EXPLANATORY MEMORANDUM TO

THE POSTAL SERVICES ACT 2011 (TRANSFER OF ACCRUED PENSION RIGHTS) ORDER 2012

NO. 2012/687

AND

THE POSTAL SERVICES ACT 2011 (TRANSFER OF ASSETS) ORDER 2012

NO. 2012/688

1. This explanatory memorandum has been prepared by The Department for Business, Innovation and Skills (BIS) and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instruments

The instruments provide for the transfer of pension liabilities (i.e. the rights of qualifying members to pension benefits) from the Royal Mail Pension Plan (the 'RMPP') to a new public pension scheme (the Royal Mail Statutory Pension Scheme, 'RMSPS'. The instruments also provide for an accompanying transfer of assets from the RMPP to Government. The intention is that taken together, the transfers of assets and liabilities will leave the RMPP fully funded as at 1 April 2012.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The operative provisions of both instruments will be brought into force by way of a separate Order made under sections 25(4) and (5) of the Postal Services Act 2011 ("the Act") so that the necessary state aid approval can be in place before the instruments are commenced.

Drafting

3.2 Much of both Orders may look unlike most statutory instruments. In particular, the Transfer of Accrued Pension Rights Order ('the Pensions Transfer Order') includes drafting styles that are not commonly used in statutory instruments. We have considered the following: i) within both Orders, the drafting device which defines terms at article 2 by reference to definitions which themselves appear in the Schedules (where one would prefer the definition itself at article 2); ii) within the Pensions Transfer Order, the private law character of the drafting of Schedule 1 and the complexity of the provisions of Schedule 2; and iii) within the Transfer of Assets Order, the specialist nature of Schedules 1 to 4 and 6.

3.3 The definition of Qualifying Member in Article 2 of the Pensions Transfer Order that refers the reader to further definitions in Schedule 1 was necessary because the concept being defined is unfortunately too complex to explain in isolation, and has to be understood in the context of Schedule 1. This same decision was taken as regards the definition of "Claim" at Article 1 of the Transfer of Assets Order.

3.4 Schedule 1 of the Pensions Transfer Order necessarily uses a “copy-out” approach which explains its private law character. In establishing the new statutory scheme the Secretary of State must mirror the benefits provided by the RMPP. The RMPP, a trust based scheme, exists in private law documents, and so it is highly desirable that the language creating the RMSPS replicates the private law language used in those documents in order to ensure no mismatch between the benefits provided by the RMSPS and the RMPP. Any unintended mismatch would risk breaching the statutory requirement at section 20(2) of the Act and create undesirable uncertainty.

3.5 A further point about the drafting is that the RMSPS Rules at Schedule 1 of the Pensions Transfer Order are merely given life by this Order. They will hereafter be a functioning set of rules for the statutory pension scheme, used in isolation from the Order. Therefore some titling and references may surprise the reader who might expect every statutory instrument convention about numbering and titling to have been followed. We have adhered to Statutory Instrument Practice as much as possible, for example referring to paragraphs, sub-paragraphs and then Paragraphs within each rule, but followed the structure and used the terminology of the RMPP and referred to clauses and rules so that the document will make sense to its users.

3.6 Schedule 2 of the Pensions Transfer Order also relies on a “copy-out” approach. It is based on two sources; i) sections 67 to 68 of the Pensions Act 1995, which do not apply to the statutory scheme, and are modified so to do within this Schedule; and ii) the existing RMPP scheme amendment restriction which is in the RMPP’s rules, which has been re-created so as to apply to the RMSPS. The language of both sources has been tracked closely to avoid changing their meaning.

3.7 Schedules 1, 2, 3, 4 and 6 of the Transfer of Assets Order are by necessity directed at a specialist audience, the Government Actuary who will perform the valuation, and the actuarial advisers of the other parties involved. Whilst we have taken every effort to ensure that proper standards of statutory drafting have been met, we have also been mindful of the highly specialist nature of the instrument and the need for maximum clarity for the intended audience.

Vires

Transfer and discharge of the qualifying accrued rights under The Pensions Transfer Order: reliance on section 89(2) in conjunction with section 17(2) and (3)

3.8 The transfer of qualifying accrued rights under article 5(a) of the Pensions Transfer Order has been extended at article 5(b) to transfer any other rights that are removed from the RMPP by way of rule amendments effected by article 11 (which gives effect to the external document which amends the RMPP). The power to transfer qualifying accrued rights under section 17(2) is relied upon in conjunction with section 89(2) to the extent that the transfer at article 5(b) does not fall within the section 17(2) or section 17(4)(d) power.

