House of Commons

Work and Pensions Committee

Oral evidence: Collective defined contribution pension schemes, HC 580

Wednesday 21 February 2018

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Watch the meeting

Members present: Frank Field (Chair); Andrew Bowie; Emma Dent Coad; Ruth George; Steve McCabe; Nigel Mills; Chris Stephens.

Questions 1-56

Witnesses

I: Nathan Long, Senior Pensions Analyst, Hargreaves Lansdown, Sandeep Maudgil, Partner, Slaughter and May, David Pitt-Watson, Executive Fellow, London Business School, and Hilary Salt, Senior Actuary, First Actuarial.

II: Jon Millidge, Group HR Director, Royal Mail plc, and Ray Ellis, National Officer, Communication Workers Union.

Written evidence from witnesses:

- Nathan Long
- David Pitt-Watson
- Hilary Salt
- Jon Millidge
- Ray Ellis

Examination of witnesses

Witnesses: Nathan Long, Sandeep Maudgil, David Pitt-Watson and Hilary Salt.

Q1 **Chair:** Welcome. Nathan, might I begin by asking you to identify yourself and we will go down the row? Today is rather exceptional, because we have specific questions for all of you but with a general wind-up at the end—I don't mean "wind-up" in a nasty way.

Nathan Long: I am Nathan Long from Hargreaves Lansdown. We are a provider of investments and pensions. We operate directly with employers through the workplace and directly with individuals. We offer guidance and information as well as advice. We have offered non-advised drawdown for around 12 years and have been one of the largest annuity brokers for the last decade.

Sandeep Maudgil: My name is Sandeep Maudgil. I have been a lawyer specialising in occupational pensions for just over 19 years. I advise employers and trustees of various different kinds of pension plans. I am also a member of the Legislative and Parliamentary Committee of the Association of Pension Lawyers, which is a non-lobbying, non-political organisation that offers comments on draft legislation to help out and confirm that we think it does what the legislators wish it to do, but I am here in my personal capacity.

David Pitt-Watson: I am David Pitt-Watson and I lead the Tomorrow's Investor programme at the Royal Society of Arts, which is chaired by Sir John Banham. For the last five years I have been an executive fellow at the London Business School and, prior to that, a pensions' investor.

Hilary Salt: My name is Hilary Salt. I am an actuary, a founder of First Actuarial, and I am a member of the Council of the Institute and Faculty of Actuaries. My day work is advising employers and trustees on defined benefit pension schemes. I have also been the adviser to the CWU in their negotiations with Royal Mail and I have been a member of the Friends of CDC for a long time—about a decade, I think.

Q2 **Nigel Mills:** Mr Pitt-Watson, can we start with you? Could you talk us through what you think the main advantages of CDC might be compared to perhaps the two forms of pension we are more familiar with?

David Pitt-Watson: Yes, the key thing is that it is an elegant way of allowing people to share what is technically called longevity risk. If you are saving for a pension, one of the big uncertainties at the point when you retire and need an income until the time that you die is: how long am I going to need that income for? Am I going to die next year or am I going to go on until I am 105? That is an important service for everyone. It is a hugely important service for people, who might run out of assets in old age, to be able to have a pension that lasts until they die. Of course, the problem is you don't know how long you are going to live but you do know much better how long a group of people is going to live. If you can come together in a group, in a collective, that is a way of being able to share longevity risk.

You asked about how DB and DC do it. With DB you do go into a pool, but then DB has all sorts of other promises that the employer needs to live up to. The employer needs to deal with not only the individual longevity risk but the pooled longevity risk, the investment risk and so on. Therefore, in the private sector, DB schemes are being closed. I think you will hear from Royal Mail later and that is an example of where that is happening. Instead, you can have a defined contribution, but that is not, in and of itself, a pension; you save during your employment and then when you retire you are given a lump sum of cash.

If you want that to become an income in retirement until you die you need to buy an annuity, but an annuity is really expensive, as Hargreaves Lansdown figures have shown. You don't know when you are saving how much an annuity will cost, because annuity prices go up and down and they vary quite a lot. On the day you buy it you have committed yourself for the whole of the rest of your life and so on. While annuities are good for some things, they are not good for everyone.

CDC overcomes those problems by creating this pool, the collective DC pension, but without meaning that the employer has to guarantee it. It is a saving that will generate an income from retirement until death. Until 2015 they were not legal in this country, but in 2015 Parliament passed an Act—with full cross-party support I should say—specifically to allow CDC pensions and other sorts of pensions to be introduced. We are at a stage now where that has been passed but we have not quite got over the writing of the regulation and the secondary legislation, which is vital for the safety of CDC. You do need it to be a proper control, but we don't have that done yet. That is where we find ourselves.

Q3 **Nigel Mills:** I remember the Bill well. Was it Aon Hewitt that did some numbers that suggested that this could boost retirement incomes by a third?

David Pitt-Watson: Yes.

Q4 **Nigel Mills:** Could you talk me through how it does that? I suppose, naively, I think there are only three things you can do: one is reduce costs and become more efficient; two is be better at investing; and the other is the people who sadly die young and pay for those who live longer. How much is it a split between the three?

David Pitt-Watson: There is a bit of all of those. If I were to take the main advantage today, it is investing better and in particular the annuity; both the cost and the investment of the annuity. If you buy an annuity, the insurance company defrays that annuity by investing in very safe bonds, gilts and AAAs and all of those sorts of things. If you do that today you get a very low return, so annuities are extremely expensive. It is not just Aon Hewitt. Four or five studies have been done on CDC versus DC and then buy an annuity. One was done by ourselves at the RSA; one by Aon Hewitt; two have been commissioned by the Government, one done by the Government Actuary and the other by the Pensions Policy Institute. All give an increase of more than 30%. The lowest, which I think is Aon Hewitt, is 33% and the highest is the Pensions Policy Institute, which was the last study that was commissioned by the Government. If I remember correctly, their conclusion is that the modelled CDC scheme produced long-term outcomes ranging from 40% higher to over double that of the DC variants that were modelled.

Why does this happen? It happens because small additions over a long period of time make an enormous difference. A 1% extra return or a 1% extra cost can add 33% to the pension that you take out, because you are saving over a very long time. What CDC is doing, particularly in the annuity period, is allowing people to enjoy those higher returns. That is not to say that there are no difficulties with that. I should say that CDC is not without its difficulties. There isn't a perfect pension scheme. CDC has to allow that, in extremis, you can reduce pensions in payment and so on and you need to think those through, but, compared to the advantages of a 30% or 40% upside with a more predictable pension, CDC feels like the core of what one ought to be doing and, indeed, is at the core of the pension systems of the world that are generally regarded as the best.

Q5 **Nigel Mills:** The magic is that you do not derisk individuals' pots like you do in defined contribution. You can keep investment returns up by keeping the risk up. Is that what you are saying?

Hilary Salt: The reason you can do that is because of this kind of magic that money is fungible. Money does not have anybody's name on it. If you are running a collective scheme, you do not have to pay to invest my contributions coming in and at the same time pay to disinvest a pensioner's contributions that are being drawn out. You save both of those costs. It also means that, because you are planning collectively and that money can flow through from contributions to pensions, you can invest for the long term, you can invest in illiquid assets and growth assets, which may be volatile day to day but that does not matter to you because you are not liquidating those assets.

