Royal Mail’s Journey to CDC

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A bit about Royal Mail Group

- Royal Mail Group is the largest delivery company in the UK – where it operates as Royal Mail and Parcelforce Worldwide.

- Royal Mail Group is one of the UK’s largest employers, directly employing around 142,000 people.

- One in every 185 jobs in the UK is provided by Royal Mail Group.

- Royal Mail and CWU remain committed to providing the best possible pension arrangements.

- We want to be able to offer a CDC scheme to our 142,000 strong workforce as soon as possible.
The DB scheme had become unaffordable

- The affordability of the Royal Mail Pension Plan (the Plan) - a career average scheme - has been a problem facing the Company for several years. The Plan closed to future accrual on 31 March 2018.

- This was a very hard decision to make. But the increase in the cost of the Plan meant it was no longer affordable:
  - If no changes were made, contributions to the Plan were expected to grow from around £400 million a year to over £1.2 billion a year.
  - Royal Mail contribution to the scheme was 17.1% of salaries – but without change it would have risen to over 50% from April 2018

- Royal Mail initially proposed moving future accrual to an improved DC Plan. Later in the negotiations, Royal Mail proposed a DB Cash Balance scheme – which addressed employee feedback and built on the CWU’s WinRS proposal.

- The DB Cash Balance scheme is a transitional scheme, while we seek the necessary changes needed to establish a CDC scheme.
The agreement to pursue a CDC scheme

• We had frank and detailed discussions with the CWU about our future pension arrangements.

• Over many months we explored a number of different pension design options, but for various reasons none of them met our needs.

• After a helpful mediation process and further talks, we agreed that CDC was a progressive option which would meet our objectives, providing the best outcome for members and the Company.

• Royal Mail and CWU have committed to work together to call on the Government to introduce the necessary legislation to enable CDC.

• Our agreement on pensions combines two elements of benefit:
  • A Collective Defined Contribution target pension; and
  • A Defined Benefit lump sum on retirement
The benefits of CDC – for employee and employer

- Royal Mail is committed to providing the best possible pension arrangements for its staff.
- CDC pensions have benefits for both employees and employers.
- We see several advantages that CDC schemes can offer:
  - They can take a less conservative investment strategy in members’ later years, allowing higher potential returns.
  - Unlike individual DC schemes, they do not require members to purchase an annuity if they want to receive an income for life in retirement, and they can benefit from an overall reduction in costs through economies of scale.
  - CDC schemes can also be simpler for members, who are not faced with making decisions about investments or what to do with their benefits at retirement.
- The combination of these features makes for a more efficient design for members when compared with a pure Defined Contribution scheme, but with no benefit guarantees to be underwritten by the Company.
Royal Mail and CWU working together to call for CDC in the UK

- Royal Mail and CWU have committed to work together to call on the Government to introduce the necessary legislation to enable CDC.

- Royal Mail and CWU gave joint evidence to the Work and Pensions Committee inquiry into CDC schemes.

- We are in the early stages of discussions with Government.

- We think we have a strong case and are hopeful that the legislative and regulatory changes we seek will be made.
The CWU’s objectives, and why CDC meets them

• Two key objectives:
  ◦ *A Wage in Retirement* - an income for life
  ◦ A unifying scheme, **open to all**

• Key benefits for members
  ◦ Schemes will be open to all employees after 12 months
  ◦ Good for DB members, good for DC members
  ◦ Much better contributions than current DC scheme
  ◦ More reliable (but still uncertain) benefit outcomes than from individual DC
  ◦ Pensionable pay of basic + pensionable allowances: no lower earnings limit offset from earnings
The negotiated solution

The agreement reached with Royal Mail combines two elements of benefit:

- A Collective Defined Contribution target pension
  - 1/80th of pay with target RPI increases
  - there are no guarantees on this part of the benefit, and
- A Defined Benefit lump sum on retirement of 3/80th of pay – this is guaranteed – with target RPI increases
  - Sponsorship risk for Royal Mail in proportion to its ability to bear it
# The CDC agreement

## Common features

<table>
<thead>
<tr>
<th>Eligibility</th>
<th>All employees with 12 months’ service, auto-enrolled</th>
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<tbody>
<tr>
<td>Member contributions</td>
<td>6%</td>
</tr>
<tr>
<td>Employer contributions</td>
<td>13.6%</td>
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<tr>
<td>Normal Retirement Age</td>
<td>67</td>
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</tbody>
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## Protections

<table>
<thead>
<tr>
<th>Lump sum death benefit</th>
<th>4 x pensionable pay</th>
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<tbody>
<tr>
<td>Ill health benefit</td>
<td>50% of pensionable pay less State benefits for up to 3 years, lump sum at end of 3 years</td>
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The life cycle of a collective* scheme

Buying assets
Low market value good
Infinite time horizon

Open scheme sweet spot
Benefits paid from income
Infinite time horizon
Market value irrelevant

Closed scheme problem:
Selling assets to pay benefits
Shortening time horizon

Scheme closed !!

* Whether DB or CDC
The life cycle of money purchase

- While contributing:
  - Investment time horizon limited by retirement date
  - Want assets to be cheap

- Big risk at retirement:
  - From sale and reinvestment of assets into an annuity
  - Want non-bonds to be expensive and bonds to be cheap

- Big risks of draw down in retirement

- Money purchase is always either accumulating or decumulating, there is no open collective scheme sweet spot
We have back tested how CDC would work

- Tested how the scheme would perform over a difficult period
- Assumes the scheme is invested 50% in UK equities and 50% in overseas equities
- The chart compares the annual increases awarded with the target increase of RPI
Any questions?

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