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Consumer and Postal Affairs

11 November 2010

Dear Colleague

During the Second Reading debate of the Postal Services Bill, Vince Cable, the Secretary of State for Business, Innovation & Skills, committed to provide Members of the House with a note giving further background on the measures set out in Part 2 of the Bill.

Part 2 provides Government with the powers to assume responsibility for the historic deficit in the Royal Mail Pension Plan (RMPP). This is a key part of our package of measures, which we have introduced in response to recommendations made by Richard Hooper in his independent reports on the future of the universal postal service. Our measures will secure the future of both the universal postal service and Royal Mail.

Background

The Royal Mail Pension Plan (RMPP) is the main pension plan for employees of Royal Mail Group, including those who work in Post Office Ltd. It has around 435,000 members, of whom around 140,000 are current employees. On 1 April 2008 Royal Mail closed the scheme to new members, and from that date new employees have become members of the Royal Mail Defined Contribution Plan.

As at 31 March 2010 the RMPP had assets of approximately £26bn and liabilities of approximately £34.4bn on an ongoing funding basis – resulting in a deficit of around £8.4 billion. This deficit is huge, volatile and threatens the future of the company. To facilitate the sale of shares in Royal Mail, and thereby secure the company's future, the Bill allows Government to take over assets and liabilities from the RMPP and in so doing to assume responsibility for the pension deficit. We propose to do this by creating a new public service pension scheme (the 'new Government scheme') which will pay out the pension benefits that members have already built up. The RMPP will be left as a much smaller, fully-funded scheme and Royal Mail and Post Office Ltd will be responsible for their respective employees' future pension benefits.

The Royal Mail and Post Office Ltd will also remain responsible for the Royal Mail Senior Executive Pension Plan (RMSEPP). The liabilities of RMSEPP are significantly smaller than those in the RMPP. As a consequence they do not need to be addressed by Government to facilitate the introduction of private sector capital into Royal Mail.

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Cut-off date

In practical terms, there will be a cut-off date dividing liabilities between the RMPP and the new Government scheme. Members' RMPP pension rights earned up to the cut-off date will be taken over by the Government scheme; members' pension rights earned after that date will be paid by the RMPP.

Whilst our proposals for the RMPP broadly mirror the solution provided by the 2009 Postal Services Bill, we have considered afresh the question of when the cut-off date should be set.

Under the 2009 Bill the cut-off date was intended to be set at 16 December 2008, the date of the first Hooper report. As I informed the Postal Services Bill Committee yesterday, we now intend the cut-off date to be set as close as practical to the date of a sale of shares in the Royal Mail. This will facilitate a sale of shares in Royal Mail by ensuring the company has an appropriately sized pension plan going forward.

Royal Mail will remain solely responsible for all pension benefits earned by members after the cut-off date. In addition the company will retain responsibility for the liabilities in the RMPP earned before the cut-off date relating to the future salary growth of members.

The majority of the benefits that the RMPP provides are based on members' salaries. As future salary growth is a matter for Royal Mail it is therefore right that responsibility for the impact of this salary growth on pension liabilities should remain with Royal Mail. Of the £34.4bn liabilities in the Plan as at 31 March 2010, approximately £1.5bn relates to this 'salary link liability'. The RMPP will be left with assets to fully fund this salary link liability. There will therefore be no deficit in the RMPP at the cut-off date.

We have undertaken benchmarking analysis that shows liabilities of around £1.5bn to be proportionate for a company of Royal Mail's current size. Any earlier date would threaten the injection of private sector capital into the business. The Government's pension proposals have to be approved by the EU Commission as state aid.

Member protection

The Government is committed to ensuring that the pension benefits of employees past and present are protected – and this commitment is on the face of the Bill. Part 2 of the Bill places an obligation on Government to ensure that members are no worse off in any material respect immediately after any transfer of their rights to the new Government scheme than they were immediately before.

To further safeguard the interests of members, the Bill places restrictions on Government's ability to make future amendments to the new Government scheme except where those amendments are not detrimental. These restrictions will reflect as closely as possible the statutory protections that currently apply to the RMPP as an

occupational pension scheme that restrict scheme amendments with detrimental effects to members' existing rights¹.

What Part 2 means in practice for members of the RMPP

The Bill provides statutory protection that no member of the RMPP will be left worse off as a result of the transfer to the Government scheme. The practical impact on individual members when Government implements the measures set out in Part 2 of the Bill will depend on the circumstances of the individual member.