Chair: We have gone into Steve's question. Steve, do you want to pick this up with Hilary?

Q6 **Steve McCabe:** Yes. I think we are exactly where I wanted to go. It is the question of the tension between individual freedom, which seems to be dominating pension thinking in this country, and the idea of collective or pooled risk. The thing I want to ask—which I am toiling with and I think Nigel just touched on it—is this: is it possible under a CDC for someone to transfer out?

Hilary Salt: I would say yes, very definitely.

Steve McCabe: Tell me how.

Hilary Salt: I don't know how much you know about DB scheme transfers. With DB scheme transfers, you generally look at the benefits you expect in the future and then you discount them to now to work out the transfer value. With a CDC arrangement each person would have a share of the fund. That share would be their property rights and they would be entitled to transfer it out at any point, even right up to retirement. There is certainly some selection against the scheme possible there, so if you don't expect to live very long you might want to transfer out at retirement. In fact, people are very unable to predict their own longevity and, certainly with DB schemes, there has not been very much of that element of selection.

There is absolutely no reason why, with a CDC scheme, any member should not be able to transfer out all or part of their benefits to some other arrangement. I would imagine with a CDC scheme a member might get to retirement and say, "I will take some of it out as cash. I will put some of it into an individual drawdown product that I can dip into from time to time, but maybe a big chunk I will leave in a CDC scheme to draw down as a wage in retirement", which is what most people need.

Q7 **Steve McCabe:** In that sense, if I am part of a CDC scheme there would be no difference in my entitlement to transfer out as if I was part of a DB scheme?

Hilary Salt: Absolutely. There is no technical reason why you should not be allowed to. We are talking about something that has not been legislated for yet, but I would certainly imagine the legislation should allow that. I would argue strongly that it should.

Sandeep Maudgil: As Hilary said, because we are designing a new system it is borderline inconceivable that now you would not design it with an ability to transfer out. The only footnote I would add to what Hilary was saying is: you would need to be careful around the system gaming to some extent. We will need to think quite carefully about how the transfer-out right is defined. I don't think it is possible, in a social context now, to be saying we should have a scheme that people cannot transfer out of before they get to retirement.

Steve McCabe: That is extremely helpful. I think that has helped clarify that.

Q8 **Chair:** Is there an opt-out in these schemes that already operate in different parts of the world?

Sandeep Maudgil: Do you mean transfer out?

Chair: Yes.

David Pitt-Watson: As I understand it, in Holland they are now introducing a flexibility that would allow you to transfer from one fund to another, but I don't think they would allow you to take a lump sum.

However, I don't think there is any constraint on you having a lump sum. It is just where they have ended up in Holland.

Q9 **Steve McCabe:** The basic point is that if you can't transfer out you have an annuity mark 2, haven't you?

Hilary Salt: You would if it was an individual pot within the collective scheme, but the point is that, while you have an individual entitlement in that scheme, it is not a pot with your name on it; it is collective.

Q10 **Steve McCabe:** Yes, I take that point but, to all intents and purposes, it has the same impact.

Hilary Salt: It is a DC scheme. That is important.

Q11 **Steve McCabe:** The other thing I want to ask about is this idea of shared pooled risk. One of the criticisms that have been raised is that this may well benefit older people at the expense of younger contributors and, if you are a high earner, you may well end up being much better off than a younger entrant to this scheme. Can you explain how it is shared, in terms of pooled risk, and how it does not repeat what is the current criticism that the younger generation may be funding pensions that they will have no prospect of obtaining themselves?

Hilary Salt: The big advantage of a CDC scheme is that you are pooling risk within a generation. All the current pensioners pool their longevity risk in the way that David explained. One of the problems we have, whenever we talk about CDC, is that it is a term that has been used to describe a lot of real and imagined schemes and everybody means something slightly different by it. You could design a CDC scheme that was intergenerationally unfair. I don't think you would want to but you could do that.

Q12 **Steve McCabe:** Don't you think you would design it so that you guarantee that isn't what happens?

Hilary Salt: Yes, absolutely. What you do is you run it on a best estimate basis. You effectively say that you do an actuarial valuation every so often—maybe every year, or maybe every three years—and you would then say, "Looking forward over the long term, what can we afford to pay out?" and that is what you would pay out. What you would not do is build up prudent margins, in the same way that we have with defined benefit schemes or the same way that, in the olden days, people did with with-profits funds. What building up reserves means is withholding money from the current generation of pensioners for the benefit of a future generation of pensioners, and we don't want to do that. We want to make this intergenerationally fair.

You would not be taking prudent reserves in the funding basis, but I think where you would be prudent is in your explanations of how it works in your communications. You don't have to be prudent in funding, but you do have to be prudent in making sure that you are transparent and clear with all the members about what they might expect or what their future entitlements might be. You also have to make sure that you have enough regulation to ensure that, for example, every scheme provides a funding and distribution and investment plan that is in the public arena. I would suggest there is almost a dashboard on the regulator's website where all those are published. Everybody can look at it, including the academics, so that everybody else can pull apart every different scheme's plan to make sure that there is a proper market and ensure that people understand what they are getting from different CDC schemes.

Steve McCabe: Does anyone want to add anything to that?

Chair: We have a question on that later.

Q13 **Andrew Bowie:** This is a question to David. The Netherlands and Denmark often rank among the best, or claim to have the best, pension schemes in the world. What can we learn from the positive and negative experiences that they have in Holland and Denmark?

David Pitt-Watson: The core positive thing is a CDC and all the stuff that sits around it, but it is important to understand what you need to get CDC to work well. For example, communication is absolutely critical. For a couple of generations, the Dutch system worked almost as though it was a DB scheme. It was working fine for everyone. We hit 2008 and, of course, at that point it did not look like you had the money that you had before. What are you going to do: keep paying out the same pensions to people, in which case you will have an intergenerational transfer, as the last questioner was asking about, or do you bring down pensions in payment? They brought down pensions in payment by an average of 2%. That was what was needed in order to get things balanced again and to make sure you did not have an intergenerational transfer. The communication was critical because everybody thought, "Hang on a minute, I thought I was absolutely promised that money," and you can imagine that they were—so you do need to be very clear about communication. That is number one.

Number two, if it was on my list, would be the governance of these things. Hargreaves Lansdown mentions with-profits. With-profits were just abused by the people who were selling them and I did not realise it myself. I remember, when I was about 30, buying a with-profits and being told, "There is a guaranteed dividend for the next three years." Where is the guaranteed dividend coming from except from somebody else's money? You do need to have governance where, at the top of these, you have trustees whose only duty is to the member of the scheme. That would be the second lesson. Again, you would find that or something similar in Holland and Denmark.

The third would be costs. Remember that 1% cost is taking 25% of your pension. You need to keep the costs low, so if you were going to introduce CDC and get the benefits from it, you would need something that was at scale with very low costs. Royal Mail is clearly big enough to be able to do that but it makes it much more difficult for smaller employers to do it. We talked about intergenerational transfer, solvency, ability to consolidate CDC schemes—you should try to think about that because we are finding that difficult with DB now—investment roles and so on. That is what you might learn from Holland and Denmark.

