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"Postal union's pensions plan doesn't deliver what it claims"

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After months of toing-and-froing, the Communication Workers Union is now balloting Royal Mail employees on industrial action. Will posties strike over their pensions?

As part of privatisation in 2012, the government took on Royal Mail's £38 billion pension liabilities, £28 billion assets and £10 billion deficit, so Royal Mail is liable only for the £6 billion of pension promises it has made since then.

Like most other UK companies, it is replacing its expensive defined-benefit pension, costing about 30 per cent of salary, with a much cheaper defined-contribution pension, at around 13 per cent of salary. Closing the DB plan also removes the risk that Royal Mail has to pay for deficits if assets underperform or if members live longer than expected.

Royal Mail is also offering a "Cash Balance" plan, guaranteeing that members get their cash contributions back (a very limited guarantee), with the possibility of an unspecified bonus.

The union has been pushing what it claims is a new type of pension: the "Wage in Retirement", with "risk-sharing" between employees and employer, for all 140,000 Royal Mail employees, including 50,000 in the present DC plan.

Although Royal Mail has rejected this idea, could the "new" union pension really work as a halfway house between DB (with the employer taking all the risk) and DC (the employee taking all the risk)?

The union pension would guarantee one sixtieth of salary a year, like the present DB pension, with a slightly higher retirement age, linked with the state pension age, and lower annual pension increases, linked with the consumer prices index, not the retail prices index. However, unlike the present DB pension, the new pension would not guarantee any annual inflation increase in the pension earned up to retirement: a £500 pension earned age 35 could still, in theory, be £500 at retirement, much less adjusted for inflation.

Despite its claims, the union's "new" type of pension is not new. It is merely a less generous, and therefore cheaper, DB plan, with Royal Mail still on the hook to guarantee a pension for life, exactly what it wants to avoid.

And here's the rub. Although this new DB pension is cheaper, the union wants Royal Mail to take much, much more investment risk.

The existing DB pension plan, with a high proportion of matching bonds, has low investment risk for Royal Mail, but the new plan would hold a much higher proportion of assets in equities, property and infrastructure, not low-risk bonds. The union claims that these assets would outperform liabilities over time and that the surplus would be used to give discretionary inflation increases; in practice, members would get pretty much the same as the present pension.

Despite the union's claims, there is no "risk-sharing" between employees and employer. Rather, it is "heads-we-win, tails-you-lose". A surplus means that members may get a discretionary increase; a deficit means that Royal Mail must make deficit contributions. Each discretionary increase would ratchet up the value of pension liabilities that Royal Mail is guaranteeing, but the increases could not be clawed back if there was then a deficit.

Even if Royal Mail did agree to a less generous DB plan, holding equities, why should it use any surplus to give increases to members, rather than simply reducing its annual cash contributions for new pension promises? Discretionary increases would hit Royal Mail's annual profits and, if the new pension ended up being the same as the existing pension, as the union expects, the overall cost would be identical.

The union's proposal is smoke and mirrors, based on faulty economics. It is a fully-fledged DB pension, with Royal Mail taking on much more investment risk and with employees, not the company, benefiting from any surplus. Rather than pushing a half-baked "new" DB plan, the union should concentrate its energies on getting Royal Mail to pay the highest possible annual contribution to the new DC plan.

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