

Pensions Update

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Are pensions to blame for “excessive executive pay”?

by Roger May

‘Oh dear me, the world is ill-divided – Them that works the hardest are the least provided.’

When the union activist Mary Brooksbank wrote *The Jute Mill Song* in the 1920s, Dundee jute spinners earned ten shillings and nine pence a week – 57 pence in modern money. They would have been absolutely astounded to hear that 90 years later bankers in the City of London were receiving annual bonuses of over £1 million, even though their banks were far from being the most successful businesses in the country.

But it appears the Government’s – or rather the Treasury’s – attack on the pensions of high earners has exacerbated the situation. As you will remember, in 2006 the Government changed the Inland Revenue limits for pension schemes, replacing them with a (theoretically) simpler system of lifetime allowances and annual allowances. These allowances would allow a pension equivalent to about £80,000 a year – more than enough for most, you would think.

However, most directors of large companies had already run up pension entitlements of very much more than £80,000 a year. The Government allowed these people to retain their high pensions by giving them what was charmingly called “enhanced protection”. The pay-off was that the amount of pension they could build up after 2006 was considerably reduced. Their pensions could increase by only about 5% a year – tough but fair.

Even this was too much for the Treasury, which hates pension schemes. They want the tax now, not in dribs and drabs over the next thirty years. So they put pressure on the Government to reduce the annual allowance to a fifth of its previous level from April 2011. A pension scheme member could build up pension above the limits, but it would be taxed at the member’s highest rate as if it were actual income.

This in turn was too much for the directors of large companies. They went to their remuneration committees and pointed out that the goalposts had been moved. A substantial part of the remuneration package would now be taxed even though it was going into the pension scheme and could not be touched until they started to draw their pension. So why bother to put it into the pension scheme? If it will be taxed as income, pay it as income, and to hell with the pension scheme.

So that may be the reason why executive remuneration looks as if it has jumped in the last year. It is probably much the same as it always was, but it has been redistributed, and now appears in a different place in the companies’ accounts. If you thought hiding unpalatable facts in small print had almost disappeared, just look at the annual accounts for a large quoted company

This also represents the final disengagement of management from the defined-benefit pension scheme. Small wonder then that Shell, the last FTSE100 company with an open scheme, has now shut its scheme.

Pensioner terrorists (almost) strike...

We tend to think of pensioners as nice old folk, stalwarts of the bowls club and the Women's Institute. Not so in the United States, apparently.

In November four pensioners with a combined age of 273 appeared in court in the state of Georgia accused of conspiring to blow up buildings used by tax officials and the Bureau of Alcohol, Tobacco and Firearms. They are also alleged to have plotted to extract the nerve toxin ricin from commercially available castor beans, and to

have investigated spraying the toxin from cars on the Atlanta freeway system or from a crop-spraying aircraft.

The group had been under surveillance for some six months, and had been infiltrated by a federal agent wearing a recording device (no doubt disguised as a hearing-aid). The FBI decided things had gone far enough when the terrorist group tried to buy plastic explosive from another undercover agent.

"Say, how much Semtex would this month's pension buy me, Jed?"

Annuity disaster

Now that defined-benefit schemes have almost disappeared (unless you work in the public sector, of course), workers reaching retirement age in a defined-contribution scheme have to fend for themselves. This usually means buying an annuity from an insurance company. While this removes the risk at a stroke, it is normally a once-and-for-all purchase.

This would be fine if annuities were good value for money. But the income from the average annuity has fallen dramatically over the last few years. A man retiring at 65 in 1994 with a pension "pot" of £10,000 could have secured a lifetime income of £1,076 a year. A man retiring this year would get just £556.

There are three basic reasons for this. Firstly, pensioners are living longer, so the insurer will have to pay the annuity for longer. Secondly, the yields on UK gilts, which most annuity providers buy to provide the pension, have dropped to levels not seen for over 100 years. And lastly, the European Solvency II regulations will force insurers to hold more money to cover their solvency requirements.

So what are the alternatives? The pensioner can choose to "draw down" his pension, while remaining in charge of his pension "pot". He takes all the risk of the fund running out, and the Government has set strict limits to the amount he can draw down. On the other hand, he receives the benefit of any growth in the remaining pension fund, and there is increasing evidence that pensioners – who tend to have a fair amount of time on their hands – have taken to playing the stock markets.

There is now so much free information available on the internet that anyone can play at being a fund manager. And those fund managers who have a direct interest in their funds tend to be the more successful ones



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