PENSIONS AND LIFETIME SAVINGS ASSOCIATION

OPTIONS FOR DEFINED BENEFIT SCHEMES: DWP CONSULTATION

PLSA RESPONSE

19 APRIL 2024

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ABOUT THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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EXECUTIVE SUMMARY

Treatment of scheme surplus

- The PLSA is generally supportive of **the government's efforts to** facilitate greater surplus sharing – particularly given 80% of DB schemes are in surplus when measured against the DB funding requirements (Technical Provisions) using the most recently available figures.[1] However, this is a fairly recent occurrence and it should not be assumed that this position will be maintained in the future, given funding levels are derived from calculations of assets and liabilities that are prone to vary, both up and down, in line with market conditions.
- We believe the benefits of introducing a statutory override are worth examining, to enable employers and schemes to return pension fund surpluses on a consistent basis, subject to adequate **member protections (eg. sufficient funding above the scheme's low dependency target, the employer** is in a good financial position, and there is a strong employer covenant in place). At all times the **security of members' benefits should the primary consideration**.
- That being said, the feedback from our members on this proposal is mixed. Whilst some PLSA members are supportive, a number of our members have suggested that, even if given the power to release surplus from the DB scheme, it is difficult to see why trustees would exercise that power and allow surplus to be released when the scheme is already mature and de-risked. Even for open schemes, there is a feeling from many of our members that trustees are unlikely to release the surplus when it might be needed in the future, should funding levels deteriorate, particularly given that DB surpluses are, as noted above, a fairly recent occurrence.
- If a statutory override to facilitate surplus release were introduced, we believe that there should be an agreement in place between trustees and the sponsoring employer – i.e. the statutory override should not allow trustees to amend scheme rules around surplus at their sole discretion, given there are material impacts on employers, not least from a financial/accounting perspective.
- Having a clear definition of what constitutes a surplus will be very important in order to avoid any conflicts between trustees and employers (and potentially scheme members). Of the 4 proposed safeguard options being considered, there is general agreement from our members that linking the surplus release eligibility criteria/hurdle to the low dependency funding basis (with an appropriate buffer) is more appropriate than maintaining the higher buyout funding level threshold.
- In terms of the form that the statutory override should take, we believe there is significant benefit in running it through the scheme rules (i.e. through a statutory power for schemes to amend their rules to allow surplus payments), to ensure that all the historical scheme-specific issues and concerns that have been carefully crafted by trustees over a long period of time (including in relation to specific issues that have been negotiated between employers and unions) are taken into consideration.
- We support the recent HMRC announcement that tax payable on surplus payments will be reduced from the current 35% tax rate to 25% (in line with the Corporation Tax rate) from 6 April 2024.
- Trustees and employers should have the flexibility on how to use the extracted surplus. Consideration should be given to establishing a legislative mechanism to allow DB surpluses to be used to finance contributions to benefit DC members in a different scheme used by the same employer group (or the same scheme in the case of hybrid funds), without incurring tax penalties that arise under the current rules, subject to conditions around the DB scheme continuing to be funded to an appropriate level.
- Most of our members feel that there would be little take-up of the 100% PFF underpin as currently proposed**, mainly due to the high cost of the "super levy" (which could very well be in excess of the** 0.6% of liability value estimate quoted in the consultation document) and also the high moral hazard risk, i.e. that some employers and schemes might make imprudent investment decisions knowing that scheme members will benefit from 100% protection in the event the decision proves unwise.

[1] Work and Pensions Committee's "Defined benefit pension schemes" report, (20 March 2024).

Model for a public sector consolidator

- The PLSA supports trustees having as many options as possible (run on, buy-in/buy-out, superfunds, DB Master Trusts etc). Therefore, the idea that a public sector consolidator (PSC) can create an additional option for schemes and employers has merit and is worth exploring.
- However, as we said in our response to last summer's call for evidence, we believe that now is not the right time to establish a PSC. More time is needed with the commercial consolidators in operation (including DB Master Trusts and superfunds) to determine what, if any, market failures or gaps exist, before establishing a completely new regime.
- But if the government is intent on establishing a PSC by 2026 managed by the Board of the PPF (or perhaps a separate Board to avoid conflicts of interest) then:
  - Eligibility should be limited to smaller schemes (eg. the size limit could be set at schemes with < 1,000 members) that may be 'commercially unattractive' (although further work may be needed to more precisely define this). This is necessary to avoid concerns about 'scope creep' and overexpansion by the PSC and minimise the potential disruption to the superfund and insurance buyout markets, which is one of the government's stated aims. In our view, allowing larger schemes to transfer into the PSC would create market distortions.
  - The PSC should be underwritten by the government – under no circumstances should the PPF reserves be considered as a source of underwriting, particularly as a significant part of the PPF's funding has come from sponsoring employers and DB schemes.
  - The PSC needs to operate completely separately from the PPF and assets of the PPF and the PSC should be legally separate and ring-fenced.
  - The PSC needs to be simple, fair, easy for employers and members to understand and relatively straightforward for schemes to enter.
  - And if the government presses ahead with a targeted PSC, we would hope to also see a Bill putting superfunds on the same legislative footing (before the introduction of any PSC Bill).
- If a public sector consolidator were to be established, it would make sense for it to run as a single pooled fund and operate on a "run on" basis rather than target buyout. For fully funded schemes, there would undoubtedly be benefits from the economies of scale of running the PSC as single pooled fund (rather than having thousands of standalone sections in the PSC with ringfenced assets). And operating the PSC on a "run on" basis would allow the fund to invest greater amounts in riskier growth assets (including potentially in UK productive finance).
- Despite some concerns about potential moral hazard risk, we believe there is merit in allowing underfunded schemes to be accepted into the PSC on the basis that they represent an under-serviced segment of the market. Also the number of underfunded schemes is low and may remain low.[2] However, where underfunded schemes enter the PSC, they should be segregated to avoid potential cross-subsidy with other schemes. Members of schemes entering the PSC on a fully funded basis should not have their benefits at risk from employers of underfunded schemes becoming insolvent.
- At face value, there could be some advantages from the PSC offering a small number of standardised benefit structures, eg. benefits which are easier to understand and predict. However, the views of our members on benefit standardisation are mixed. While there are likely to be advantages to schemes and employers resulting from its simplicity and the reduction of costs, there are concerns that, from a member perspective, there will be winners and losers created, which may cause some trustees to reflect on whether or not the PSC is an appropriate option for their scheme.

