribution shows that 80 per cent of executive directors received salaries of €250,000 or more per year.

⁹ Company accounts provide information on the allocation of company shares and share options to executive directors. This component of the total remuneration package amounts to a sizable part of total compensation for many executive directors but it is difficult to estimate its value on an annual basis. Consequently, it is not included in our table showing total remuneration.

Table 3: Highest Salaries Paid to Executive Directors in 2008

Name of Company	Highest Salary
Independent News & Media	1,019,000
Diageo Ireland	1,087,000
Anglo Irish Bank	1,150,000
Bank of Ireland	1,172,000
Smurfit Kappa Group	1,262,000
CRH	1,450,000

Table 4: Distribution of Executive Directors Salaries in 2008

Salary Range (€)	No. of Executive Directors	Percent	Cumulative Percent
0 – 99,999	5	3.3	3.3
100,000 – 249,999	25	16.7	20.0
250,000 – 499,999	74	49.3	69.3
500,000 -749,999	32	21.3	90.7
750,000 – 999,999	8	5.3	96.0
1,000,000 and over	6	4.0	100.0
Total	150	100.0	

In addition to their basic salary 62 per cent of the executive directors received a performance bonus. Their average bonus was €239,544. As in the case of salaries this figure is influenced by several bonus payments exceeding €1 million such as the €1,462,000 paid to the chief executive of Bank of Ireland and the €1,291,000 paid to the chief executive of Vodafone Ireland. The median bonus payment was €163,000, or 68 per cent of the average bonus, so half of those who got a bonus got more than this while half got less.

Total Remuneration

Adding the salary, fees, bonus, benefit in kind and pension expense gives the total remuneration package of each executive director. The average total remuneration package for executive directors in 2008 amounted to €756,474, or just over €³/₄ million. Table 5 shows the distribution of total remuneration packages by size category. Less than one per cent had a total remuneration package of under €100,000. Just over 7 per cent had packages ranging in value from €100,000 to €249,999 while

Table 5: Distribution of Executive Directors Total Remuneration Packages, 2008

Total Remuneration	Frequency	Percent	Cumulative Percent
0 -99,999	1	.7	0.7
100,000 – 249,999	11	7.3	8.0
250,000 – 499,999	43	28.7	36.7
500,000 – 749,999	36	24.0	60.7
750,000 – 999,999	29	19.3	80.0
1,000,000 – 1,249,999	13	8.7	88.7
1,250,000 or more	17	11.3	100.0
Total	150	100.0	

nearly 30 per cent had remuneration packages ranging from €¼ to million to €½ million. Nearly a quarter of the executive directors were in receipt of total remuneration packages of from €½ million to €¾ million while almost a fifth received from €¾ million to €1 million. Total remuneration packages ranging from €1 million to €1¼ million were paid to 9 per cent of the executive directors and the remaining 11 per cent had total remuneration packages in excess of €1¼ million.

The cumulative data in Table 5 shows that 40 per cent of executive directors received total remuneration of up to €499,000 while 60 per cent received €500,000 or more.

Limits on Pension Contributions and Size of Fund

As the average total remuneration package for the executive directors in our sample amounts to €¾ million per year it is clear that all of them, and anyone else with the same income, are in a position to make their own pension arrangements without any support from the State. Yet their pension arrangements, and those of other high income groups, continue to be subsidised by the State. In the last ten years or so the State has introduced contradictory policies relating to these subsidies by increasing the tax relief which could be claimed on pension contributions and introducing a cap on the size of an individual's pension fund to limit the cost of the subsidies and to create more equity in the private pension system.

Rather than having to buy an annuity on retirement, provision was made in the Finance Act 1999 for self-employed workers to continue managing their pension funds after retirement in an Approved Retirement Fund (ARF) or an Approved

Minimum Retirement Fund (AMRF). The legislation provided for (a) age-related limits on contributions which ranged from 15 per cent of net relevant earnings up to age 30 to 30 per cent at age 50 and over (see Table 6) and (b) an earnings contribution cap of £200,000 (= €254,000) for contributions to Retirement Annuity Contract. The maximum contribution on which tax relief could be given, therefore, amounted to €76,200 (= €254,000 x 30%). The same limits were imposed in 2002 on contributions

Table 6: Age-Related Maximum Pension Contribution as a Percentage of Earnings Eligible for Tax Relief, 1999-2005 and 2006-2009

