Department for Work & Pensions

Options for Defined Benefit Schemes

Public consultation

23 February 2024

Table of Contents

Ministerial foreword 4
Introduction 5
About this consultation 6
Purpose of this consultation 6
Scope of this consultation 6
Duration of this consultation 6
How to respond to this consultation 6
Government response 6
How we consult 7
Consultation principles 7
Feedback on the consultation process 7
Freedom of information 7
Chapter 1: Treatment of scheme surplus 8
Aims 8
Core propositions 8
Proposed changes 8
Statutory override 8
Taxation 9
Safeguards for member benefits 10
Alternative safeguard: 100% PPF underpin 12
Chapter 2: Model for a public sector consolidator 14
Aims 14
Context 14
Approach to eligibility 15
Proposed model 16
Structure 16
Member benefits 17
Governance 18
Funding 18
Treatment of entering scheme deficits and surplus 19
Investment Strategy 19
Underwriting 20
Chapter 3: Potential take-up and impacts 22
Survey for DB schemes 22
General Scheme information: 22

Scheme interest (Treatment of scheme surplus and 100% PPF underpin): 22
Scheme interest (Public Sector Consolidator Model) 22
Annex: Analysis for eligibility criteria of a public sector consolidator (Buyout basis) 24

Ministerial foreword

The government is overhauling the pensions landscape to provide better outcomes for savers, drive a more consolidated market, and enable pension funds to invest in a diverse portfolio. At Autumn Statement 2023, we committed to a bold range of measures to drive these changes. As part of this work, we will ensure that the assets held in UK pension schemes can work harder for scheme members, provide a secure retirement and support the growth of the wider economy. In that spirit, we are delighted to launch this consultation on aspects of private sector Defined Benefit (DB) schemes, which seeks substantive stakeholder feedback on important strands of this vision for the future pensions market. This follows the impressive industry response to our July 2023 call for evidence on options for Defined Benefit (DB) schemes and represents a key step towards realising our ambitious and far-reaching agenda.

Private Sector DB schemes will play an important role in this vision for the future of the pensions market. That is why, at Autumn Statement, we committed to make it easier for trustees of well-funded schemes to make payments from surplus to sponsoring employers and scheme members. We will ensure that employers and savers alike can take advantage of strong investment returns, supported by the revised scheme funding regime, which makes the headroom for more productive investment explicit whilst keeping members' benefits safe.

The government also committed to establish a public sector consolidator targeted at schemes unattractive to commercial providers. We must give more choice to DB scheme trustees and their sponsoring employers. To do this, we will press ahead with creating a permanent legislative regime for Superfund consolidators. We must also ensure that by establishing a public sector consolidator operated by the Pension Protection Fund by 2026, we drive better outcomes and improve member security for schemes unattractive to existing commercial consolidation providers.

We intend for these reforms to give additional options to schemes and sponsoring employers, leading to positive impacts for the wider UK economy. I also support the Chancellor's three golden rules in the pensions space, including his commitment to support a strong and diversified gilt market. However, we are clear that the primary objective of a pension scheme is that members get the pensions they are expecting. We are keen that any additional measures arising from the pensions investment agenda prioritise high levels of security for the millions of DB pension savers across the country. In the case of surplus extraction, this must take the form of clear rules as to which schemes can be eligible. With respect to the future public sector consolidator, this means a clear approach to eligibility and robust underwriting to give the best chance of members receiving full benefits.

We encourage all interested parties to provide feedback on the proposals outlined below. With the benefit of your expertise, we can ensure continued success in the DB pensions landscape.

Paul Maynard MP	**Mel Stride MP**
Minister for Pensions	**Secretary of State for Work and Pensions**

Introduction

1. At Autumn Statement 2023, DWP announced a number of 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. DB pension schemes are currently enjoying high levels of funding, with many schemes running a surplus. The revised funding regulations, which were laid earlier this year, make clearer what prudent funding plans look like, make it explicit that there is headroom in the regulatory environment for schemes to invest more productively, and require schemes to be clear about their long-term strategy to protect member benefits.

3. In this context, there is potential for trustees to share surplus with scheme members and sponsoring employers in recognition of their historical contributions. Current legislation, however, makes it difficult and costly for many scheme trustees to do this. We therefore committed to introduce measures to make surplus extraction easier for trustees, where they choose to do so.

4. Past experience of sponsoring employer "contribution holidays" has shown that the security of member benefits should be paramount in any major reform of the pensions landscape. We are clear that changes to the surplus sharing regime should be made only where they are safe from a member benefit perspective. We are consulting on a range of potential safeguards to ensure these additional flexibilities for trustees do not threaten member security.

