

NDA Pension Forum: Defined Contribution Pensions

Prospect submission to the NDA Pension Forum on proposed improvements to defined contribution pension arrangements in the NDA estate.

September 2017

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INTRODUCTION

1. Difficult discussions about reform of the final salary pension schemes across the NDA estate concluded earlier this year. During those discussions the trade unions sought to raise the issue of the appropriateness of the defined contribution pension arrangements available to newer entrants. The NDA declined to include the defined contribution pension schemes in the scope of those discussions but agreed that this could be addressed at a later stage. This submission sets out Prospect's case for reform of the defined contribution arrangements in the Combined Nuclear Pension Plan (the CNPP).
2. Prospect welcomes the opportunity to discuss potential improvements to the defined contribution pension arrangements. Defined contribution pension scheme members face the greatest challenges in planning for retirement. Many important aspects of the defined contribution arrangements in the CNPP have not been reviewed since it was established and there have been many significant developments since then that need to be assessed and potentially taken into account.
3. We hope this submission is viewed as a constructive attempt to raise a number of very important issues for further discussion. Prospect is committed to working with the NDA and employers to bring about a number of improvements to the defined contribution arrangements to the benefit of scheme members, employers and taxpayers generally.

SUMMARY

4. There are a number of areas where it is important to improve the defined contribution section of the CNPP.
5. **Charges.** We believe there is scope to negotiate a further reduction in charges for defined contribution scheme members that would have a material impact on the size of their pension pots at retirement.
6. **Support at retirement.** We are concerned that defined contribution scheme members are faced with difficult choices related to accessing their pension pot. Too many are at high risk of getting a poor value product or paying excessive fees. A small investment in additional support at retirement when members make these choices could make a significant difference to income levels throughout retirement.
7. **Level of employer contributions.** We believe there have been a number of significant developments since the contribution structure for defined contribution scheme members was negotiated that should be allowed for. In particular there is a strong case for gradually increasing employer contribution rates to ensure members continue to be able to retire at a reasonable age with a decent standard of living.

8. **Governance.** We believe that it would be useful for a forum involving the NDA, employers and member representatives who are in the defined contribution arrangements to meet regularly to discuss issues specific to these members.

BACKGROUND

9. The current CNPP defined contribution pension arrangements were negotiated by the trade unions, the NDA and BNFL. Many of the main elements of the arrangements have remained unchanged since they were introduced shortly before the break up and contractorisation of BNFL.
10. In early 2017 the NDA consulted on reforms to the final salary pension schemes across the estate. Government argued that NDA pension schemes should be reformed in line with the overall public sector pension reform process. As a fundamental element of public sector pension reform was the retention of defined benefit pension provision for new entrants it seemed logical that members of the CNPP defined contribution pension arrangements should be transferred to the reformed defined benefit schemes. Many defined contribution members raised this point with Prospect and through the consultation.
11. Despite the beneficial impact extending defined benefit pension provision would have had, both for the members concerned and for the cashflow position of the NDA, this proposal was rejected.
12. Prospect and the other trade unions remained committed to raising other potential improvements for defined contribution scheme members. It was agreed that, due to the timescales involved in the discussions around the reforms to the final salary schemes and the implementation of the redundancy compensation cap, it would be better to raise these issues later in 2017. The NDA Pension Forum seems to be an appropriate choice for starting discussions about the defined contribution arrangements.
13. Prospect received a significant number of representations from defined contribution members both during the earlier consultation and since then. There is strong demand from these members for a review of the issues relevant to their pension provision.
14. We recognise that the CNPP defined contribution pension arrangements are very well run. Some of the issues raised in this submission are ultimately the responsibility of the trustee directors of the scheme. However all the issues raised have a significant impact on members and are also legitimately the subject of discussion between member representatives and scheme employers and the NDA.

DETAILED ISSUES

15. There are a number of potential improvements to the CNPP defined contribution pension arrangements that Prospect would like to discuss.

- **Charges**

16. The reduction in charges since the defined contribution arrangements were established is the most important development for these members to date.
17. All else being equal, the reduction in charges achieved so far will result in accumulated pension pots being up to 5% higher than otherwise. For many members this is equivalent to an extra 1% employer contribution.
18. This development is very much welcomed and will obviously make a significant difference to the income these members can enjoy in retirement.
19. The trustees and pension team are continually driving improvements in relation to charges with the latest reduction taking effect in only April this year.
20. We also recognise that the quoted charge levels are only one element (though a key one) in an assessment of the value provided by any pension provider.
21. However Prospect would like to discuss the potential for driving charges even lower. Any further reduction in charges would directly benefit members but would also maximise the return from contributions made by employers. Prospect deals with employers with similar sized defined contribution schemes who have negotiated annual management charges of less than 0.3%.
22. We recognise that ultimately this is an issue for the trustee directors but a discussion between the trade unions, the employers and the NDA may result in opportunities for improvements that benefit all stakeholders in the defined contribution arrangements.