[2] By the end of 2022, 80% of schemes were in surplus on a Technical Provisions basis (according to the Work and Pensions Committee's "Defined benefit pension schemes" report, 20 March 2024).

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There is also the unlevel playing field argument – i.e. if it is appropriate for the PSC to be able to offer standardised benefits, why shouldn't insurers or superfunds be able to offer them as well? We believe more work needs to be done by DWP, in consultation with the pensions industry, to explore the feasibility of wider benefit simplification and the impact it would have on 'solving' some of the pipeline issues that the PSC is expected to address, as well as how it could help superfunds and DB Master Trusts take off.

- To avoid unfair competition between the PSC and commercial consolidators, the PSC should be required to provide at least the level of security expected of commercial consolidators (i.e. DB superfunds). Under TPR's current consolidation guidance, this level of security requires a prudent funding basis (current minimum is calculated using gilts +0.75% pa), access to a buffer fund, and in the event of failure, PPF protection. In our view, similar requirements should be established for the PSC, in order for it to provide a secure solution for members and protect taxpayers.
- If the PPF is selected as the public sector consolidator, then the Board of the PPF should remain responsible for independently setting the investment strategy and asset allocation. That being said, if the government were to underwrite the PSC, they will legitimately expect to have a say in the overall level of risk that should be taken in the investment strategy. But in the absence of government backing, investment risk is likely to be more constrained and the ability of the PSC to invest in UK productive finance would be substantially limited due to the risks involved.
- In our view, an unlimited government guarantee of the PSC is unlikely to be required. We believe the total level of support available could be capped to a certain amount, however more work is needed to determine the appropriate level of support required. It will certainly need to be set at a level that supports the desired scale and ensures that the PSC retains at least the same level of security as required of commercial consolidators.
- If more work can be done to clarify the entry requirements, including what constitutes 'unattractive to commercial providers' and with eligibility limited to the smaller end of the market (eg. to schemes with < 1,000 members), it is possible that many of the other issues (eg. around price, fairness, impact on members, security etc) might resolve themselves.
- Also, the industry would be more likely to support the PSC initiative if they could clearly understand the government's overall view of how the PSC, superfunds, running-on DB schemes and buyout sit together and alongside each other. It would also be helpful to understand over what timeframe the government is seeking to facilitate greater consolidation, as this could have implications for the right policy mix.

INTRODUCTION / GENERAL COMMENTS

1. The PLSA welcomes the government's aim of exploring measures to ensure that the £1.4 trillion currently held in DB pension schemes can deliver for the wider economy, while maintaining the long-term security of DB member benefits.

2. As is widely recognised, DB pension schemes are currently enjoying high levels of funding, with many schemes running a surplus. The overall funding position of private sector DB schemes has improved significantly in recent years. Using the most recent publicly available figures, 80% of DB schemes are in surplus when measured against the DB funding requirements, i.e. on a Technical Provisions (TP) basis.[3]

3. According to TPR's recent report, DB and hybrid scheme funding levels have improved since 2022, with the number of schemes with 100% or greater TP funding levels increasing from 2,565 to 3,620.[4] With these improvements in scheme's funding positions likely to continue, the number of DB schemes in surplus is anticipated to rise in the coming years.

4. In this context, we believe it appropriate for the government to consider whether there is potential for trustees to share surplus with scheme members and sponsoring employers in recognition of their historical contributions, and the most suitable mechanism for achieving this.

5. As announced by the Chancellor in his Mansion House speech last July and again in the Chancellor's 2023 Autumn Statement, the government is seeking to identify ways in which DB pension schemes can increase the amount invested in productive asset classes. The success of this objective is likely to be achieved, in large part, through greater consolidation of the DB sector, which the PLSA supports.

6. It is therefore unsurprising that, in looking for ways to encourage greater DB consolidation, the government is looking to establish a public sector consolidator (PSC), with the aim of providing an alternative endgame solution for DB schemes unattractive to commercial consolidation providers.

7. That said, there is a fair degree of uncertainty around whether either of these proposed measures will ultimately result in more DB scheme assets being invested into UK productive finance (without a significant time lag).

8. It will be important for the government ensure that, if introduced, both of these measures (repayment of DB surplus and the establishment of a PSC) are introduced in a careful and considered manner, and align fully with the need to protect members' benefits. To assist with this, we have provided responses to the specific consultation questions in the following section. Please contact Jon Echevarria (jon.echevarria@plsa.co.uk) with any questions or comments.

[3] According to the Work and Pensions Committee's "Defined benefit pension schemes" report, (20 March 2024).

[4] It should be noted that this increase is on a Technical Provisions basis and not necessarily on a low dependency basis.

RESPONSES TO CALL FOR EVIDENCE QUESTONS

CHAPTER 1: TREATMENT OF SCHEME SURPLUS

Statutory override

1. Would a statutory override encourage sharing of scheme surplus?

1. As stated in our response to last summer's call for evidence on the options for DB schemes, we believe the benefits of introducing a statutory override should be examined, to enable employers and schemes to return pension fund surpluses on a consistent basis, subject to adequate member protections (eg. sufficient funding above the scheme's low dependency target, the employer is in a good financial position, and there is a strong employer covenant in place).

2. However, we note that the views of our members are mixed on this proposal. Some PLSA members support the introduction of a statutory override to allow DB schemes in robust financial health to explore options around surplus extraction. On the other hand, other members are less supportive on the basis that:

   - It is unclear whether introducing a statutory override will encourage sharing of scheme surplus (possibly around the margins). While it may be that some larger schemes (with sufficient governance capacity) might prefer to run on and release surplus, many other DB schemes (including smaller schemes that are well funded) are likely to still aim for buyout and retain the surplus in the scheme rather than releasing it. Also, if a DB scheme is large and dominating on the balance sheet, an employer may still want to buy in/buy out, especially in industries that have regulated income.

     In a recent survey of PLSA members, there were mixed views as to whether the introduction of a statutory override would encourage sharing of scheme surplus, with 41% agreeing and just over a quarter disagreeing (27%).

   - Overriding scheme rules to make surplus payments seems risky, with some members suggesting that, even if given the power to release surplus from the DB scheme, it is difficult to see why trustees would exercise that power and allow surplus to be released when the scheme is already mature and de-risked. Even for open schemes, there is a feeling from a number of our members that trustees are unlikely to release the surplus when it might be needed in the future, should funding levels deteriorate particularly given that DB surpluses are, as noted above, a fairly recent occurrence.

   - There is little belief that surplus release will result in riskier investment strategies. However, it is worth noting that increased investment in the corporate (through surplus relief) is a form of productive finance.