5. Against the backdrop of maturing schemes and improved funding levels, the introduction of superfunds will provide a secure alternative to traditional avenues for relatively well funded schemes. However, we believe opportunities will remain restricted for schemes less attractive to commercial providers. In response, we will establish a public sector consolidator by 2026 aimed at schemes unattractive to commercial endgame providers.

6. While making these changes will involve using and enhancing existing structures such as scheme funding regulations, we want to support trustees to use their fiduciary duties in the best interests of members. We are proposing a number of new measures intended to balance enhanced options for trustees with prioritising the security of member benefits.

About this consultation

Purpose of this consultation

7. The overarching aim underlying this consultation is to introduce reforms to private sector defined benefit (DB) pensions system that jointly benefit scheme members, sponsoring employers and the wider economy.

8. This consultation builds on 'Options for defined benefit schemes: a call for evidence'[1], published in July 2023. In its response to this call for evidence, published in November 2023[2], the government committed to publicly consulting on measures to make surplus extraction easier and the design of a future public sector consolidator.

Scope of this consultation

9. This consultation builds on the principles of the forthcoming revised funding regime to understand what may be considered surplus funding and to provide more options for sponsors in dealing with legacy DB liabilities.

10. It seeks views on additional safeguards with respect to treatment of scheme surplus and the model for a future public sector consolidator run by the Pension Protection Fund (PPF).

11. The scope of this consultation does not extend to public service pension schemes as defined in the Pension Schemes Act 1993.

Duration of this consultation

12. This consultation begins on 23 February 2024 and runs until 19 April 2024.

How to respond to this consultation

13. Please respond to this consultation via email at pensions.consultations@dwp.gov.uk.

Government response

14. We will aim to publish the government response to the consultation on GOV.UK. The report will summarise the responses and outline our next steps.

[1] Options for Defined Benefit schemes: a call for evidence - GOV.UK (www.gov.uk)
[2] Government response to Options for Defined Benefit schemes - GOV.UK (www.gov.uk)

How we consult

Consultation principles

15. This consultation is being conducted in line with the revised Cabinet Office consultation principles published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

16. We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to the issues which are the subject of the consultation), or if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please email: caxtonhouse.legislation@dwp.gsi.gov.uk.

Freedom of information

17. The information you send us may need to be passed to colleagues within the Department for Work and Pensions (DWP), published in a summary of responses received and referred to in the published consultation report.

18. All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit or remove any personal information. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

19. To find out more about the general principles of FoI and how it is applied within DWP, contact the Central FoI team: freedom-of-information-request@dwp.gsi.gov.uk.

20. The Central FoI team cannot advise on specific consultation exercises, only on FoI issues.

Chapter 1: Treatment of scheme surplus

Aims

21. The government's aims with respect to scheme surplus are to:

    - Support schemes to invest for surplus in productive asset allocations[3] by making it easier to share scheme surplus with employers and scheme members;
    - Remove practical barriers to surplus extraction such as those relating to scheme rules; and
    - Remove behavioural barriers by bringing surplus extraction in line with trustee duties.

Core propositions

22. The government's core propositions with respect to scheme surplus are as follows:

    - Surplus should only be extracted where safe to do so from a member benefit perspective;
    - In all cases, trustees would retain responsibility for managing scheme funding levels; and
    - Extracting surplus will not be conditional on use of funds for particular purposes.

Proposed changes

Statutory override

23. The Pensions Act 2004 required DB scheme trustees to pass a resolution before April 2011 to have the power to make payments from the scheme to the sponsoring employer. This date was extended to 2016 by the Pensions Act 2011. Schemes which did not pass this resolution before 2016 cannot make payments to the sponsoring employer.

24. TPR analysis[4] suggests that of the approximately 5,000 DB schemes, over 3,750 are in surplus on a **low dependency basis**[5], with a further 950

---

[3] Productive finance does not have a formal legal definition. However, it is often described as investment that expands productive capacity, furthers growth and can make an important contribution to the real economy. Examples of productive finance include:

- plant and equipment, which can help businesses achieve scale
- research and development, which improves the knowledge economy
- technologies, for example green technology
- infrastructure
- private equity related to these sectors

[4] Figures provided by TPR with a calculation date as at 30 September 2023.