3.9 We rely on the power to make supplemental provision at section 89(2) because there is a risk that it would be impossible to effect the transfer of qualifying accrued rights as defined by section 16(1) of the Act without doing so.

3.10 The risk of impossibility arises because of the restriction on what a qualifying accrued right can be within the meaning of section 16(1).

3.11 Section 16(1) provides that a qualifying accrued right is any right or entitlement that has accrued up to a certain date (the qualifying time) in the RMPP, in respect of qualifying members. (Both the qualifying time and the qualifying members are prescribed at article 2). The definition of a qualifying accrued right is unique to the Act (and does not exist elsewhere in pensions legislation). It is the vehicle for the transfer of rights out of the RMPP and into the RMSPS, at sections 16 and 17, and was designed to capture all defined benefit rights in the RMPP (up to the prescribed time, and in respect of the prescribed members), so that two separate schemes, the RMPP and the RMSPS would provide benefits before and after the qualifying time respectively.

3.12 The definition specifically excludes money purchase benefits at section 16(2)(a), and in respect of active members, requires that qualifying accrued rights are determined as if the member had opted out of the RMPP (i.e. become a deferred member but continued in employment with the employer) immediately before the qualifying time.

3.13 This potential difficulty has arisen since the Act was enacted because of doubt cast by a Supreme Court decision[1] about what benefits fall within the definition of "money purchase benefits". The definition in question is at section 181 of the Pension Schemes Act 1993, and is the one employed by the Act by way of section 26(1). Under this definition it is clear that money purchase benefits are different from final salary benefits. The doubt cast by the case means that certain other RMPP defined benefits that were assumed not to be money purchase benefits (and hence that would have been considered to be qualifying accrued rights) may now considered to be money purchase benefits within the meaning of section 181.

3.14 In particular, doubt is cast on additional years of service purchased by members on a voluntary basis and certain pension payments made by the RMPP that members originally purchased on a money purchase basis which have come into payment as part of their final salary benefits. These benefits have been and continue to be considered by the industry to be final salary benefits, and DWP has amended section 181 of the Pension Schemes Act 1993 in order to 'correct' any doubt about the effect of the Supreme Court case on section 181, by way of section 29 of the Pensions Act 2011. However, section 29 of the Pensions Act 2011 will not yet be in force at the time of transfer on 1 April 2012.

3.15 To carve out these two types of benefit from the transfer would cut-across the definition of a qualifying accrued right as understood when the Act was enacted – all defined benefit rights accrued by a beneficiary up to a certain date in relation to past service. Furthermore, it would not be possible to unravel where accrued benefits had been acquired by a different method, as they are part and parcel of a member's accrued defined benefit entitlement.

3.16 Section 17(4)(d) appears to allow for the transfer of money purchase benefits from the RMPP and their conversion into benefits under the RMSPS. For this purpose money purchase benefits are also defined by section 181 of the Pension Schemes Act 1993, which would mean that the power to transfer such benefits under section 17(4)(d) would enable the transfer to the RMSPS of RMPP defined benefits that are not qualifying accrued rights. However, there is some concern that section 17(4)(d) may only allow for transfers after the establishment of the RMSPS, although this is ambiguous.

[1] *Houldsworth and another v Bridge Trustees Ltd and another* [2011] UKSC 42

3.17 Therefore, to avoid any doubt as to whether these two categories of are transferred and discharged we have included articles 5(b) and 7(b) and rely on either the power at section 89(2), or alternatively section 17(4)(d) to do so.

3.18 To the extent that the rights transferred and discharged are outside the definition of qualifying accrued rights, thus falling under 5(b) and 7(b) respectively, the vires at section 89(2) to make supplemental provision is adequate. Following Viscount Dilhorne in *Daymond v South West Water Authority*[2] that 'supplementary' means "something added to what is in the … Act to fill in details or machinery for which the … Act itself does not provide; supplementary in the sense that it is required to implement what was in the … Act" the impossibility of transferring accrued defined benefit rights without those at risk of being deemed money purchase benefits in the light of *Houldsworth v Bridge* is such that Part 2 of the Act's transfer scheme must include the transfer of these rights. Without including them, it would not be possible to create the two separate schemes divided at the pivot point of the qualifying time in accordance with the structure provided by section 16 and 17.