3. Notwithstanding the mixed views of our members, we believe that, on balance, the proposal of a statutory override to ensure that all DB schemes in robust financial health can explore options around surplus extraction is a positive one – particularly as there are significant amounts of money currently tied-up in DB surpluses, which could otherwise potentially end up trapped in the scheme.

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?

4. We believe that there should be an agreement in place between trustees and the sponsoring employer – i.e. the statutory override should not allow trustees to amend scheme rules around surplus at their sole discretion, given there are material impacts on employers, not least from a financial/accounting perspective.

5. There is clear support from our members for this position. In a recent survey of PLSA members, 77% felt that an agreement between trustees and sponsoring employers is appropriate, with only 10% saying that trustees should be allowed to amend the scheme rules at their sole discretion.

6. **The overriding concern is for trustees to protect members' benefits in the scheme. Once that** criteria has been met and a joint trustee/employer decision is taken that a surplus payment is eligible to be made, trustees are effectively accepting that they are losing control of what that surplus will be used for by the employer. However, the negotiation in some cases might result in part of the surplus being used to enhance member benefits, with the remainder going back to the employer (at which point we believe the employer should have full freedom as to what the returned surplus is used for).

7. Having a clear definition of what constitutes a surplus will be very important in order to avoid any conflicts between trustees and employers (and potentially scheme members).

8. The source of the surplus will also be a consideration in the trustee/employer decision, since for a shared cost scheme some of the surplus is attributable to members.

9. There was a concern raised by our legal panel (consisting of major advisory firms in the sector) around the possibility of a two-stage negotiation process arising for surplus payments, whereby initially there would be an agreement required between the trustee and the employer on whether a permissive rule is included in the scheme rules to allow surplus payments (and all the legal costs and complications associated with this), and then again another round of negotiations when it comes time to actually pay a surplus. To avoid such complex and potentially costly situations, it will be important for TPR to publish appropriate guidance for the industry around surplus extraction (see our response to question 10 below).

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?

10. **The trustee's role** in assessing whether or not a scheme should be allowed to share a surplus with the sponsoring employer is very important. Therefore, in terms of the form that the statutory override should take, overriding scheme rules by introducing a statutory power to make surplus payments seems disproportionate.

11. We believe there is significant benefit in running it through the scheme rules (i.e. through a statutory power for schemes to amend their rules to allow surplus payments), to ensure that all the historical scheme-specific issues and concerns that have been carefully crafted by trustees over a long period of time (including in relation to specific issues that have been negotiated between employers and unions) are taken into consideration.

12. This would also ensure that any new power to enable the payment of surpluses on an ongoing basis can be properly captured in the right place and in the right way within the scheme rules.

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?

13. Based on advice from our legal panel, the issue of whether the government needs to introduce a statutory power to enable trustees to make one-off payments to members largely comes down to whether or not DB scheme rules contain some form of power to augment members' benefits (and if so, whether they are sufficiently broad).

14. However, it is difficult to ascertain whether some/many/most scheme rules already contain these sufficiently broad benefit augmentation powers. We therefore believe more work may be needed to determine whether or not this is the case (unless such information is provided by schemes responding to the scheme-specific questions in chapter 3 of the consultation document).

15. Separately, we note that this question seems to focus on one-off surplus payments. However, we believe the emphasis (particularly in any guidance published by TPR) should be on the ability of DB schemes to generate and subsequently pay out regular surplus payments. This focus on regular surplus extraction could serve to incentivise trustees and employers to invest greater amounts in riskier growth assets (including in UK productive finance) if they know that they can extract value from the scheme at various points in time (over and above the minimum funding levels established to protect members' benefits), thereby maximising the long-term potential benefits of sharing scheme surplus across the industry and potentially the UK economy. That said, there is the possibility that they may not want to take on extra risk, given that whilst this brings potential upside, there is also potential downside risk.

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

16. These proposals are designed to give trustees greater confidence to more readily distribute surpluses to members and/or sponsoring employers. This could potentially lead to greater numbers of DB schemes investing more in productive finance, and for longer, which might lead to schemes running on for longer and delaying some trustees' buyout plans by a few years. Of course, it may be that some maturing schemes may not have sufficiently long timescales needed to invest (more) in illiquids.

17. In a recent survey of PLSA members, two-thirds of respondents (66%) felt that the ability to share surplus would have a neutral effect on the insurance buyout market, with almost a quarter (24%) suggesting it could have a negative effect and only 9% saying it would have a positive impact on the buyout market.

Taxation of surplus payments

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

18. On 12 March 2024, HMRC published a policy paper confirming that the tax rate payable on authorised surplus payments will be reduced from the 35% free-standing tax that currently applies to 25% (in line with the Corporation Tax rate) from 6 April 2024.

19. We support this tax reduction and have done so for some time, including in our response to the DWP call for evidence last September. As such, the recent HMRC announcement is welcome.

20. Given that 80% of DB schemes are in surplus when measured against the DB funding requirements (Technical Provisions)[5], this could result in a net benefit to government, as the

[5] According to the Work and Pensions Committee's "Defined benefit pension schemes" report, (20 March 2024).

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tax on the surplus repatriation would be applied at an earlier point than would otherwise be payable when a scheme winds up (where a surplus repatriation may never be realised).[6]

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

21. Although some trustees might prefer to use the surplus to make one-off payments, others might want to use it to improve benefits for DB members or to pay additional contributions for their DC members.

22. In our view, trustees and employers should have the flexibility on how to use the extracted surplus. As stated in our response to last summer's call for evidence on options for DB schemes, we believe that consideration should be given to establishing a legislative mechanism to allow a DB scheme's surplus to be used to finance contributions to benefit DC members in a different scheme used by the same employer group (or the same scheme in the case of hybrid funds), without incurring tax penalties that arise under the current rules, subject to appropriate conditions around the DB scheme continuing to be funded to an appropriate level. Many of our members (51% of those surveyed last summer) were supportive of this proposal.

Safeguards

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

23. As stated previously, the PLSA supports the government's efforts to make it easier for surpluses to be shared, particularly given the large and growing aggregate DB surplus,[7] provided there are sufficient protections in place for members, which is paramount.