[5] For these purposes low dependency liabilities are calculated using a generic approach of gilts + 50 bps. Other bases might be suitable.

schemes approaching surplus[6] on a low dependency basis. For those schemes in surplus, there was in excess of £225 billion in aggregate surplus assets on a low dependency basis across the DB universe[7], roughly 17% of total DB assets. However, data suggests the amount of surplus accessed, relative to current surplus, is low. HMRC analysis suggests around £180 million in surplus has been extracted over the 5-year period between March 2018-March 2023[8].

25. Respondents to the call for evidence suggested that the major barrier to surplus extraction is that many scheme rules prohibit trustees from extracting surplus. We are considering introducing a statutory override to ensure that all schemes can choose to share surplus subject to the appropriate funding levels.

26. We could achieve this through introducing a statutory power for schemes to amend their rules to allow for payments from surplus funding. We could also do this through introducing a statutory power to make payments.

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

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?

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?

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?

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

Taxation

27. In its response to ‘Options for defined benefit schemes: a call for evidence’, the government committed to reduce the rate of tax payable by employers on repayment of surplus from 35% to 25%. To complement these changes, we plan to simplify the process under which trustees can make one-off payments to members. Some stakeholders have suggested that trustees might prefer to

[6] Schemes funded over 75% are considered as approaching surplus levels.
[7] Based on the net funding position of schemes in surplus, on a buyout basis. Purple Book 2023.
[8] This figure was estimated using Accounting for Tax (AfT) data on reported DB surplus payment charges divided by the 35% charge rate to estimate total payments, aggregated over a 5-year period

use part of any extracted surplus to make one-off payments, rather than permanently uprate benefits thereby increasing scheme liabilities.

28. Current pensions legislation does not prevent scheme trustees from making one-off payments as part of pension benefits. However, stakeholders have suggested that trustees' ability to do so is limited, given these payments are classified as unauthorised payments under pension tax legislation and are taxed accordingly. Further details on unauthorised payments and how the charges apply can be found in the HMRC Pensions Tax Manual here.

29. The government would welcome views on whether it would be appropriate to make any changes here, or elsewhere in the tax system, to make extracting surplus attractive to trustees while ensuring that surplus continues to be taxed at an appropriate level.

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

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

Safeguards for member benefits

30. When allowing surplus to be extracted from a scheme, it is important to ensure that sufficient safeguards are in place to protect the security of member benefits within the scheme. The 1995 Pensions Act (the 1995 Act)[9] introduced stricter funding requirements and tightened up regulatory control, including the criteria allowing the trustees to make payments from a DB scheme surplus to the sponsoring employer.

31. In recent years we have seen rapid improvements in scheme funding positions, making surplus extraction a more viable option for many schemes. Currently, schemes are only allowed to distribute surplus to the employer when funding exceeds the level needed to secure a full buy out with an insurer. We are seeking views in this consultation on amending these requirements to enable greater sharing of surplus, provided high levels of member protections are maintained.

32. Any extraction of surplus will reduce security for members. In establishing a new basis to permit surplus extraction we need to ensure there remains a very high probability that member benefits will be paid in full. This implies that any surplus extraction should still leave the scheme over 100% funded on a prudent basis. However, the level of investment risk and the strength of the sponsoring employer will also have a significant bearing on what level of surplus is 'safe' to extract.

[9] The 1995 Act was later amended to take account of the post-2006 tax regime introduced by the Finance Act 2004.

33. Eligibility criteria for surplus extraction currently being considered include:

- **Funding above the low dependency funding basis plus a fixed margin**, for example, above 105% of the low dependency basis. The Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024 require schemes' liabilities to be calculated on a low dependency funding basis. If a scheme is 100% funded on this basis with a 'buffer' and holds a low dependency asset allocation highly resilient to short-term changes in market conditions, then there should be little reduction in member security as a result of sharing surplus. In cases where schemes are taking more investment risk than in a low dependency asset allocation and have a weaker covenant, member security could still be reduced following surplus extraction if assets were to perform poorly.

- **Funding 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. This could help address the challenge posed by variable investment risk levels where the covenant may not be strong enough to support higher levels of risk.

- **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 (this could be a requirement for employers to be of investment grade strength). Alternatively, there could be an additional funding margin based on covenant strength, for example, above 100% + x% of the low dependency basis, where x is determined by the covenant strength. In practice, covenant can be challenging to quantify and can change over time. This is therefore not our preferred option.

- **Maintain a buy-out funding level threshold but introduce a statutory override** so that trustees can exercise this option even if not codified in the scheme rules by the previous 2016 deadline.

