

LLOYDS BANKING GROUP HARMONISATION OF TERMS AND CONDITIONS

FOCUS ON PENSIONS AND RETIREMENT- THE DETAIL BEHIND THE PROPOSALS

This more detailed bulletin provides much more information about how the proposals for pensions changes could affect our members in real terms and follows on from our update no:2 issued to members recently.

Members are reminded that Unite has rejected the proposed package of proposals including the pensions changes. We will not consider agreement unless we believed our members were happy for us to do so through democratic means of consultation.

Pensions is a complicated subject meaning many people tend to switch off, make wrong assumptions or worse still think everything will be ok if they ignore it.

Here are some questions and answers which should help to make things clearer. These are not intended to give members advice about what action to take regarding their own pension provision. Unite cannot provide such advice and members should seek advice independently.

EFFECT OF EMPLOYER'S PROPOSAL TO CAP GROWTH IN PENSIONABLE PAY

How are final salary scheme pensions currently calculated?

When you come to retire a calculation is made based upon how many years service you have completed and your pay in the final 12 months of your employment. Members accrue their pension at the rate of one 60th of their final years pay multiplied by the number of completed years service.

Therefore someone with 30 years service could receive a pension of 30/60ths (in other words 50%) of that final years pay figure. This is a simplified explanation as periods of part time service are taken into account and there are some slight differences between the schemes in the definition of the final years pay. However this example is only intended to be a general guide.

What changes have been proposed by LBG?

For those colleagues who are members of the Defined Benefits (or Final Salary) pension schemes, Lloyds Banking Group (LBG) proposes that growth in the pay used to calculate pensions in the defined benefit pension schemes be capped at 2% each year, or RPI (rate of inflation) if lower. In simple terms what this means is that

- the salary figure used to calculate your pension when you retire, can only increase by a maximum of 2% each year
- this would be a maximum of 2% of your pensionable salary not your actual salary
- in the vast majority, if not all cases, your pensionable salary would be lower than your actual salary and the gap would only widen between the 2 figures year on year
- if your pay rise in any year was lower than 2% or RPI your pensionable pay would increase by the amount of your pay rise
- if you didn't get a pay rise in any one year your pensionable salary would not increase. You could call your pensionable salary a shadow salary if you like
- future reward or pensions statements would in future show your actual salary and the salary that would be used to calculate your future pension.

For example in the first year after this capping took effect for someone earning £20,000 year who receives a 3% pay rise, and the rate of RPI is 1.5% it means.

- 1) your actual annual salary would increase by 3% to £20600

2) your pensionable salary would increase by 1.5% to £20300 (you could call this a shadow salary)

If the same thing happened the following year

1) your actual salary would increase to by 3% to £21218

2) your pensionable (or shadow) salary would rise by 1.5% to £20605

In the third year

1) your actual salary would increase by 3% to £21855

2) your pensionable (or shadow) salary would increase by 1.5% to £20914

This demonstrates that for every year when your annual pay increase was more than 2% (or the rate of inflation if that was lower than 2%) the gap between your actual salary and the salary that would be used to calculate your pension when you retire becomes wider and wider. Remember as well that if you didn't get a pay rise in any one year your pensionable (or shadow) salary would not increase.

Should members expect better or worse pensions as a result of the change?

LBG has given no comparisons in the announcement. However active members are likely to be worse off and in some circumstances very substantially worse off. Deferred and pensioner members are not affected.

What is the main effect for active members?

The effect can be severe as members will be exposed to substantial inflation risk. If price inflation is higher than 2% over the period to retirement, the purchasing power of active members' pensions at retirement will be eroded. If inflation is very high then the pensions become less and less valuable. Previously LBG carried the inflation risk and members' purchasing power was protected so long as pay kept pace with price inflation. Members would now also lose benefit for any difference between future pay growth and inflation and no extra pension will be earned for promotional increases which might take a member over the 2% annual cap.

Why does inflation matter when it is currently below 2%?

Inflation is low because the calculation includes the impact of recent reductions in commodity prices, energy prices and mortgage rates. However these effects will fall out shortly and inflation is expected to rise.

It matters because the difference in outcome between the proposed capped pension and the pension on the current system is very sensitive to future inflation and the impact becomes more acute at higher rates of inflation.

What could happen to inflation in future?

The Bank of England publishes an implied inflation curve. This suggests that inflation will average 3.1% over the next ten years and 3.7% over the next twenty years. So inflation might be 3.5% or more over the working lifetime of the current active members. There is also the unknown effect of 'quantitative easing', the printing of money to prop up a financial system damaged by the banking meltdown. The scale of this stimulus is generally expected to lead to higher inflation at some point, perhaps significantly higher. It is ironic that LBG seeks to pass the inflation risk to members when its own rescue may ultimately contribute to higher inflation.

Is there protection for pension for service already completed?

No. The cap also applies to pension for past service in as much that all of your service including that already completed would be used to calculate your pension based on your shadow salary when you retire not your actual salary.

Members would have been expecting to have that past service "in the bag" in terms of calculating pension based on those past years service but at the salary being earned when you retire - not some unknown shadow salary. Press comment has called the proposals 'sneaky' because of this retrospective effect. A shocking aspect of the proposal is that it could leave active members with significantly lower pension at retirement for service to date than the pension they would get if they left today. Members who withdraw from the scheme will have a leaver's pension that revalues at inflation capped at 5%, not 2%. This has not been explained to members. Of course members remaining in the scheme would accrue further years service but on a capped salary.

How can LBG worsen past service?

Pensions and trust law protect pensions already earned. Generally it is only possible to worsen accrued benefits in a pension scheme by obtaining members' informed consent. However LBG are not proposing a change to the pension scheme. They are proposing to redefine pay in a way that can significantly reduce pensions for past service and they are doing so without explaining the consequences. Pensions are complex and the danger is that many members will not appreciate the impact in time to do something about it.

