## Proposals for improving outcomes for DC members

This note covers Prospect’s preferences for improving pension outcomes for members of the defined contribution sections of the CNPP in the NDA’s group of companies.

This has been prepared in consultation with Prospect representatives from all the branches where members have access to the DC section of the CNPP.

**Background**

The 2006 agreement between the NDA and trade unions, that led to the establishment of the DC section of the CNPP, included a commitment to review employer contribution levels.

A further commitment to review outcomes for DC members was given by the NDA as part of the process that led to the agreement to reform the final salary schemes in 2017.

It has taken some time to make progress on these commitments, but we appreciate the opportunity to discuss these issues at the forthcoming NDA Pension Forum.

Prospect has previously written to the NDA to set out the reasons that we believe that improvements to pension outcomes for DC members are necessary. These are:

* The DC contribution structure was initially set by reference to the cost of the main DB scheme that it replaced (the UKAEA’s CPS). Since then, the cost of that scheme has increased significantly. The DC scheme no longer gives members a reasonable expectation of retiring with a similar level of pension, the growing gap between the two tiers of pension provision has become a chasm.
* Members contributing at the lowest contribution tiers in the DC scheme have very little chance of building up sufficient pension pots to be able to retire at a reasonable age with a decent level of income. Younger and female members are disproportionately represented at those tiers.
* The government has recognised the impact of these issues in relation to its own DC scheme and has already significantly increased contribution levels for those members (and is planning a further review that is likely to result in another significant increase relatively soon).
* The original contribution structure allowed for the more generous additional state pension entitlement that applied at the time. DC members have not been entitled to this benefit since April 2016, and the relevant adjustment to the contribution structure is no longer appropriate.

We recognise that there are factors resulting in the cost of the DC section of the CNPP being higher than anticipated. For example, more members are contributing at the maximum matching level than originally expected.

However, on balance, we believe that the case for improving pension provision for this group of members is clear.

We appreciate the NDA’s position that Treasury will require a cost / benefit analysis to approve any significant improvements to the pension arrangements for these workers. We hope to be able to work with the NDA and employers on making such a case for any agreed reforms that emerge from these discussions.

**Access to a DB scheme**

During the negotiations on reform of the final salary pension schemes in the NDA estate, the trade unions argued for DC members to be given access to these schemes once they had been reformed.

This proposal was rejected. The main stumbling block was the higher contribution rates that would have to be paid into these schemes on behalf of DC members.

* Ability to offer Alpha now

There has been a material change in circumstances since then. The main employers are now all wholly owned subsidiaries of the NDA. Having returned to the public sector, these companies can now resume offering public sector pension scheme membership to their employees.

The most relevant public service pension scheme for employees of these companies would seem to be the Alpha scheme (which is managed by the Cabinet Office and is also expected to subsume the remaining members of the UKAEA’s pension schemes in due course).

These companies are eligible to be added to the list of employers that can offer membership of the Alpha scheme to employees. This would just require a simple statutory instrument to be laid before Parliament (under the negative procedure).

Access to an unfunded public sector pension scheme would completely change the calculations about the sustainability of offering DB provision to this group of workers.

* Financial impact of offering Alpha (spending review period V long-term)

There is a significant difference between the employer contribution in respect of Alpha members (currently an average of 27.3% of pay) and the average employer contribution rate on behalf of DC members (a weighted average of the different contribution rates from 6% to 13.5%).

At first glance, this would appear to mean that it would be prohibitively expensive for employers to offer workers access to the Alpha scheme instead of the DC sections of the CNPP.

However, Alpha operates very differently from private sector DB schemes (and DC schemes). It is unfunded.

It is important to look at the impact of such a move on overall government finances (ie the net impact on taxpayers), and not just through the narrow prism of NDA’s funding settlement.

From the point of view of taxpayers (and of Treasury), providing access to Alpha to DC members in the NDA estate would be cashflow positive over the period of the spending review.

This is because Treasury would immediately start to receive member contributions (an average of 5.6% of pay) as well as the employer contributions (currently an average of about 27.3% of pay).