24. On the 4 proposed safeguard options under consideration, there is general agreement from the majority of our members (77% of PLSA members recently surveyed) that linking the eligibility criteria/hurdle to the low dependency funding basis (with an appropriate buffer) is more appropriate than adopting the higher buyout funding level threshold (option 4). However, of those members who prefer some form of the low dependency funding basis, there was no consensus on which of options 1–3 would be the most appropriate:
    - 37% support setting the surplus eligibility criteria at a funding level above the low dependency funding basis plus a fixed margin, for example, above 105% of the low dependency basis (option 1).
    - 34% support a covenant requirement, for example only allowing access to surplus where funding is above the low dependency funding basis plus a fixed margin, and the strength of the employer covenant is considered sufficient to offset any additional risk posed to members (option 3).
    - 29% support setting the surplus eligibility criteria at a funding level above the low dependency funding basis plus a variable margin based on investment risk, for example, above 100% + y% of the low dependency basis, where y is determined by the level of investment risk in the scheme (option 2).

25. That being said, a few of our members expressed concern about setting the bar for releasing surplus too low, noting that it was not so many years ago that the whole industry was worried about DB scheme deficits (rather than the significant surpluses we now have), and the situation

[6] Although it should be noted that the TP basis is not as strong as is likely to be required to pay out surplus (i.e. low dependency basis plus a buffer or buyout funding level basis).
[7] £455.5 billion as at the end of March 2024, PPF 7800 Index, 31 March 2024.

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could conceivably revert to those times if, at some point in the future, rising inflation and interest rates cause a sustained fall in asset values including government bond prices. Although in the minority, these members felt the buyout funding level threshold should be adopted.

26. On balance, **PLSA's view is that** a simple non-prescriptive framework is needed outlining the **factors to consider, so that trustees and employers can access the scheme's surplus should they** wish to do so.

27. We believe that the lower funding hurdle, where payments to employers could be made where the scheme would retain a meaningful surplus on a low dependency basis (plus an extra x% based on either investment risk and/or covenant strength), is the more appropriate criteria.

28. In particular, we note that the buyout funding level threshold is arguably of no relevance to a scheme that is intending to run on, has confidence in the employer covenant and has reached low dependency. Therefore, just because the insurance market is charging a certain price for buyout, the buyout funding level threshold would seem to have less relevance to continuing schemes than the low dependency funding level.

29. It is worth pointing out that, whatever eligibility/safeguard criteria is established, this would be the minimum funding level at which surplus can be extracted, and ultimately it is up to trustees if they want to set a higher funding level for surplus extraction for their particular **scheme's** circumstances.

30. In terms of alternative criteria that could potentially apply, consideration could be given to somehow taking into account how long a DB scheme has been in surplus. The objective of incorporating such a measure would be to demonstrate the stability of **the scheme's** funding over time and to ensure that surpluses are not being extracted based on a **scheme's funding** position at a particularly favourable point in time, which may be short-lived and not truly reflective **of the strength of a scheme's funding positio**n.

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

10. What might remain to prevent trustees from sharing surplus?

31. The issues around when and how return of surplus can be paid has the potential to become very technically complex, and therefore costly, very quickly (i.e. there is the potential for it to turn into a mini-valuation process) with significant adviser fees accruing. This needs to be avoided – industry will therefore need clear guidance and rules around when/in what circumstances surplus payments can be made.

32. The options for the form of the trustee guidance on surplus extraction include:

- Adding an extra module to the final DB Funding Code;
- Introducing a separate code on surplus extraction; or
- TPR publishing guidance on surplus extraction.

33. In terms of which form of guidance would be the most appropriate, the third option is likely to be the quickest/simplest and therefore worth considering. However, it is difficult to say which of the three options would provide the most confidence to trustees since all of them would be coming from TPR. From a holistic DB perspective, we believe it would make sense for the guidance on surplus extraction to form part of the final DB Funding Code in the long term.

Alternative safeguard: 100% PPF underpin

> **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?**
> **12. Are there other benefits to a 100% underpin that the government should consider?**
> **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?**
> **14. Are there other methods outside of the PPF that could provide added security to schemes choosing to run on?**

34. There is a view in some quarters that extracting surplus from pension schemes will only work if member benefits are 100% protected by a new PPF underpin, whereby employers could opt to pay a higher "super levy" to the PPF in exchange for the PPF offering a 100% level of compensation in the event of insolvency of the sponsoring employer. For instance, there is a view that such a proposal would give trustees more confidence that member benefits would be fully protected regardless of what happened to the sponsoring employer in the future, and that this could free up many billions of pounds of DB pension scheme assets to be invested more productively.

35. The argument is that, even with a surplus distribution power and appropriate guidance from TPR, most trustees will be very nervous about exercising this power unless they have strong protection in the form of a 100% PPF underpin. As stated in the consultation document: "Any extraction of surplus will reduce security for members". So in the absence of any proposals to alter trustees' overriding fiduciary duties, it is unclear whether trustees would use a new surplus power in such a way as to reduce security for members (unless there was a 100% PPF underpin in place).

36. However, feedback from PLSA members suggests there may be little take-up of the 100% PFF underpin as currently proposed, mainly due to the high cost of the "super levy" (which could very well be in excess of the 0.6% of liability value estimate) and also the high moral hazard risk, i.e. that some employers and schemes might make imprudent investment decisions knowing that scheme members will benefit from 100% protection in the event the decision proves unwise. This is reflected in the results of our recent survey of PLSA members, where only 26% of respondents felt that a 100% PPF underpin needs to be in place to allow surplus extraction.

37. It is worth noting that the government's own assessment of this proposal recognises that the cost will be high, acknowledging that: "*Even with these strict entry requirements and subsequent reduced risks, to provide a high level of protection the initial aggregate levy collected would need to be high: at least 0.6% of scheme's buy-out liabilities each year, with costs potentially increasing above these levels in the event of low take-up across the industry*." This equates to £6 million per year for a £1 billion pound scheme. Perhaps if the cost associated with the "super levy" were significantly lower, there would be less industry ambivalence towards the 100% PPF underpin.

38. That being said, we believe there are also other (more cost-effective) ways to achieve similar outcomes as a 100% PPF underpin, including the use of escrow accounts, surety bonds (which have the added benefit of annual re-pricing), captive insurance, charges over assets etc., so this proposal does not seem to be addressing a specific market failure. That said, we recognise that there are added costs (including legal and other fees) and complexities associated with these alternative options.

CHAPTER 2: MODEL FOR A PUBLIC CONSOLIDATOR

39. The overall objective of consolidation in the DB space is a positive one. The PLSA supports trustees having as many options as possible (run on, buy-in/buy-out, superfunds, DB Master Trusts etc). Therefore, the idea that a public sector consolidator can create an additional option for schemes and employers has merit and is worth exploring.

