Mineworkers' Pension Scheme

Member Update – a message from the Chairman of Trustees

July 2019

Mineworkers' Pension Scheme

Dear Member,

I am writing to you, on behalf of the Trustees, following a recent debate in Parliament on the Mineworkers' Pension Scheme, during which a number of MPs were lobbying the government to undertake a review of the Scheme's surplus sharing arrangements.

We thought it would be helpful to share our perspective on this important debate, to tell you what we're doing to improve the Scheme for members, and to recap on how the Scheme currently works.

1. The current situation

To help you understand the changes which might be made to the Scheme, and how they might benefit you, I would like to start by outlining how the Scheme currently works. Firstly, I will look at the Scheme's assets, and secondly at how members' pensions are made up.

Scheme assets

The Scheme at 30 September 2018 had total assets of nearly £12 billion, split into four sub-funds - two of which will be used to pay members' pensions (referred to as 'Member Assets') and two which, under the rules of the Scheme, are due over time to be paid to the government (referred to as 'Government Assets') – see below.

Scheme assets at 30 September 2018

	Assets (£m)
Member Assets	
Guaranteed Fund	7,883
Bonus Augmentation Fund	1,938
Sub-total	**9,821**
Government Assets	
Investment Reserve	1,130
Guarantor's Fund	1,028
Sub-total	**2,158**
Total	**11,979**

Member Assets total just over £9.8 billion and these need to be sufficient to fund all members' pensions throughout their retirement, a period estimated to last until around 2070. After allowing for future expected investment returns, £9.8 billion is currently estimated to be just enough money to pay the guaranteed pension and current bonuses throughout the life of the Scheme.

The Government Assets represent its share of surpluses from previous valuations both since privatisation of the coal industry in 1994 (the Guarantor's Fund) and before privatisation (the Investment Reserve). These assets are not available to pay member pensions, unless the Scheme is in deficit and the guarantee required. The Scheme's rules dictate that this money will be paid to the government over time and without a change of government policy, this money is not available for members.

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How pensions are made up

Each member's pension broadly consists of two elements – a guaranteed pension and a bonus pension. The guaranteed pension is paid from the assets in the Guaranteed Fund and the bonus pension from the assets in the Bonus Augmentation Fund.

An average pension is around £84 per week, made up as shown below. Many members receive much smaller pensions than this because pensions earned for service before 1975 were small and many members had little service after 1975, when the Scheme improved and became linked to earnings.

How an average weekly pension is made up

	£ per week
Guaranteed pension	65
Bonus pension	19
Total	**84**

The guaranteed pension increases by inflation each year and cannot be lost.

The bonus pension is the additional pension provided to members from the good investment returns made on the Scheme's assets. These bonus pensions depend on the future performance of the Scheme's assets and could go up, down or stay the same. Under current rules, if the Scheme is in surplus at a valuation, 50% of that surplus can be used to fund new bonus pensions. The other 50% is moved to the Guarantor's Fund and paid to the government over the following ten years.

However, if the Scheme is in deficit, members' pensions go into 'standstill'. This means that members' total pensions would not increase. For example, for the average pension of £84 per week (shown above), the guaranteed pension of £65 would increase in line with inflation, but the bonus pension of £19 would reduce by the same amount so that the total pension 'stands still'. In this situation, if investment returns are low for a long period, as some experts are suggesting is possible, members may experience a prolonged period during which their pension does not increase, so that they lose purchasing power, and eventually the current bonus pension could be lost entirely.

It is very important to remember that members' pensions are backed by a government guarantee. This is the most important part of the way the Scheme works. Under the guarantee, the total pension paid can never reduce, even if investment returns are poor. Without the guarantee, the Trustees may need to adopt a lower risk investment strategy in an attempt to protect members' pensions, but this would lead to lower investment returns and at the current time would make it highly unlikely that there would be a surplus at any future valuation. As a result, it would not be possible to award new bonuses to members.

2. Changes to the Scheme which would benefit members

Changes to the MPS Scheme rules which might benefit members can only be made if the government agrees to such changes.

As Trustees, our primary responsibility is to manage the Scheme within its existing rules and we must take into account the best interests of all members when making decisions. However, in addition, the Trustee Board also has an ongoing focus on how changes to the Scheme rules might benefit members. When thinking about potential changes we take into account the complexities of the way the Scheme works as well as being realistic about what might be achievable. For example, a transfer of funds from the 'Government Assets' to the 'Member Assets' would be very beneficial to members, but of course the government would have to agree to such a change to the Scheme rules.

The Trustees believe that there are two types of rule changes which might benefit members, both of which we would, at the current time, support:

- Changes to the surplus sharing arrangement in members' favour
- Changes which protect bonuses so that they can't be lost

The Trustees have thought very carefully about both of these possibilities.

Changing the surplus sharing arrangement

Since privatisation in 1994, any surpluses in the Scheme at valuations have been shared 50% for members and 50% for the government. In the past, the Scheme's Trustees have asked several times for changes to this ratio, to increase the percentage going to members, but on each occasion the government of the day has declined the request.

The surplus sharing arrangement only comes into effect if there is a surplus at the valuation which, as highlighted later in this letter, is not always the case. When there is a surplus, the amount of new bonus pensions will depend on the amount of that surplus.

