30th January 2018

CWU Submission to the Work and Pensions Committee on Defined Ambition Pension Schemes

Introduction

1. The Communication Workers Union is the largest trade union for the communications industry in the UK, with approximately 190,000 members in the postal, telecoms, financial services and related sectors. We represent members in many different occupational pension schemes, both Defined Benefit (DB) and Defined Contribution (DC), including in the Post Office, Royal Mail, Telefonica UK, the Santander Group, BT and Capita.

2. Over recent years the CWU has consistently argued that the current accounting and regulatory framework and investment strategies are forcing the premature closure of many defined benefit final salary schemes. We have also been critical of profitable companies being able to pay out hundreds of millions of pounds in dividends each year while cutting employees' pension entitlements. At the same time, the CWU has become increasingly concerned about the adequacy of individual defined contribution schemes that are characterised by inadequate contribution rates and uncertain outcomes and which do not provide a decent standard of living and a 'proper wage' in retirement. Faced by Royal Mail's decision to close the company's defined benefit scheme to future accrual in March 2018 and in the face of growing evidence about the inadequacy of Royal Mail's individual Defined Contribution plan, the CWU (working with our advisors First Actuarial) have developed a proposal for a defined ambition scheme to secure the future pension provision of over 100,000 employees in Royal Mail Group.

3. Against that backdrop, the CWU therefore welcomes the Work and Pensions Committee Inquiry on Defined Ambition (DA) pension schemes, of which Collective Defined Contribution (CDC) schemes is one form. We wish to see DA schemes enabled through regulation and used to improve overall occupational pension provision. Evidence from other countries demonstrates that DA schemes have the potential to offer a far more beneficial alternative to traditional DC schemes.

Key points

4. Collective Defined Contribution schemes can have a number of advantages over individual DC schemes. A long-term study found that those retiring on the average DC scheme received 21% of their previous salaries whilst those on a CDC scheme received 28% of salary. The pooling of assets creates economies of scale for administrative costs and helps to spread risk, allowing for higher yield investments.

5. The Government's failure to introduce the regulations needed to enable shared risk schemes and collective benefits, as intended under the UK Pensions Act 2015, represents a serious missed opportunity.[1] We believe immediate progress should now be made on this as one of a number of steps needed to help avert a growing pensions crisis.[2] The average contribution rate into a DC scheme was just 4.2% in 2016[3] and the average pension pot is £50,000 which would give an annual income of just £2,500 a year.[4]

6. Following a vigorous CWU campaign and intensive negotiations, Royal Mail has proposed a pension scheme that would combine a collective defined contribution scheme and a target income in retirement with a defined benefit cash balance lump sum. However, such a scheme will only be possible if the Government introduces the necessary regulations to facilitate Collective Defined Contribution pension schemes. The CWU and Royal Mail are working together to call on the Government to enact these regulations.

Benefits to savers and the wider economy

Would CDC deliver tangible benefits to savers compared with other models?

CDC would be considerably better for savers than DC schemes

7. Collective Defined Contribution schemes would deliver considerable benefits to savers compared with traditional DC schemes. Collective investment provides better returns, in part because it is relatively low-cost to administer, but more importantly because it allows savers to pool their risk.[5]

8. The UK government actuary has concluded that collective pensions are expected to deliver a retirement income that is 39% higher than the corresponding individual pension outcome. The actuary has also reported that a collective pension plan would be subject to less volatility than an individual one; and that the pension paid would, on average be more predictable.[6]

9. A study of CDCs between 1955 and 2011 by consultants Aon Hewitt compared them with individual defined contribution schemes. It concluded that those retiring on the average DC scheme received 21% of their previous salaries whilst those on a CDC scheme received 28% of salary.