There is one other thing I was thinking of, which is that Australia has been moving down the same line that we have but with much higher contributions into DC. They are now introducing collective solutions, or thinking of introducing them to the retirement part. You still have your cheque when you retire in Australia, but I can put that into a pool when I am 65 and I retire and that will last me until the day I die. If I was thinking about what might be lessons for the UK, the first would be, if you have Royal Mail or somebody who wants to do this, surely it is the intent of Parliament that they should be allowed to do that and you should allow that. The second thing would be that the gap—because we are following Australia—that will be particularly acute is at that point when people retire and could we do something specifically for them. That is a long list of things to do.

Q14 **Andrew Bowie:** That is very helpful. Is there any particular reason why we could not introduce any of those?

David Pitt-Watson: No. You just need to be careful how you do it and get the governance right and, in particular, the communications right, make sure that the first people who are doing this have scale, that they have the trust of the people who are putting the money in and are well managed, but there is absolutely no reason why we could not have it here.

Chair: Let's start looking at the disadvantages.

Q15 **Ruth George:** What is actually stopping CDC schemes coming into force now?

Sandeep Maudgil: From a legal perspective, the way the law currently works in an employer-sponsored world is that you either come within the definition of what is called money purchase or DC, in which case the employer does not have to underwrite the various risks associated with the scheme, or you are something else. Anything else that is not money purchase is automatically subject to the defined benefit or something called final salary framework. Anything that is final salary the employer has to underwrite until it goes bust. The employer has to underwrite all the risks associated with providing pensions in the scheme.

One important point, which we can talk about later when we come on to the specific legislative framework, is that the definition of money purchase was significantly changed in 2011 after a Supreme Court case called Bridge, which effectively said that the words that had been in the legislation for many years did not mean exactly what people thought they meant and, therefore, a bunch of schemes that had thought they were one thing turned out not to be that thing.

Q16 **Chair:** Sandeep, that was your job, wasn't it: advising the Government on wording?

Sandeep Maudgil: It was before my time, and we had always thought the words were a bit weird anyway, but there you go. That is a kind of footnote but the basic point is that at the moment, if you are providing a pension from within the funds of a scheme, you are automatically not money purchase. This idea of proving the longevity risk and providing this thing called a pension cannot be done without the scheme becoming defined benefit and the employer underwriting the risk.

There are various ways one could conceptualise it, so you might possibly come within the definition of something that calls itself drawdown. But the reason I went into the footnote regarding the Bridge case in 2011 was to say that very few employers would be comfortable relying on that. Effectively, the reason we need a law change is in order for pensions to be provided from within the scheme on this collective basis, and potentially even the pre-pension phase investments on a collective basis, without the scheme automatically becoming designated as defined benefit and subject to employer underwriting of all the risk. As you have already heard, the key thing about CDC is that it is a DC scheme but the members are able to pool the risk, basically.

Q17 **Ruth George:** David mentioned earlier that secondary legislation would be vital to ensure the safety of CDCs. What particular issues do you feel need that secondary legislation?

David Pitt-Watson: A lot of them would be similar to what you would have in DB, so that the thing is solvent and there are funding gates and you know what you are going to do at the point at which the trustees are forced to take difficult decisions, for example multiple pensions. That is the funding gate. I think governance is critically important. Possibly, you would want to have the communications with members in secondary legislation as well. There is a list in our submission, and the list is in the 2015 Act as well, of all the various different powers that you might want to take. They are not extraordinary powers, in the sense that they exist under DB or under pension rules in this country and they exist in a more similar form in other countries as well.

Q18 **Chair:** Sandeep, how do you respond to what David has just told us?

Sandeep Maudgil: I am in remarkable agreement with it. If I could jump ahead to how this could be done, the first thing to say is that the Pension Schemes Act 2015 is a really seriously, well thought through piece of work. If you look at part 2, you will see that someone has clearly put some serious thinking into it and done a fantastic job. It does cover basically the things one would think need to be covered around specifically what we have already heard about, which is governance, and the communication and transparency are really important. A lot of the lessons that have been learned about the past and about other countries are that these things may not have been communicated properly. It needs to be quite clear that CDC—assuming it happens—starts from now, rather than there being a potential that existing schemes can call themselves CDC.

The first thing you would need is a very clear law change to make it clear that these schemes will be treated as money purchase. That needs to be done unambiguously, so that employers are not worried about the Bridge recharacterisation risk that we talked about. From a governance perspective, maybe you do something like you do with master trusts, which is have some sort of licensing authorisation arrangement and—assuming we are talking about the trust-based occupational sphere—one would assume that would be the Pensioners Regulator. I know they are busy, but assuming they are willing to take that role on.

Once you are in the money purchase space, you then need to have a look at what that means for these schemes. There might be some changes you would need to make specifically to CDC to avoid the money purchase legislation imposing specific design requirements that you don't want. Then you need to layer on specific governance, transparency and communications requirements, to make sure that if people are in one of these schemes they know exactly what it is. As David has already said, when you get to the position where you might need to cut pensions in payment or say, "Sorry, your pension will not be increased this year by as much as you thought it would be," no one is surprised. That is the area. It is everyone being quite clear how this thing works from the outset.

Hilary Salt: You could argue that what we could be saying here is that we want to put into practice all the possibilities that were set out in the 2015 Act. I don't think we are actually arguing that. We are saying that, while that might be a longer term aspiration, recognising constraints on parliamentary time, we do think there is a way to allow these kinds of schemes to be legislated for in a way that involves small changes to existing legislation without a full enactment of the 2015 Act.

Chair: Let's come back to that.

Q19 **Emma Dent Coad:** Do you think there is a risk that introducing another form of pension provision will generate more complexity, confusion and mistrust of pensions altogether? How will you get that trust?

Nathan Long: We are not necessarily anti-CDC. Clearly there has been lots of work done that models the benefits and there has shown to be improvements. We come at this from the fact that we don't think it necessarily fits with freedom and choice, and not just that but also more modern-day working practices. The fact that more and more people work part-time, and if you look at the Fuller Working Lives initiative that is around: how do we extend people's working lives? It is going to mean that, increasingly, people are retrained to be self-employed or working part-time.

What we already see from our clients and our prospective clients is that people have to work part-time. They are accessing part of their pension, and that is our experience. If you look in the FCA data you see much the same for what people are doing with their pots in this post-pension freedom world. For example, 55% of people have taken their pot as a cash lump sum, which on the face of it looks terrible, but actually 94% of those people had another pension. Retirement is very personal and people will need to make choices that suit their circumstances.

If you look at this through a CDC lens, we think you need to offer that flexibility and offer people the ability to take lump sums and to transfer out. If you offer that, we think the problem will be that the people who transfer out will be those who have larger benefit provision built up, because they will want to manage that into their retirement, and it will also be people who don't expect to live as long on average. If those people bring their moneys out all of a sudden, the shared pooling of risk in retirement is weakened, because people who are not going to live as long, who effectively supplement those who live longer, will be brought out of the pool and will not be sharing that risk.

We are not against the idea, but we don't think freedom and choice has been modelled in the work that has been done already. We think it would be better to have a good understanding of all the ifs and buts to say, "What is the reality? How much better are the outcomes, if at all, if you bring in these assumptions?" That is our concern.