40. **However, as we said in our response to last summer's call for evidence,** we believe that now not is the right time to establish a PSC. More time is needed with the commercial consolidators in operation (including DB Master Trusts and superfunds) to determine what, if any, market failures or gaps exist, before establishing a completely new regime. In particular, the government should be clear on what it is trying to achieve through this proposal.

41. In a recent survey of PLSA members:
    - There were mixed views as to whether the government should establish a PSC to operate alongside commercial consolidators, with 35% of respondents agreeing and 30% disagreeing.
    - Views were also mixed on whether the existing private sector buyout/consolidator market is providing sufficient access to schemes that are below scale but fully funded, with 38% agreeing and 23% disagreeing.
    - Importantly, almost half of respondents (48%) said they believe **the PPF's role should** not be expanded to become a public consolidator of DB schemes, with only 22% supportive. Many of those who were against the PSC proposal cited issues of regulatory arbitrage and also concerns around the introduction of public consolidator in an area where, they argue, there is no market failure.

42. Whilst we question the timing **of the PSC's** proposed introduction (and whether commercial consolidators should be given more of an opportunity to operate), if the government is intent on establishing a PSC operated by the PPF by 2026, we believe it needs to be simple, fair, easy for employers and members to understand and relatively straightforward for schemes to enter.

43. With this goal in mind, we have focused our responses below on helping the government shape how the public consolidator could/should operate, so that the PSC can be properly established as another viable option for DB schemes and with as few unintended consequences as possible.

Eligibility

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

44. The PLSA recommends that, if a PSC is to be established, eligibility should be limited to the smaller end of the market (eg. the size limit could be set at schemes with < 1,000 members, with this segment consisting of around 2,500 schemes with £80 billion in assets). We believe consolidation of smaller schemes could have substantial benefits in terms of better governance, lower costs and greater efficiency.

45. Smaller schemes may find themselves more likely to be 'commercially unattractive', although we note that many insurers have been strengthening their internal resources and implementing solutions in an effort to increase capacity and improve buyout solutions for smaller schemes.

46. A public sector consolidator operated by the PPF could also be attractive to:
    - Schemes with weaker funding, who may have no commercially available option; and
    - Schemes with significant illiquid assets, who may find commercial options limited.

47. In contrast, most schemes that are attractive to commercial providers – particularly larger, well-funded schemes – are likely to continue to prefer existing commercial options (either a buyout or a transaction with a commercial consolidator). Although it could be that some of these schemes may also be attracted to PSC because, intentionally or not, it could be perceived to have an implicit tax-payer guarantee (as a result of the government underwriting) and therefore perceived to provide greater benefit security.

48. We note that, in their recent discussion document, the PPF assert that the potential market is around 2,400 schemes with around £120bn in assets.[8] But they also recognise that the PSC may only attract transfers from a small proportion of these schemes, so the PSC may not significantly **contribute to the government's wider objective of investing in UK productive finance.** For this to be the case, the PSC would need to achieve significant scale, and changes to the proposed structure are likely to be needed – potentially moving away from limiting the PSC to small schemes and those that are unattractive to commercial providers.

49. However, our members have expressed strong **concerns about 'scope creep' of** such a move, particularly as PPF have said they are not looking to reject any schemes from entering or **limiting eligibility to schemes that are "unattractive to commercial consolidators"** – i.e. as long as schemes can meet their terms, they are welcome to transfer into the PSC. In our view, allowing larger schemes (i.e. those with > 1,000 members) to transfer into the PSC would create market distortions, which the government has said it is keen to avoid.

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?

50. On face value, it makes sense for the PSC to be required to accept transfers from all schemes that that are unattractive to commercial providers and that can meet its terms (comparable to Nest, who have a public service obligation to allow any employer, regardless of size, to join; and to provide a flat rate per member charge, regardless of pot size or earnings potential).

51. In a recent survey of PLSA members, 40% of respondents said they believe the PSC should be set a duty to accept transfers from schemes unattractive to commercial providers.

52. As noted above, the PPF are **not proposing 'harder' eligibility criteria.** In their view, setting sized based criteria would ignore the challenges that poorly funded schemes may face or those with complex benefit structures, where particular benefit features can be disproportionately expensive. The PPF also acknowledged that it **is hard to define exactly what size is or isn't "unattractive to commercial providers".** As such, they are instead proposing to establish the consolidator with a distinct design from commercial alternatives and allow scheme trustees freedom to choose the right solution for their scheme.

53. However, in our view, setting the PSC a duty to accept transfers from schemes unattractive to commercial providers would not limit the impacts on commercial providers. As noted in our response to the previous question, it is important for there to be a limit on the size of the schemes that can be targeted by the PSC (eg. schemes with < 1,000 members).

54. **In terms of ensuring 'no unfair advantage', r**efer to our responses under the section headed **"Member benefits" below for the PLSA's views on benefit standardisation** – in particular, the importance of having a level playing field by ensuring all schemes are offered the ability to standardise benefits if legislation permits the PSC to do so.

[8] The PPF numbers exclude those DB schemes that are less than 80% funded, which they believe are not appropriate for the PSC.

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?

55. As stated above, if the government is intent on establishing a PSC managed by the Board of the PPF by 2026, then it should target smaller schemes (eg. with < 1,000 members) that may be 'commercially unattractive' (although further work may be needed to more precisely define this). This is necessary to avoid concerns about 'scope creep' and overexpansion by the PSC and minimise the potential disruption to the superfund and insurance buyout markets, which is one of the government's stated aims.

56. If the PSC were established on this basis, then we do not believe that the government would need to set an explicit limit on the size to which the consolidator could grow, or limit the annual amount consolidated, particularly at the outset.

57. We believe the main issue would likely be more around whether the PSC will be able to generate sufficient interest from enough smaller schemes, and how quickly they can be transitioned into the PSC, to build the required scale.

58. In a recent survey of PLSA members:
    - Only 25% of respondents said the government should set an explicit limit on the total size to which the PSC could grow (with 36% disagreeing),
    - And only 21% said the government should set an explicit limit on the annual amount that can be consolidated into the PSC (with 40% disagreeing).

59. We note that the PPF have recently expressed confidence about being able to onboard between 300 and 1,000 schemes into the PSC in the first few years of operation (based on their previous experience with transitioning schemes into the PPF and the skills and expertise they have built up as part of that process). However, it remains to be seen whether (1) these existing skills/expertise will be entirely transferrable to the onboarding of schemes into the PSC, and (2) whether there will be sufficient numbers of schemes that are willing and ready to transfer to the PSC, particularly in the early years.