4. Legislative Context

4.1 The instruments are being made to implement Part 2 of the Postal Services Act 2011 ('the Act'), which provides the powers for the Government to effect a transfer of assets and liabilities from the RMPP. During the course of Parliamentary debate on the Act, Ministers set out the reasons why secondary legislation was required. Firstly, the detail of the Government's proposals are subject to clearance by the European Commission as State aid and secondary legislation allows the necessary flexibility for the detail of the transfer arrangements to meet any terms imposed by the Commission. Secondly, the amount and complexity of legislation required to effect the transfer of pension liabilities and assets means secondary legislation is more appropriate vehicle than primary legislation. (See for example, Public Bill Committee, Postal Services Bill, 25 November 2010; Hansard: Column 431).

5. Territorial Extent and Application

5.1 The instruments apply to all of the United Kingdom.

6. European Convention on Human Rights

As all of the instruments are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 In 2008, in view of declining mail volumes, the then Government commissioned a report from Richard Hooper into the future of the Postal Services Sector. Hooper made a package of recommendations aimed at providing Royal Mail with access to commercial capital and expertise in order to secure the future of the universal postal service. Those recommendations included Government addressing the significant pension deficit that weighed heavily on Royal Mail's balance sheet.

[2] [1976] 1 All ER 39

7.2 In June 2010 the new Coalition Government asked Hooper to update his report. In so doing Hooper found that the underlying issues that threatened the universal postal service at the time of his original review remained and required urgent action. Hooper further noted that the pension deficit was even more unsustainable than at the time of his previous report. The Postal Services Act was the implementation of those findings.

7.3 The Postal Services Act is divided into four parts:

- Part 1 provides for the restructuring of Royal Mail, including the introduction of private sector capital from the sale of up to 90% of Royal Mail, an employee share scheme and provisions for Post Office Ltd to continue to be owned by the Crown or a mutual ownership structure
- Part 2 provides powers to deal with the Royal Mail's pension deficit by transferring the historic liabilities of the scheme to the Government
- Part 3 makes provisions for the regulatory arrangements for postal services through the transfer of powers from Postcomm to Ofcom
- Part 4 contains provisions for a "special administrative regime" should the universal postal service be at risk from the provider entering insolvency proceedings.

7.4 The Act is being implemented in stages, starting with the transfer of regulatory arrangements, then the transfer of pensions, then the injection of private capital.

7.5 Ofcom took over responsibility for postal services regulatory arrangements in October 2011. The instruments covered by this explanatory memorandum will implement the second stage of the Hooper reforms, Part 2 of the Act, by removing Royal Mail's pension deficit.

The Transfer of Accrued Pension Rights Order

7.6 As at 31 March 2011 the RMPP contained around 432,000 members of which around 184,000 were currently receiving pensions. At the time of the last update to its actuarial valuation in March 2010, the scheme had liabilities of £34.4bn and assets of £26bn. The resulting deficit of £8.4bn is volatile; latest estimates suggest it might currently measure around £10bn.

7.7 The deficit is removed by way of the Transfer of Accrued Pension Rights Order ('The Pensions Transfer Order') which provides for a new public pension scheme (the Royal Mail Statutory Pension Scheme or RMSPS) to be established and for pension liabilities accrued in the RMPP before 1 April 2012 to transfer to the RMSPS. That Order also provides that the RMPP will continue to be responsible for pensions that accrue after 1 April.

7.8 Addressing the deficit in this way has significant advantages over other possible approaches, for example providing Government funding to the RMPP to plug the gap, as it not only removes the existing deficit but also significantly reduces the size of the ongoing RMPP. This in turn reduces the scheme's volatility, and hence the likelihood of a significant deficit by reference to the size of the business, arising in the future.