Age Band	1999-2005	2006-2009
Under 30	15	15
30-40	20	20
40-50	25	25
50-55	30	30
55-60	30	35
60+	30	40

to Personal Retirement Saving Accounts (PRSA), by individuals who were not in the labour force, and also on employee contributions to occupational pension schemes. The Finance Act 2006 increased the age-related contribution limits to 35 per cent of earnings for those aged 55-60 and to 40 per cent of earnings for those aged 60 and over and the earnings cap was indexed from 2007 in line with earnings, as Table 7 shows. At the peak earnings limit of €275,239 in 2008 the maximum individual pension contribution on which tax relief could be claimed was just over €10,000. In 2009 the earnings cap was reduced to €150,000 and the maximum contribution qualifying for tax relief fell to €60,000. Roisin Shortall T.D. said in a statement in the Dail on 14 October 2008 that this change affected around 6,000 people who earned in excess of €250,000 and who availed of the maximum possible tax relief. The Minister for Finance said in his budget speech that this big reduction in the earnings cap would “promote greater equity in tax relief”. The Tanaiste elaborated on this point when she said in the Dail on 14 October 2008 that:

“The measure will only affect taxpayers on higher incomes and will save the Exchequer €100 million in a full year. However, for the vast majority of taxpayers who save for retirement through supplementary private pension provision, this change will have no impact.”

“As the Deputies are aware, the Green Paper on pensions estimated the total cost of tax relief and supplementary pension provision for 2006 was close to €3 billion. Over one third of this cost is estimated to be accounted for by relief

Table 7: Limits on Annual Pension Contributions and the Size of the Pension Fund, 1999-2009

Tax Year	Annual Contribution on which Personal Tax Relief is Allowed	Size of Pension Fund
1999	£200,000	No limit
2006	€254,000	€ million or value of fund at 7/12/05
2007	€62,382	€0.165 million or indexed value of the personal fund threshold (as agreed with Revenue)
2008	€75,239	€0.418 million or indexed value of the personal fund threshold (as agreed with Revenue)
2009	€150,000	€0.418 million or indexed value of the personal fund threshold (as agreed with Revenue)

on employee contributions to occupational schemes and individual contributions to personal pension plans.”

“Over recent years, many individuals and reports have raised the issue of the equity of the current tax relief arrangements given the significant Exchequer costs involved and the fact that the reliefs are skewed significantly towards those on higher incomes. Apart from helping to meet the challenging budgetary circumstances we are now facing, the decision to reduce the earnings limit should also be taken as a signal of the Government’s intent to move towards more equitable tax arrangements generally for private pension provision in the context of the development of the long-term policy framework for the pensions.”

The age-related percentage limits and the annual earnings cap apply only to pension contributions by individuals. Employers were left free to contribute whatever amount they wished to employee pensions. Consequently, as the Minister for Finance (2009) noted in a written reply to a Parliamentary Question on 6 October 2009 “changes could be made to the terms of employment contracts, due to the reduction in the annual earnings cap, to provide for a switch from employee contributions to employer contributions.”

In order to create greater equity in the arrangements for pension tax relief, consideration was given in a review of tax reliefs for pensions in 2005 by the Revenue Commissioners and the Department of Finance (2006) to including employer contributions within the age-related and annual earnings limits. However, it was decided that the best constraint on employer contributions would be a limit on the maximum allowable tax-relieved pension fund. Hence, a cap of € million was imposed in 2006 on the lifetime size of individual pension funds (see Table 7). In addition, the lump sum that could be taken tax free on retirement was limited to 25

per cent of the value of the fund. The lifetime cap is called the standard fund threshold and it was increased by the Revenue Commissioners to €1.165 million in 2007 and to €1.418 million in 2008.

The introduction of the standard fund threshold had no effect on the overwhelming majority of those covered by pension schemes as their annual contributions and the size of their pension funds are far below the Revenue Commissioners' limits. It had little effect on 116 individuals who already had more than €1 million invested in an Approved Retirement Fund. They were allowed to apply to the Revenue Commissioners to keep the fund which they had built up and to increase it in line with the indexed value of the €1 million fund (see Hughes, 2007 for further discussion of this issue). The threshold did have an immediate effect on a small number of individuals whose pension funds amounted to around €1 million. These individuals included self-employed holders of Retirement Annuity Contracts, 5 per cent Directors and senior executives of companies. Some executive directors, whose pension funds were in excess of the size limit, were given cash payments by their companies from 2006 onwards in lieu of pension contributions¹⁰.

