The Society of Pension Professionals (SPP) response to the DWP consultation, "*Options for Defined Benefit Pension Schemes*"

1. Introduction

1.1. The Society of Pension Professionals (SPP) is pleased that the Government is examining alternative options to the existing regulatory landscape for DB schemes.

1.2. Whilst we have reservations about some of these proposals, we are encouraged by the fact Government is trying to find solutions that help members, employers and the wider economy.

2. Executive summary

2.1. **We welcome the desire to make returning surpluses to employers easier for those that wish to.** The proposed measures to enable extraction of surplus could create an economically attractive rationale for sponsors to run on pension schemes, whilst maintaining a reasonable level of security for members and potentially making discretionary increases in benefits more likely. It also has the potential to support the UK economy through supporting the sponsors of DB schemes, and potentially encouraging schemes to invest more in UK based productive assets (though we would question whether this is likely to be material).

2.2. The proposals are not without risk. Any extraction of surplus would reduce the security of member benefits. As a result, the proposals need to be very carefully considered to ensure an appropriate balance is maintained.

2.3. The SPP has serious reservations about the implementation of a 100% underpin from the Pension Protection Fund (PPF). Whilst we can see that this could have benefits, the cost of accessing the underpin appears to be prohibitively expensive - especially as it would only be accessible to well-funded schemes with strong covenants. Given this we would expect very low take-up from schemes. Moral hazard is also a concern, though we acknowledge that there may be ways that this can be managed.

2.4. A public sector consolidator has many potential benefits. However, the precise rationale for such a consolidator remains unclear and significant care is needed not to disrupt the well-functioning insurance market or stifle the development of the superfund market. If the Government does proceed, then we strongly suggest that the terms for entry are consistent with commercial superfunds. For example, in terms of price, the level of guarantee provided, the ability to adjust benefits and the required gateway tests. We also have significant concerns about the proposal to allow schemes in deficit to enter the vehicle, as that would be a clear commercial advantage and likely lead to significant market disruption.

3. Consultation response

CHAPTER 1: TREATMENT OF SCHEME SURPLUS

Question 1: Would a statutory override encourage sharing of scheme surplus?

3.1. We believe that Government plans to introduce a statutory override could lead to a small increase in the sharing of scheme surplus. However, whilst this would remove a key barrier to sharing surplus for many schemes, it is unlikely to be a driver for change in isolation given existing trustee duties to safeguard existing benefits for members. To be comfortable with returning surplus the trustee board would likely either need to be very confident in the existing covenant support/contingent assets, or be given something in return (for example, additional security or discretionary benefits for members).

3.2. So, in isolation, we would see such an override as “facilitating” rather than “encouraging” the sharing of surplus. However, the introduction of a 100% PPF underpin may provide the security trustees desire if it could be affordable and accessible to a wide range of pension schemes.

3.3. It is also worth noting that for such a statutory override to be effective, fundamental changes will be required to Section 37 of the Pensions Act 1995, as it does not always allow for a return of surplus on an ongoing basis. In particular, the requirement at section 37(3)(d) for the trustees to be satisfied that it is in the interests of the members that the power to pay surplus is exercised is viewed by some as meaning this effectively prevents the power from being exercised.

Question 2: What is the appropriate balance of powers between trustees and employers? Should a statutory override allow trustees to amend scheme rules around surplus at their sole discretion, or should such amendments be contingent on an agreement between trustees and the sponsoring employer?

3.4. Allowing trustees sole discretion to make changes may improve the speed of change and add a degree of simplicity. However, employers would likely have significant concerns if the trustees had unilateral power to amend surplus rules, noting that trustees could then choose to allocate surplus wholly to members rather than share with the sponsor.

3.5. We therefore believe that agreement between trustees and the sponsoring employer is important for the use of any statutory override.

3.6. There are some schemes where the amendment power in the rules may not be a joint decision, but we believe that if the statutory override is being used, then it is sensible to require a joint decision.

3.7. It is also important that policymakers give due consideration to multi-employer arrangements.

3.8. Finally, we also consider that any statutory override should apply both where a scheme is ongoing and where it is in winding-up. Some schemes do not allow repayment of surplus to an employer even on a winding-up.

Question 3: If the government were to introduce a statutory override aimed at allowing schemes to share surplus with sponsoring employers, should it do so by introducing a statutory power to amend scheme rules or by introducing a statutory power to make payments?