7.9 The RMPP retains responsibility for any increases that members receive to "final salary" pensions accrued before the transfer that arise as a consequence of any real (i.e. above inflation) pensionable salary awards made on or after that date (hereafter termed 'the salary link liability'). As the Royal Mail will be wholly responsible for setting future wage increases, the Government considers it important that Royal Mail retain responsibility for the salary link liability. The Government's position on this point appears on the face of the Act at section 16(3) and was debated during its Parliamentary passage. (See, for example, Public Bill Committee, Postal Services Bill, 11 November 2010; Hansard: Column 134)

7.10 All of the current around 427,000 members of the RMPP will have at least some benefits that will transfer to the RMSPS. For pensioner members (i.e. those around 184,000 members in receipt of their pension entitlements before 1 April) and deferred members (i.e. those around 120,000 members who have left the RMPP before 1 April) all benefits other than money purchase benefits[3] will transfer to the RMSPS. For active members (i.e. those around 123,000 members who continue in employment with Royal Mail or Post Office Limited after the 1 April) non-money purchase benefits will be split between the RMPP and the RMSPS: the RMPP retaining responsibility for the salary link liability and any post 1 April 2012 accrual and the RMSPS taking responsibility for pensions built up before that date.

7.11 The Pensions Transfer Order has been drafted so that the test at section 20(2) of the Act, which requires that no member of the RMPP is disadvantaged in any material way with respect to their pension provision by the intervention, has been met. Indeed, in terms of security, members will be in a better position as in future their benefits earned up to 31 March 2012 are provided by Government.

7.12 For pensioner and deferred members, the RMSPS will entirely replicate the benefits payable to those members by the RMPP. However, the split of benefits for Active members introduces some necessary complexity where those members have part years of service and where certain pension increases need to work in tandem between the RMSPS and RMPP to ensure members are no worse off.

7.13 The Secretary of State is restricted in how he can amend the RMSPS in the future, as the Pensions Transfer Order provides protections to members' accrued benefits analogous to those that RMPP members currently enjoy under section 67 of the Pensions Act 1995 and certain scheme-specific restrictions that apply under the RMPP scheme rules.

7.14 The Pensions Transfer Order provides for the Trustee of the RMPP to be discharged from the liabilities that are transferred to the RMSPS. The benefits transferred to the RMSPS will include all Guaranteed Minimum Pensions (GMPs)[4]. The RMPP will retain no liability for, or referable to, GMPs and the discharge of the RMPP Trustee necessarily extends to any obligation that the RMPP Trustee might otherwise have had in relation to GMPs.

7.15 The RMPP is amended by the Pensions Transfer Order, firstly to reflect the fact that the RMPP has no continuing liability in respect of the rights that are removed (given that these will have been transferred to the RMSPS) and secondly, to create a new Post Office Limited section. The sectionalisation of the RMPP reflects the separation of Post Office Limited from Royal Mail to allow for the eventual injection of private capital into Royal Mail. As stated during the passage of the Act, the assets and liabilities of the scheme within each of the sections will be segregated. (See, for

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[3] The term money purchase here and throughout this section refers to AVC money purchase benefits (as opposed to the benefits described in paragraph 3.14) that are not yet in payment. Such benefits will be retained by the RMPP at transfer.

[4] Guaranteed Minimum Pensions relate to benefits accrued before 6 April 1997 in schemes that were contracted out of the State Second Pension. Relevant statute relating to the treatment of GMPs and other contracted out benefits is applied to the RMSPS by way of the Pensions Transfer Order.

example, Public Bill Committee, Postal Services Bill, 25 November 2010; Hansard: Column 436).

The Transfer of Assets Order

7.16 The Transfer of Assets Order provides for the transfer of assets from the RMPP to a fund established by the Secretary of State for this purpose (the 'Fund').

7.17 The calculations under the Transfer of Assets Order value the liabilities and the assets of the scheme as at 31 March 2012, and then provide for some of the assets to transfer to the Fund. On 1 April, after the historic liabilities have been removed, the RMPP will only retain liabilities for the salary link (described above in para 7.9) (as well as any new accrual from 1 April 2012). Under the Transfer of Assets Order, the RMPP will be left fully-funded in respect of the salary link liability as at the effective date of calculation.

7.18 The Transfer of Assets Order further provides that an actuarial valuation will be undertaken as at the 31 March 2012 to determine the amount of assets required to fully fund the salary link liability and sets out the actuarial assumptions that will underlie that valuation. In accordance with Ministerial commitments made during the passage of the Act, the assumptions are based on those that applied at the last triennial valuation undertaken by the Trustees of the RMPP at March 2009. (See, for example, Public Bill Committee, Postal Services Bill, 30 November 2010; Hansard: Column 447)

7.19 It is not possible to calculate the exact split of assets and liabilities between the Fund and the RMPP in advance. However, based on the latest available actuarial assessment of the funding position as at March 2012, it is estimated that the salary link liability would be valued at around £2.5bn. Hence, of the around £40bn of liabilities of the scheme £37.5bn would transfer to the RMSPS, whilst around £28bn of the £30.5bn of assets would transfer to the Fund

7.20 In practice the assets of the RMPP will transfer to Government in stages reflecting the fact that the provision of accurate membership data and consequently the actuarial valuation will take some time to complete. The Transfer of Assets Order makes allowance for this staggered approach, in particular by providing for an investment buffer to be retained by the RMPP between the initial and final transfers of assets to minimise the consequential impacts of any changes in data or relevant market conditions between the assets transfers on the RMPP.

