Written evidence from the Communication Workers Union (PPF0075)

Summary
1. The Communication Workers Union (CWU) has serious concerns about the growing threat to the future of UK defined benefit (DB) pension schemes. The scandal of the BHS pension collapse has highlighted the woeful lack of protection for pension funds against corporate greed and negligence, and this must be properly addressed through regulation. However, the overwhelming threat to the ongoing sustainability of DB schemes is the increasing and unjustified reluctance of employers to commit the necessary funding to keep them open to future accrual.

2. Over the last few years we have seen the closure of the Royal Mail, Post Office and BT defined benefit schemes to new members. We are now faced with the threat of the imminent closure of the Royal Mail and Post Office defined benefit schemes to future accrual. This is despite the Royal Mail Pension Plan’s position as the best funded scheme amongst the FTSE 100, and the Post Office scheme retaining a healthy surplus which can be used to fund ongoing accrual for the foreseeable future.

3. The decline in gilt yields following the EU referendum has led to a dramatic increase in pension deficits, but the problem is actuarial and relates to a scheme’s projected deficit. It does not mean that a pension scheme will actually be in deficit in 10 years’ time, and it should not be used as an excuse to close a scheme.

4. Evidence suggests that the decline of DB schemes in favour of cheaper defined contribution (DC) schemes is driven by a desire to cut costs and maximise profits rather than a problem of affordability. A recent report by consultancy firm LCP reveals that in 2015, FTSE 100 companies paid five times more in dividends to shareholders than contributions to their defined benefit plans.¹

5. We believe it is essential that defined benefit pension schemes are placed on a sustainable footing. We support the view that this should involve strengthening the powers and resolve of the Pensions Regulator to act early, quickly and firmly with those who seek to avoid their pension responsibilities.²

6. Making pensions sustainable should involve giving the Regulator new powers to ensure that employers cannot simply choose to close a DB scheme to future accrual in an effort to cut costs and boost profits. Schemes should be subject to rigorous affordability tests by the Regulator before changes can be made, and rules should be introduced that require employers to explore every possible opportunity to keep them open for future accrual.


7. In light of the sharp decline in gilt yields, we consider that the Regulator should have powers to ensure that employers can not overreact to pension deficits. Pension schemes are long-term investments, and the focus of pensions regulation should be on requiring employers to take more long term responsibility for pension funds. The Regulator should play a role in ensuring pension trustees and sponsors revise their approach to valuing pension schemes liabilities where appropriate.

8. We consider that the Post Office’s consultation on the closure of its section of the Royal Mail Pension Plan has been misleading, pre-determined and in breach of its statutory duty to consult. The Regulator should have adequate powers to ensure that employers properly fulfil their statutory duty to consult on pension scheme closures. This should include tougher financial penalties and the power to alter any listed change made following a failure to comply with the consultation requirements.

9. We also consider there is a need to strengthen consultation requirements on pension changes, including by introducing a duty to consult with a view to reaching agreement as currently provided for in the law on handling redundancies.

10. We believe it is necessary to introduce better pension protection in a TUPE situation. This should include a requirement to offer actuarial equivalent benefits for workers who are transferred out of a pension scheme under TUPE.

11. The CWU believes the Government’s strategy for occupational pensions must also include ensuring better governed DC schemes with far more generous employer contribution levels and more certainty over retirement income.

**Introduction**

12. The Communication Workers Union represents approximately 192,000 members in the postal, telecoms, financial services and related industries. We represent members in defined benefit schemes such as the Royal Mail Pension Plan (RMPP), the Post Office section of the RMPP, Telefonica, the Santander Group, and the BT Pension Scheme.

13. The CWU welcomes the Work and Pension Committee’s inquiry into defined benefit pensions, which was launched following its report into the collapse of BHS and its pension fund.³ We believe the Pensions Regulator should be given new powers to help ensure employers stay loyal to their pension promises, and to encourage employers to improve their commitment to occupational pension schemes in general terms.