3.9. Our preferred outcome would be the introduction of a statutory power to make payments. Indeed, a requirement for amendments to be made to scheme rules would be more onerous for schemes to implement and thus less effective in encouraging the sharing of scheme surpluses.

3.10. That said, the Government would need to ensure that the override legislation was drafted in such a way so as not to cause unintended consequences for schemes, and would need to be accompanied by clear guidance from The Pensions Regulator. For example, is the policy intention to allow the sharing of a surplus where the existing rules require benefits to be enhanced before any surplus is returned?

Question 4: Should the government introduce a statutory power for trustees to amend rules to enable one-off payments to be made to scheme members, or do schemes already have sufficient powers to make one-off payments?

3.11. Schemes do not routinely make one-off payments even if they have the powers to do so.

3.12. This is not simply a matter of scheme rules. Instead it is widely acknowledged that one-off payments are not made because of the substantial tax implications of making such payments. Making one-off payments to members 'authorised' would remove the main tax barrier but there are others e.g. implications for the annual allowance and state benefit eligibility etc.

3.13. It is also challenging to treat all members equitably due to the difficulties inherent in making one-off payments to non-pensioner members (e.g. members under age 55 not being eligible, bank details not readily available for over 55s).

3.14. In practice, greater flexibility around one-off payments would be welcome. There are different ways of doing this. One option would be to create a new lump sum authorised payment (being a lump sum return of surplus). To avoid complexity, the legislation could provide that the payment of such a lump sum does not affect a member's Lump Sum Allowance, Lump Sum and Death Benefit Allowance or annual allowance. This lump sum could also be payable to members who have not reached normal minimum pension age.

3.15. Another option could be for a scheme to grant members a cash balance benefit from which members could then take an UFPLS (schemes are unlikely to want to provide money purchase benefits because of the increased governance requirements connected with providing such benefits).

3.16. This is a complex area and would perhaps benefit from a separate consultation, with different options for how the one-off payments might be structured set out in more detail.

Question 5: What impact, if any, would additional flexibilities around sharing of surplus have on the insurance buyout market?

3.17. Easier return of surplus easier would, in theory, result in a lower demand for insurance buy-outs in the short term, as schemes' funding levels would reduce making buy-out less affordable.

3.18. However, in isolation we do not believe this policy change would result in a significant number of schemes choosing to return surplus, as it would be difficult for a trustee to conclude that it was in the best interests of their scheme's members to do so. Those that do choose to do this would likely be larger schemes, where running on in the long-term is a more viable option due to economies of scale and access to different investment opportunities, and those with very strong covenants. Alternatively employers that can offer contingent security may be able to reach agreement with trustees.

3.19. That said, if these proposals were supplemented with a viable and affordable option for a 100% underpin from the PPF, a number of schemes may opt to run on over the long term, which could therefore have a significant impact on demand for insurance.

Tax treatment of surplus

Question 6: What changes to the tax regime would support schemes in delivering surpluses to distribute as enhanced benefits?

3.20. We agree that in some circumstances it may be desirable for trustees to more easily be able to make one-off payments to members. However, as also noted above, the tax treatment of such one-off payments is a substantial barrier to these being made and should be reviewed.

3.21. One potential solution would be to ensure alternative tax rules apply under specific circumstances e.g. only under a 'lump-sum' surplus distribution payment. For example, a flat tax rate of 25% could be applied (i.e. aligned with the charge on surplus refund), with no annual allowance charges or reporting requirements. Alternatively, the tax could be at individual's marginal rate (with no annual allowance charge). That said, care would be needed to ensure no loopholes were created.

3.22. The regime should also be designed so that individuals who are in receipt of means-tested state benefits are not negatively impacted.

Question 7: Are there any other alternative options or issues the government should consider around the treatment of scheme surplus?

3.23. The government could enable schemes to pay out DB surplus where it will explicitly be used to fund DC contributions, even when the DC benefits are provided under a different pension scheme, under a more simple and tax efficient process.]

Safeguards

Question 8: Under what combination of these criteria should surplus extraction be permitted? If you feel alternative criteria should apply, what are they?