10. CDCs are widespread in the Netherlands and have proved to be a great success, with the prospect of much better returns for savers than individual DC schemes. Whilst the Dutch

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[1] Pension Schemes Act 2015, accessed at: https://www.gov.uk/government/collections/pension-schemes-bill-2014-to-2015

[2] Regulations are a pre-requisite to introducing shared risk schemes in the UK, but other changes will also be needed to avert a pensions crisis, including far higher minimum pension contribution rates and the extension of pensions auto-enrolment to workers under 21 years of age and to the self-employed.

[3] ONS. September 2017. *Occupational Pension Schemes Survey: UK, 2016.* Accessed at: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/uk2016

[4] Average pension pot rises to £50,000, but this will only give you £2,500 a year, iNews, 5th April 2017, accessed at: https://inews.co.uk/inews-lifestyle/money/average-pension-pot-rises-to-50000-as-more-people-save/

[5] Collective pensions in the UK, David Pitt Watson, Hari Mann, the RSA, July 2012

[6] David Pitt Watson, Hari Mann, the RSA, ibid

model involves a level of risk for members, this is shared with future generations. This allows schemes to pursue riskier investment strategies, on average. CDC pension schemes in the Netherlands also involve a limited risk for fluctuating pension commitments from the employer.[7]

11. Risk sharing continues post retirement under the Dutch model. Although this is a potential area of concern for savers because it means pensions in payment can decrease, where schemes have cut pensions in the Netherlands these cuts have been marginal. For example, in 2012, a quarter of the schemes in the Netherlands cut pensions by an average of 1.9%, in order to restore their finances.[8] Provided a reductions ceiling and strong regulatory regime were established on any potential cuts, a similar model for the UK would enhance stability within the pensions market and improve savers' confidence in the long-term. Equally though, statutory protection for indexation of DB pensions in payment remains important and must not be watered down any further. We believe statutory protection for indexation should be reinstated for DC schemes as far as practical, and applied to CDC schemes so that pensions in payment continue to keep pace with inflation wherever possible.

The inadequacy of DC pension scheme provision

12. There is a growing debate in Government and across the UK pensions industry about the adequacy of DC provision where contribution rates are insufficient, outcomes are inferior and uncertain, they don't offer a decent standard of living and wage in retirement – and members don't feel qualified or informed to determine how to manage and use their pot of money when they "cash out" at the point of retirement.

13. Around 83% of private sector employees with workplace pensions have a DC pension and the average combined contribution rate into a DC scheme was just 4.2% in 2016.[9] This simply will not provide enough retirement income for people on low and average wages. Someone on an average full time salary of £28,000 a year putting 4.2% of their wages into a defined contribution pension each year over 30 years would save a pension pot of around £48,000, giving an annual retirement income of just £2,400 a year[10]. The average UK pension pot is reportedly £50,000 which would give an annual income of just £2,500 a year.[11]

14. Whilst we welcome that auto-enrolment has extended access to occupational pensions to millions more people, the minimum contribution rates – currently 2% overall (1% from employees and 1% from the employer) - are far too low to build up a decent pension. Even with the planned rise to 5% in 2018 and 8% in 2019, pension savings through auto-enrolment will fall a long way short of providing a living wage and dignity in retirement. The Government's automatic enrolment review announced in December 2017 indicates there is

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[7] The Dutch pension system – an overview of the key aspects, Dutch Association of Industry Wide Pension Funds

[8] Going Dutch, What is a collective pension scheme? BBC News, 4th June 2014, accessed on 2nd August 2017 at: http://www.bbc.co.uk/news/business-27665364

[9] ONS. September 2017. *Occupational Pension Schemes Survey: UK, 2016, a*ccessed at: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/uk2016

[10] This Is Money Pension Calculator, accessed at: http://www.thisismoney.co.uk/money/pensions/article-1633402/Pension-pot-calculator-How-need-save-retirement.html (At long term average interest rates of 5%)

[11] Average pension pot rises to £50,000, but this will only give you £2,500 a year, iNews, 5th April 2017 https://inews.co.uk/inews-lifestyle/money/average-pension-pot-rises-to-50000-as-more-people-save

no plan to radically improve this situation. A recent study found that young people today should be saving 18% of their earnings into a pension to enjoy a comfortable retirement.[12] Pensions in the Netherlands are significantly higher than in the UK not only because of the use of CDCs, but also because Dutch workers reportedly contribute between 21% and 25% of their pre-tax pay to their pensions.[13] Equally, it has to be recognised employers are simply not paying enough to afford employees a decent standard of living in retirement.