In terms of how it clouds the landscape, currently people don't really understand the difference between defined contribution and defined benefit. If we add a third, that is going to be increasingly hard. With defined benefit you have the fact that it is a guaranteed income, albeit, subject to the strength of the employer, but you still have a very robust back-up position. Clearly that is not the case with CDC, although it does give a target and something to aspire to.

We find one of the biggest problems with trust, when you talk to clients, comes from what I cite as Equitable Life. It is very difficult for people to be enthusiastic about saving for a pension if either they or a family member has had a poor experience with Equitable Life. It is very common when people come to retirement that an annuity might be the absolutely best thing for them to opt for; however, if they have family experience where someone dies shortly after taking state pension or final salary pension or annuity they have a very critical view of the pension system. That is why we think drawdown appeals, for that control element, and we think that needs to be factored in.

There is a real danger that there could be mistrust of this kind of regime if people perceive that they are not necessarily locked in but this is the route to provide them with a good income in retirement.

Q20 **Andrew Bowie:** There is not much work for you, though, is there, Mr Long?

Nathan Long: If we carry on entering into one of these we wouldn't need to. We think that people will exercise choice because we don't think people will trust this. Bear in mind, for example, that lots of people did not opt for with-profits and looked to manage their own investments. We don't see that as too big a concern because we think the appetite is there for people to want to own their own retirement.

Q21 **Emma Dent Coad:** The system still seems very complicated and if you are to introduce this as a parallel choice, as opposed to an alternative, we have yet more complexity, don't we? A lot of people may very well be able to get to grips with it and deal with it, but a lot of people won't. How are we going to communicate that better to people—I don't think it is communicated well—if we are to have parallel systems?

Nathan Long: If we had CDC in addition. I genuinely think it would be very tricky. I will point to one issue that has come about fairly recently, which is the introduction of the tapered annual allowance where the amount you can pay into a pension is reduced if your income is over £150,000. That has caused a great deal of complexity in the pension system because employers need to be mindful of that when speaking to their staff yet don't know their full income situation, because people obviously have income outside of their earnings from work. You also have the fact that, as a pension provider, we have to make sure that caveat is known to everyone, even though we know full well that it will hardly apply to anyone at all. The problem is that one little change causes a lot of extra complexity in the system, even though the perception is that it only impacts on a very small number of people, but that is what is required to make sure there is compliance in providing everyone with the information they need to make the right decisions.

Q22 **Emma Dent Coad:** We are getting further and further away from any kind of clarity for the pensions, it seems.

Nathan Long: Yes, absolutely.

Q23 **Andrew Bowie:** I would like to go back to something that Hilary said about how only minor changes would be needed to introduce this and you would not need to enact all of the 2015 Pensions Act in its entirety. What did you mean by that and what would those small changes be?

Hilary Salt: Sandeep is probably better placed to answer that, if that is okay.

Sandeep Maudgil: On the assumption that we are talking about the employer-sponsored trust-based space, although the 2015 Act was a great piece of work, I can understand that there might not be appetite right now to go through the full schema in that Act. The short answer is yes, you would not need to enact the 2015 Act in order to open up the space for an employer-sponsored trust-based scheme. Effectively, there is already power to amend the definition of money purchase for these purposes in a different Act. Having made that amendment, you could effectively say that anything that falls within a collective benefit scheme—

as it needs to be defined—will be treated as money purchase, so you don't need the 2015 Act and you can make that amendment.

Then it is a question of just going through what that means in terms of what it imposes on the benefit design, checking if anything needs to be changed, so in some ways it will not be money purchase. For example, a money purchase scheme does not need to appoint an actuary at the moment. Clearly these schemes need to appoint an actuary in order to work out the probability of the target benefit being delivered and what the target benefit should be and so on. Again, as we heard, you would need to be clear that the transparency and governance framework applied to them was appropriate. There would be a more surgical way of enabling the employer-sponsored trust-based arrangement to operate, whereas I think the 2015 Act—which I say really was impressive—was quite ambitious in opening up the whole pensions' world again to reformulation, and if we are looking at something more specific here we would not need to do that.

Q24 **Chair:** David, do you want to come in on that?

David Pitt-Watson: It was on the point about complexity, because pensions can get complex. We started this work at the RSA about eight years ago with some citizen juries, asking them, "What do you want from the pension system?" There were some people—I think they would be good Hargreaves Lansdown customers—who wanted to be thinking about the pension and investing in different things, but most people on the juries said, "What I want to do is to give my money away to somebody that I can trust and then to have an income from the time I retire until the time I die." As a group of interested people, we then did this international study of how people do it, and the best answer to the simple question, "If you couldn't do DB" was that you went to CDC.

While I agree that this is introducing something new to the system, the aim would be that it is not something for people who have enough money. For ordinary working people who want to save properly during their lifetimes and know that they have an income in their retirement, CDC looks like the best architecture for that.

Q25 **Chair:** Nathan, linked to what David has just told us, if I was starting out again I think the overriding thing for me, if we were discussing freedom, would be the freedom to be in a pension that might deliver 30% more than I might get from what the other options now are rather than what the options used to be, even if that clashed with the freedom about drawdown and other things later on. Isn't David's point a valid one, that there are different markets here? There will be the sophisticated side with some fools in it who think they can manage all these things. There will be people—a growing number probably—who are rather clever at managing their own affairs, but there will be a big pool of us, like me, who would like to get the biggest possible pension going under the options that are now available.

Nathan Long: Absolutely. Like I say, we are not anti-CDC. What we don't think we have seen evidence of yet is how you will interact freedom and choice with what those enhanced pots are. If all of a sudden you modelled that, for example, the 25% of people who have the lowest life expectancy decide to transfer out and the 25% of people who have the biggest pots transfer out, you are not going to have the same level of benefit increase as has been estimated so far.

From our point of view, we want to see, when we incorporate freedom and choice, where does that revised uplift leave us? If we still have the evidence that it is far superior, there is going to be an element of people who would like to stay in this type of pension plan. But, in an increasingly flexible working pattern that we will have, post-65 for example, people will access their pension while they are still working and any pension regime needs to be able to cope with that.

Q26 **Chair:** My gut feeling would be that the exiteers would be the more knowledgeable ones rather than ones who are mortally ill.

Nathan Long: Possibly. I don't think you should underestimate the fact that people really do have an unhappy relationship with the fact that their family may have not benefited from the pension system. It would not surprise me at all if you saw people move out because either they expect not to live as long or, for example, family members have had a similar experience. That is very common.

Chair: That is really clear.

Q27 **Chris Stephens:** What is the appetite out there among the pension industry and employers to kick off collective defined schemes?

Hilary Salt: There is a bit of a misconception that this is a solution for employers who have DB now and perhaps are looking to transition away from that. There will be some employers like that, but I think the much bigger win here is for all those people who currently have defined contribution pensions and cannot see an easy way to transfer that into the wage in retirement. It is important that the pensions industry provides a pension for the living. What most people find confusing about the pensions industry at the moment is that a pension does not provide a pension, and that is what we need to be able to do. We need to be able to provide all those people—even if you are an actuary, it is hard to understand how to draw down without under or overspending your money. Those people need to find a good default way of converting that DC pot into income.

