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2006 ROYAL MAIL PRICE AND SERVICE QUALITY REVIEW

In your recent consultation document you sought views on your proposals on the revision of Royal Mail's price and service quality regulation. The views I am expressing in this letter are those of the Board of Royal Mail Pensions Trustees Ltd which is the trustee of the Royal Mail Pension Plan. Accordingly, this letter responds only to the relevant sections of your consultation document.

We agree with you that Royal Mail should be allowed to fund fully the current pension deficit which on the FRS17 basis, as you state, is considerably larger than the net assets of Royal Mail.

In S8.84 you state that a deficit is expected to remain from April 2006. This is consistent with the interim actuarial valuation results of 31 March 2004 which we expect to be confirmed by the interim actuarial valuation results of 31 March 2005 as the reduction in bond yields and the improvement in mortality rates continue.

We can confirm that the Royal Mail Pension Plan has received the deficiency contributions to date in accordance with the Schedule of Contributions drawn up as a consequence of the 31 March 2003 actuarial valuation results which revealed a deficit of £2.522 billion. The deficiency contributions would extinguish the deficit over a period of 40 years, in accordance with the Trust Deed, although it should be noted that the Trustee has recommended to Royal Mail that the deficit should be repaired over a considerably shorter period.

We support the CMA and CWU strong beliefs that Royal Mail's pension commitments should be fully funded in the next price control.

We agree with Postwatch that Royal Mail should act commercially in dealing with the pension deficit and the ongoing contributions. However, we do not agree with the view

that Royal Mail should not be allowed to pass these costs directly through to customers as for many years customers have benefitted from lower prices as a consequence of the pensions contribution holiday. We would point out that precedence exists in other regulated industries to allow the pass through of defined benefit pension costs to customers.

Turning now to the Hyman Robertson's review, we welcome their view that the pension deficit should be recovered over a shorter period than the 40 years permitted in the Trust Deed and Rules, but we consider that the 20 year period proposed should be reduced. We also note the comments regarding investment strategy which was adopted in 2003. Investment strategy will be subject to formal review again in 2006 when we will take into account, *inter alia*, the maturity of the liabilities, the employer covenant and the deficit recovery period.

Incidentally, we are unsure which basis and date Hymans Robertson have adopted for the allowance for pension deficit contributions in Table 8.12. By basis we mean type of valuation (eg funding, SSAP24 or FRS17) and date (eg 31 March 2003 or 2004). We would welcome clarification on this point and would add that there has been continual improvement in longevity which is not yet reflected in the funding level. The cost consequences of this have not yet been quantified.

In S8.99 you refer to a deficit that has accumulated over a very long period. In reality, the funding situation moved from surplus to deficit in a very short period between 2000 and 2003, due to adverse investment conditions and improved longevity.

You also state that the Trustee has the option of seeking additional funding from the shareholder. However, it is our understanding that there is no guarantee from the shareholder to fund the pension deficit; therefore, in the absence of such a commitment we have to look to protect the interests of the beneficiaries of the Royal Mail Pension Plan.

The Pensions Act 2004 clearly states that a pension fund in deficit is an unsecured creditor of the company. Given the relative size of the deficit and the net assets of Royal Mail, we are of the view that the recovery period should be far shorter than the 20 years proposed and that the company's normal cashflow should be permitted to meet the consequential higher annual contributions that would be required.

In conclusion, while we consider your proposed allowance in the price control - to fund the deficit over 20 years from 2003 and to permit further reduction in the equity exposure - to be helpful, we do not consider that the recovery period proposed is reasonable. A period of ten to fifteen years for a Plan Sponsor with a strong covenant would be more the norm. Where the covenant is uncertain, Trustees require a far shorter period, or indeed immediate deficit repair.

Jane Newell