3.24. We believe that the legislative minimum for surplus extraction should be simple, to reflect that there will be different scheme-specific factors for each scheme to consider. Further guidance would then be needed to separately support decisions on whether to release surplus, which is where we think investment and covenant considerations should come into play (rather than in a prescribed formula).

3.25. There is a range of views amongst SPP members, but on balance we consider that out of the range of options presented, 105% of a low dependency funding basis is the most appropriate, with some prescription required around the low dependency funding basis. Alternatively, the introduction of a 100% PPF underpin could lower this to 100% of a low dependency basis, consistent with the DB funding code.

3.26. The Government could consider setting lower eligibility criteria, which might make it easier for employers to extract surplus, though of course trustees would need to be satisfied around their duties. Indeed, the lower the bar, the greater the impact on the security of members' benefits, and the greater the need for detailed regulatory guidance for trustees to help them exercise their fiduciary duties. As stated previously, we think the majority of trustees would be unlikely to be comfortable releasing surplus given their fiduciary duties, unless additional support is provided or the existing covenant was very strong.

3.27. In any event there would be a risk of trustees feeling under pressure from the employer, especially those trustees that are employees and/or appointed by the employer and hence may be conflicted.

Question 9: What form of guidance for trustees around surplus extraction would be most appropriate and provide the greatest confidence?

3.28. We believe that statutory guidance would be most appropriate. We would not advocate including the guidance in a code of practice as these cannot be easily updated. This is an area where thinking and practice is likely to develop over time and so is important to provide the guidance in a format that can be easily updated.

Question 10: What might remain to prevent trustees from sharing surplus?

3.29. There are many understandable barriers preventing trustees from sharing surplus including sponsor viability, covenant strength, regret risk, member challenge and perhaps most importantly ensuring the security of members' benefits, which are all legitimate reasons for caution and should remain.

3.30. That said, there have been cases where a scheme has been winding-up and the Trustees have decided to pay all of the surplus to the employer notwithstanding that they had a discretion to increase member benefits. In some of these cases, the amount that the employer had contributed to the scheme since it had closed to future accrual was a significant factor in the Trustees' decision making. In our view, this would also be a relevant factor where a scheme is ongoing.

100% PPF underpin

Question 11: Would the introduction of a 100% underpin have a material impact on trustees' and sponsors' willingness to extract surplus? If so, why and to what extent?

3.31. We have previously expressed some reservations about the implementation of a 100% underpin due to the issue of moral hazard.

3.32. The PPF guaranteeing 100% of member payments in the event of employer insolvency would arguably reduce the incentive for the scheme to be carefully managed in the most appropriate way and in some cases may encourage increased risk taking. It is very difficult to quantify the extent of that moral hazard and then to properly account for that in a risk-based super levy.

3.33. However, if the risk of moral hazard could be sufficiently addressed (e.g. with strict eligibility criteria and ongoing requirements in relation to which schemes could benefit from a 100% PPF underpin), we agree that a 100% underpin would allow trustees to feel confident of the security of members' retirement income, and therefore more able to share surplus.

3.34. Indeed, if such a guarantee were to exist, some trustees may consider opting into it as a pre-requisite for surplus extraction.

3.35. There are also certain legal hurdles which would likely need to be addressed in order for the 100% underpin to have a material impact if it were introduced. Firstly, current case law provides that trustees cannot take account of the compensation available under the PPF when making investment decisions. In addition, any PPF compensation must also be disregarded by The Pensions Regulator when assessing whether an employer has acted in a way that has materially affected the likelihood of accrued scheme benefits being received (for the purpose of section 58B of the Pensions Act 2004).

Question 12: Are there other benefits to a 100% underpin that the government should consider?

3.36. The existence of such an underpin would likely encourage the sharing of DB surplus (within the confines of the requirements of the super levy) and encourage more schemes to run on for longer.

3.37. It would also potentially encourage greater risk taking and investing in productive finance, albeit care would be needed to ensure that this was allowable in law (as noted above). That said, it is not clear that these assets would be UK based. Also, it is not clear whether overall the pensions system would have higher level of investments in UK productive finance if, for example, fewer schemes bought out with insurers (who do invest in productive finance) as a result.

3.38. It would also clearly be a positive for members – both because it would grant additional security but also it may encourage the granting of discretionary increases.

3.39. However, all of these benefits would only be the case for schemes who choose to pay the super levy, which as noted below we do not feel will be many given the costs suggested.