	50%/50%	**75%/25%**
Guaranteed Fund Surplus	£500m	£500m
Amount used to pay bonuses	£250m	£375m
Amount payable to the government	£250m	£125m
Average weekly pension		
Guaranteed pension	£65	£65
Bonus pension	£19	£19
New bonus pension	£1.09	£1.63
Total	**£85.09**	**£85.63**

The table on the previous page shows how this works. With the current 50/50 surplus sharing arrangement a healthy surplus in the Guaranteed Fund of £500m would enable the Trustees to award a new bonus worth around £1.09 per week, to a member with an average pension, over each of the next three years. If the share of surplus taken by members was increased to 75%, for example, then the Trustees would be able to award around an additional 54 pence per week. If the surplus was £1bn then the additional pension resulting from the change would be around £1.08 per week and so on.

While a change in the surplus share would of course be very welcome, this simple example illustrates clearly that in the absence of strong investment returns and a large surplus the impact on member pensions would be incremental not transformational. Moreover, and importantly from our perspective, targeting a large surplus requires an investment strategy which involves risks which could, in some circumstances, lead to deficits and 'standstill'. Current bonuses would not be protected.

Protecting bonuses

As previously explained, if there are deficits at future valuations, bonus pensions can be lost. Bonus pensions make up a substantial part of members' pensions, so we are very conscious that losing them would cause hardship. Protecting bonuses would extend the government guarantee to cover all current bonus pensions. Or, put another way, protecting bonuses would mean they can no longer be lost.

With current bonuses protected, if the scheme was in deficit following an actuarial valuation, an average member's original guaranteed pension would increase in line with inflation (say 3%) from £65 to £66.95 per week, while their bonus pension would remain fixed at £19. As a result, their total pension would therefore rise from £84 to £85.95 per week. Without protection, members' pensions might increase by less than this, or not at all. Moreover, as noted earlier, if investment returns are low for a long period, the standstill mechanism can mean that members do not receive any increases to their total pension for several years.

Since 1994 there have been five surpluses and three deficits at the three-yearly valuations, so unfortunately a loss or reduction of bonus pensions is a realistic possibility. For these reasons, we believe, at this time, that protecting current bonus pensions for the life of the Scheme would be of very significant value to members. An important further benefit of a rule change which protected current bonuses would be that with today's total pensions guaranteed, the Trustees could confidently manage the Scheme's assets with a view to targeting the investment returns needed to generate additional bonuses for members.

3. The Trustees' perspective on possible changes to the Scheme's rules.

The **government guarantee is a critical feature of the MPS**. Simply put, as previously explained, the Scheme would not work without it. We would not contemplate changes to the Scheme rules that compromised the guarantee in any way.

We would, of course, welcome a change to the **surplus sharing arrangement** in members' favour. However, we recognise that a change in surplus share would only benefit members if the Scheme is in surplus at future valuations and even then the benefit would only be material if the surplus was significant. A change in the surplus share would still leave current bonuses exposed to risk.

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Protecting current bonuses would address this risk and would mean these bonuses could no longer go into 'standstill' following the 2023 or future valuations. For example, looking at the average weekly pension, the £19 bonus pension could never be reduced and would always be paid in the future. And of course, should investment returns be good, and a surplus declared, members would continue to benefit. For this reason, at the current time, we believe that **protecting current bonuses** would be of most value to members.

We have therefore made proposals to the government which are designed to achieve this objective of protecting bonuses. We were delighted to hear Andrew Stephenson MP, minister with responsibility for the MPS, state that he is supportive of our proposals and that he has written to Treasury to register his support. We have subsequently met with Mr Stephenson and he has confirmed this. This does not mean that the government has agreed to make our proposed rule changes or that it will eventually do so. However, we are encouraged that our proposals have been well received and are now being considered.

Your pension will increase steadily between now and 2023

I hope that my comments about the risk to current bonuses haven't caused alarm. I cannot deny that this risk is real and that is why we have been so focused on finding a solution. However, I can reassure you that, as a result of what was achieved at the last actuarial valuation, your total pension is guaranteed to increase steadily until September 2023. The bonus pensions awarded to date will be paid over that period regardless of investment performance.

Thank you for reading this letter. We know the MPS is a complex pension scheme to understand and that there is a lot of information above. We will keep you informed about discussions with the government through Pensions Newsline and the MPS website. If you would like any further clarification on points in this letter, please contact the Scheme Secretary by emailing the Trustees Office at **mps.enquiries@coal-pension.org.uk** or by writing to MPS Scheme Secretary, Coal Pension Trustees Services Limited, Ventana House, 2 Concourse Way, Sheffield S1 2BJ. You can also visit the MPS website at **www.mps-pension.org.uk** for general information on the Scheme.

Chris Cheetham

Chris Cheetham
Chairman of Trustees
Mineworkers' Pension Scheme

Summary

- We are very focused on securing changes to the Scheme's rules which have the most potential to benefit members. At the current time we believe that changes designed to protect bonuses would have very significant value to members.
- We can assure you that your pension will increase steadily until 2023 whatever happens to the Scheme's assets. Any changes agreed now would impact the way the Scheme works from 2024.