- **Support at retirement**

23. Defined contribution scheme members are at significant risk of very poor outcomes in the retirement income market.
24. Before the Coalition government implemented the 'freedom and choice' agenda in April 2015 there was evidence that nearly half defined contribution scheme members failed to exercise the open market option when purchasing an annuity and as a result a significant proportion were receiving far less income than the best provider would have offered.
25. 'Freedom and choice' has exacerbated these problems because now there are far more options for most defined contribution scheme members and it is far more difficult to assess value in the market and charges can be very opaque.
26. 'Freedom and choice' also exposes defined contribution scheme members to more risks in retirement.
27. In the current regulatory environment it is impossible for most defined contribution pension scheme members to achieve value for money and properly manage the risks they face without advice.

28. We understand that the trustee directors have responsibility for issues around the support provided to members at retirement. We also recognise the arrangements that the trustee directors have put in place to help members navigate the options they face at this time.
29. However we believe that a small investment from employers at this hugely significant time could make a real difference to the quality of life of defined contribution members throughout retirement.
30. If employers made a payment towards advice at the point of retirement this would greatly increase take-up of such services and would help drive much better outcomes for members as they choose better value products that manage the risks they face more appropriately.

- **Level of employer contributions**

31. The level of employer contributions to the defined contribution arrangements was the main focus of the negotiations between the trade unions, the NDA and BNFL before the scheme was established.
32. In the 'Joint Statement by Unions and NDA and BNFL' issued after the meeting of 25 September 2006 it was noted that "the employer's contribution rate could be increased in the future, if required" and that the proposed consultation forum "will provide a mechanism to consult with the Unions on whether any future changes may be justified".
33. It is over ten years since that statement was made and there have been a number of significant developments. Prospect believes that now is an appropriate time to review the level of employer contributions.
34. There are a number of reasons for reviewing the level of employer contributions:

(a) **Original basis for establishing the contribution structure**

The joint statement referred to above states that "the NDA has agreed that the total cost [of the defined contribution arrangements] to the employer will be no less than the current CPS employer contribution rate of 15%". While the CPS employer contribution rate for funding purposes has not been recalculated since then we know that, if it were, the figure would be far in excess of 15%. On an accounting basis the latest employer contribution rate for the CPS is reported to be 33.4%¹. While this estimated contribution rate is grossly inflated by the effect of current gilt yields on the discount rate used for accounting purposes, we know that the real discount rate for the valuations of the main public sector schemes has also been reduced from 3.5% to 3% and subsequently to 2.8%. When the Cabinet Office reviewed

¹ See Report of the Actuary in latest accounts:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/548307/web-united-kingdom-atomic-energy-authority-pension-schemes-combined-annual-accounts-2015-16.pdf

the contribution rate for its defined contribution scheme the change in the discount rate was one of the main drivers behind the increase in employer contributions of about 1% to 2.5% (depending on age) implemented from October 2015². It should be noted that the maximum employer contribution to defined contribution arrangements in the civil service is now 17.75%.

(b) **End of contracting out**

During the negotiations on the level of employer contribution to the defined contribution pension arrangements, the additional national insurance costs for this group were explicitly allowed for. An employer cost of c3% of pay, or about 20% of the overall employer cost in relation to defined contribution members, was added to cover the fact that there would be no employer contracted out rebate. Contracting out was abolished from April 2016 and since then there has been no additional national insurance cost in respect of defined contribution members. The State Second Pension was also abolished and replaced by the new State Pension. While this will generally result in higher state pension income for final salary scheme members, it will result in lower state pension income for defined contribution scheme members. As the differences in national insurance were explicitly allowed for in the negotiations establishing the defined contribution arrangements there should be an explicit increase in employer contributions now to reflect the changes that have happened in the interim.

(c) **Adequate level of income in retirement**

Like all pension schemes, the defined contribution arrangements are intended to allow members to retire at a reasonable age with a decent standard of living. Since these arrangements were established the cost of securing income in retirement has increased significantly as longevity has improved and gilt yields have fallen. Consequently higher contributions are necessary now to deliver the same standard of living envisaged when the arrangements were first negotiated.

35. We recognise that there are wider issues of cost that go beyond the factors we have raised in this submission. We are not calling for a mechanistic approach or for significant changes to be implemented immediately. However we believe there are compelling reasons for addressing the levels of employer contributions and we would like to start to address these now.

- **Governance**

36. The CNPP defined contribution arrangements are well run and have a strong governance structure.

37. To supplement the vital role played by the trustee directors, and to help engage defined contribution scheme members in the running of their pension scheme, we believe it would be useful to have a forum involving defined contribution

² See Table 1: <http://www.civilservicepensionscheme.org.uk/media/95044/dc-consultation-response.pdf>

members from various sites across the NDA estate that meet annually to keep relevant issues under review.

38. The latest annual report of the Independent Governance Committee of the pension provider and the adequacy of total contribution rates are two of the many issues that could usefully be discussed at such a forum.
39. Having reps from a variety of sites would also be a good opportunity for any issues that are being experienced locally to be raised with the NDA.