Question 13: If you consider a 100% underpin could deliver valuable benefits, what does the government need to prioritise to ensure an effective design? For example, does the way the "super levy" is calculated need to ensure that the "super levy" is expected to be below a certain level? How high a level of confidence does there need to be that the PPF will be able to pay a 100% level of benefits?

3.40. Applying strict eligibility criteria to access the underpin (as suggested above) could substantially lower the cost of the super levy. Providing the underpin to well-funded schemes with a prudent approach would certainly be manageable.

3.41. We consider the proposed cost of the underpin, of at least 0.6% of liabilities on a buy-out basis, to be prohibitively expensive. This rate is likely to substantially reduce take-up, especially given the criteria of requiring the schemes to have an investment grade sponsor and to maintain full funding on a gilts + 0.5% pa measure. The requirement to be locked-in would also reduce demand.

3.42. Again, we note that applying strict eligibility criteria to access the underpin would minimise the risk of the PPF needing to support a pension scheme.

3.43. In addition to lowering the cost, for this to be a success, the Government would need to provide some assurance of levy stability year to year, and/or the option for a scheme to opt-out in future.

3.44. Also, for fairness, the super levy would need to be associated with the risk of each scheme (much like the existing levy framework). For example, related to the investment risk, risk of sponsor insolvency and amount of underwriting required above core PPF benefits. It is not clear from the consultation whether that is what you envisage.

3.45. There would need to be a very high degree of confidence that the PPF will be able to pay a 100% level of benefits in the event of a claim in order for there to be any meaningful take-up.

3.46. There would also need to be clarity on what would happen if the funds built up were less than the amount required to cover claims.

Question 14: Are there other methods outside of the PPF that could provide additional security to schemes choosing to run on?

3.47. The recent transfer of the Debenhams pension scheme to Clara demonstrates a viable commercial alternative to pension schemes which are seeking additional security and positive member outcomes. It is also noted that other third-party capital-backed solutions are available for pension schemes that do not require the transfer of assets and liabilities to a consolidator.

3.48. We would welcome greater flexibility and innovation to allow schemes to run on in an insolvency scenario. This could result in better outcomes for members rather than forcing schemes to do an insurance buy-out or consolidator transaction.

3.49. Other forms of security include contingent assets such as Asset Backed Funding or escrows, and/or additional guarantees whether from wider company groups or banks / insurers.

CHAPTER 2: Model for a public sector consolidator

Eligibility

Question 15: Would the proposed approach to eligibility allow schemes unattractive to commercial providers to access consolidation? Would it be attractive to such schemes?

3.50. We have sought to answer this question as comprehensively as possible but it is challenging to do so when the objectives of a public consolidator remain unclear. As the Work & Pensions Committee stated in their DB Pensions report last month, *"…the Government should explain whether the core aim of a public consolidator is to rescue stressed schemes likely to enter the PPF in any case, or is it for small schemes who may face challenges accessing the buy-out market."*[1] Or indeed for some other purpose such as the productive finance agenda.

3.51. In our experience, difficulties for smaller schemes in obtaining insurance quotes are generally solvable. Where problems have arisen, e.g. difficulties in obtaining quotes, these have been resolved by better preparation before approaching the market; waiting for an available slot in the insurer's pipeline or accepting exclusivity. It is also noted that recent new entrants to the insurance market are likely to target such schemes.

3.52. The superfund market is still developing and is expected to become a consolidation option for smaller schemes over time, and other commercial consolidators (e.g. master trusts) are available for smaller schemes too.

[1] **DWP Select Committee, "Defined Benefit Pension Schemes" 20 March 2024: https://committees.parliament.uk/publications/44035/documents/218268/default/**

3.53. The proposed approach for the PPF consolidator (especially eligibility and pricing proposals) is likely to be attractive to smaller schemes, and indeed to all schemes, regardless of size (on which we comment further below).

3.54. In order for the “less attractive”’ schemes to be able to access consolidation, policymakers would need to restrict entry / prioritise these schemes in some way – for example through a series of gateway tests.