15. The CWU has been able to secure comparatively good DC pension contribution rates in many of our recognised employers, but even then these schemes are not going to give members the level of income they need to avoid poverty in retirement. In Royal Mail's DC scheme, only 12% of employees are paying the maximum contribution rate of 6% (giving a combined rate of 15%), whilst 37% are paying the lowest rate of 4% (giving a combined rate of 11%). In BT's DC scheme, most members are paying the lowest contribution rate of 5% (giving a combined rate of 13%). With discussions ongoing in BT over pensions, the company has offered a minimal 1% increase in employer contribution rates to its defined contribution scheme, which the CWU has rejected as inadequate.

The need to protect and promote DB pension schemes

16. Whilst CDC schemes will provide better returns than traditional DC schemes, they will not be as predictable and secure for savers as DB schemes. We therefore wish to see pensions regulation that is focused on protecting and promoting DB pension schemes as far as possible. In particular, we have been calling for a new regulatory approach for scheme valuation methods and investment strategies to ensure DB pensions are manageable and sustainable for the long term.

17. We believe it is unacceptable that, despite being generally affordable[14], DB pension schemes are being closed to future accrual by employers who are turning to inferior Defined Contribution (DC) schemes in an effort to cut costs and maximise profits and dividend payments. This has been our experience in many of the schemes run by our recognised employers, including in the Post Office and Capita TV Licensing. Royal Mail and BT have also made proposals to close their DB schemes and move members into a DC scheme, and the CWU is working hard for an improved offer in both of these companies.

18. Nevertheless, where DB schemes are genuinely not viable, we consider there is scope for CDC schemes to offer a target income similar to that of a DB scheme.

<u>Post Office</u>

19. Last year we saw the closure of the Post Office scheme to future accrual, despite the scheme retaining a healthy surplus which could have been used to fund ongoing accrual for the time being. The CWU campaigned strongly against the closure of the Post Office DB scheme, but

[12] How much should you save for decent retirement? This Is Money, 25 July 2017, accessed at: 2017http://www.thisismoney.co.uk/money/pensions/article-4714600/Save-18-salary-old-age-young-told.html

[13] Going Dutch: What is a collective pension scheme? BBC News, 4 June 2014, accessed at: http://www.bbc.co.uk/news/business-27665364

[14] According to the Government, the number of members in schemes with affordability issues could be as low as 5%: Security and sustainability in Defined Benefit Pension Schemes, Department for Work and Pensions, February 2017, para 128, p.35

after running what we consider was an inadequate and misleading consultation, the Post Office has pressed ahead regardless. Scheme members were transferred into an inferior DC scheme, reducing their expected retirement benefits by over 30% in some cases.

Royal Mail

20. In April 2017, Royal Mail confirmed plans to close its DB scheme to future accrual, even though the scheme was well funded. The CWU condemned the company's decision, and put forward an alternative proposal for a defined benefit Wage in Retirement Scheme (WINRS) which would provide the company with a credible, cost efficient and lasting pension solution for all its employees.

21. The CWU's modeling showed that the WINRS scheme could be managed within the fixed contributions provided by the employer and employees while the benefit outcomes were likely to be comparable with or beat traditional DB schemes. Furthermore, the outcomes were much better and more dependable than any DC alternative or those from a Defined Benefit lump sum scheme proposed by Royal Mail.

22. Following mediation, Royal Mail has proposed a scheme that would combine a collective defined contribution scheme and a target income in retirement with a defined benefit cash balance lump sum. The CWU has welcomed this development and we believe it has brought us within reach of an agreement. However, such a scheme will only be possible if the Government introduces the necessary regulations to facilitate Collective Defined Contribution pension schemes. The CWU and Royal Mail are working together to lobby the Government to enact these regulations.

