

# Royal Mail's Journey to CDC

Jenny Hall: Royal Mail

Derek Benstead: First Actuarial, adviser to CWU

Cass Business School

Pensions Workshop

9 April 2018

**Royal Mail Group**



# 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.**



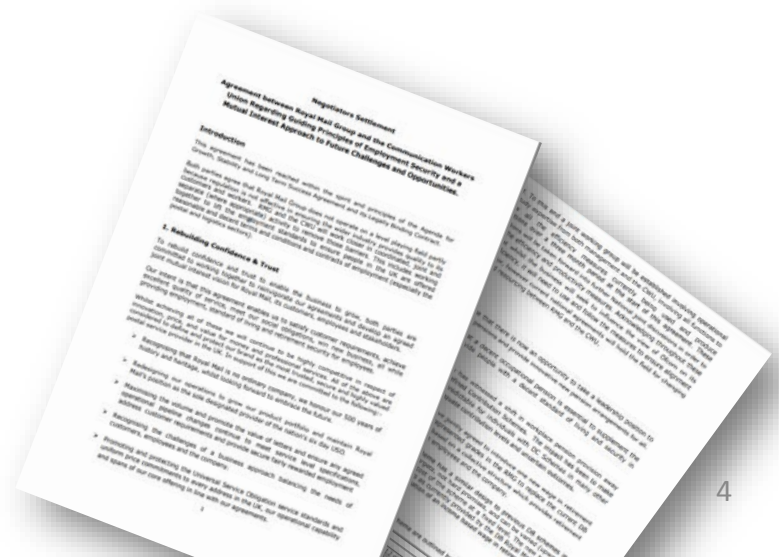


# The DB scheme had become unaffordable

- 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
    - $1/80^{\text{th}}$  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  $3/80^{\text{th}}$  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

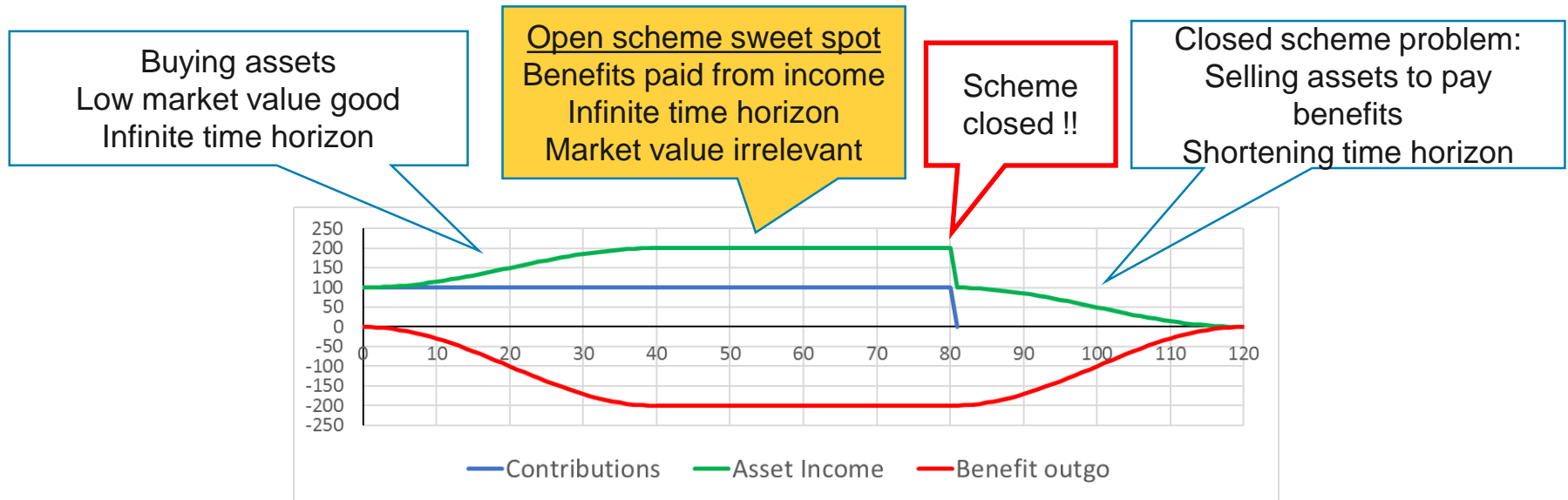
## Common features

Eligibility	All employees with 12 months' service, auto-enrolled
Member contributions	6%
Employer contributions	13.6%
Normal Retirement Age	67