<u>Question 16: Is setting the consolidator a duty to accept transfers from schemes unattractive to commercial providers and mandating certain design features (for example, benefit standardisation) and ensuring no unfair advantage sufficient to limit impacts on commercial alternatives? If not, what alternative approaches would you recommend?</u>

3.55. No. We believe that the bulk annuity market is a thriving, well-functioning one and the establishment of a public consolidator could disrupt this. It could also dissuade new entrants from both the bulk annuity market and commercial superfund market.

3.56. A public sector consolidator as proposed could have a number of significant advantages over existing insurers/superfunds:

- Whilst the proposed capital-backing arrangement is expected to be ring-fenced and limited in nature, it will still likely be seen as a stronger arrangement than any commercial-backed entity given it has been established by Government
- Proposed pricing is materially better than currently offered by the private sector insurance regime, albeit similar to superfunds
- The possibility of transferring to the new consolidator whilst still having a deficit is a clear commercial advantage
- Many schemes will view the need to change benefit structure as being an advantage, rather than something to be avoided, as this is a greater flexibility than currently allowed with insurers/superfunds.

3.57. Without appropriate controls and limits, the current proposals would likely lead to the public sector consolidator (at least in part) displacing the UK DB pensions framework, potentially impacting the UK economy in a negative manner.

3.58. If the Government wishes to minimise market disruption we recommend:

- Removing the option to transfer in with a deficit
- Ensuring the powers to amend benefits on entry into a private sector vehicle are consistent with the public sector consolidator
- Ensure consistent pricing and security provided with the existing superfund regime
- Schemes be subject to “gateway” tests that are at least strict as the existing superfund regime; and
- Careful consultation with existing insurers and superfund providers on the criteria used to determine whether a scheme is “unattractive” to them, and for this to be subject to annual review.

<u>Question 17: Would a limit on the size of the consolidator be needed? If so, how might a limit on the size of the consolidator be set? Would limits on capital and a requirement to meet the same capital adequacy requirements as commercial consolidators suffice, or are there alternatives?</u>

3.59. The need for an overall size limit would be determined by the entry criteria. If schemes with deficits and schemes that could achieve a private sector solution were not allowed (as is our preference), and the terms were on the same basis as commercial superfunds, then there would likely be no need for a size limit.

3.60. If looser entry criteria are used, then a limit of the capital put forward could help to manage the risk of market disruption. To avoid market disruption, the amount of capital should be sufficiently low as well as at a level which the Government would find an acceptable risk.

3.61. It is also worth noting that having more demand than capital available would create its own challenges. A specific priority order would need to be established to enable the consolidator to know which schemes to prioritise for onboarding.

3.62. In this instance we would suggest that the consolidator targets smaller schemes, given larger schemes are more easily able to achieve a solution from the private sector. However, the priority order should reflect what the Government is trying to achieve – something that this consultation does not make clear.

Question 18: How in practice might the public sector consolidator assess whether a scheme could access a commercial consolidator?

3.63. We strongly encourage Government to consider the views of existing insurers and superfunds in setting this criteria, and for this to be subject to regular (e.g. annual) review.

3.64. Schemes in deficit should not be allowed to transfer to the public sector consolidator, as that is a clear commercial advantage and would disrupt the market. However, if this were allowed then clearly having a deficit would be one way of assessing whether a scheme could access a commercial consolidator.

3.65. In our experience most schemes that can afford an insurance buy-out will be able to obtain a quotation and do so. Several of our members have experience of achieving a buy-out for schemes with less than £1m in liabilities. This suggests a size limit is inappropriate for those that can afford a buy-out. Therefore, a scheme should have to demonstrate that a buy-out is not feasible over a reasonable timeframe in order to access a public sector consolidator. This could be done through obtaining an estimate from the Scheme Actuary or buy-out pricing, though it is worth noting that in practice we see a wide range on insurer quotes and so this is by no means a guarantee that a scheme could not afford a buy-out within a reasonable timeframe.

3.66. If a scheme cannot afford a buy-out, then a superfund transaction may still be an option. There is only one approved superfund at present, and so a pragmatic way of demonstrating that you cannot access this superfund would be to show evidence that you have asked for a quotation and had this declined.

3.67. An alternative method would be to set some criteria (for example based on asset size), following discussions with commercial superfunds. However, these would need to be reviewed regularly over time to take into account how the market develops.