What is the effect on future service?

The scheme will continue providing new defined benefit pension for members but on significantly worse terms. However, the reality is that members can effectively end up paying for a proportion of their new benefit through the worsening of terms for past service.

How could the proposals affect a 40 year old with 20 years past service if inflation is in line with the Bank of England analysis?

Assuming the member continues in active service over the twenty years until retirement at 60 the impact is:-

- Instead of a pension of two-thirds of final pay the member would expect a pension of just over one-third of final pay. Half the pension is lost.
- The total pension, including pension for future service, will barely reach the pension currently expected for past service. More than nineteen years of the twenty years future service pension is needed to repair the damage to pension already earned. The continuation of future service is effectively paid for by the member.
- Past service will be worth less as an active member than as a leaver. Around seven years of future service pension is needed just to bring the pension back into line with the pension for a leaver.

These figures assume that future inflation averages 3.5% over the period and future real increases in pay are 2% pa (for market adjustments and promotion).

And if inflation is higher?

In the above example if inflation averages 5% instead of 3.5% the impact becomes:-

- Instead of a pension of two-thirds of final pay the member would expect a pension of around one-quarter of final pay.
- The total pension, including pension for future service, will be less than the pension currently expected for past service - new accrual does not compensate for the damage caused by the retrospective change to past service.
- Sixteen years of future service are needed to rebuild the pension to the level of a leaver.

If inflation were to be much higher, at 10% say, then:-

- The total pension will be one-tenth of final pay and is becoming worthless.

Inflation is not at 10% now, but this scale of inflation is not unprecedented. The last time inflation ran out of control was in the 1970s when it averaged 13%. The question is why members should have the risk imposed on them, especially when government policy is that pensions from accrued service should be protected against inflation.

What should a 50 year old with 30 years past service look out for?

An older active member will be affected in a similar way to the examples for the 40 year old above, though the impact is less because inflation has less time to reduce the pension. If inflation were 3.5% the 50 year old might get around half of final pay, rather than the two-thirds currently expected. If inflation were 5% the benefit might be 40% of final pay and if inflation were 10% it might be a quarter of final pay. The assumptions behind this are as above.

How does capping affect those at the top of their pay band?

Being at the top of the pay band does not make the inflation impact any less acute. Pay bands generally increase each year according to the bank's market data making future pay rises possible (though not guaranteed). This market movement has quite often been similar to the rate of inflation. Where market movement in the pay scales is higher than 2% the proposal means that as actual pay may stay at the top of the band, capped pensionable pay moves down the band.

Would high inflation be bad for scheme funding and LBG?

No. In an era of high inflation, the capped scheme would be expected to generate surpluses and these surpluses could be returned to LBG. Surpluses are likely because return-seeking assets would be expected to provide high rates of return when inflation is high, but the liabilities would be capped under the proposal. There is therefore the prospect of LBG profiting as members pensions decline sharply.

Are benefits unchanged if inflation stays below 2%?

No. Active members lose benefit for the difference between future pay growth and inflation and no extra pension is earned for promotional increases which might take a member over the annual 2% cap. If inflation is expected to remain below 2% there is no reason in Unite's view to put in a cap at 2%.

If the proposal goes ahead, would members be better off withdrawing from the scheme and joining the new DC scheme?

Unite will not and should not give any member advice about what to do about their own individual pension provision. Individual specialist advice would be needed.

However, members need to understand that if they withdraw from the scheme freezing their past service entitlement they would have a leaver's pension that revalues at inflation capped at 5%, not 2%. This, together with a joining and making contributions to the Defined Contribution scheme, could give a higher benefit outcome than the capped scheme, if inflation does increase. However, members remaining in the scheme would accrue further years service albeit at the capped salary. The member's decision will depend on the view taken of future inflation and also on the member's precise circumstances and attitude to risk etc. However, withdrawing may affect death-in-service benefits (spouses pension for example though not lump sum death benefits).

How could the proposal be modified?

Unite are considering a number of counter proposals which could be put to the company which if agreed may be more palatable to members whilst still giving the Bank the certainty on cost which they so desperately are seeking to do by bringing forward these proposals. We will communicate further on this in due course.

RETIREMENT AGE

Some members have taken it from the Banks booklet that the retirement Age being set at 65 means they would be unable to access their pension without deductions being made until the age of 65. Alternatively people have taken it that they must remain at work until they are 65.

In fact what it means is that the Bank would expect colleagues to stop work at age 65. Colleagues would not need to give notice that they intended to stop at age 65. Colleagues wishing to continue to work after age 65 would have to request permission to do so. The Bank would have to consider the request but would not have to agree nor give reasons why they did not agree. This is the current situation in LTSB but in HBOS colleagues can currently continue to work past 65 without needing to seek the agreement of the Bank.

Remember:

- Let the Bank have your reaction to the pensions proposals through the Interchange facilities so that they are in no doubt what colleagues think
- Email lbg.support@unitetheunion.org to let us have your thoughts
- Unite is the only union recognised in all areas of Lloyds TSB.
- Unite is the only union recognised in both Lloyds TSB and HBOS
- Unite has a network of 150 MPs and has broad political and media influence
- Unite has a workplace reps structure of 150+ to ensure your voice is heard at negotiations

Only Unite and Accord members will be able to take part in our Consultation exercise in January.

To join Unite you can do so by going on line at www.unitetheunion.org or by calling the LBG helpline on 08081 449595. Alternatively contact your local rep who would be only too happy to help. If you are interested in being a rep, please click on www.unitetheunion.org/lloyds for more information

**Gwyn Bates/ Wendy Dunsmore
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