There is a lot of appetite from employers who have DB. I think it is going to be very interesting to see how USS plays out. I know you are talking to Royal Mail. But I do think there is a lot of interest and we have people banging on our doors from housing associations, employers who want to provide something better than pure DC, but also from people like master trusts, people like NEST. These are not people who have annual allowance problems. We are not talking about people with annual allowance problems. We are talking about postmen, steel workers, care workers, all those people who are badly served by the current retail individual market.

Q28 **Chair:** They are still badly served, aren't they?

Hilary Salt: They are now, absolutely. They are not the kind of people who can afford to take advice on drawdown. Their pot is quite small. Also, don't forget what this means for employers. It is not just a member thing. There are a lot of employers who are worrying now that they will get to a stage where a lot of employees reach retirement, the employer cannot make them leave the workforce because of age discrimination, the employee can't afford to retire, and for employers the idea of managing everybody out of the workforce on capability grounds is just an HR nightmare. This is not just a member thing.

David Pitt-Watson: I think there is demand out there. People are not going to go boasting about how they want to do it because it is not legal yet and I think Royal Mail is rare that it has got to this place through arbitration and is becoming public about all of it. Before the passage of the 2015 Act, we took a delegation—I think it was half a dozen or eight employers and pension funds—to see the Minister to say, "We want this to be a private meeting, but please can you put in CDC because this is an option that we would like to see." I remember the Minister himself, in introducing the Act to Parliament, noted that there had been an extensive engagement with stakeholders and that employers wanted greater flexibility to create pension schemes that would suit the needs of their workforce, describing defined ambition. I think the demand is there.

By the way, if this happened, it would not all be there within 24 hours but I think you would see that building among employers. As Hilary said, if there was a way of starting with that, with the Royal Mails of this world, then thinking about the next problem, which is, as Hilary was saying, how people can buy an income in retirement rather than a complicated drawdown, and then we can go on to broader reforms after that. That staging of thinking about it would be very helpful, but I am pretty sure the demand is there. Yes, I am sure the demand is there.

Sandeep Maudgil: I agree with what we have just heard from both Hilary and David. The key thing from an employer perspective is the way the legislation is done and it being completely clear that these are, in legal terms, within the money purchase space rather than the defined benefit space. A lot of the concern when defined ambition was first talked about for employers was, "Aren't we just going to end up where we ended up with our old DB scheme and look where that got us?" We will need to be very clear, if legislative changes are made, that these schemes are not at risk of being recharacterised as defined benefit later. Once that happens, from an employer perspective, if you are spending X amount of money on your people's pensions, you want that money to be spent as efficiently and as well as possible. It is difficult to see why, if they are clear that their contribution rate is fixed, they would not be keen to make sure it is used in the best way.

Nathan Long: Our own experience is that we have not seen the appetite, but equally I would share Hilary's comment that there is a big issue about people being stuck in work and not being able to afford to retire, so I completely agree with that. We don't tend to deal with employers of the size of Royal Mail, but certainly with the size of employers that we do deal with—which is somewhere between 200 and 1,000 employees—there is just no appetite at all. I would go as far as to say that lots of employers are suffering from pension fatigue. They have had auto-enrolment. They are happy to support their workforce. They are happy to provide guidance and support to them to make informed decisions and to own their own retirement, but I think the appetite for them to do much more is not there at all.

Q29 **Ruth George:** Sandeep and David talked earlier about the amount of clarity and communication that there needed to be in the setting up of CDC schemes. Do you feel that that would prevent existing schemes from becoming CDC schemes, something like NEST would have to set up from day one as a different sort of scheme, or would it possible for schemes to transfer into a CDC scheme? If so, or on either scenario, is it not essential—if it is something that is coming in future where we have lots of people auto-enrolling very recently—that it needs to be an option as soon as possible?

Hilary Salt: It is relatively easy for those DC schemes to transition into a CDC-type arrangement. We are working on the basis of what we imagine the legislation might look like. You are right that the key part of that will be that they will need to have very clear disclosure requirements for how they have to explain what they are doing to members.

I want to introduce a note of caution, though, because I would not want this to be seen as a way for DB schemes to transition to CDC. It is not about giving employers an option to move away from promises they have already given. It is not an easy transition that way. I think it would be very dangerous to go there.

Q30 **Chair:** But some of them will want to, won't they? Isn't that what the Post Office is doing?

Hilary Salt: Royal Mail is setting up a CDC scheme for future service. This is what people will build up benefits for in the future. It will still have its defined benefit liabilities in place.

Q31 **Nigel Mills:** Ms Salt, can you talk us through what a nightmare scenario is? I picture it as I have saved £200,000, so an annuity, Mr Long, would get me £8,000 roughly.

Nathan Long: Probably a bit more.

Nigel Mills: This is promising me 30% more, so I am going to get

£11,000 or £12,000 or something. Your aim is what the ambition is. What happens if there is a big 2008-09-style crash and we lose 30% off the stock market? What is the range in which you then say to me, "I am sorry but that £11,000 or £12,000 that you have been getting is now going to have to be £5,000, £6,000, £7,000, £8,000 or something"?

Q32 **Chair:** David, you gave us an example, didn't you, of what actually did happen?

David Pitt-Watson: What happened in Holland after 2008 was that there was an average 2% reduction of pensions in payment. The most stressed pension fund brought it down by 6%, I think. That was enough to respond to 2008 and now they have made it back up again and they are moving forward. Hilary can explain this better because she will be better at the maths, but a little bit of flexibility about whether you are meeting inflation and whether you can bring down pensions in payment can make a very big difference to what the overall liability is. Of course, you would do it over time so that people can respond to it. If you think what working people had to respond to after 2008, a reduction of 2% by pensioners—

Q33 **Nigel Mills:** That is why I was asking what the nightmare scenario is. What is the worst that can happen?

Hilary Salt: Remember that, if you have an open CDC scheme, the fact that there is a stock market crash actually does not matter. You have fungibility of money, so you can use the money coming in to pay your current pensioners. It does not matter that the market is down here today. What really matters for that pension scheme is that its assets continue to produce long-term income and capital appreciation over the next 10, 20, 30 or 40 years.

The nightmare scenario: trying to construct something, where does it fall apart? Where it falls apart is, let's say, we have got a CDC scheme. Maybe there are a couple of years when it has not paid quite what it expected. Maybe it loses the confidence of its members and new members stop coming in. At that stage, the market value of things does start to matter. Part of the legislative framework would be a really clear possibility for a scheme like that to say, "Either we draw the line here, everybody can walk away with their transfer value, or we transfer this into another CDC arrangement."

I absolutely don't see a nightmare scenario where all of a sudden everybody does not have a pension anymore. The point on the maths is that you are planning the funding of a scheme and you are saying, "Let's aim for this level of pension with, say, full inflation increases." If you do that and when you do your valuation you find out that you have maybe 10% not enough to pay all those, so you have 90% of what you would need to pay full inflation linking forever, that might mean for this year you pay 0.1 below inflation, because you are planning all the time to pay that increase forever. It is just knocking a really small amount off the expected increase this year, because you plan it as if you are going to pay that smaller increase every single year.

Q34 **Chair:** One of the weaknesses surely would be that we would be getting new schemes and we might have a crash soon after the new schemes are established, so they don't have what David was describing, a big capital base behind them, as they did on the continent.