18. How in practice might the public consolidator assess if a scheme could access a commercial consolidator?

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

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

60. As noted in our response to Q16 above, it will be difficult for the PPF to assess whether or not a scheme is "unattractive to commercial providers" and therefore whether they can or cannot access a commercial consolidator, which makes this a difficult criteria for determining a scheme's eligibility for entering the PSC.

61. There are a number of issues with this – not least is establishing what evidence a scheme would need to provide to the PSC to prove that they cannot access a commercial consolidator. We therefore cannot see how the PPF can justifiably use this criteria as a basis for accepting or rejecting schemes.

62. That said, we do not support the PPF's position that the PSC should be open to any and all schemes (that are at least 80% funded) to enter the PSC if they wish to do so. As stated above, we believe entry into the PSC should also be limited to small schemes (< 1,000 members).

63. If more work can be done to clarify the entry requirements, including what constitutes 'unattractive to commercial providers' and with eligibility limited to the smaller end of the market (eg. to schemes with < 1,000 members), many of the other issues (eg. around price, fairness, impact on members, security etc) might resolve themselves.

64. Also, the industry would be more likely to support the PSC initiative if they could clearly understand the government's overall view of how the PSC, superfunds, running-on DB schemes and buyout sit together and alongside each other. It would also be helpful to understand over what timeframe the government is seeking to facilitate greater consolidation, as this could have implications for the right policy mix.

Proposed model

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?

65. If a public sector consolidator were to be established, we believe it would make sense for it to run as a single pooled fund and operate on a "run on" basis rather than target buyout.

66. For fully funded schemes, there would undoubtedly be benefits from the economies of scale of running the PSC as single pooled fund (rather than having thousands of standalone sections in the PSC with ringfenced assets).

67. And operating the PSC on a "run on" basis could potentially allow the PSC to invest greater amounts in riskier growth assets (including in UK productive finance). In contrast, targeting buyout would likely result in the PSC being invested in lower risk assets, including fixed income investments, which would detract from the government's growth agenda.

68. We note that over half of PLSA members recently surveyed (54%) indicated that the public consolidator should operate as a single pooled fund rather than as multiple standalone sections with ringfenced assets and liabilities.

69. And almost two-thirds of our members (63%) said they believe the public consolidator should operator on a "run on" basis rather than target insurance buyout.

70. That being said, whether establishing the PSC as a single pooled fund operating on a "run on" basis ultimately satisfies the government's ambition to increase investment in UK productive finance remains to be seen, particularly given the likely absence of scale (at least initially). Of course, if the government does 100% underwrite the PSC, it would be possible to have a higher allocation of risky assets and illiquids, even if the fund were smaller than might currently be thought of as the minimum necessary to invest in the full range of assets, eg. £25bn plus.[9]

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

71. Yes. We believe underfunded schemes should be able to be accepted into the PSC, but with their assets ring-fenced and their members readily identifiable (in case the employer becomes insolvent before the end of the repayment schedule). See our response to Q33 for further details.

[9] Recent PLSA analysis indicates that larger schemes, for example those with more than £25bn-£50bn of assets, have considerable governance capability and find it easier to invest directly, or alongside others, in productive finance.

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

72. Possibly. As noted above, some smaller schemes may find that they are less commercially attractive in the current market, although we note that many insurers have been taking steps to improve buyout solutions for smaller schemes . For these schemes, a public sector consolidator operated under the model being proposed by the government may hold some appeal.

73. A public sector consolidator could also be attractive to:
    - Schemes with weaker funding, who may have no commercially available option; and
    - Schemes with significant illiquid assets, who may find commercial options limited or with unattractive terms.

74. In a recent survey of PLSA members, 70% of respondents said they believe that schemes that are unattractive to commercial providers would be attracted to a public sector consolidator.

75. However, there is also some sense from our members that a proportion of small schemes (particularly those that are reasonably well funded) might still aim for buyout.

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

76. We believe that there would be very few (if any) open schemes that would qualify and be eligible to enter the public sector consolidator, or indeed that would want to. If a scheme is open, it is probably large and well-funded and therefore more likely to either run on (at least for the foreseeable future) or target another endgame solution.

77. Focusing on open schemes in our view is unnecessary and could be another example of potential 'scope creep'. In addition, having large open schemes mixed in with smaller closed (possibly less well-funded) schemes could make it more difficult to set a single investment strategy that suits all schemes and members of the PSC.

78. Separately, we note that there is no mention of multi-employer schemes in this consultation (as has been the case with many recent DB consultations). We believe that greater focus should be placed on the issues specific to multi-employer schemes and their interaction with the PSC.

Member benefits

25. The government proposes that the consolidator pay the actuarial equivalent of full scheme benefits to the members of transferring schemes but does so under a small number of standardised benefit structures. 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?

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

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

79. We note that, in their recent discussion document, PPF have said they believe they can commit to trustees and members that:
    - on transfer the consolidator will pay existing pensioners (at least) the same amount of pension as they are already receiving,

- the starting value of a deferred member's pension when they retire is projected to be the same as they would have expected to receive under their scheme,
- the consolidator will match the NPA of the original scheme – i.e. it will pay people at the age they would have expected to retire,
- in most cases the consolidator will broadly match the annual increases that the scheme would have provided – many members will only see a change in the date the annual increase is calculated and paid,
- the PSC will pay generous benefits to surviving spouses, partners, or other dependents,

and that the above can be achieved through a menu of choices (as outlined in their design discussion document).

80. At face value, there could be some advantages to members from standardisation, eg. benefits which are easier to understand and predict.

81. However, we note that the views of PLSA members on the PSC having a small number of standardised benefit structures is mixed, with 50% of those recently surveyed suggesting that the PSC paying the actuarial equivalent of full scheme benefits under a small number of standardised benefit structures could provide a good balance between limiting transaction costs and remaining reasonably attractive to trustees. On the other hand, almost a third of PLSA members (29%) disagree that this would be the case.

82. Those in support of benefit standardisation by the PSC cited the significant advantages to schemes, employers and members resulting from its simplicity and the reduction of costs. They also argue that it ultimately comes down to a decision by the trustee – i.e. if trustees can satisfy themselves that, on the whole, it is in the best interests of their members to transfer the scheme into the PSC then that is entirely appropriate and consistent with their fiduciary duty.

83. Those who do not support benefit standardisation are concerned that, from a member perspective, there will be winners and losers created. As such, even though standardisation of benefits could be a valid approach (particularly for the smaller end of the market), there are concerns that it may cause some trustees to reflect on whether or not to pursue this as an appropriate option for their scheme if their members will lose out on some of their benefit entitlements as a result of benefit standardisation within the PSC.