---

14. There is a clear and ongoing shift away from defined benefit pension schemes in the private sector. Companies are opting for lower cost DC schemes which moves the risk onto individual savers – and hence ultimately onto governments. The Pension and Lifetime Savings Association (PLSA) Survey 2015\(^4\) found that 45% of main DB schemes in the private sector are now completely closed to future accrual compared to 17% in 2010.\(^5\) Among private sector respondents who have a main DB scheme open to future accrual, one in four say that they expect the scheme to close over the next five years.

**The rise in pension deficits**

15. Over the last few years, a combination of rising longevity, low interest rates and quantitative easing have weakened the funding position of pension schemes and led to a rise in pension deficits.

**The recent increase in pension deficits is largely due to the slump in long term gilt-yields**

16. Pension scheme deficits increased by £100bn in August 2016, based on the cash funding measure according to one index.\(^6\) However, this measure is typically calculated with reference to gilt yields which means the problem is to a large extent actuarial rather than definite or immediate. Gilt yields have slumped following the EU Referendum result and the Bank of England’s recent cut in interest rates and this has had the impact of deepening a scheme’s projected deficit. It does not mean the scheme will actually be in deficit in 10 years’ time, but it gives employers an excuse to claim that pension schemes are falling into unaffordable deficits and to propose closing them on that basis.\(^7\)

**Commentators are calling on companies not to overreact to pension deficits**

17. Pensions experts have argued that in reality, pension liabilities are mainly affected by inflation and longevity rather than gilt yields. They say that given the expectation of lower yields for longer, pension trustees and sponsors should revise their approach to valuing pension schemes liabilities. They should not overreact to the large deficit numbers being quoted, which represent a hypothetical scenario and do not reflect the reality of how most pension schemes will be managed over the next few years. There are diverse strategies available for managing pension assets and liabilities, including asset portfolios which are not primarily dependant on gilts.\(^8\)

---

\(^4\) Pension and Lifetime Savings Association, Annual Survey 2015, December 2015

\(^5\) In the private sector, respondents to the Annual Survey 2015 represent 3.7 million members across 243 DB schemes


\(^7\) The scandalous changes to company pension schemes, the Guardian, 13 August 2016, accessed at: [https://www.theguardian.com/money/blog/2016/aug/13/scandal-closure-company-pension-schemes](https://www.theguardian.com/money/blog/2016/aug/13/scandal-closure-company-pension-schemes)

\(^8\) City AM, ibid, 1st September 2016
The cost of funding DB pension schemes has risen but not dramatically
18. In the PLSA 2015 Survey, respondents reported an increase in the cost of funding DB schemes for sponsors. Mean employer contributions increased to 24.1% in 2015 from 20.8% in 2014. The Office for National Statistics has reported that between 2011 and 2013, employer contribution rates for DB schemes have risen slightly, from 14.2% to 15.4%.9

FTSE 100 companies are paying out generous dividends at the expense of pension schemes
19. Consultancy firm LCP’s annual study of pensions reveals that in 2015, FTSE 100 companies paid five times more in dividends to shareholders than contributions to their defined benefit plans.10 This suggests that companies are serving the interests of their shareholders at the expense of their DB schemes. It also suggests that despite the increased costs of DB pensions, they are significantly more affordable than employers claim.

20. We consider that the provision of a decent occupational pension scheme rests on a question of priorities. The evidence suggests that FTSE 100 employers can typically afford to contribute far more to the funding of pensions, but they choose not to in order to maximise profit and cut costs.

The CWU’s experience of DB scheme closures

Post Office
21. The Post Office Ltd (POL) closed its section of the Royal Mail Pension Plan (RMPP) defined benefit scheme to new members in 2008 but remained open to future accrual. The scheme has 3,500 members, with current assets of approximately £484.4m and liabilities of approximately £341m.

22. POL is now proposing to close the POL section to future accrual at the end of March 2017, a move which appears to be driven purely by a desire to cut costs out of the business. There is no need to close the scheme as there remains a sizeable surplus which can be drawn upon to continue the scheme. We also consider that POL’s statutory consultation exercise on the closure of the scheme has been inadequate and misleading, and we are concerned that the Pensions Regulator has limited powers to address this problem.