BT

23. BT made proposals earlier this year to close its DB scheme to future accrual, or dramatically increase costs for active members whilst reducing benefits. If the scheme is closed, members will be transferred to a DC scheme for which the company has offered to increase its standard contribution rate by just 1%. If the scheme stays open, members will be required to pay up to 3% more in return for 12.5% less benefit accrued each year.

24. The CWU has rejected all of the company's proposals as inadequate and unacceptable. BT made £7.5 billion in profit last year and paid over £1 billion in dividends to shareholders. The CWU's claim for an improved pension proposal would cost the company around 1% of its latest annual profit. We believe that BT can afford to pay more to ensure decent pension provision and dignity in retirement for its employees.

Capita TV Licensing

25. Capita TV Licensing informed us earlier this year it was seeking to close its DB pension scheme, and despite representations from the CWU for a delay in light of the Select Committee Inquiry on DA schemes, this went ahead on 30th November 2017. Capita TVL's proposal was for all active members to be placed into a DC pension plan with a matched contribution rate of up to a maximum of 5% of salary. Following negotiations, the CWU was able to improve on this position, securing an offer of employer contributions up to a maximum of 14%. We will be looking to engage with Capita TVL in the future on DA/CDC

pension schemes with a view to securing a better deal on pensions for our Capita TVL members.

How would a continental-style collective approach work alongside individual freedom and choice?

26. We do not agree with those who argue that CDC schemes run counter to the trend towards greater individual freedom and choice in pensions. There is ample scope for building in flexibility and freedom within CDC, or giving members the ability to opt out of such schemes.

27. Aon Hewitt has suggested that individuals could save more on top of a CDC "core". This saving could also be matched by the employer. It would give savers the ability to address their variable, changing needs in retirement, with the security of a basic retirement income from the CDC core and their state pension.[15]

28. We believe that given the level of inadequacy and uncertainty associated with individual pension savings, the Government must now look to promote policies that will support pensions security and stability as an alternative option to freedom and choice. The majority of scheme members are not knowledgeable enough about pensions and investments to want to take responsibility for managing their savings pot when they come to retire. Most are simply looking for a pension that will give them an income stream and financial security throughout the whole of their retirement, free from the threat of exhausting their pension savings.

29. More than two years after the government brought in a range of pension freedoms, there have been warnings that millions of workers risk being plunged into insecurity in old age after an official report revealed a surge in people accessing their pension funds early without taking advice.[16] The Financial Conduct Authority concluded that early intervention may be necessary as a result of this trend. This should prompt the Government to act so that pensioners are not condemned to a life of poverty as a result of policies on pensions freedom and choice which are not balanced by pensions security and stability.

30. It is also important to recognise that criticism of CDC schemes from UK commentators is often from a biased position and with obvious ulterior commercial motives.[17] Another criticism is that CDC could not work effectively in the UK because its success relies on a highly unionised environment such as in the Netherlands. However, Aon Hewitt has dismissed this argument, saying that CDC plans have been adopted in a variety of different jurisdictions and cultures including in Denmark and Canada.[18]

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[15] Collective DC Top ten mythbusters, Aon Hewitt, accessed on 3rd August 2017 at: http://www.aon.com/unitedkingdom/retirement-investment/defined-contribution/collective-defined-contribution.jsp

[16] FCA warns it may intervene as millions take pension cash early, Guardian, 12 July 2017, accessed at: https://www.theguardian.com/money/2017/jul/12/fca-intervention-pension-freedoms-workers-financial-insecurity-tuc

[17] Collective DC Top ten mythbusters, Aon Hewitt, accessed on 3rd August 2017 at: http://www.aon.com/unitedkingdom/retirement-investment/defined-contribution/collective-defined-contribution.jsp

[18] Top ten mythbusters, Aon Hewitt, ibid

Does this risk creating extra complexity and confusion? Would savers understand and trust the income 'ambition' offered by CDC?

