Rt Hon Frank Field MP
House of Commons
LONDON
SW1A 0AA

Dear Mr Field

At my recent appearance in front of the Work and Pensions Select Committee, I agreed to write in a little more detail on the legislative changes we believe will enable our proposed Collective Defined Contribution (CDC) scheme.

**Royal Mail’s proposed pension schemes**

In order to explain the changes needed, I would like to set out our proposal for our scheme. Royal Mail and the CWU have agreed to work together to introduce a CDC pension plan – subject to the necessary legislative and regulatory changes - with a Defined Benefit Lump Sum (DBLS) building up alongside it. This would provide one overall arrangement for all Royal Mail employees. The CDC scheme would provide members with an income during retirement, with the DBLS providing a lump sum at the point of retirement.

The new CDC and DBLS arrangements would target, but not guarantee, a similar level of retirement benefits to those currently provided by the Royal Mail Pension Plan (RMPP), our DB scheme which closes in its current form on 31 March 2018. The Company would expect to contribute 13.6% of members’ pensionable pay and members would contribute 6% of pensionable pay to the new arrangements.

Under the proposed arrangements - assuming the necessary legislative and regulatory changes are made – risk would be shared between members and the Company. The CDC scheme would pool risk amongst its members, while the Company would guarantee a set lump sum at the point of retirement through the DBLS.

**Legislative changes required to introduce a CDC scheme**

We envisage offering a CDC scheme under similar governance arrangements to those currently used for DB schemes. That is, a trust based model whereby the board of trustees act as fiduciaries with overall responsibility for running the scheme and administering its benefits in accordance with its rules and any legislative requirements, managing scheme investments and communicating actively with members to enable a clear understanding of the way in which benefits are calculated, and of how risks are shared between the members of the scheme.

We are currently exploring how we could introduce a collective scheme with the minimum set of legislative changes, given the constraints on parliamentary time. We are engaging with the Department for Work and Pensions (DWP) on this issue.

We believe we have identified a possible route to enabling a CDC scheme through the 2011 Pensions Act power to amend the “money purchase” definition in the 1993 Pension Schemes Act. Our proposal would enable such a pension scheme to be treated for legislative purposes as “money purchase” and so exempt from the various “defined benefit” employer funding and debt requirements which would otherwise apply to a plan which pays pensions from its own assets, rather than backing each member’s pension with an annuity.
At the highest level, the amendments to the legislation will need to:

- be clear that a scheme which is established at the outset as a “CDC” scheme can pay members a pension for life without risking being recharacterised as a “defined benefit” scheme;
- be clear that the prevailing rate of a pension in payment from a CDC scheme can be reduced without infringing Section 67 of the Pensions Act 1995 or HMRC “authorised payment” rules;
- clarify how CDC benefits should be assessed for HMRC annual and lifetime allowance purposes and enable the lump sum and CDC elements of our proposal to fit together appropriately from a “pension commencement lump sum” perspective;
- ensure there is public confidence in CDC schemes with appropriate levels of transparency;
- ensure that members are clear as to the nature of CDC arrangements including how benefits are calculated and what members’ rights on transfer and retirement may be; and
- make consequential amendments to ensure the “money purchase” designation of the scheme does not cut across the intended collective benefit nature of the scheme design. For example, by setting out key principles governing the rules around revaluation and transfers in and out of the scheme so that there is no discrimination against “early leavers”, and there are appropriate provisions to guard against “system gaming”.

I hope that this information is useful to this Committee as it continues its inquiry into CDC schemes. Whilst we are in the early stages of discussion with the DWP, I would be very happy to keep the Committee updated on any significant developments as work in this area progresses.

Yours sincerely

Jon Millidge
Group HR Director, Royal Mail Group