The closure of the Post Office DB scheme to future accrual is unnecessary, unjustified, and a betrayal of scheme members
23. The CWU and our members have worked hard with the Post Office in recent years and agreed to certain compromises to ensure the DB pension scheme remains on a sustainable footing. In 2014, members agreed to give up their salary link for their benefits accrued before April 2012 in return for continued DB accrual. This adjustment generated a surplus in the scheme

which was expected to be used to subsidise future defined benefit accrual, and POL’s General Counsel wrote to members twice in late 2013 saying that the proposal was designed to safeguard the scheme to keep it open to future accrual.

24. POL is now proposing to reverse this commitment and to use the surplus generated by members’ sacrifice of their salary link in order to buy out the scheme benefits with an insurance company – the most expensive way of securing them. We see no justification for this decision which we consider is designed to remove the pension scheme from POL’s balance sheet and to save significant amounts of money transferring members to an inferior defined contribution pension scheme from April 2017. We believe this is a betrayal of the trust placed in POL by scheme members and displays utter disregard for the sacrifice they made in 2014 to secure the future of the scheme.

POL consultation on the closure of the final salary scheme has been wholly deficient
25. The CWU has serious concerns about POL’s statutory pension consultation on the closure of its section of the Royal Mail Pension Plan, which we have raised directly with the Pensions Regulator. The period of consultation ran from 5 February 2016 to 31 May 2016. We do not believe the company has worked with us, or our members, “in a spirit of co-operation taking into account the interests of both sides” as required by its duty to consult. We therefore believe the Post Office has breached its statutory obligations and we have urged the Pensions Regulator to issue an improvement notice at the earliest opportunity to rectify this.

The consultation exercise was misleading
26. We believe the consultation exercise has been thoroughly misleading, including because:

- It has been designed to scare members into believing their benefits are not secure, when that is not the case.
- It neglects to mention that the reason why the surplus exists at all is because members gave up their salary link.
- It implies that a reduction in the surplus is unexpected when that is not the case.
- It implies that the need to increase employer contributions is around the corner when that is not the case.

The outcome of the consultation was pre-determined
27. We consider that the outcome of the consultation was pre-determined, due to a statement by POL’s CEO Paula Vennell’s just four days after the consultation period formally ended saying that ‘The Group Executive have taken the decision that we will cut significant costs out of our business….One of the decisions we’ve taken is to close the DB pension scheme to future accrual’. We believe the Post Office could not have given any meaningful consideration to the representations put forward by unions and employees in that timescale. This included a 74 page Body of Evidence submitted by the CWU setting out why the proposals are unjustified and unnecessary. A consultation is not meaningful if the outcome has been pre-determined.

**The consultation was rushed and no alternatives to closure were considered**

28. We consider that the consultation has been rushed and ill-prepared. The Post Office is pressing for an early closure date which has no rational defence in light of the funding position of the scheme and the promises made by POL to members in 2014. It has not considered realistic alternatives to closure either before or following the consultation.

**POL failed to consult on changes to contractual benefits**

29. We believe that POL’s consultation was especially defective because POL’s proposal is to withdraw existing contractual rights to special benefits on ill health and redundancy on closure of the scheme, but was not dealt with in the consultation. Neither has POL conducted a concurrent employment law consultation on the withdrawal of these rights. We consider that these changes have not been formally proposed and cannot be made after this consultation.

**The Pensions Regulator has limited powers to address our concerns**

30. In responding to our concerns regarding POL’s statutory consultation exercise, the Pensions Regulator informed the CWU that the issues we raised regarding any redundancy employment law consultation are outside of its remit. It also said that whilst it can investigate the process of how the employer has run the consultation exercise, it has no remit over the final outcome for the scheme nor can it require the employer to change their decision.

31. The CWU would like to see powers introduced for the Pensions Regulator that enable it to effectively address, challenge and remedy failures of the kind committed by POL with regards to its statutory pensions obligations. We believe this should include the power to alter any listed change made following a failure to comply with the consultation requirements. It should also include tougher financial penalties for failure to comply with the duty to consult. The minimum £5,000 and maximum £50,000 fine currently in place are simply not an effective deterrent to non compliance when considering the size of DB funds. We believe that consideration should be given to linking the level of the fine to the size of the fund or the level of company turnover.

