Terms in **bold** are defined in the glossary at the back of the enclosed booklet.

Dear colleague

## 2018 Pension Review: our proposal

### What is happening?

- We know how important your pension benefits are to you. Since the Pensions Reform in 2014 we have worked very hard to keep the Royal Mail Pension Plan ('the Plan') open until at least March 2018. We are still confident we can keep that commitment.
- We wrote to you in June 2016 to say we had started talking with our unions, CWU and Unite/CMA, to review the future of the Plan after March 2018. We are now setting out our proposal for the Plan's future after that time, for consultation with all active members. We will feed the outcome of that consultation back into our pension review process.
- We are very sorry that we now have to write to you to say that we believe the current Plan will soon not be affordable. Despite all our best efforts, **financial market conditions** make the Plan unsustainable. Our proposal is designed so that your interests – and the **Company's** – are at the heart of it. It is about continuing to provide sustainable, good quality pension benefits, a healthy **Company**, and as many high quality jobs as possible.
- We believe our proposal, if implemented, offers a very competitive pension package compared to our industry and other large employers.
- However, before we make any decision we want to hear your views and the views of your representatives. We will carefully consider your feedback and any affordable proposals you or your representatives may have.

### Why are we proposing changes?

- The Plan is currently in surplus. But, we expect this surplus will run out in 2018. We need to take action before then. The **Company** currently contributes around £400 million a year in ongoing pension contributions. The most recent financial review indicates the **Company's** contribution rate would increase from around 17 per cent of pensionable pay to over 50 per cent. This would more than double the **Company's** contribution after March 2018 - to over £1 billion a year - if members continue to build up benefits on the current basis beyond that date.
- This increase would not be affordable. It is significantly more than the cash we generate each year – around £290 million in 2015-16. It would reverse the benefits for you and the **Company** of the previous actions we have taken, which improved the viability of your **Company** and enhanced your future job security.
- With our unions, we have been actively exploring possible changes to potentially enable us to keep the Plan open on a **Defined Benefit** basis after March 2018 as part of our pension review process. Unfortunately, we have not been able to find an affordable way of doing this so far. See page 10 of the enclosed booklet for more information on the options we looked at.

### What would be the new changes?

- In the absence of an affordable alternative, from April 2018, we are proposing you would no longer build up future pension on a **Defined Benefit** basis. Instead, you would build up future benefits on a **Defined Contribution** basis. This could be either in a new section of the Plan or in the Royal Mail Defined Contribution Plan.
- The proposal is not about reducing what the **Company** spends. It is about avoiding an unaffordable increase in costs.
- The **Company** would continue to make a very significant contribution to your pension. We would expect to pay around the same amount in pension contributions and National Insurance contributions in 2018-19 as we did in 2015-16.
- Active Plan members as at 31 March 2018 would be given a one-off £750 payment, if the proposal is implemented.

### What happens next?

- We have already explained the **Company's** position to our unions as part of our pension review process.
- The **Company** believes this proposal is the best option available. But we do want to hear your views. Please take the time to read the enclosed booklet carefully. In the next few weeks, you will also receive your personal illustration of the possible effects of the proposed changes on your benefits.
- We will consider your views and discuss these with our unions. We will also consider any other ideas put forward by our unions. In any event, under the **Company's** proposal, no changes would come into effect before April 2018.

## 1. What our proposal means for you

### 1 a. Now until 31 March 2018

- We remain committed to not making any changes before April 2018 (subject to the conditions we told you about in 2013). If you're close to retirement, we expect that our proposed changes would have a smaller effect.
- You would continue to build up benefits as you do now until 31 March 2018.
- The age at which you can take your Plan benefits would stay the same. You would also have the same options for taking your benefits early - and taking a cash lump sum - as you do now.
- There would be no changes to the benefits transferred in 2012 to the Government scheme - the **Royal Mail Statutory Pension Scheme**. The Government is legally responsible for the benefits you built up until 31 March 2012.
- The benefits you build up in the Plan until 31 March 2018 would remain unchanged and you can get these benefits when you come to take your pension. The exception would be that from 1 April 2018, Section C members' pre-April 2008 benefits would be linked to **RPI** (up to 5% a year) until they leave Royal Mail employment or take their benefits, rather than to **Final Salary** pensionable pay.