Hilary Salt: In general, that is not a problem, because if you have just established the scheme and there is a stock market crash, you can buy equities that give you the same expected income much more cheaply, so that is a good thing for a long-term pension scheme.

Q35 **Chair:** One of the restraints, it seemed to me, was that you had to be pretty slow not to realise with quantitative easing that you need to get out of Government bonds and into equities. None of the very big pension schemes challenge the Government to say, "There is a risk of us moving over, given the age structure of our pension scheme, but the gains on the other side are going to be so enormous we are going to do it," like the university pension schemes and so on. That is fine if you have quite a lot of investment, but if you are starting out you don't have much investment to play around with, even if you have the freedom to go into equities.

Hilary Salt: You also don't have much outgo. You start off on day one, your membership is relatively young, and you don't have very much outgo either. The other point you make, though, is really important. One of the bad outcomes of some of the actions that the Pensions Regulator has taken is that they have driven lay trustees out of the trustee room. The kind of people who have a real long-term interest in a pension scheme—that is its members and its sponsoring employer—have been driven out to be replaced by professional independent trustees who just, I would say, protect their own backs. They are not interested in either the members or the scheme long term or the sponsoring employer and they are infected by herd instinct.

Chair: We are going to come on to that tomorrow with the Pensions Regulator.

Q36 **Steve McCabe:** I want to go back to the point Hilary made about defined benefit schemes opting for this, and I think you have mentioned it twice. How would you stop that? It seems to me that is the risk. There are people looking to get out of defined benefit schemes. What CDC is promising is a third way, but if we end up with the situation where we simply accelerate the death of defined benefit, it is not actually the deal we are being promised. How would you stop that happening?

Chair: If I could add to that, Hilary: are you not saying that what happens now is that the schemes are closed to new members and they get a very inferior deal, and this would run alongside employers limiting their risks by continuing to run a closed scheme and doing the new scheme for existing and new members' contributions? Is that right?

Hilary Salt: We have to accept—even I have to accept these days—that there are very few employers, outside the public services, who are continuing to offer defined benefit pensions going forward. Could this tip some of those employers over? Possibly, but many of those employers are going anyway: British Airways is going; Royal Mail is going obviously. I think we are down to about 500,000 people who are now in pension schemes where it is open to active members.

Could this mean that some more employers stop providing defined benefits going forward? Yes, it could, but what I am more concerned about it not doing—and I think it is really important that we don't paint it as this is what CDC is about—is employers being able to rip up promises they have already made. Existing legislation stops employers doing this, so what an employer could not do, once we have CDC, if we get CDC, is to suddenly say, "From now on I am converting all those defined benefits into CDC and I am walking away from my promise." We need to be really careful that that is not what we are trying to do.

Of course it would be possible for individual members in that DB scheme to take a transfer into a CDC arrangement, and there might be some employers who incentivise employees to do that. We need to be very careful about that. It is not a way to allow employers to walk away but it could be a better solution for some members. We need to not confuse this with letting employers rip up past promises.

Chair: Thank you all very much for your evidence. I think we are clearer.

Examination of witnesses

Witnesses: Jon Millidge and Ray Ellis.

Q37 **Chair:** Welcome. Ray, would you introduce yourself, and then Jon, so that we have you on the record, and then Steve will begin.

Ray Ellis: I am Ray Ellis. I am National Officer for the Communication Workers Union, which represents over 200,000 people in the communications industry. I work in the postal department, which represents people in Royal Mail and Post Office Ltd, where we have about 100,000 members.

Jon Millidge: I am Jon Millidge. I am the Group HR Director for Royal Mail. We have 143,000 employees. I have responsibility for HR policy and pension policy in particular, and I was the lead negotiator for the company in the recent agreement and mediation that we have had with the CWU.

Q38 **Steve McCabe:** Okay, Jon, your time starts now. Sell it to us. Tell us why CDC is the way forward for Royal Mail.

Jon Millidge: I think CDC gives us a much better outcome for people than a traditional DC scheme. It removes the individual risk that people get in the build-up to retirement—it pools that risk. It reduces the risk of them being big losers when it comes to retirement, so it gives them a better outcome. Providing our people with great pensions is important to us and it is very clear that the current pension scheme—the defined benefit pension scheme that we have had—has become unaffordable. The cost has increased for the company from about £400 million a year to a projected cost this year of £1.2 billion for pension costs, and that is simply unaffordable. It is more than the profits that we make. The cost is substantial. We think this provides much better pension outcomes in an affordable and sustainable way, and that is important to us.

Q39 **Andrew Bowie:** Ray, what do you expect the benefits of CDC to be for your members? We have heard already about the risks.

Ray Ellis: For one thing, it is one scheme for all. At the moment in Royal Mail we have a two-tier pension provision. The DBC schemes closed to new entrants in 2008, so around a third of our members in Royal Mail—about 40,000 people—are in a DC scheme and the remaining two thirds are in a DB scheme.

We reluctantly came to the same conclusion that the company had come to about the long-term viability of the DB scheme. Jon is right that the company would have needed to increase its level of contribution substantially—I think the figure was £1.2 billion a year—and even if we could have in some way persuaded Royal Mail that that was a good idea, it would not have left any money for anything else; not just no money for dividends, but no money for wage increases or for investment. It was simply not possible.

A CDC scheme offers the potential for a similar level of outcome to the existing DB scheme for the DB members, but at the same time a substantially increased level of expectation for people in the DC scheme. It is very important to us that we can get back on to a level playing field on pensions for the entire workforce. It is one scheme for all. It offers people the prospect of a decent wage in retirement. It is a proper pension scheme, in that sense, given the way it is designed. We do think it is the way forward for the 140,000 people who work for Royal Mail.

Q40 **Andrew Bowie:** It is quite historic—we were talking about this before you came in—to have a company the size of Royal Mail and a union agreeing on a way forward in terms of where they want to be on pensions.

Ray Ellis: I suppose we have been in a rear-guard action defending a DB scheme for a number of years, and I think that was absolutely the right thing for us to do as a trade union, because that scheme has benefited many thousands of people, even during the periods post-2008 and post-2013 when we made some changes to the scheme. Being able to extend the life of the existing DB scheme for scheme members has meant that many thousands of people have been able to go into retirement with their expectations fully met.

Q41 **Chair:** Is that part of the trade-off that, with you accepting this scheme and supporting it, the employers gave an agreement not to tamper further with the Crown jewels, so to speak?

Ray Ellis: The employer was and is closing the DB scheme in March. In terms of the accrued benefits in the DB scheme, they will not be touched and, indeed, my understanding is that they cannot be under current legislation.

Jon Millidge: Indeed. That scheme is fully funded. This is not a scheme that is trying to get rid of its past liabilities at all. It is fully funded. It is the future cost of accrual that has been the problem that we have been trying to deal with here. All of the benefits that people have built up in that scheme are there in a fully funded scheme, which is a great thing.

The other important thing for us is that I have been out and about quite a lot speaking to people about our planned changes on pensions over the last year, not specifically about CDC, but the one thing that comes from our posties—from Ray's members—consistently to me is people want some kind of surety that they are going to get an income in retirement, a wage in retirement. They don't want a lot of the complexity of having to make decisions about what they do with the pot of money when they get to retirement; they want to know that they are going to get something. Of course, that is what everyone loves about a DB scheme. A DB scheme is not affordable going forward for us, but a CDC I think gives much better certainty to people about what they will get than a traditional DC scheme.