**Royal Mail**

32. The Royal Mail Pension Plan was closed to new members in 2008 but remains open to future accrual. The scheme has over 90,000 members**, with assets of £6,619m and liabilities of £3,425m. It is the best funded pension scheme amongst the FTSE 100, with a funding level of 193% as at 29 March 2015.**

33. Despite this strong position, Royal Mail has announced that it may close its final salary scheme to future accrual in 2018 citing unaffordability due to a deterioration in financial market conditions.**

---

12 More than 90,000 Royal Mail told their final salary pension is unaffordable and may close, Telegraph, 10th August 2016, accessed at: [http://www.telegraph.co.uk/news/2016/08/10/more-than-90000-royal-mail-told-their-final-salary-pension-is-un/](http://www.telegraph.co.uk/news/2016/08/10/more-than-90000-royal-mail-told-their-final-salary-pension-is-un/)


14 Telegraph, ibid, 10th August
34. The CWU rejects Royal Mail’s closure plans and we have a clear policy to safeguard the future of the defined benefit scheme. We also have a legally binding agreement with Royal Mail on pensions to safeguard the future of the Royal Mail Pension Plan and improve the Royal Mail Defined Contribution Plan. We do not accept that closure of the Royal Mail Pension Plan is inevitable and we will explore every avenue to encourage the company to think again.

35. Since Royal Mail was privatised in 2013, it has paid out £564m in shareholder dividends, and it has made a commitment to growing dividends. At the same time, it has relied on a sizeable pensions surplus to help fund its pension liabilities, which is not due to run out until 2018. We believe that Royal Mail’s strong financial position means that it should be able to find a way of continuing to fund its pension promises, despite current financial market conditions. We also consider that its commitment to a progressive dividend policy unfairly prioritises the interests of shareholders at the expense of the pension scheme.

36. In addition, we are concerned that just 12% of members in Royal Mail’s defined contribution pension plan are paying the maximum contribution rates and thousands are still stuck on the lowest tier where the contributions will not provide a decent income in retirement.

**The need for stronger regulation to defend DB pension schemes**

37. We consider that the loss of pension benefits for thousands of BHS workers should never have been allowed to happen, and that steps should be taken to prevent similar situations occurring in the future. The Pensions Regulator should be given the responsibility and the power to intervene swiftly and at an early stage to address cases where corporate greed and negligence puts the future of a pension fund at risk. We also believe there must be a clear path to justice so that those responsible for the collapse of the BHS scheme are held to account and those affected receive their full pension entitlement.

38. We also consider that, against the backdrop of a rapid and significant decline in DB pension provision, the Government should focus its efforts on defending and improving pension saving through DB pension schemes. This will rely on strengthening the powers of the Pensions Regulator to ensure employers continue to fully fund and maintain their DB schemes where they can afford to do so.

39. Making pensions sustainable should involve giving the Regulator new powers to ensure that employers cannot simply choose to close a DB scheme to future accrual in an effort to cut costs and boost profits. Schemes should be subject to rigorous affordability tests by the Regulator before changes can be made, and rules should be introduced that require employers to explore every possible opportunity to keep them open for future accrual.

40. We consider that the Pensions Regulator should have powers to intervene where a company with a large pension deficit is paying out significant sums in shareholder dividends whilst the future of its pension scheme remains at risk. This should include a power to ensure that an employer fulfils its pension promises where it can do so, and strikes a fair balance between the interests of its pension scheme and its shareholders.

---

15 Comprises £133m in 2014, £210m in 2015 and £221m in 2016, according to Royal Mail Reports and Accounts
41. We also consider that the Pensions Regulator should have powers to ensure that employers can not overreact to pension deficits. Given the expectation of lower gilt yields for longer, the Regulator should play a role in ensuring pension trustees and sponsors revise their approach to valuing pension schemes liabilities where appropriate. Overall, the focus of pensions regulation should be on requiring employers to take more long term responsibility for pension funds, rather than closing schemes on the basis of sudden and potentially short term changes in financial markets.