Royal Mail's pension arrangements are split into different sections that provide different benefits, based on the various changes to these arrangements over the years. Some current and former employees receive defined contribution (or 'money purchase') benefits only, provided through a separate arrangement, the Royal Mail Defined Contribution Plan. Such individuals will see no change as a result of our proposals. However the bulk of current and former employees have accrued rights to a defined benefit pension based on their salary in the RMPP. For these RMPP members the administrative impact of Government's actions will largely depend on whether they remain in active employment with Royal Mail at the cut-off date.

Those members who are already pensioners at the cut-off date will receive their entire pension from the new Government scheme. Likewise, members who have left employment with Royal Mail but are not yet drawing their pension will receive their entire pension from the new Government scheme ("deferred members"). However, members who are in employment with Royal Mail at the cut-off date ("active members") will receive two payments when they start drawing their pension – one from the new Government scheme in respect of pensions accrued up to the cut-off date and the other payment from the ongoing RMPP in respect of any accruals after the cut-off date. Because liabilities relating to the salary link will also be retained by the RMPP these members may also receive a 'top-up' payment from the RMPP in respect of the benefits they built up which transferred across to the new Government scheme. This 'top-up' payment would depend on a member's salary progression after the cut-off date. In this way such members will receive their full entitlement in relation to past accruals albeit from two different sources.

In practice, we intend that all members of the RMPP will continue to get one monthly pension payment so the individual member should not notice that they are getting payments from two sources. A high level illustration of how this would work in practice is provided in an **annex** to this note.

We are committed to ensuring that members not only receive their full pension entitlements but also that they continue to receive the high standard of service to which they are accustomed. We are in discussion with the trustees of the RMPP on future administration arrangements for the new Government backed scheme and how these might be best coordinated with the payments made by the ongoing RMPP. Our aim is to ensure a seamless service is provided to members.

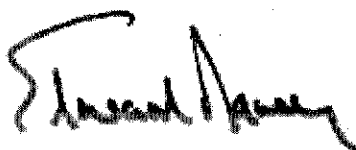
¹ Under Section 67 of the Pensions Act 1995

We are also determined that members' interests will continue to be represented once the new scheme is set up. In particular we want to ensure that adequate measures are put in place for members to raise any concerns they might have about the operation of the new arrangements. When considering this we will take account of the views of members and their representatives and of practices in other large public sector pension schemes. For example, the NHS Pension Scheme and the Principal Civil Service Pension Scheme have governance groups that include employer and member representation. The governance groups meet regularly and their remit includes monitoring service delivery and member communication.

We will also continue to work with the trustees to ensure that RMPP members receive regular updates on the changes we are proposing.

