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Royal Mail Group

CWU The communications union

first actuarial

Willis Towers Watson

The pensions solution at the Royal Mail: Collective Defined Contribution

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Agenda

Jon Millidge	Royal Mail Group	Why we want a CDC scheme for employees
Terry Pullinger	Communication Workers Union	Why we want a CDC scheme for union members
Derek Benstead	First Actuarial LLP	Why a CDC design best meets CWU's objectives
Simon Eagle	Willis Towers Watson	Current thinking on CDC design for Royal Mail

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Jon Millidge

Group HR Director

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 194 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.

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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.

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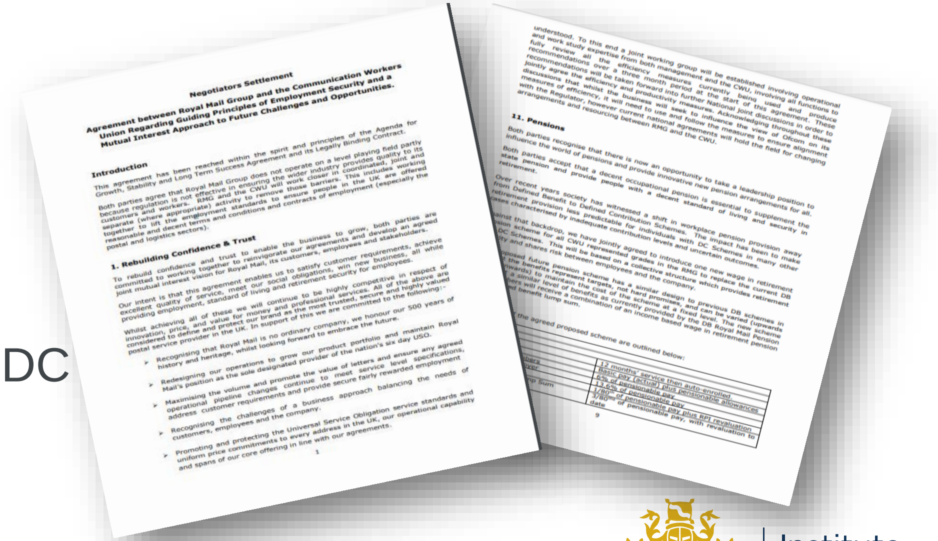
The agreement to pursue a CDC scheme

- 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
- Royal Mail and CWU are also working together to explain CDC to our workforce. Clear communications about the target benefit will be key.


Negotiators Settlement

Agreement between Royal Mail Group and the Communication Workers Union Regarding Guiding Principles of Employment Security and a Mutual Interest Approach to Future Challenges and Opportunities.

Introduction

1. Rebuilding Confidence & Trust

11. Pensions

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The benefits of CDC – for employee and employer

- Royal Mail and CWU are committed to providing the **best possible pension arrangements** for our 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.

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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 Select Committee inquiry into CDC schemes.
- We are in discussions with Government about how CDC schemes could be enabled with a more minimal set of legislative changes.
- We think we have a strong case and are hopeful that the legislative and regulatory changes we seek will be made.
- In his evidence to the Select Committee Pensions Minister Guy Opperman MP said ““we are minded to assist”. DWP also explained how – if CDC is enabled - the process would work:

DWP draft legislation → Approval by other Gov. dep’ts → Public consultation → Parliamentary process → **Implement CDC**

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Terry Pullinger

Deputy General Secretary, Postal

Communication Workers Union

Derek Benstead FIA

First Actuarial LLP

Advisers to the Communication Workers Union

Objectives

- To provide a pension
- Cost efficiently
  - Invest to earn a good return supporting benefits and contributions

- Design a scheme to:
  - Provide the best pension we can
  - Within the employer's budget
  - With acceptable risk to the employer's contribution rate
  - With acceptable risk to the members' benefits

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Royal Mail Pension Plan

- Employer’s cost of future service in excess of 50% of pensionable pay
  – For 1/60 pension, or 1/80 pension and 3/80 cash, at 65
- Logical funding approach for a low asset / high labour employer
  – Untenable cost for the employer
  – If benefits cut to fit employer’s budget, inadequate benefits for members
- No employer would start a scheme on this basis

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Benefit design – Hypothetical Step 1

- Suppose we decide UK equities are an attractive asset
- Offer a career average pension of 1/80 of pay, indexed to UK equity dividend growth
  - UK equities are the matching, low risk asset
  - We have designed the benefits to match the assets
    - In a reversal of the convention of matching the assets to the benefits

Benefit design – Step 2

- Offer a DB pension of 1/80 of pay, with discretionary annual increases
- The benefit outgo can be matched to asset income through use of the discretion, wherever the assets are
  - Not tied to UK equities
  - Subject to the rule that DB pensions cannot be decreased
  - Fixed employer's contributions
- This is the original Wage in Retirement Scheme (WinRS) proposed to Royal Mail

Benefit design – Step 3

- Take the WinRS design, but now allow pensions to decrease
  - There are no defined benefit promises
  - Communicated benefits are targets, not guarantees
- Fix the employer's contributions
- Now we have a Collective Defined Contribution scheme
  - Defined Contributions for the employer
  - Collectively invested

Simon Eagle FIA

Willis Towers Watson

Advisers to the Royal Mail Group

CDC scheme design objectives

RMG / CWU agreement February 2018

- Fixed joint contribution rate of 19.6% of pay*
- 1/80th career average pension
- Target pension increases of RPI
- Normal retirement Age 67

* 19.6% is to fund CDC pensions, DB lump sums and risk benefits

Pension increase design

- Pension increases must be fair
- Acceptably low risk of pension cuts
- Robust to population changes
- Excellent governance required
- Member comms must illustrate variability

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CDC scheme design – summary of current thinking

Investment approach

Objectives:

High returns

Acceptable volatility

Sufficient cashflow

Resulting holdings:

Mainly growth assets

Bonds as required for cashflow / robustness to a closure

Valuation approach

Best estimate assumptions, including discount rate

Carried out annually to determine pension increase

Increase policy

Annually, determine future rate of increases afforded by the assets; grant resulting increase to all members

If the assets suffer and become insufficient for non-indexed pensions, there must be a cut

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CDC scheme design – modelling so far

- Proof of concept – can the CDC design objectives be met?
- Stochastic modelling by both WTW and Aon
- Conclusions so far:
  - Target increases of RPI achievable
  - Increase expectations do not vary by generation
  - Increases are robust to a closure
  - Pension increases will be variable:
    - Increases well above RPI in upturn scenarios
    - Pension cuts could be required in severe economic downturns

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Questions

Comments

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