Q42 **Emma Dent Coad:** This is for both of you. Perhaps I will start with Ray. What arrangements for governance, decision making and accountability do you envisage for the CDC scheme? I am concerned with the interface between the clever people looking after the money and the really important people whose money they are looking after.

Ray Ellis: Yes, indeed. We have agreed that the scheme will be set up under trust, so it will have a set of trustees who will run the scheme, made up of employer and employee trustees, who will of course have access to the appropriate professional support. It is important to us that we have people who are involved in the scheme, who benefit from the scheme, involved in running the scheme. Over and above that, we are putting in place a governing body on pension issues generally between the employer and the union, which will oversee the way the scheme is operating and pensions-related issues generally, but the management of the scheme will be in the hands of a trustee board.

Q43 **Emma Dent Coad:** So the accountability is very clear?

Ray Ellis: Yes.

Jon Millidge: Yes, and clearly as part of that there has to be a framework—this has to be developed—for how trustees will make decisions: what criteria would have to be met in order to award increases? That all has to be very transparent to the members of the scheme. We think that the key to making this successful is a good, robust governance arrangement. In principle, it is going to be very similar to the type of governance arrangement you would see for a DB scheme, and I think that will give it a degree of transparency as well so people will be able to understand what is going on in it.

The really key thing about this—and I think it came up from what David Pitt-Watson was talking about in the earlier session—is communication and the governance of the scheme. The trustees will be responsible for member communication, for making sure people understand what the targets are, that they are not promises, that people understand what could change things, and what they can do about it.

We are starting now with the communication. It is going through a ballot process at the moment. We are going out over the next few weeks. This will be landing from next week: a booklet to all the members explaining how we would see such a scheme working, what the risks of it are, being very, very clear that this is about targeting outcomes for them. It is about targeting outcomes that for the existing DC members are much better, and for the existing DB members it is a target outcome that is very similar to what they would get from the current existing DB scheme.

Q44 **Emma Dent Coad:** Would you say that you are making decisions with people rather than for them? Is that your principle? Do you think that is why it is working perhaps?

Jon Millidge: The trustee board will be the people who will make the decisions. In setting this up, what we will be doing is writing the rules. As Ray has alluded to, we have agreed that there is a reference group between the company and the trade union. We will be writing those rules and setting them up so it is very clear what the parameters are for how they will make decisions.

Q45 **Chair:** Ray, from someone who really wants trade unions to grow and be more effective, this is a hugely important move you have made, isn't it, in that your members see you making big decisions over their lifetime incomes in a way that lots of trade unions don't seem to be aware could be on the agenda?

Ray Ellis: I would not necessarily be critical of others. We were faced with a particular situation in Royal Mail where, as I said before, we had a two-tier pension provision already. We were faced reluctantly with the realisation that funding future accrual was going to be impossibly difficult in the DB scheme. We had to try to think creatively, and the original push for a new type of scheme came, in fact, from the CWU, with the assistance of First Actuarial, which was giving us advice. That was originally framed as a DB scheme because we wanted to introduce it under current legislation. During the course of negotiation with the company it evolved into the scheme it is now, which is a hybrid. It has a DB element relating to the lump sum and a CDC element relating to the wage in retirement.

Yes, we have made a big move. We have been proactive and I think we have come up with something that is of huge potential benefit to our members. I also think Royal Mail deserves some congratulations. It took a long time for us to get there, but we are coming to you today with an agreed position on behalf of 140,000 people who work for that company.

Chair: I will come back to other people, but there is another person to this party, or ought to be, isn't there? Nigel, might we come in with your questioning and then we will go around the room?

Q46 **Nigel Mills:** First, I am always slightly nervous when someone tells me in pensions that the solution is better communication and I then see somebody waving what looks like a very thick and complicated document. I wonder how many postmen in Amber Valley are going to work out that that means that their pension has gone from a promise, to a hope, to an expectation. Then when you say, Mr Millidge, that for those who are not in the DB scheme this is going to be far better and for those who are in the DB scheme it is going to be much the same, that starts to sound like you are promising quite a return that I am not sure your saving was meant to be getting you to, but anyway.

There is a problem here, isn't there, in that we have not turned on the regulations that we took three or so years ago? How keen do you think the Government are on enabling you to have this scheme?

Jon Millidge: If I can deal with your first point, we are very clear that this is targeting benefits. As you know, pensions are remarkably complicated issues and communicating them is very difficult. We and the CWU are both trying very hard to get communication going, so, at the same time as we are talking about it through these booklets and things, there are various roadshows going on that the CWU is doing. It is important that people understand it, and I am sorry if it sounds trite that communication is important on pensions but it absolutely is. People do need to understand what they are getting into.

In terms of the changes around the legislation, we are currently going through trying to identify what the things are that need to change. We don't think that to put in the type of scheme that we are talking about that we need the full range of the 2015 Act to be put in, but at the moment we are going through the process of trying to work out exactly what has to change. We are then going to be sharing that with officials from the DWP to see if that is possible. We think that there will be a route through this.

Q47 **Nigel Mills:** What timeframe do you need?

Jon Millidge: We reached agreement only a few weeks ago, so we are still going through that process with actuarial advisers, lawyers and so on, to understand exactly what has to change. We have put our shoulders to the wheel on this. We are moving as quickly but as thoroughly as we can to try to get this in as soon as we can.

Q48 **Nigel Mills:** If I remember rightly, you are about to write to your 140,000 staff setting out what this new pension is going to look like, yet can you actually create this pension any time in the near future?

Jon Millidge: We have transitional arrangements, which are coming in from the beginning of April. We simply cannot afford to keep the defined benefit scheme as it is open beyond the end of March. We have these transitional arrangements in. Those are ones that we have already consulted people on, and we have been very clear that this is the route that we want to go down in the longer term—the collective defined contribution. We have been very clear that there has to be change in legislation and regulations to enable this to happen. We are clear with people that there are some risks on the route that we are going down, but we are determined to get there. We do think there is a route through to get this.

Q49 **Chair:** Can you give us a list of the changes that you think you will need? Nigel's question was slightly different, wasn't it? Are the Government going to be as enthusiastic as you and the trade unions and members are?

Jon Millidge: As I say, we are going through the list of changes and, once we have done that, we can certainly write to you and let you know what those are. We are having active discussions with the DWP about the need for support on this.

Q50 **Chair:** What does that mean? Do you go in there thinking, "They are going to meet us here, pick up this baton and run with it," or is it all pretty slow like this?

Jon Millidge: As I say, I have had meetings with the DWP; we have had them jointly with the CWU. Clearly the onus is on us to tell them what it is that we want to change, and that is what we are going through at the moment.

Q51 **Nigel Mills:** When is this change to be in force: this April, next April, April 2020? When does it need to be done by?