3.68. A public sector consolidator could have significant benefit where an employer of a scheme is distressed, or ultimately becomes insolvent and so there could be some form of access criteria around the financial health of the employer. That said, the Government would also need to consider the interaction of this with the PPF, and the fairness to historic members in similar situations.

Question 19: On what basis should the public sector consolidator be entitled to reject schemes from entering?

3.69. Due diligence should be of the same standard as that undertaken by commercial consolidators in relation to the cleanliness and reliability of data, benefit specifications, etc. It would not be appropriate to accept schemes with a lower tolerance level than the market as this would create a market distortion, but also leave an undue level of risk with the provider of capital (i.e. the taxpayer).

3.70. As noted above, analogous gateway tests should apply to the public sector consolidator as commercial consolidators.

3.71. We do not consider it to be appropriate to accept schemes with a deficit but if policymakers decide to allow this then commercial providers could also be permitted to do so in order to achieve a level playing field.

Question 20: Do you have additional views on the expected characteristics of the consolidator outlined above?

3.72. Consideration would need to be given to both the interaction of the entry criteria with the funding regime (for example, it could lead to sponsors choosing to not fund at a higher level than the public sector consolidator) and PPF Section 143 entry requirements.

Structure

Question 21: Do you agree that the consolidator should run as a single pooled fund and operate on a "run on" basis rather than target insurance buyout? If not, what alternative structure or operating basis would you propose?

3.73. If these proposals are to be implemented then SPP agrees that the consolidator should run as a single pooled fund and operate on a "run on" basis rather than target an insurance buyout, in order to meet the Government's objectives in relation to productive finance.

Question 22: Should underfunded schemes be segregated to avoid potential cross-subsidy with other schemes?

3.74. This problem is avoided if our recommendation (above) not to allow underfunded schemes to join a public consolidator is adopted.

3.75. As noted above, allowing underfunded schemes to enter the consolidator, is likely to create market distortion.

3.76. This would allow employers to sever their link to future deviations in experience that they cannot otherwise avoid under the funding regime. This arguably provides an unfair advantage to those employers who have not satisfactorily fully funded their pension schemes over those who have.

3.77. Policymakers will need to be alive to the opportunity that this provides for gaming the system, noting that ultimately it will only be the members who suffer if an employer over-commits to deficit contributions and then subsequently becomes insolvent.

3.78. In a scenario where schemes in deficit are able to enter the public consolidator, significant care would be needed to establish what would happen if the employer contributions were unpaid. Members of other schemes should certainly not suffer as a result of an underfunded scheme's employer defaulting. This could potentially be achieved without fully segregating the assets and liabilities of the underfunded schemes. For example, a notional asset allocation could be kept for such a scheme rather than actually having a segregated asset portfolio.

Question 23: Would schemes unattractive to commercial consolidators be attracted to a public sector consolidator given the model proposed above?

3.79. Yes, but if structured and priced as proposed we believe the public sector consolidator would be attractive to all schemes. This reinforces the need for careful thought around pricing and eligibility.

Question 24: Should open private sector DB schemes be eligible to enter the consolidator? Should the focus be on closed schemes specifically?

3.80. We believe that making open private sector DB schemes eligible to enter the consolidator would not be a good idea under any circumstances.

Member benefits

Question 25: Will this achieve the right balance between limiting the cost of transactions whilst remaining reasonably attractive to scheme trustees and their members? Are there certain elements of schemes' benefits that should always be retained?

3.81. Whilst a standardised benefit structure alleviates a number of operational challenges for the proposed consolidator, there are significant time and cost implications e.g. in calculating the revised benefits and certifying actuarial equivalence. The cost of this should not be overlooked or underestimated as it will be a barrier for small schemes in particular, which may defeat the purpose of the consolidator. In particular we would expect the amount of preparatory work for entering the public sector consolidator to be greater than for insurance, not less – since all data and benefits work, including and GMP equalisation or other matters, would need to be completed before actuarial equivalence could be carried out.

3.82. Care will be needed to consider what legal framework will be used to alter members' benefits. For example, would this require consultation with members? Will this require the Scheme Actuary to certify, or another actuary? Would the choice of benefits be the trustees' decision or the consolidators? And so on.

3.83. The expected initial amount of pension and contingent spouse's pension, and broad eligibility for death benefits should be retained.

3.84. As with any certification of actuarial equivalence, there will be winners and losers depending upon how actual experience compares with what was assumed at the time of certification. The Government should be comfortable enabling this change to happen.