42. We are concerned that the current arrangements when employers want to make changes that affect a pension scheme only require a duty to consult. This contrasts with other arrangements such as for redundancy where there is a requirement to consult with a view to reaching agreement. We believe such a requirement to seeking agreement should be extended to pensions in order to help prevent abuse by employers including the Post Office.

43. We wish to see new powers for the Regulator to prevent TUPE transfers being orchestrated as a means to force individuals out of their defined benefit schemes in order to cut costs. While moves out of the public sector are protected to some degree by the Fair Deal arrangements there is no equivalent for private sector transfers except the requirement for employers to match contributions up to six per cent. We consider this to be highly inadequate and we call for a requirement to offer actuarial equivalent benefits for workers who are transferred out of a pension scheme under TUPE. This would go a long way to protect individuals and ensure a fairer approach.

44. The CWU opposes any move to automatically index pension schemes in line with Consumer Price Inflation (CPI) which tends to rise at a slower rate than Retail Price Inflation (RPI), and would reduce pensioners’ benefits by up to 13 percent over the course of an average 25 year retirement. However, where such a measure was deemed essential to keep a scheme open to future accrual having exhausted all other avenues, we accept that this would be preferable to scheme closure.

45. We also oppose any move towards ‘conditional indexation’ which would allow firms to reduce annual pension uplifts to as little as zero, shrinking savers’ total retirement income by as much as 30 percent. We understand that conditional indexation is being looked at as a way of giving employers ‘breathing space’ in the funding of pensions for a short period. We believe that the introduction of any such policy should be accompanied by special conditions to prevent employers from abusing the rules.

---

18 Radical Government plans to reform final salary pensions could cost savers 30 percent of their pension, The Telegraph, 22nd August 2016.
19 Telegraph, ibid, 22nd August 2016
The balance between meeting pension obligations and ensuring the ongoing viability of sponsoring employers

46. In cases where there are genuine affordability problems, there should be safeguards to ensure that employers meet their pension promises as far as possible. The Pensions Regulator should have powers to ensure that companies respond in a measured way and find solutions that are proportionate to the problem. This will likely involve a level of compromise, rather than the common approach of shutting a DB scheme down and moving to a very low cost, poorly funded defined contribution scheme where workers have no guarantees over their retirement income. We do not believe it is fair or reasonable for companies to resort to drastic measures, such as closing DB schemes to future accrual, when there are potentially alternative options available.

The growth of defined contribution pension schemes

47. The increasing cost and risk of defined benefit pension schemes has led to many employers switching to defined contribution schemes, which have no guarantee of income for savers.

The inadequacy of DC pension scheme provision

48. Around 75% of private sector employees with workplace pensions have a DC pension\textsuperscript{20} and the average contribution rate into a DC scheme was just 4.7% in 2014, down from 9.1% in 2013.\textsuperscript{21} This simply will not provide enough retirement income for most workers. We have already highlighted the inadequacy of the Royal Mail DC scheme, and the Post Office DC scheme is similarly deficient, with 80% of members paying the minimum 4% employee contribution rate.

49. Not only are average contribution rates too low, but it is a serious concern that the latest figures show they are heading in the wrong direction, with employer contribution rates for defined contribution schemes falling from 6.1% in 2013 to 2.9% in 2014.\textsuperscript{22} The rates may have been brought down by automatic enrolment into workplace pensions, with new members starting on the minimum contribution rates of 2%, with just 1% coming from the employer. Whilst we welcome that auto-enrolment has extended access to occupational pensions to millions more people, these contribution rates are too low to build up an adequate or reasonable retirement income.

The need to improve DC schemes

50. We believe there should be a significant increase in the minimum levels of contributions into the Government’s auto enrolment scheme, and into DC pension schemes. In addition, we believe the Government should introduce better governance for DC schemes which provide more certainty over retirement income. This should include new powers for the Pensions Regulator to promote better funding and investment strategies for DC schemes. In particular, there should be a focus on improving access to Collective Defined Contribution schemes which allow for greater collective investment and risk sharing than traditional DC schemes.

September 2016