31. CDC schemes are likely to be more complex than other schemes, but this should not create extra confusion providing they are properly explained. It should be emphasised that traditional DC schemes can be extremely confusing for members because of their complexity and because of the lack of certainty people have about what they will ultimately receive. We consider that savers would understand and trust the income 'ambition' offered by CDC, and that this would give them more certainty about their retirement income, allowing them much more opportunity to make plans for the future. We believe that greater focus on providing members with more certainty about income in retirement is likely to increase confidence in saving in a pension.

Converting DB schemes to CDC

Could seriously underfunded DB pension schemes be resolved by changing their pension contract to CDC, along Dutch lines?

32. The CWU is in negotiations with Royal Mail to introduce a CDC scheme for future service, in place of the existing DB and DC schemes. We believe this would be a satisfactory solution for all in Royal Mail, given that despite our concerted efforts we have been unable to persuade Royal Mail to keep its DB scheme open to future accrual. There is the potential for a CDC scheme in Royal Mail to deliver a target pension that is equal to the current DB scheme.

33. However, we believe there would need to be robust safeguards in place with any new regulations that facilitate such a change, to ensure that DB scheme sponsors do not deliberately scale back funding to justify a shift to less predictable CDC schemes.

34. Furthermore, we would be strongly opposed to any proposal that allowed underfunded DB schemes to convert accrued pension assets into a less secure or less generous CDC scheme. Pensions are deferred pay and such a proposal could deliver a significant financial blow to members in future years. CDC pensions should not be used to undermine the integrity of existing DB schemes.

Regulation, governance and industry issues

How would CDCs be regulated?

35. CDC schemes may be more complex than other schemes, and there is an indirect relationship between contributions and benefits in a CDC scheme. For these reasons, a robust regulatory regime will need to be put in place and there will need to be strong standards of communication and governance. This should include common standards for information reporting, cost and charge disclosure and benchmarking. Members will need to be fully informed of the investment risks and guarantees.

36. CDC schemes should be overseen by trustees acting on behalf of members, including member nominated trustees, taking decisions at scheme level and removing the need for individuals

to make difficult choices about fund allocations and retirement income products. In addition, regulations should ensure that schemes set out clearly to members in advance details about how their rights are defined, what they can expect from the pool, and how positive and negative shocks will impact on their pension benefits.

37. The Government should create a regulatory framework that draws on the experiences of other countries where CDC schemes operate - such as the Netherlands, Sweden and Denmark - and prioritise clarity and transparency in the interests of members.

38. As noted in paragraph 11, the Dutch model of risk sharing post retirement could enhance stability within the UK pensions market and improve savers' confidence in the long-term. However, this would rely on a strong regulatory regime and a reductions ceiling being established on any potential cuts. We also believe statutory protection should be introduced for indexation of CDC pensions in payment in line with inflation, so that benefits keep pace with inflation wherever possible. Clear rules should be set out to determine under what circumstances a pensions uplift in line with inflation may not be possible or affordable.

Is there appetite among employers and the UK pension industry to deliver CDC?

39. The delay in implementing legislation on CDC has stifled interest in this option. However, the example of Royal Mail and its proposal for a CDC scheme would suggest that there is an appetite amongst employers to do this. Many employers will see it as their role to help individuals generate a steady stream of income in retirement. This is not just the right thing for an employer to do from a moral perspective, but it brings a number of business benefits. An attractive occupational pension serves as a recruitment and retention tool, and it suits employers if their employees can retire in an orderly fashion, rather than being forced to continue working because they cannot afford to retire.

Would CDC funds have a clearer view towards investing for the long term?

40. Yes, the evidence from the Netherlands shows this is the case. As mentioned above, the Dutch model allows schemes to share risk with future generations. This enables schemes to take a long term approach and pursue riskier investment strategies.

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