### Where your benefits would come from if the proposal went ahead

| Royal Mail Statutory Pension Scheme (backed by Government) | Royal Mail Pension Plan (backed by the Plan's assets, and by Royal Mail) | Defined Contribution arrangement |
|---|---|---|
| **Defined Benefit (DB)** benefits earned up until 31 March 2012.<br><br>Increased in line with **RPI** (up to 5% a year) until you take them or leave Royal Mail employment. | **Defined Benefit (DB)** benefits earned between 1 April 2012 and 31 March 2018.<br><br>Increased in line with **RPI** (up to 5% a year) until you take them or leave Royal Mail employment. | **Defined Contribution (DC)** benefits built up from 1 April 2018.<br><br>Increases until you take your benefits would depend on, among other things, investment returns (and charges) in your retirement account. |

### 1 b. From 1 April 2018

- You would no longer build up your future pension on the current **Defined Benefit** basis. Instead, you would build up future benefits on a **Defined Contribution** basis (see explanation on page 6). This could be either in a new section of the Plan or in the Royal Mail Defined Contribution Plan.
- The **Company** would pay a contribution of 10% into your **Defined Contribution** retirement account. Unless you tell us otherwise, you would continue to pay a 6% contribution, as you do now[1].
- You could choose another contribution level. If you were to pay in 4% or 5%, the **Company** would pay in 7% or 8%, respectively. If you choose to contribute a lower percentage of your pensionable pay, you may end up with lower pension benefits when you retire.
- You could continue to make contributions by Pension Salary Exchange (PSE) which may mean that you make National Insurance contribution savings[2].

| Your contribution choice | The Company contribution |
|---|---|
| 4% | 7% |
| 5% | 8% |
| 6% | 10% |

- Salary changes after 31 March 2018 would immediately flow through to your **Defined Contribution pensionable pay**. You and the **Company** would pay more contributions into your retirement account if your pensionable pay increased.

[1] Or we pay the equivalent amount under Pension Salary Exchange (PSE).

[2] Please note that the availability of Pension Salary Exchange (PSE) is governed by tax legislation, and that legislation may change in the future.

- You would be provided with benefits, on reduced terms, if you die in service, or if you have to leave service due to serious ill-health. The **Company** would meet the cost of these benefits, in addition to its contribution into your retirement account. Before making any final decision, we would have separate discussions with our unions about the proposed changes where ill-health arrangements are governed by collective agreements. See page 9 of the enclosed booklet for more information.
- If the proposal is implemented, the **Company** would make a one-off payment of £750 to each active Plan member as at 31 March 2018. If paid as a PSE pension contribution to a member's new **Defined Contribution** account, there would normally be no income tax or National Insurance contribution (NIC) deductions. If paid as cash, it would be subject to income tax and NIC deductions.

In the circumstances, we believe that our proposal would be a fair outcome for members. If the proposal is implemented, the **Company** believes that it would:

- be a very competitive pension package compared to our industry and other large employers;
- help us to meet our objective of helping to protect the pension benefits you have built up;
- provide more sustainable pension arrangements in the future; and
- help us to continue to provide as many good quality jobs as possible.

The **Company** believes that our proposal is the best option available in the circumstances. But we will, of course, consider any other affordable proposals that members or their representatives wish to put forward during the pension review process. We know how important your pension benefits are to you. We want to hear from you.

We will continue discussions with our unions during and after the consultation. We will carefully consider your feedback and any affordable proposals you or your representatives make. We will consider your views and discuss these with our unions, as part of the pension review process.

**What's the difference between Defined Benefit (DB) and Defined Contribution (DC) pension schemes?**

The main difference between **DB** and **DC** pension schemes is how certain you can be about the amount of benefit you will get when you retire. In a **DB** scheme, there is one pot of assets out of which all scheme members' benefits are paid. Benefits are usually based on a formula using pensionable pay, pensionable service, and the rate at which you build up benefits. The amount you receive when you retire does not depend on investment returns. It is the **Company** that has the responsibility to ensure that the contributions paid into the scheme, along with investment returns, are sufficient to pay all the benefits.

In a **DC** scheme, each member has their own individual retirement account. Contributions from both the employee and the **Company** are paid into the retirement account. They are invested in order to grow. The amount you receive when you retire depends to a certain extent on the returns of these investments, as well as on charges levied. Benefits depend on the size of the retirement account when you retire as well as the cost of options chosen at retirement. There is no guaranteed amount.

## 2. Why are we in this situation?

It is a legal requirement for the Trustee and the **Company** to review the financial position of the Plan every three years.

At the time of the 2012 review, **financial market conditions** for many pension schemes - like our Plan - were not favourable. Consequently, following a consultation with members and our unions, we introduced the Pensions Reform in 2014. This allowed us to commit to keeping the Plan open until at least March 2018, subject to certain conditions.