## Protections

Lump sum death benefit	4 x pensionable pay
Ill health benefit	50% of pensionable pay less State benefits for up to 3 years, lump sum at end of 3 years

# The life cycle of a collective\* scheme



\* Whether DB or CDC

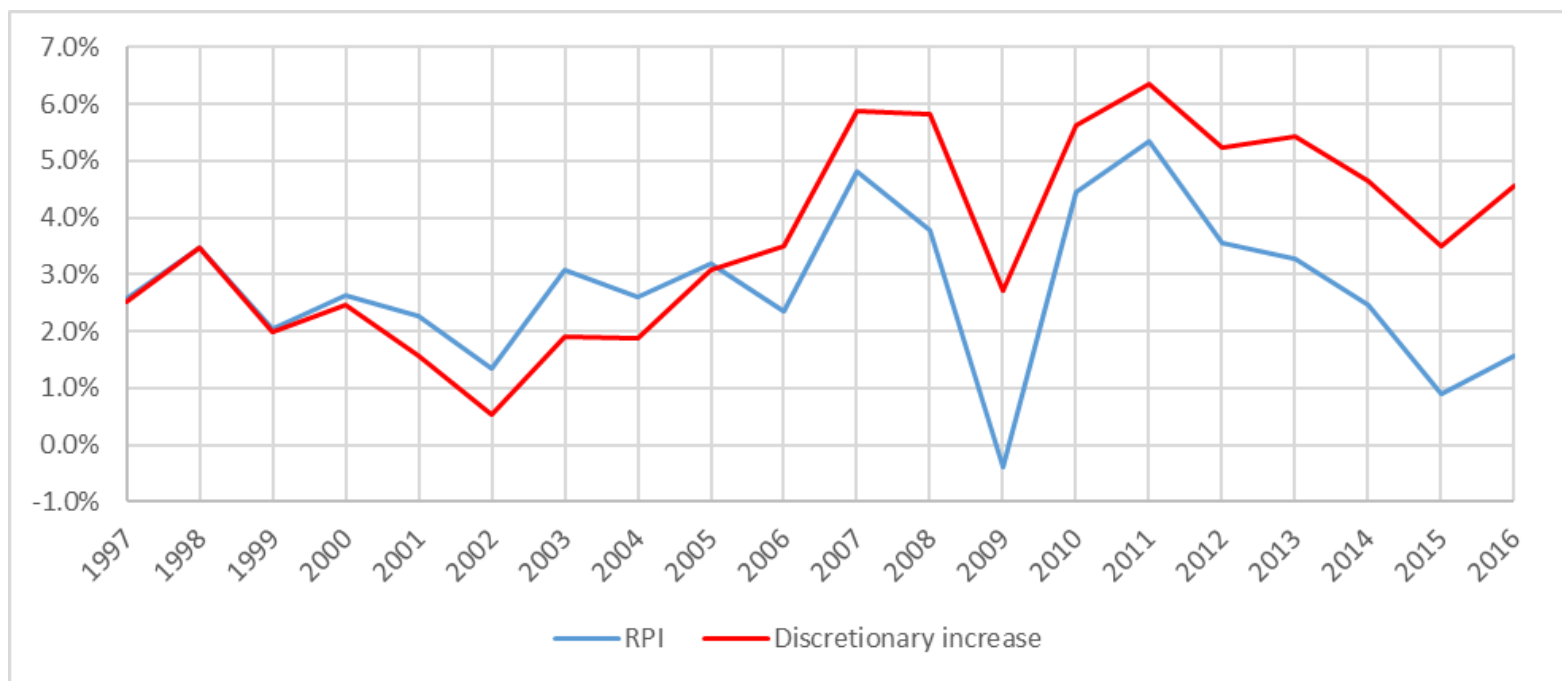
# The life cycle of money purchase

- 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

?

Jenny Hall  
Royal Mail  
020 7449 8238  
jenny.hall@royalmail.com

Derek Benstead FIA  
First Actuarial LLP  
0161 868 1721  
derek.benstead@firstactuarial.co.uk