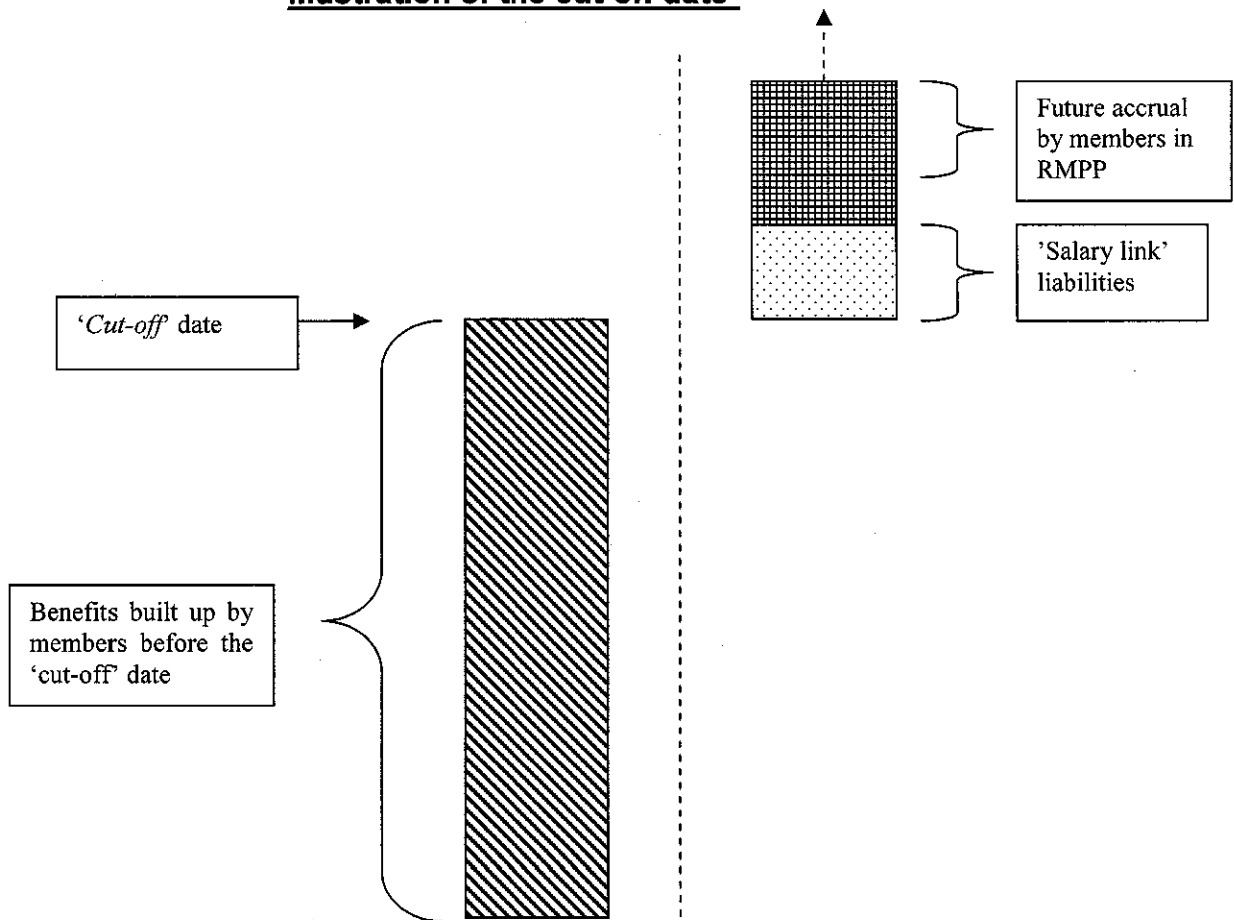
Conclusion

I hope this information is of interest and is helpful in terms of explaining the measures set out in Part 2 of the Bill – which by their very nature are complex. In particular I would like to assure you that the pension solution we are proposing will serve to ensure Royal Mail has the 'right sized' pension plan going forward. This will facilitate the Government objective of introducing private sector capital into the business and of course will also provide members of the Plan with comfort that the massive deficit has been addressed and their pension benefits are safe. I look forward to your support for these measures during the passage of the Bill.

A handwritten signature in black ink, appearing to read 'Edward Davey', written in a cursive style.

EDWARD DAVEY

Illustration of the cut-off date²



	New Govt scheme	Ongoing RMPP
Size of plan (liabilities) ³ :	c£35bn	c£1.5bn
Members in plan:	- Pensioners ⁴ - Deferred members ⁵ - Active members ⁶	- Active members only
Liabilities in the plan	- All benefits accrued by members up to the cut-off date	- Salary link ⁷ - Future accruals by members after the cut-off date

² This diagram is for illustration only and is not to scale.

³ Indicative size on an ongoing basis, based on an illustrative cut-off date of 31 March 2012

⁴ Members of the RMPP who have retired and are in receipt of pension payments

⁵ Members who are no longer employed by Royal Mail but have not yet retired and have left their rights in the plan

⁶ Members who are still in employment with Royal Mail

⁷ This is the liability currently in the RMPP which relates to the fact that the benefits already earned by members in the RMPP is linked to their future salary growth

What this means for different types of member in the RMPP:

Type of member	How benefits will be paid
Pensioner	<ul style="list-style-type: none">• Entire pension will be paid from the new Government scheme
Deferred member	<ul style="list-style-type: none">• Entire pension will be paid from the new Government scheme
Active member	<ul style="list-style-type: none">• Benefits earned up to the cut-off point paid from Government scheme• 'Top-up' relating to salary growth after the cut-off date paid from the RMPP• Benefits built up after the cut-off date also paid from the RMPP
Members who joined on or after 1 April 2008 (including future employees)	<ul style="list-style-type: none">• Unaffected as not members of the RMPP. Benefits instead build up on a money purchase basis in the Royal Mail Defined Contribution Plan