The Covered Institution Remuneration Oversight Committee has criticised this practice:

“We consider that pension arrangements for top management should be reviewed. We have become aware of a practice in which cash allowances were paid to compensate for the effects of the “pensions cap” imposed by the Finance Act, 2006. Pension schemes should reflect public policy and tax law and it is unacceptable that arrangements should be put in place which would be inconsistent with the intent of the relevant legislation.” (see Department of Finance, 2009, par. 5.21)

In addition the committee suggested that:

Pension arrangements for senior executives in each institution should, in our view, be at least broadly similar to those applicable to the generality of the staff of the institution.” (see Department of Finance, 2009, par. 5.23)

The evidence presented in this paper relating to the very favourable pension terms which executive directors enjoy compared with other employees suggest that the principle of broad similarity of treatment for the two groups of employees should

¹⁰ Examples of companies making cash payments in lieu of pension contributions are Vodafone and C & C Group respectively. An example of a company receiving cash payments from executive directors is Bank of Ireland. Three executive directors of this bank returned sums ranging from €103,000 to €382,000

apply to all companies providing pension schemes for their employees and not just to those in the financial sector.

The reduction in Finance Act 2009 of the annual earnings limit on pension contributions to €150,000 was a step towards greater equity in the pension system. However, the government gives no indication in its document on the National Pensions Framework (see Department of Social and Family Affairs, 2010) that it is considering any further reduction in the earnings limit.

Unfortunately, the reduction that has occurred was not accompanied by any reduction in the standard fund threshold. As this threshold was introduced in 2006 to complement the earnings limit it should change in line with changes in the earnings limit. The Commission on Taxation (2009, Recommendation 10.8) notes:

“There should be a correlation between the annual earnings limit and the standard fund threshold, and the reduction in the annual earnings limit suggests that there should be a corresponding reduction in the standard fund threshold.”

If the standard threshold were based on the amount needed to provide a maximum pension of half salary for someone with earnings of €150,000 in 2009 the lifetime size of the pension fund should be reduced from €5.418 to €1.5 million using a valuation factor of 20:1 to convert a defined benefit pension to a cash equivalent¹¹. If, as Fine Gael has suggested, “tax relief on pensions should be limited to €40,000 per year in contributions”(see Bruton, 2009) the standard fund threshold should be set at €1 million (= (€40,000/0.4) x (0.5) x 20) or the same amount implied by the suggestion in the Dail Debates on 14 October 2008 of Rosin Shortall T.D. for the Labour Party that an annual earnings limit of €100,000 would be fair.

The Minister for Finance’s indication in the Financial Statement of Budget 2010 that he accepted “the Commission on taxation’s recommendation that pension lump sums below €200,000 should not be taxed” implies that a lower annual earnings limit of €133,333 (= €200,000/1.5) would be preferable to the present limit of €150,000.

While the limits suggested by the opposition parties, and implied by the Minister for Finance, would be fairer than the existing annual earnings limit of

¹¹ This is the valuation factor used by the Revenue Commissioners in the United Kingdom where an annual earnings limit and a lifetime size limit are imposed on pension funds. The UK valuation factor implies that an annuity would yield 5 per cent per annum. See http://www.sharingpensions.co.uk/pensions_simplification.htm

€150,000, neither of these limits are based on integrating private pension benefits with those provided by the public pension system. The National Pensions Policy Initiative (1998, Section 5.1.7) report argued that in retirement income from all sources, including Social Welfare and private pensions, should replace 50 per cent of pre-retirement income subject to the Social Welfare pension replacing 34 per cent of average industrial earnings. This target in conjunction with recommendations that tax reliefs for private pensions should be concentrated on earners at the middle and lower end of the income distribution (see Hughes and Stewart (2007), Tasc (2008) and OECD (2009)) suggests that the annual earnings limit should be aligned with the ceiling for payment of PRSI which was set at €75,000 in 2009. The target pension for someone retiring in 2009 with earnings of €75,000 would be €37,500. Average weekly earnings in industry in Q2 2009 amounted to €787.96 or €40,975 per annum. If the Social Welfare pension had met the 34 per cent target it would have amounted to €13,931. However, it actually amounted to €11,976 or 29 per cent of average industrial earnings. This means that a private pension would have had to provide an income in retirement of €25,524. Applying the 20:1 valuation factor to this sum indicates that a standard fund threshold of around €10,000 in 2009 would have been sufficient to achieve the 50 per cent replacement rate target. The size of the fund could, of course, be much larger but the portion benefitting from tax relief would be capped at around €0.5 million.

Reducing the limits on contributions and the size of individual pension funds would save the Exchequer millions of euro which could be used to maintain the level of the State pension on which the great majority of pensioners are dependent. It would also reduce the tax distortion in favour of long-term saving and help to allocate savings to their most effective use in the real economy. The latter point is particularly relevant for small and medium enterprises as the tax relief for private pensions encourages owners of small businesses to invest in financial products rather than self-investing in their own businesses.