The new Alpha liabilities that these members would start to build up would not be payable for many decades. There would only be a trivial cost over the spending review period.

Of course, the upfront additional cost to employers would be over 15% of pay.

But that extra money would just be paid to Treasury (along with the current employer contribution to DC members, and the member contribution of c.5.6% of pay).

If Treasury committed to just giving the increase in the employer contribution costs back to the NDA for the spending review period, then employers could be reimbursed and would be no worse off.

Treasury would actually receive a significant benefit (which the NDA could potentially seek to share over the spending review period, in the form of additional funding for meeting objectives).

Of course, this would result in higher pension costs in the long run. But in the long run the cost of the civil service pension scheme is projected to fall (when expressed as a percentage of GDP). So, this change would likely just result in the reduction in future costs for the scheme being a little bit less than currently projected. It is for Treasury to say whether they view these long terms impacts as more material than the significant short-term effects.

* Appropriateness of Alpha (vs individual DC accounts)

It is worth returning to what Lord Hutton said about pension provision for public sector workers in his interim report:

“This range of issues cannot be tackled through provision of final salary defined benefit schemes. But neither would it be feasible or desirable to move towards a funded, individual account DC model for all public service employees. Apart from the major financing burden on the current generation of taxpayers, who would have to pay for both employer contributions and current benefit payments, this ignores the ability of Government as a large employer to pool and manage certain types of risk better than individuals. In addition, if lower paid employees were fully exposed to investment risk, this would increase uncertainty of income in retirement, which is difficult in particular for the low paid to manage. This is not desirable or necessary. Instead, the public service should aim to identify an appropriate way of sharing the uncertainties and risks inherent in pension provision between both the employee and employer.”

Since his interim report was published, government has come up with a form of defined benefit pension provision (and cost cap mechanism) that delivers on Hutton’s recommendations, while dealing with the challenges he outlined.

It would be far more appropriate (for the reasons Hutton outlines above, and in more detail in the rest of his interim report) to offer these reformed pension arrangements to all public sector workers in the NDA estate as well.

* Resolving two-tier workforce

This is significant discontent across the NDA estate about the two-tier structure of the workforce.

Over time, the perceived difference in the level of benefits of those who are entitled to membership of a DB pension scheme, and those who are not, has grown.

Alpha does not provide the same level of benefits as the reformed DB schemes in the NDA estate. But the fact that all workers would have access to DB schemes would effectively resolve this issue.

Prospect representatives reported significant strength of feeling about this issue amongst members across all sites.

* Recruitment and retention

Access to a DB scheme would be a unique selling point that would attract workers to the NDA’s group of companies.

The benefit would be disproportionate to the actual difference in pension provision that these workers would enjoy.

Employers are having difficulty recruiting. There are gaps right across the workforce that are a burden on the remaining employees. A significant reason for this is the inability to meet pay expectations and having nothing else to offer instead. Being able to say to potential recruits that the pay may not match, but that pension offer is much better than is available elsewhere could be game-changing.

* Employee welfare

We all want for the workers who are delivering nuclear decommissioning to be able to retire at a reasonable age with a decent standard of living.

The current pension arrangements for DC members will not provide this for a large proportion of that population.

The consequences will be for thousands of employees to be working for longer than is reasonable (with all the risks that entails), or to have less comfortable retirements than they should have.

The Alpha scheme provides an opportunity to resolve these issues and to ensure that the future welfare of workers across the NDA’s group of companies is protected.

* NDA’s views

It is important for us to understand whether the NDA believes that access to Alpha would be a more satisfactory outcome for workers currently in the DC section of the CNPP (if that could be achieved).

If so, we would like to work with the NDA on presenting the strongest possible case for giving access to this pension scheme to this group of workers to Treasury as part of the Spending Review process.

**Improving the DC scheme**

For the reasons given above, we strongly believe that providing access to Alpha is the best possible outcome from the current review of pension arrangements for DC members.

But we recognise that this outcome is subject to approval from others (such as Treasury and the Cabinet Office).

