‘Stealth’ Pensions Hide Huge CEO Payouts

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Most companies make it very difficult to tally the value of CEOs' pension plans. And investors who don't know the real cost of pensions can make big mistakes.

The new boss at the Securities and Exchange Commission wants you to know more about the colossal pay packages collected by the top brass in Corporate America.

Too often, SEC Chairman Christopher Cox said recently, the lion's share of executive pay “almost entirely” eludes disclosure. If Cox fixes the problem, it will be welcome news for investors and corporate governance watchdogs alike.

Until then, investors will need plenty of help to get a true picture of the perks awarded CEOs. That's particularly true in the area of pensions. Most companies have stopped providing traditional pension plans for employees, instead pushing employees into 401(k) plans that shift the risk of saving for retirement to the employees themselves. At the same time, company chiefs -- paid enough already, one would think, to sock away a bit for retirement -- are awarded huge pensions that should fill the trust funds of several generations of heirs.

Here's a taste of what investors would discover if Cox comes through:

- The most recent annual proxy statement for **Pfizer** (PFE, news, msgs) contains the standard table showing that Chief Executive Henry McKinnell earned more than $38 million between 2002 and 2004 in salary, bonus, stock grants, options and other incentive payments.

That's a lot. But it’s actually not too far out of line with the industry average. What puts McKinnell’s pay package into the stratosphere is a pension plan that adds an $83-million dollop of retirement pay.

Pfizer -- like many companies -- provides pension tables and other tidbits that reveal some information about the cost of McKinnell’s retirement plan. But the tables leave shareholders in the dark about the $83 million McKinnell will collect in retirement.

Pfizer’s opaque disclosure is ironic because McKinnell is chairman of the Business Roundtable, a CEO lobbying group. On his watch, the group has urged companies to provide shareholders with complete disclosure of “all significant elements of compensation.”

- **Black & Decker** (BDK, news, msgs) gave CEO Nolan Archibald a salary and bonus worth more than $27.5 million for 2002-2004. On top of that, he has a pension plan worth $38.3 million -- but you won’t find that number anywhere in the proxy.

And, from the ranks of retired CEOs:

- You can easily see from the March 12, 2004 proxy filed by **Motorola** (MOT, news, msgs) that Christopher Galvin made more than $13.5 million in salary, bonus, options, restricted stock and other pay between 2001 and 2003, while he was chairman and chief executive. Nowhere is it spelled out, however, that he also got a pension worth about $41.3 million.

- SouthTrust -- a bank that's now a part of **Wachovia** (WB, news, msgs) -- paid CEO Wallace Malone, Jr. more than $21 million in salary, bonus and options between 2001 and 2003, according to the company's March 8, 2004 proxy. The part the bank left out: He also got a pension package worth $45.1 million.

- Even **Gannett** (GCI, news, msgs) falls short, though you might think a newspaper publisher would do a better job of disclosure. Former CEO Douglas McCorkindale made more than $14 million in salary and bonus in the 2002-2004 period. It's not clearly spelled out that he is receiving a pension package worth $27.3 million.

Not a do-it-yourself project

Of course, armed with actuarial statistics and a couple of hours of work, you could figure out the cost of pension plans on your own. Even then, it might take a little more information from the companies.

But why should you have to?

After all, most companies already have a single number that represents the value of pension obligations for each top executive. Those companies that don't could compute such numbers at little cost, says Harvard Law School professor Lucian Bebchuk, author of a book on executive pay called "Pay Without Performance: The Unfulfilled Promise of Executive Compensation."

The numbers aren't in the proxy because the companies don't want them there.

To highlight what investors are missing, Bebchuk recently calculated the cost of CEO pensions at about 50 companies in the **S&P 500** ($INX). He zeroed in on companies where CEOs either recently retired or are about to retire. The estimated cost of stealth pension plans I listed above come from his study, called "Putting Executive Pensions on the Radar Screen," written with Robert Jackson Jr.

In fairness to these companies, they all provide the standard tables listing how much execs will get each year in pension payments, based on the number of years served and the amount of pay received in the final years with the company.

They just don't say what the pension is worth. And they don't make it easy to figure out.

"These plans are notoriously complex and it takes a substantial amount of research to figure them out," says Brandon Rees, a research analyst with AFL-CIO's Office of Investment. "Many institutional shareholders and most individual investors don't have the time to understand this."

Even if some investors can manipulate actuarial tables, many company reports leave out -- or make it hard to find -- relevant clues such as whether a spouse continues to receive pension payments after the executive dies.

Some companies, like **Home Depot** (HD, news, msgs), don't even offer the pension table. The company's April 11, 2005 proxy reveals that CEO Robert Nardelli is enormously well paid, collecting over $29 million in 2004 alone, including forgiven loans. But what you don't see is that he also has a pension plan worth $33 million, by Bebchuk's calculations.

Home Depot, Gannett, Pfizer, Motorola and Black & Decker all responded that they supply enough information for anyone willing to do the work to nail down the executive pension costs. They also point out that they follow SEC rules, just like the rest of the companies mentioned in this column.

Gannett and Black & Decker don't think it would help investors much if companies provided a single number on pension costs because underlying actuarial and interest assumptions may turn out to be wrong, creating a false picture of the costs. Unless the SEC set down strict guidelines, says a Gannett spokeswoman, those assumptions would vary from company to company, leading to unfair comparisons.

A Pfizer spokesman said that in light of the current interest in executive pensions, "We will continue to evaluate our disclosure practices, including providing information that is well beyond SEC requirements."

What it means for investors

Does any of this really matter for investors? You bet. Investors who don't know the real cost of executive pensions can end up making two basic mistakes, says Bebchuk.

First, studies show companies that pay their executives too much are more likely to be on the road to a credit downgrade. That's usually not good for a company's shares. If you don't know the size of the CEO's pension, you may not really understand whether a CEO is overpaid. Bebchuk found that pension plans on average tack on an extra 34% to pay packages.

Second, investors like to see a big portion of executive pay tied to company performance. But if you overlook the cost of pensions, you overestimate the amount of pay that is linked to performance. About 85% of the CEO pay is based on performance, according to Bebchuk's study. Throw in pensions, and that number dwindles to 60%.

The good guys

A few companies do a better job of reporting the cost of executive pensions.

- **Exxon Mobil** (XOM, news, msgs) tells shareholders straight out that CEO Lee Raymond's pension would be worth about $81 million if he cashed out right now.

- **Colgate-Palmolive** (CL, news, msgs) does the same thing -- revealing that CEO Reuben Mark's pension plan would cost $36 million if he cashed out now. "That's a total rarity," says AFL-CIO's Rees. "You won't find that in most other companies."

That may change if the SEC's new chairman keeps his word and brings transparency to executive pay.

At the time of publication, Michael Brush did not own or control shares in any of the companies listed in this column.