84. There is also the unlevel playing field argument – i.e. if it is appropriate for the PSC to be able to offer standardised benefits, why shouldn't insurers or superfunds be able to offer them as well? If standardisation of benefits were to work well in this context, might it not be possible (or even beneficial) to roll it out more broadly? It is likely that insurers and superfunds in particular would appreciate being able to offer standardised benefits.

85. Other practical issues regarding benefit standardisation that have been mentioned include:
    - Trustees will likely need to take advice about benefit standardisation. This advice (legal, actuarial etc) is specialised and will likely be expensive, i.e. the costs associated could potentially render standardisation unpalatable to the target schemes.
    - Benefit standardisation could put additional strain on pension scheme administrators in the short-to-medium term, at a time where these resources are already very stretched.

86. In a recent survey of PLSA members, over half of respondents (52%) said they believe all schemes should be offered the ability to standardise benefits if legislation permits the PSC to do so.

87. We believe more work needs to be done by DWP and PPF, in consultation with the pensions industry, to explore the feasibility of wider benefit simplification and the impact it would have on 'solving' some of the pipeline issues for small funds that the PSC is expected to address, as well as how it could help superfunds and DB Master Trusts take off.

Governance

28. Will this proposed governance structure achieve effective administration and public confidence in the public sector consolidator?
29. What alternative governance structures should be considered?

88. The PLSA supports the legal and functional separation between the PSC and PPF. In response to last summer's call for evidence, we stated that the PLSA (and our members) were keen to ensure that the PSC would operate completely separately from the PPF (i.e. as completely separate legal entities), with assets ring-fenced.

89. In a recent survey, the majority of our members (70%) again reiterated this view and said that the PSC should have a separate Board and governance structure from the existing PPF.

90. That being said, in our recent member survey:

- A third of respondents (33%) said they believe that the proposed governance structure will have a little or no chance of achieving effective administration and public confidence in the public consolidator.
- Just under half (47%) said they believe it will have a moderate chance.
- While only 20% said they believe the proposed governance structure will have a good chance of achieving effective administration and public confidence in the public consolidator.

Funding

30. To avoid any unfair competition the government expects the public consolidator could be required to meet the same funding standards as commercial consolidators, which will need to comply with forthcoming superfund legislation. Is the proposed funding basis appropriate to achieve the consolidator's aims and in particular its aim to maintain the security of member benefits?

91. Yes. We believe that, to avoid unfair competition between the PSC and commercial consolidators (i.e. DB superfunds), the PSC should be required to provide at least the level of security expected of commercial consolidators.

92. Under TPR's current consolidation guidance, this level of security requires a prudent funding basis (current minimum is calculated using gilts +0.75% pa), access to a buffer fund, and in the event of failure, PPF protection. In our view, similar requirements should be established for the PSC, in order for it to provide a secure solution for members and protect taxpayers.

93. If a public consolidator is established for those schemes that are unattractive to commercial providers, then that should not affect the price – i.e. there is a strong feeling from our members that schemes should not be able to get a better price via the PSC compared to the insurance market (there should be a level playing field on cost and security between public sector and commercial consolidators). Importantly, in our recent survey of members, most respondents (62%) believe that the PSC should have a higher funding standard than commercial consolidators.

94. We acknowledge the government anticipates setting the entry price in line with the target funding basis. We agree that the price will naturally need to be more dynamic to reflect the market conditions at the point of transfer, the risk characteristics of the individual scheme and the anticipated onboarding and running costs.

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95. In our recent member survey, most respondents (65%) said they believe the proposed funding basis is appropriate to achieve the consolidator's aims of maintaining the security of member benefits.

96. However, it is worth noting that some of our members believe that the proposed entry price (ranging from gilts +0.5% to gilts +0.75%) is potentially one of the negative aspects that is likely to detract from the attractiveness of the PSC model.

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?

97. Whether or not the proposed entry price approach using the technical provisions basis is feasible is unclear.

98. In a recent survey of our members, less than half of respondents (41%) agree that the proposed entry price approach using the Technical Provisions basis is feasible. However, we note that many respondents are undecided (47%).

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

99. Any surplus generated by the PSC should be considered from a member perspective, since the link between the employer and pension scheme will be severed when the scheme transfers to the consolidator. There is an argument that any surpluses generated by the public consolidator should be used to enhance members' benefits. That being said, employers may only want to use the surplus to enhance the benefits of current employees, whereas trustees will need to consider the benefits of all members of the scheme (many of whom may be non-employee members, particularly in the case of closed DB schemes).

100. Of course, members of underfunded schemes, if they are allowed to enter the PSC (see below), should not be entitled to receive any uplift in their benefits until such time as their employer has finished paying off the deficit under the agreed repayment plan, at which time the link with the employer would be severed and the relevant members join the rest of the PSC pool and could then benefit from future surpluses generated by the public consolidator.

Schemes in deficit vs surplus

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

101. Despite some concerns about moral hazard risk of the PSC taking on underfunded schemes, there is broad agreement from PLSA members that there is a place in the PSC for underfunded schemes, on the basis that they represent an under-serviced segment of the market.

102. Where the employer is continuing to operate but the DB scheme not being managed as efficiently and effectively as it could be, these schemes would seem to be prime candidates for entering the PSC. We note that, under the PPF's proposed design (as outlined in their discussion document), it is envisaged that the PSC will not accept schemes that are severely underfunded (i.e. with less than 80% funding)[10]. We support this proposal, as allowing severely underfunded schemes to join the PSC would create a disproportionate risk to the PSC and its other (better funded) schemes and their members.

[10] Calculated using schemes' TP funding levels. Note, the analysis undertaken by the PPF is based on data sourced from TPR DB and Hybrid Scheme records as of 31 March 2023, which is consistent with the Purple Book 2023 and the PPF 7800 Index.

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103. We believe that accepting transfers from schemes with a deficit (as long as they are at least 80% funded) is likely to be an important part of ensuring the PSC can meet its objectives. Furthermore, it will help ensure the consolidator can support the schemes least attractive to commercial providers (including schemes with poorer funding).

104. However, where underfunded schemes enter the PSC, we believe these schemes should be segregated to avoid potential cross-subsidy with other schemes. Members of schemes entering the PSC on a fully funded basis should not have their benefits at risk from employers of underfunded schemes becoming insolvent.

105. In a recent survey of PLSA members, 80% of respondents said that, where a scheme has a deficit measured against the consolidator's entry price, the employer should be required to enter into a contract to make good the deficit by instalments over a specified time period.