Conclusion

Executive directors in the private sector have far more favourable pension terms than other employees in terms of the employer contribution to their pension fund both in absolute terms and as a percentage of their salary.

The replacement of DB schemes with DC schemes has been largely confined to other employees in publicly quoted companies. Most executive directors continue to enjoy access to a DB scheme which is generously funded by their employer who bears the risk of a poor performance of the fund whereas most other employees now belong to DC schemes in which they will have to bear the risk of any underperformance of the fund.

Executive directors benefit from much larger average employer pension contributions (€123,882) than other employees (€2,700) as the average size of the employer contribution to executive pensions is related to the average size of their salary (€122,771) and this is much greater than the average earnings of other employees (€35,750).

The average employer contribution rate for an executive director amounted to around 30 per cent in 2008 compared with 20 per cent for public sector employees and about 8 per cent for private sector employees.

Although the data on executive directors' accrual rates and normal retirement age is too limited for us to make valid comparisons with other employees, they suggest that executive directors may benefit from better accrual rates and that they may have a lower normal retirement age than other employees.

There is better data on the average pension to which executive directors would be entitled if they had retired in 2008 and it shows that the average executive director would have been entitled to a company and State pension of €91,761, assuming the company pension is integrated with the State pension, compared with average company, personal and State pensions in payment in 2007 of €12,421 for a single pensioner.

As with so many aspects of pension policy the government's priorities for social welfare pensions and private pensions appear to be very different. In response to the crisis in the public finances it suspended payment of the 2009 Christmas bonus to social welfare recipients and considered reducing social welfare pensions in the run up to Budget 2010. The government did not take the opportunity to avoid a reduction in the State pension by taking the obvious step of standard rating the tax relief on private pension contributions, continuing to reduce the annual earnings cap and reducing the standard fund threshold. If these steps had been taken the additional

revenue they would have yielded could have been used to maintain the incomes of pensioners and other social welfare recipients.

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Appendix 1

Appendix Table A1: Executive Pension Arrangements in 45 Mainly Irish Non-Financial and Financial Companies, 2007 or 2008

IT Rank	Name	Listed on Irish (ISX) or UK Stock Exchange (UKSX)	Annual Report Year end
Non-Financial Companies			
43	Aer Lingus	ISX	31/12/08
60	An Post	NL/Semi-state	31/12/08
62	An Post National Lottery Company	NL/Semi-state	31/12/08
42	Bord Gais Eireann	NL/Semi-state	31/12/08
57	BT Ireland	UKSX	31/12/08
80	C & C Group	ISX	29/2/08
200	CPL Resources	ISX	30/6/08
1	CRH	ISX	31/12/08
5	DCC	ISX	31/3/08
28	Diageo Ireland	ISX	30/6/08
332	Donegal Creameries	ISX	31/12/08
83	Dublin Airport Authority	NL/Semi-state	31/12/08
172	Eirgrid	Semi-state	31/12/07
13	ESB	NL/Semi-state	31/12/07
69	Fyffes	ISX	31/12/08
23	Glanbia	ISX	3/1'09
18	Grafton Group	ISX	31/12/08
45	Greencore Group	ISX	24/9/08
388	Hilton Food Group	UKSX	31/12/07
384	IFG Group	ISX	30/12/08
39	Independent News & Media	ISX	31/12/08
270	Irish Aviation Authority	Semi-state	31/12/08
142	Irish Continental Group	ISX	31/12/08
9	Kerry Group	ISX	31/12/08
32	Kingspan Group	ISX	31/12/08
160	McInerney Holdings	ISX	31/12/08
271	Newcourt Group	ISX	31/12/07
38	Origin Enterprises	ISX	31/07/08
183	Paddy Power	ISX	30/6/08
53	Payzone	UKSX	30/09/08
445	Qualceram Shires	UKSX	31/12/07
370	RPS Group	UKSX	31/12/08
17	Ryanair	ISX	31/3/08
4	Smurfit Kappa Group	ISX	31/12/08
19	Total Produce	ISX	31/12/08
68	Tullow Oil	ISX	31/12/08
31	United Drug	ISX	30/9/08
49	Vodafone Ireland	UKSX	31/3/08
Financial Companies			
4	Allied Irish Bank	ISX	31/12/08
5	Anglo Irish Bank	ISX & UKSX	31/12/08
2	Bank of Ireland	ISX	31/3/08
14	Educational Building Society		31/12/08
72	FBD Holdings	ISX	31/12/08
7	Irish Life and Permanent		31/12/08
23	Irish Nationwide Building Society		31/12/08

