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20 April 2009



Follow up to Postal Services Bill Committee Day 2

I am writing to follow up on my commitment given at the debate at Committee of the Postal Services Bill on 31st March 2009. You raised two points where I thought it would be helpful to provide a more detailed response in writing.

Basis of calculation for deficit in Royal Mail Pension Plan (RMPP)

You raised a question on the basis used to calculate the deficit which Government will be assuming as part of the proposal laid out in Part 2 of the Bill. Your specific question was the basis of calculation and whether FRS 17 should be applied to size the deficit.

In terms of background, the Pensions Act 2004 requires Trustees of a defined benefit pension scheme to undertake a full actuarial valuation of the scheme's assets and liabilities at least every three years. This valuation is calculated using a number of actuarial assumptions (such as expected return on investment, longevity etc) that are set by the Trustees on the advice of the scheme actuary, and with the agreement of the sponsoring employer. The valuation is then used to determine the contributions paid into the scheme, both in respect of future service, and any past deficit. This actuarial valuation is also referred to as being on a '*technical provisions*' basis ("*technical provisions*" is the term used in the Pensions Act 2004 to refer to the amount required, on an actuarial calculation, to make provision for the scheme's liabilities).

The last technical provisions valuation of the RMPP was carried out as at 31 March 2006. This showed a deficit of £3.4bn (based on assets of £21.9bn and liabilities of £25.3bn).

This valuation was updated as at 31 March 2008, using assumptions set in a consistent manner to the 31 March 2006 valuation but updated for movements in market conditions (e.g. gilt rates, value of assets). This showed an increased deficit in the RMPP of £5.9bn (based on assets of £23.7bn and liabilities of £29.6bn). The next formal Trustee valuation of the RMPP on a technical provisions basis is due as at 31 March 2009. Regulations allow the Trustees and the Company to take up to 15 months to finalise the valuation exercise (i.e. until June 2010).

However, the pensions liabilities that are disclosed in company accounts are assessed on a different basis, using a prescribed set of assumptions defined by the relevant accounting standard (FRS17 in the UK accounting standard and IAS19 for companies reporting under International Financial Reporting Standards). FRS17 was introduced in 2000, and after a long transitional period companies were required to adopt FRS17 in full for accounting periods beginning on or after 1 January 2005. UK listed companies are required to account under IAS19 from 1 January 2005. The accounts of the Royal Mail Holdings are prepared under International Financial Reporting Standards, including IAS19.

IAS19 specifies the use of a discount rate based on a high quality (usually interpreted to mean AA-rated) bond yield to measure the liabilities in a scheme. The yields on AA-rated corporate bonds have increased since mid-2007, and so the discount rate used by Royal Mail under IAS19 is now higher than the discount rate used for the technical provisions valuation of the RMPP. The result is that, as at 31 March 2008, the pension scheme deficit reported by Royal Mail on the accounting basis under IAS19 is £2.9 billion, which is less than the RMPP deficit on a technical provisions basis of £5.9bn.

The Government's estimate of the deficit, as set out in our Impact Assessment, is based on the 31 March 2008 technical provisions position. This is the value used by the Trustees to set employer contributions rates, and so has a direct impact on Royal Mail's cash flow. It has become common practice for the counter-parties to use this value in commercial transactions. In these circumstances the technical provisions position is therefore more relevant than the IAS19 position.

Clause 19 –Government's proposed amendment powers in new public service scheme compared to Armed Forces scheme

As mentioned during the debate, the powers in clause 19(6) and (7) of the Postal Services Bill, which deal with Government's ability to make changes to the new public service scheme, are based on provisions that apply to armed forces pension schemes under the Armed Forces (Pensions and Compensation) Act 2004. In Annex A to this letter, I have set out the relevant provisions in clause 19 of the Bill (together with the relevant definitions) and the provisions in section 3 of the Armed Forces (Pensions and Compensation)

Act 2004. You will see that the two provisions are very similar, although not identical. The main differences arise because of different definitions used in the Postal Services Bill and because the new scheme envisaged by the Bill will only contain rights accrued up to the qualifying time, whereas members may continue to accrue new rights in the armed forces schemes.

I hope that this letter is helpful. If you would find it helpful to meet with me or my officials on the Bill Team to discuss these matters further in advance of Report, then please do not hesitate to contact my office.

I am copying this letter to Peers who have spoken on Part 2 of the Bill and will place a copy of in the House Library.

A handwritten signature in blue ink, appearing to read "Bill McKenzie".

Bill McKenzie

ANNEX A

Member protection in Part 2 of the Postal Services Bill and in the Armed Forces (Pensions and Compensation) Act 2004

1. Relevant provisions of Part 2 of the Postal Services Bill

- Subsections (6) and (7) of clause 19 (Protection against adverse treatment) read as follows:
 - “(6) The power of the Secretary of State to amend a new public scheme may not be exercised in any manner which would or might adversely affect any provision of the scheme made in respect of qualifying accrued rights unless –*
 - (a) the consent requirements are satisfied in respect of the exercise of the power in that manner, or*
 - (b) the scheme is amended in the prescribed manner.*
 - (7) The consent requirements are those prescribed for the purpose of obtaining the consent of members of the scheme to its amendment.*
- “Qualifying accrued rights” are defined in clause 15 as follows:
 - “(1)...“qualifying accrued rights” means –*
 - (a) any right which, at the qualifying time, has accrued to or in respect of a qualifying member of the RMPP to future benefits under the RMPP,*
 - (b) any entitlement under the RMPP to the present payment of a pension or other benefit which a qualifying member of the RMPP has at the qualifying time, or*
 - (c) any entitlement to benefits, or rights to future benefits, under the RMPP which a person who has survived a qualifying member of the RMPP has at the qualifying time in respect of the member.”*
 - (2) In the definition of “qualifying accrued rights” references to a right include –*
 - (a) a pension credit right within the meaning given by section 124(1) of the Pensions Act 1995 (c.26), and*
 - (b) a right to future benefits under the RMPP attributable to additional voluntary contributions.*
 - (3) In the event that qualifying members of the RMPP include any person (“P”) who is in pensionable service under the RMPP after the qualifying time –*

(a) *the qualifying accrued rights in respect of P, and*

(b) *the amounts payable in respect of those rights,*

are to be determined for the purposes of this Part on the assumption that P had opted, immediately before the qualifying time, to terminate that service."

- Under clause 25:

"prescribed" means specified in, or determined in accordance with, an order made by the Secretary of State".

- Under clause 24, any such order will be subject to the negative resolution procedure.

2. Relevant provisions of the Armed Forces (Pensions and Compensation) Act 2004

- Section 3 (Accrued rights) provides:

(1) *The power of the Secretary of State to modify an armed forces pension scheme may not on any occasion be exercised in any manner which would or might adversely affect any entitlement, accrued rights or pension credit rights of any member of the scheme acquired before the power is exercised unless –*

(a) *the consent requirements are satisfied in respect of the exercise of the power on that occasion in that manner, or*

(b) *the scheme is modified in the prescribed manner.*

(2) *The consent requirements are those prescribed for the purpose of obtaining the consent of members of the scheme to its modification.*

(3) *In this section –*

"prescribed" means prescribed by an order under section 1,

"accrued rights", "entitlement", "member" and "pension credit rights" have the same meanings as in Part 1 of the Pensions Act 1995 (c.26)".

- Under section 10, an order made under the Act will be subject to the negative resolution procedure, unless it is an order amending another Act.