106. And almost two-thirds of PLSA members (64%) said that, where a scheme with a funding deficit seeks to access the consolidator, members of the scheme should be separately identifiable by the consolidator.

107. However, there are mixed views as to whether scheme members' benefits should be reduced in line with the proportion of instalments made where the employer becomes insolvent before the instalment are complete, with 44% of PLSA members agreeing and 36% disagreeing.

108. There are a few issues that should be considered before allowing underfunded schemes to enter the PSC:

- Having a payment schedule for employers of underfunded schemes to make instalment payments will likely add complexity and cost to the PSC model. If these underfunded schemes have any similar 'characteristics', that could potentially make them easier to administer in a similar way (and therefore reduce the complexity and cost).

- The design of the PSC needs to mitigate risks to the funding position of the scheme, and the risk of opening up a mechanism for 'pension dumping' by employers (i.e. allowing employers to walk away from their pension liabilities on the cheap).

- Underfunded schemes could be in deficit within the PSC for a significant period of time. We believe more thought needs to be given to whether further constraints or safeguards will be necessary to address issues that incorporating schemes with a deficit could bring, such as how the repayment plan is structured, the legal protections that are established, and the access to recoveries in insolvency scenarios.

109. Nevertheless, on balance, we believe that underfunded schemes should be able to be accepted into the PSC, but with their assets ring-fenced and their members readily identifiable (in case the employer becomes insolvent before the end of the repayment schedule).

110. Schemes in surplus should be fine (indeed many schemes that transfer to the PSC are likely to be in surplus on the consolidator's pricing basis). We believe it would make sense to allow the surplus to be used to purchase higher levels of benefit from the PSC. And any surplus not used in this way could be returned to the employer on completion of a transaction with the PSC.

111. In our recent PLSA member survey, where a scheme looking to enter the PSC has a surplus measured against the consolidator entry price:

- Almost two-thirds of respondents (63%) said that employers and trustees should use the available surplus flexibilities to share the surplus alongside entering the consolidator; and

- Over half of respondents (51%) suggested that employers and trustees should use the available surplus flexibilities to purchase a higher level of benefits from the consolidator for its members.

Investment strategy

34. Is the proposed investment approach appropriate to achieve the consolidator's aims as set out above?
35. Will the proposed approach also allow the consolidator to reach a scale at which it can operate effectively?

112. If the PPF is selected as the public sector consolidator, then the Board of the PPF should remain responsible for independently setting the investment strategy and asset allocation.

113. In a recent survey of PLSA members, over half (53%) said they feel that the proposed investment approach is appropriate to achieve the consolidator's aims, with only 10% disagreeing.

114. That being said, if the government were to underwrite the PSC (see 'Underwriting' section below), they will legitimately expect to have a say in the overall level of risk that should be taken in the investment strategy. But in the absence of government backing, investment risk is likely to be more constrained and the ability of the PSC to invest in UK productive finance would be substantially limited due to the risks involved.

115. Whether establishing a PSC ultimately satisfies the government's ambition to increase investment in UK productive finance remains to be seen. In our recent member survey, over half of respondents (55%) said they believe that the proposed approach will allow the public consolidator to reach a scale at which it can operate effectively, with only 5% disagreeing (although 40% were undecided).

116. We note the comment from some of our members that, if the main objective of the government is to increase investment in productive assets, they should be focusing on ways to incentivise trustees to invest DB scheme assets in UK productive finance from within the scheme itself,[11] rather than inorganically trying to consolidate schemes to create one giant pool of assets that will be able to benefit from scale.

117. It is also worth noting the Pensions Policy Institute (PPI) research on Value for Money frameworks in other countries, which indicates that scale efficiencies start to reduce above the £400m – £500m level (based on their analysis of recent experiences in the pensions markets of the Netherlands and the USA).

Underwriting

36. What method of underwriting would be most appropriate to achieve the aims of the consolidator, given the expected capital requirements and timescales?
37. Are there other options that the government should consider to provide underwriting for the consolidator?
38. Should government underwrite the consolidator and set the investment strategy?

118. The PSC should meet the same stringent requirements as those that apply to commercial consolidators, i.e. DB superfunds: (1) to operate with prudent technical provisions; (2) to provide an adequate capital buffer; and (3) maintain funding above a stated level.

119. To achieve this (while maintaining an entry price that is attractive to schemes) the PSC will require underwriting from third party capital (equivalent to the buffer fund available to commercial consolidators).

[11] If possible, given TPR's focus on schemes – particularly maturing schemes – holding 'matching assets' in order to manage investment risk relative to the liabilities.

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120. The PLSA supports the view of the PPF, as outlined in their recent discussion document on the PSC design, that there is a clear case for the government to provide the buffer for the PSC (or a facility that mimics the effect of a buffer fund – i.e. a level of capital that the PSC can draw on in pre-determined scenarios).

121. Our members also strongly favour government underwriting, with over half of those recently surveyed (57%) stating that government underwriting is the most appropriate way to achieve the aims of the public consolidator, given the expected capital requirements and timescales. Less than one in five (19%) suggested that a proportion of the PPF's current reserves should be used to underwrite the PSC.

122. By underwriting the risk (up to a finite limit), the government could legitimately expect to be able to require a certain level of investment in UK productive finance – although as indicated in the 'Investment strategy' section above, we believe the Board of the PPF should remain responsible for independently setting the investment strategy and asset allocation.

123. That being said, we note some concerns expressed by a few of our members around the potentially significant negative consequences of the government setting the investments of the PSC, and then something going wrong (with only limited underwriting).

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

124. There are a number of ways such a facility could be structured. We agree with the PPF (as outlined in their recent discussion document) that an unlimited guarantee is unlikely to be required. We believe the total level of support available could be capped to a certain amount, however more work is needed to determine the appropriate level of support required.

125. Whatever total amount of government support is determined, it will need to be set at a level that supports the desired scale and ensures that the PSC retains at least the same level of security as required of commercial consolidators.

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

126. As indicated above, the PLSA and our members are strongly against the use of PPF reserves to underwrite the PSC, particularly as a significant part of the PPF's funding has come from sponsoring employers and DB schemes (especially in the case of multi-employer DB schemes).

127. And we note that the PPF itself, as stated in their recent discussion document, do not believe this is a viable option and they have a clear preference for the government underwriting the risk (up to a finite limit) to allow them to have a say in directing the PSC to invest in UK productive assets, which is one of their main objectives for establishing a public consolidator.

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