Ray Ellis: There were quite a number of issues that you have touched on in the last couple of minutes. Jon has already made the point about communication, but I would like to reinforce it from the union's point of view as well. We will be seeing our members, and certainly our representatives for members, in Amber Valley and everywhere else in the UK. I should be in Royston today, which is where my colleagues are. We are going to every part of the United Kingdom. We are meeting every single one of our union representatives up and down the UK. A large part of those meetings is taken up with explaining the deal that is on offer on pensions. It does not stop there, obviously. We want to equip those people to go back into the workplace and be able to explain it directly to their members as well.

In terms of the expectations of returns for members, there are a number of very clear reasons why we expect that members in the DC scheme at the moment will be much better off under this new scheme. One is that the employer is putting more in, in terms of the level of contribution. It goes up for those people from 9% to 13% from the employer, so it is a total contribution of 19.6%, which is quite a sizeable contribution.

Q52 **Chair:** Is that why they will be represented on the trustee board, because otherwise I could not understand why you were letting them do that, and why you did not just run it yourself?

Ray Ellis: Yes, it is a thought. We do think it is appropriate to have a number of trustees from both the employer and the workforce. It is a high contribution rate and it is on a bigger element of pay than for the DC people at the moment, because it includes pensionable allowances as well as basic pay. It is a significant change in that respect for those people.

The scheme is based on the structure of part of the existing DB scheme. It is an 80th accrual scheme with a separate additional 3/80ths lump sum, which is a defined benefit element of the scheme. Because of the way the scheme is structured and because of the way it is funded in terms of contributions, that is why we are confident that it can produce a similar outcome for DB members, which is obviously a much better outcome than DC members would currently have.

In terms of the timescale, though, that is a crucial question. From the perspective of a trade union negotiator, you know that you have done the right thing when the question you are getting from people is, "When does this come in?" rather than, "Why should I vote for it?" That is the question that we are getting at the moment and that, unfortunately, is the question we cannot answer.

We have been involved with Royal Mail in meetings with the DWP. I was at the last such meeting. I certainly interpreted the mood music as being broadly positive. We are jointly meeting the Minister next week. We would hope that it would be possible to make the appropriate minimal changes to existing legislation to enable the Royal Mail scheme to get through the door. I have been persuaded that CDC schemes are the way forward on a much wider basis. At the moment, though, what we are looking for is to get this scheme through as quickly as we can for the benefit of our members.

Q53 **Chair:** We will have the Secretary of State before us in a few weeks, so we will ask her. Maybe she will want to make the announcement then that she has given you the go-ahead.

Ray Ellis: I hope so.

Jon Millidge: I think Royal Mail is a very good business to put a scheme like this in. We have a very large workforce. They are a staggeringly loyal workforce. On average, they stay with us for 17 years, and that is great because people get to know their posties. It does mean that we have stability there, which I think would help a scheme like this. I think we are a very good company for this to work in. Also, we have the trade union and us hand-in-hand wanting to do this.

Q54 **Nigel Mills:** What happens if the Government say, "Sorry, there is no parliamentary time before 2022"?

Chair: Even if we know that is untrue because there is no business going on here at all, apart from debates occasionally about Brexit.

Jon Millidge: As I say, we are having the discussions with the DWP. As Ray mentioned, we are meeting with the Minister. We do think there is a route through here and we will be doing everything we can to persuade them. We have these transitional arrangements that are in place. We would like that transition to be as short as possible and we are very keen to get this in. That is our focus at the moment.

Q55 **Chair:** It would be a real win for the Prime Minister, wouldn't it? She wants to build a social programme but cannot seem to make progress. Here you are helping her do it. Well, anyway, I should not be asking those questions. It could be very easily a very important gain in the way that Ray has described it, controlled to one particular area to begin with. It is not as though you are risking bringing down the whole 2015 Act here. You are asking for specific powers in this instance, and other people would have to go through the same procedure, wouldn't they?

Jon Millidge: I presume others would have to go through the same procedure, or at least adopt the same model.

Chair: Exactly, the same scheme, yes. We will finish with you, Ruth.

Q56 **Ruth George:** I visited my local sorting office last week, so I know that posties are talking about pensions quite a lot, which is good.

Can I just play devil's advocate a little bit here? Royal Mail shareholders have already done incredibly well out of the Government, which is shouldering around £47 billion of historic liability for the pension scheme. The current DB scheme I think is, as you say, eating into the surplus by about £1.3 billion a year. To what extent will the creating of a new scheme enable Royal Mail shareholders to get out of the liabilities under the existing DB scheme, which were known liabilities at the time the company was privatised and the shares were sold off?

Jon Millidge: I will deal with each of those issues. The liabilities for service prior to 2012 transferred over to the Government in 2012—that was before privatisation, obviously—but along with it went the assets that were in the scheme. It was not an unfunded scheme; there were assets in the scheme there as well and those transferred to the Government at the same time.

We changed the rules of the scheme in 2014, which did create a surplus and allowed us to keep building up benefit. As Ray said, we first looked at this scheme back in 2008 and thought, "Can we keep this defined benefit pension plan going?" Between us, we have managed to keep it going for 10 years up to 2018, which is a great achievement. We did that by various changes to it, including what we did in 2014.

All of the benefits and all of the liabilities that have been built up remain funded. We are not eating into a surplus by £1.2 billion. That is what the cost would be from April this year. We have been eating into the surplus, which, as I say, was a deliberate strategy to prolong keeping that scheme open.

What we have done between us over the last 10 years is keep that scheme open, allow people to have another 10 years of defined benefit accrual. All of the benefits that people have built up, and will have built up by the end of March this year, are fully funded. This is not a scheme that has a deficit. They are fully funded. The money is in there and the money is staying in there. No, shareholders are not ducking any responsibilities at all.

At the moment, we are putting £400 million a year into pensions. When people close their DB schemes they normally put less into the replacement pension scheme. We are continuing to put £400 million into pensions. We are doing that. That was a key part of what we agreed and, as Ray said, that is how we have managed to increase the contribution level for people in the DC scheme.

What we have done is put a good deal together. It does mean that we don't have this risk of a huge balance sheet problem going forward. It does mean that we have an affordable and sustainable pension arrangement going forward and we are continuing under this scheme, and under the transitional arrangements, to put in the £400 million that we were always putting in.

Ray Ellis: From the CWU point of view, if we had believed for one moment that the DB scheme was being sacrificed to sustain dividends for investors, we would have fought tooth and nail to protect the DB scheme. It became clear that the level of employer contribution necessary to sustain the scheme would have been unsustainable by Royal Mail, not simply as a plc but it would have been unsustainable even had Royal Mail remained in the public sector. It would have involved the company paying about 40% to 50% of pensionable pay into the pension scheme, which is a colossal sum of money.

For us, necessity was the mother of invention and we had spent a decade fighting a rear-guard action to protect a DB scheme, which I think was the right thing for us to do at that time, for the reasons we have already mentioned. We came to the conclusion that we could no longer sustain that position, and it was the union that started actively looking at an alternative, from which this current scheme was born. There is certainly no question in our minds that we have, and we would never have sacrificed the existing pension arrangements in Royal Mail simply to sustain dividends to shareholders.

Chair: Great. We are going to end on that good note. Ray and Jon, let me give you both a huge thank you.

Jon Millidge: Thank you for the opportunity.

Chair: Good luck in selling it. It does not sound, from what Ruth says, that it will take you long—people can see that there is something here, can't they? Yes, it is really good. Thank you very much.