Since then, **financial market conditions** have significantly worsened and recent improvements have not materially changed that position. The cost of keeping the Plan open, on a **Defined Benefit** basis, has increased a great deal. Many companies have already closed their **Defined Benefit** pension schemes. Only a few FTSE 100 companies, like Royal Mail, still have a significant number of their employees in a **Defined Benefit** scheme.

These issues have come to a head. The **Company** and the Trustee are legally required to finalise the 2015 three-yearly financial review of the Plan. In February 2015, as part of its preparations for the 2015 review, the Trustee sent us an estimate of the funding position of the Plan as at 31 March 2015. This estimate showed that, while the Plan remains well funded now, the surplus generated by the 2014 Pensions Reform would be likely to run out in 2018. Unless the Plan is changed, the **Company's** contribution rate would then have to go up very significantly.

Since receiving that estimate we have - with our unions CWU and Unite/CMA - been reviewing the future of the Plan. During the course of this review process, we received a number of further funding estimates from the Trustee. The latest one, which set out the preliminary results of the 2015 financial review of the Plan, confirmed 2018 as the time the Plan surplus would likely run out. It made clear that once that happened, the **Company's** contribution rate would more than double from around 17 per cent of pensionable pay, to over 50 per cent. This would mean that, unless we make changes to the Plan from April 2018, the **Company's** ongoing pension contributions would more than double in cash terms from around £400 million a year, to over £1 billion a year. This increase would not be affordable. It is significantly more than the cash we generate each year – around £290 million in 2015-16. We could not make this level of contributions and invest to grow and provide good quality jobs in the future. It would reverse the benefits for you and the **Company** of the previous actions we have taken. Those actions helped to make your pension more secure, improved the viability of your **Company** and enhanced your future job security.

To address this issue and to agree the 2015 financial review of the Plan with the Trustee, we now need to move to the member-wide consultation phase of our pension review process. We will then feed back the outcome of that consultation into our pension review process, before we decide what will happen to the Plan from April 2018.

### 3. Other options we carefully considered

We considered our proposal very carefully. We know how important your pension benefits are to you. And we know that you, like us, will be very disappointed that we cannot continue to build up future benefits the way we have previously. The **Company** actively considered a number of other options. We do not believe any of these options are affordable for either you or the **Company.** See page 10 of the enclosed booklet for more information.

### 4. Next steps

This is an important proposal that would affect your future. The posting of the enclosed consultation booklet begins the formal, member-wide consultation phase of our pension review. This member-wide consultation phase will end on **10 March 2017**. Please take the time to read the booklet carefully.

We want to help you understand the potential impact of these changes as well as we can. The enclosed booklet includes illustrations which show the possible effect of the **Company's** proposal on members' benefits, based on assumptions set out at the end of Section 2 of the booklet. We will be sending you in the next few weeks a personal illustration showing the possible impact of the proposed changes based on your individual details and the assumptions stated in the illustration.

### Getting in touch with us

If you have questions on the **Company's** proposal or on your personal illustration once you receive it, you can call the Pensions Consultation Helpline on 0345 850 0081. Lines are open Monday-Friday, 8.30am-5pm, not including bank holidays. We will also be regularly updating the Question & Answer section on our website **www.myroyalmail.com/pensions**

We want to hear your views. Please provide your feedback by post or email. Details can be found on page 2 of the enclosed consultation booklet. Feedback will not be taken over the phone, as we want to make sure your views are properly recorded and considered at the end of the consultation. If you wish to provide feedback through your union representatives, then you should contact them through the normal channels.

We will continue discussions with our unions during and after the consultation as part of our pension review process. We will carefully consider your feedback and any affordable proposals you or your representatives may have. No decisions will be made until the consultation process is completed, we have considered your views and we have had an opportunity to discuss responses with our unions as part of our pension review process. We will write to you again once the **Company** has made a decision.

Please look out for more information on RMtv and myroyalmail.com.

Yours faithfully,

**Jon Millidge**
Group HR Director

**Important legal note:** this letter and its enclosures are for consultation purposes only and do not guarantee or change your benefits. Benefits under the Royal Mail Pension Plan are subject always to the rules of the Plan in force from time to time. Once we have considered the responses to the consultation and had an opportunity to discuss matters further with our unions as part of our pension review process, we will write to you with our decision and the full terms of any changes. We have the right to withdraw, suspend or amend any part of any Royal Mail pension arrangement, including Pension Salary Exchange (PSE), at any time.