- ***Consolidation***

7.21 Not applicable

8. Consultation outcome

8.1 Under section 25 of the Act, the Government is required to consult the Trustee of the RMPP and the Royal Mail on the Pensions and Assets Transfer Orders. In practice these instruments have been developed in close and collaborative consultation between BIS officials, and executives from the Trustee company and the Royal Mail in order to ensure, for example, that the complex provisions required to establish the RMSPS scheme and the changes needed to the RMPP rules dovetail in a way that ensures active members will receive combined benefits from the two schemes that at the point of implementation are at least as good as they would have received had Government not intervened. The Trustee and Royal Mail support the Government's action in relation to removal of the pension deficit and the detail of implementation of this policy objective as contained in the secondary legislation.

8.2 Member representatives have also been consulted on the content of the Pensions and Assets Transfer Orders. On 31 January, a consultation meeting was held with the Royal Mail unions - the CWU and Unite CMA - and the National Federation of Occupational Pensioners (NFOP) who represent a significant proportion of the pensioner membership of the RMPP. Opportunity was provided for these groups to provide further comment after the meeting.

8.3 The Government's intervention in relation to the Royal Mail deficit as provided for in the instruments is broadly welcomed by these groups and no issues were identified in relation to the operation of the legislation during consultation. Concerns were raised by the CWU in relation to the any changes that might be made to future pension provision after the implementation of the legislation. As maintained during the passage of the Act, the Government continues to consider that future pension arrangements are a matter for the employers, the Trustee and the members.

8.4 Member representatives will continue to have a voice once the RMSPS is up and running. As part of the administrative arrangements for the operation of the RMSPS the Government has constituted a governance group - charged with monitoring the operation of the RMSPS - that will include representatives from the CWU, Unite CMA and NFOP and a member nominated pensioner representative.

9. Guidance

9.1 Not applicable

10. Impact

10.1 The impact on business, charities or voluntary bodies is restricted to the impact on Royal Mail as described in the Impact Assessment that accompanied the Act as quoted below.

10.2 The impact on the public sector is as described in the Impact Assessment that accompanied the Act as quoted below.

10.3 An Impact Assessment has not been prepared for this instrument as a full Impact Assessment was prepared for the Act and the figures are commensurate. Relevant extracts as follows:

> "The transfer of historic liabilities and assets from Royal Mail to Government results in a benefit to Royal Mail (£10.3 bn - point figure from 2009 triennial valuation), and a corresponding cost to Government (and the taxpayer). This does not result in any net economic gain or loss because the deficit is no larger or smaller than before the transfer. The net economic impact of this aspect of the proposal is in itself therefore nil." (*Postal Services Bill 2010 Impact Assessment*, p. 39, paragraph A11)
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> In addition, the summary of analysis and evidence of the costs and benefits of implementing the Hooper review package of measures in the Impact Assessment estimates that the new pensions provisions implementation costs are at £278m (present value) over 10 years; whilst the pension administration benefits are estimated at £249m (present value). The deficit of the RMPP is also

listed as a cost to HMG of between £8.4bn and £10.3bn (present value) (*Postal Services Bill 2010 Impact Assessment*, p. 3)

http://www.bis.gov.uk/assets/biscore/business-sectors/docs/p/10-1204-postal-services-bill-impact-assessment.pdf

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The instruments provide for a one-off removal of the Royal Mail's pension deficit by the transfer of liabilities (and commensurate transfer of assets) out of the RMPP. Monitoring and review is therefore not applicable.

12.2 The management and administration of the new government scheme (the RMSPS) will be monitored by the governance group described in paragraph 8.4 above.

13. Contact

Andrew Maggs at the Department for Business, Innovation and Skills Tel: 020 7215 5708 or email: andrew.maggs@bis.gsi.gov.uk; can answer any queries regarding the instruments.