3.85. It is also worth noting that schemes of all sizes can be faced with challenges when looking to insure unusual and/or complex benefits. If insurers and superfunds were also given the capability to standardise benefits, this may remove some of the market failure that the Government is trying to address.

Question 26: If standardised benefit structures are applied, what should these benefit structures be?

3.86. Broadly, we are comfortable with the PPF's suggested menu of standardised benefit structures for this purpose as detailed in its paper of 1 March 2024.

3.87. However, this list would result in some significant reshaping of benefits for some members in some schemes. Most notably:

- Many members have fixed revaluation which is greater than 3% pa due to GMP. This can have, in particular, a large impact on the amount of death before retirement spouses pension due
- Some schemes have members without a spouses pension on either death before retirement or after retirement
- Many schemes only provide spouse pensions to someone who was married or in a civil partnership, whereas the PPF's definition is broader
- Many schemes provide a child's pension.

3.88. Even if the proposed benefits initially appear more generous than the scheme's, to maintain actuarial value something else would need to worsen. This may force schemes to enhance benefits (i.e. "level up" to gain entry).

3.89. It is also worth noting that many schemes (and some insurers) allow deferred members to transfer-out (and hence access pension freedoms) after NPA, whilst the PPF's proposals would remove this option.

Question 27: What effect will this have on the existing market of commercial consolidators?

3.90. Although the need to change benefits would dissuade some trustees, if the ability to make these changes only exists for the public sector consolidator (or was significantly more straight forward) then this would be another competitive advantage / market disrupter.

3.91. Without further detail on exactly how the benefit standardisation is expected to work, and confirmation on whether standardisation will be an option just for the PSC or for insurers and superfunds too, it is not possible to be sure what effect it will have.

Governance

Question 28: Will the proposed governance structure achieve effective administration and public confidence in the public sector consolidator?

3.92. We agree that if this model is introduced, it appears reasonable for the consolidator to operate as a statutory fund administered by the Board of the PPF; that it should be a distinct function for the Board; and that the fund be ring fenced i.e. that the PPF's existing funds and the consolidator funds will be legally separate.

3.93. As the consolidator would probably become a large PPF levy payer, the decision in relation to how the PPF levy is calculated for the public sector consolidator should be taken independently in order to avoid conflicts of interest.

Question 29: What alternative governance structures should be considered?

3.94. We are broadly supportive of the proposed governance structure and do not suggest an alternative.

Funding

Question 30: Is the proposed funding basis appropriate to achieve the consolidator's aims and in particular its aim to maintain the security of member benefits?

3.95. We believe that the public consolidator should operate under the same funding requirements as commercial superfunds.

Question 31: Is the proposed entry price approach using the technical provisions basis feasible? What alternative entry pricing approach might appeal to the consolidator's target market whilst still meeting the overall aims?

3.96. We believe that the public consolidator should operate the same entry criteria as commercial superfunds (assuming, as suggested, that pricing would be at a similar level).

Question 32: How should any surplus generated by the consolidator be treated?

3.97. In general, this should be returned to whoever is providing the capital buffer/guarantee, in line with the superfund regime. For example, the Government if it was a Government guarantee.

3.98. If a material amount of the surplus were to be given to members this would risk being seen very positively by schemes and hence be another competitive advantage over existing commercial arrangements, leading to a negative impact on the existing market.

Transfers

Question 33: Are the arrangements for schemes transferring into the consolidator sufficient to achieve the consolidator aims outlined above? If not, what alternative arrangements would you propose?

3.99. Whilst accepting schemes with a deficit would help meet the Government's aim of scale, it is a huge commercial advantage relative to insurers and commercial consolidators and would be very disruptive to the private sector market.

Investment Strategy

Question 34: Is the proposed investment approach appropriate to achieve the consolidator's aims as set out above?

3.100. An explicit objective of increasing productive asset allocation differs from the fiduciary responsibility pension trustees face, which focusses them on achieving the best risk adjusted returns for a level of risk appropriate for their circumstances.

3.101. Productive asset allocation does not appear to have been defined, but there could be the potential for member outcomes to be compromised by this dual objective, in which case trustees might reasonably be reluctant to voluntarily transfer their pension liability to the consolidator. However, if the consolidator is backed by a Government guarantee, this is likely to be less of a concern.

