

## *A question of balance – dividends versus pension contributions*

**E**quity dividends are important to UK pension funds. The average fund holds nearly two thirds of its assets in equities with the majority still in UK equities. Whatever happens to headline measures, like the FTSE 100 index, it is the flow of dividends that is expected to generate two thirds of equity returns in the long run.

No wonder that pension funds were – and still are – up in arms about Gordon Brown's infamous "£5bn p.a. raid" on their dividends in his first budget. At a stroke, Mr Brown put an end to the tax relief that pension funds had enjoyed on UK dividends and, thereby, effectively reduced their dividend income by 20%.

Payment of dividends looks set to become a major issue once again for UK pension funds. This time though it is not the dividends which the funds may or may not receive from the companies that they invest in, but the dividends paid by their sponsoring employers to their shareholders. The Pensions Act 2004 has firmly pitted pensioners against shareholders, with finance directors caught in the middle and the Pensions Regulator acting as referee.

How has this come about? Back in 2002, the government promised us "simplicity, security and choice" but it quickly recognised that it could not deliver all three. The Pensions Act 2004 therefore concentrates solely on security, leaving us to wonder about simplicity and choice.

The new Pension Protection Fund (PPF) is based on the US model – the Pension Benefit Guaranty Corporation – which is reported to have a deficit of tens of billions of dollars. To avoid the PPF suffering a sim-

ilar fate, the government has given unprecedented powers to the Pensions Regulator to persuade or coerce employers into making the funding of their pension scheme a high priority.

As the regulator says: "A pension scheme in deficit should be treated in the same way as any other material unsecured creditor". Therefore, companies who wished to return funds to shareholders, whether via special dividends, share buybacks or de-mergers will need first to have addressed their pension scheme deficit.

What will this mean for UK companies? Those with a large deficit – like British Airways for example – may find themselves unable to pay dividends to shareholders. More companies are likely to follow suit, until their deficits are cleared.

FTSE 100 companies declared dividends amounting to £39bn in 2004; their aggregate UK pension fund deficit was £37bn in July this year. Solving the pensions crisis is not as simple as stopping all dividend payments for one year – after all, for some companies, their pension deficit is much greater than the dividends they declared – but, in the new environment, companies are going to have to put pensioners first or risk incurring the wrath of the Pensions Regulator.

In the short term, this will mean more contributions into pension funds and lower dividends to shareholders. In the longer term, the hope is that we will see more pensioners receiving the benefits that they have been expecting throughout their working lives.

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