There are limited opportunities for the trade unions to discuss improving retirement outcomes for members of the DC section of the CNPP, and it is possible that there may not be a practical opportunity to address this until the time of the subsequent spending review.

So, Prospect would like to maintain a dialogue about the improvements that could be made to the DC section of the CNPP in the event that access to Alpha is not granted.

* Improving the DC contribution structure

As a default, the simplest way to improve the contribution structure in the CNPP is to increase the employer contribution rate in each of the tiers by the same rate (the highest possible rate subject to constraints such as affordability etc.)

(It should be noted that any such increase would cost less than an equivalent increase in payroll for all employees.)

This would have the advantage of simplicity and would benefit everyone equally. However, the challenges facing DC members are not the same.

Members contributing at the top tier are in a strong position to accrue a pension pot that is sufficient to allow them to retire at a reasonable age with a decent standard of living.

Members contributing at lower levels are not.

Prospect believes that there is a strong argument that more needs to be done to improve the position of those at the lower contribution tiers, because they are in much greater danger of facing a shortfall in retirement.

It is also the case that younger and female members are more likely to be contributing at lower contribution tiers, so focussing efforts here will help address indirect age and gender discrimination (see table below based on information provided by the NDA).

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Contribution Band | Total | Male | Female | <30 | 30 - 45 | >45 |
| 3% / 8% (11%) | 13.8% | 13.1% | 15.2% | 14.8% | 15.4% | 9.8% |
| 4% / 9.5% (13.5%) | 3.7% | 3.5% | 4.0% | 4.4% | 3.8% | 2.2% |
| 5% / 11% (16%) | 10.9% | 10.2% | 12.3% | 13.5% | 10.3% | 7.8% |
| 6% / 12.5% (18.5%) | 3.7% | 3.8% | 3.5% | 3.9% | 3.6% | 3.4% |
| 7% / 13.5% (20.5% | 67.9% | 69.4% | 65.0% | 63.4% | 66.8% | 76.7% |

Members contributing at the highest tier are getting 20.5% of pay into their pension every year, this can potentially enable them to accrue a sufficient pot to retire at a relatively reasonable age with a fairly decent standard of living.

Members at the lowest tier get just over half that amount (11%) and this is unlikely to be sufficient.

* Targeting improvements in the DC contribution structure

Rather than applying the same increase in employer contributions across all contribution tiers, we believe that it would be appropriate to try to target improvements in a way that delivers two specific outcomes:

(1) direct more of an increase to the lowest tiers and

(2) narrow the contribution structure (to make it easier to get the maximum amount from the employer)

However, even within this framework, it is important to also deliver improvements for members contributing at all tiers, and to take into account what employers in other relevant organisations are offering to DC members.

Because major employers that the NDA’s group of companies is competing with for recruits offer higher maximum contribution rates to DC schemes (eg Edf – 15%, NNL – 15%, civil service – an age-related structure that can be much higher than 15%), we believe it is important for the maximum level of employer contribution to be increased to 15% of pay.

The following proposed contribution structure meets the various objectives set out above:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Existing | | | Proposed | | |
| Member | Employer | Total | Member | Employer | Total |
| 3% | 8% | 11% | 3% | 12% | 15% |
| 4% | 9.5% | 13.5% | 4% | 13% | 17% |
| 5% | 11% | 16% | 5% | 14% | 19% |
| 6% | 12.5% | 18.5% | 6% | 15% | 21% |
| 7% | 13.5% | 20.5% |  |  |  |

Notes:

1. The number of tiers would be reduced from five to four (with 6% the maximum matching level), but members could continue to pay 7% (or even more).
2. The proposed improvements are greatest for the members contributing at the lowest tiers.
3. Everyone would see an increase in employer contributions of at least 1.5% of pay.

**Other issues**

We will write jointly with the other trade unions around issues to do with supporting DC members at retirement.

We believe that death-in-service benefits for members of the DC section of the CNPP are too low and should be increased.

We note the ongoing review of the Group Income Protection scheme and look forward to inputting to this at an early stage.