Question 35: Will the proposed approach also allow the consolidator to reach a scale at which it can operate effectively?

3.102. Whether the public sector consolidator reaches scale will largely depend on the entry criteria, which have not been set out in enough detail for us to adequately answer this question.

3.103. There is a balance to be struck between achieving scale and disrupting the existing market. The right balance would largely depend on the Government's aims, which are not clear, but we would advise significant caution against disrupting the existing buy-out and consolidator markets.

Underwriting

Question 36: What method of underwriting would be most appropriate to achieve the aims of the consolidator, given the expected capital requirements and timescales?

3.104. We see shortcomings with both of the options presented in the consultation.

3.105. Government underwriting, whilst expected to be ring-fenced and limited in nature, will be seen as a stronger arrangement than any commercial-backed entity. As previously noted, this is likely to directly compete with and harm the UK private sector.

3.106. The consultation suggests that use of PPF reserves would result in the PPF taking more risk in its investment strategy than it otherwise would, with levy payers being the ultimate source of replacement income if required. We do not consider it to be appropriate for all ongoing pension schemes to effectively underwrite those that transfer to the consolidator in this way.

3.107. The PPF would also have a conflict of interest in relation to setting the PPF levy, as it may struggle to justify an increase to the levy for the public consolidator in the knowledge that this would further worsen its performance as an investment.

Question 37: Are there other options that the government should consider to provide underwriting for the consolidator?

3.108. Use of commercial capital could potentially be a viable option, though this would present other challenges.

Question 38: Should government underwrite the consolidator and set the investment strategy?

3.109. If the Government underwrites the public consolidator, it is hard to envisage a scenario where there is a crisis and Government would be able to limit the level of underwriting. This would therefore give a public consolidator a competitive advantage relative to commercial consolidators and would influence the market demand levels between these consolidators. Any government underwriting therefore needs to be very carefully considered to avoid introducing market distortions.

3.110. If Government underwriting is adopted, it would be reasonable for Government to be involved in setting the investment strategy. However, if the underwriting is limited then the investment strategy must still be reasonable, in the context of the risks being run, given it could influence the level of benefits members receive.

3.111. It is also worth noting that investing in UK productive finance would provide a concentration risk for the government i.e. if the UK investment market were to perform poorly, this would impact on the funding level of the consolidator, leading to an increase in the likelihood of government underwriting being required whilst the government simultaneously receives lower tax revenues from a poorly performing economy.

Question 39: How could any government underwriting be structured to support the aims of the consolidator whilst limiting risks to the taxpayer?

3.112. Underwriting should be structured in the same way as commercial superfunds, to ensure there is no competitive advantage to public sector consolidation.

Question 40: What conditions ought to be met for the PPF reserves to be considered as a source of underwriting?

3.113. As already highlighted, the SPP does not consider it to be appropriate for the PPF to invest in this way. However, if it were to do so, the investment would need to be treated as exactly that i.e. with the same terms that commercial investors have in relation to private consolidators.

CHAPTER 3: POTENTIAL TAKE-UP AND IMPACTS

3.114. Given that this survey is directed at individual DB schemes and seeks an overview of the size of the respondents scheme (assets, liabilities and number of members etc.) these are not relevant questions to which SPP can respond.

4. About The Society of Pension Professionals

4.1. Founded in 1958 as the Society of Pension Consultants, today SPP is the representative body for a wide range of providers of pensions advice and services to schemes, trustees and employers. These include actuaries, accountants, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and pension specialists.

4.2. Thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds.

4.3. SPP seeks to harness the expertise of its 85 corporate members - who collectively employ over 15,000 pension professionals - to deliver a positive impact for savers, the pensions industry and its stakeholders including policymakers and regulators.

5. Further information

5.1. For more information about this consultation response please contact the lead author Rosie Twist or SPP Chief Executive Fred Emden at: info@the-spp.co.uk or telephone the SPP on 0207 353 1688.

5.2. To find out more about the SPP please visit the SPP web site: https://the-spp.co.uk/

5.3. Connect with us on LinkedIn at: https://www.linkedin.com/company/the-society-of-pension-professionals/

5.4. Follow us on X (Twitter) at: https://twitter.com/thespp1

12 April 2024