34. We also propose to introduce additional guidance for trustees around the considerations required when considering extraction of DB scheme surplus. We could do this through adding an additional module to the 'Funding defined benefits' code of practice, introducing a separate code on surplus extraction or via TPR guidance. We hope this will give confidence to trustees to share the benefits of strong investment returns with employers and members where this is safe to do so.

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

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

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

Alternative safeguard: 100% PPF underpin

35. The call for evidence invited stakeholder views on a potential regime proposed by the pensions industry, under which 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, described here as a "100% PPF underpin."

36. While the safeguards listed above could be sufficient to protect members' interests while enabling greater freedom for trustees, we would be interested in understanding if the additional security of a 100% PPF underpin is still valued and necessary to enable increased surplus extraction. We would also be keen to understand if schemes and sponsors see wider benefits in this approach – for example, providing an additional level of security for large schemes that plan to run on over the long term rather than seek to buy out with an insurer or transfer to a consolidator.

37. We would also welcome stakeholder views on the most appropriate design for any 100% PPF underpin. The government recognises there are important trade-offs between the level of protection provided, placing constraints on schemes to mitigate the level of risk posed to the PPF and the cost of the levy. To help illustrate these trade-offs the PPF has conducted some initial approximate analysis using a range of assumptions. Specifically, the PPF assumed that schemes could only be eligible for a "super levy" arrangement if they had investment grade sponsors, were funded on a 'gilts + 0.5% p.a.' basis and had an ongoing requirement to fund to this higher level. Additionally, once a scheme entered the arrangement, it was assumed the scheme was locked in and therefore that the PPF was responsible for any claims that arose in the future.

38. 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 estimate differs from others carried out by the pensions industry, which provide for a lower "super levy" rate but assume integration of the PPF lifeboat and 100% PPF underpin funds. The government is clear that funds from these functions should remain separate.

39. The PPF's assessment was based on the super levy structure being a 'top up' to existing PPF compensation payments (funded by the existing levy). Crucially, the top up was assumed to be funded purely by the super levy, meaning the amounts collected need to cover all 'top up' future claims that

may occur (i.e., no cross subsidy from the PPF's existing fund) with the PPF levy payable in addition.

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?

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

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?

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

Chapter 2: Model for a public sector consolidator

Aims

40. The Government intends to establish a public sector consolidator administered by the Pension Protection Fund (the "consolidator") by 2026. The aims of the consolidator will be to:

    - Maintain the security of members' benefits by ensuring that members' interests are protected;
    - Provide an alternative endgame solution for DB schemes unattractive to commercial consolidation providers;
    - Enable greater investment in high-growth UK assets than would be achievable by eligible schemes in the absence of a public sector consolidator; and
    - Minimise the potential distortion of the superfund and insurance buyout markets.

Context

41. There are around 5,000 defined benefit schemes, with a total of around £1.4 trillion in assets. They range in size from a handful with assets of tens of billions of pounds, to a large number with assets of below £10 million. The majority of schemes have seen their funding improve in recent years; however, smaller schemes and their sponsors in particular face a range of challenges. Government believes that consolidation of this sector can bring a range of benefits: improving member security, improving governance standards and risk management while also providing the opportunity for increased investment in UK productive finance assets.

42. Private sector consolidation options include insurance buyout and commercial superfunds. However, given the number and scale of schemes likely to seek endgame solutions over the next few years, government considers that not all of the market – particularly smaller schemes and those less than fully funded - are likely to have a practical option for consolidation.

43. It is intended to set up a public sector consolidator with an objective to accept transfers from schemes that can accept its terms. Although the consolidator would primarily be targeting smaller and less well funded schemes, we recognise that there is merit in setting a predominantly principles-based approach to eligibility, as opposed to restrictive eligibility criteria, at the start. The position of schemes can change significantly in relatively short periods, and prescriptive eligibility measures might exclude schemes that would benefit from the public sector consolidator solution. In particular, outside of the primary target of smaller or underfunded schemes, we are aware there may be larger and/or more complex schemes that may not be able to secure an endgame solution via the current market offering.

44. At the same time, being open to all schemes does not necessitate being an attractive option to all schemes. The consolidator will aim to appeal to smaller schemes by minimising the price penalty that small schemes pay for consolidation, through specific design features such as a standardised benefit structure. These would lead to the consolidator being more attractive to schemes that do not have commercial alternatives (which could for example replicate existing benefit structures) and less attractive to those that do.

45. There would be an expectation, subject to achieving sufficient scale that the consolidator would invest part of its funds in high-growth UK assets – though the extent of this may depend on the nature of underwriting.

Approach to eligibility

46. The extent to which existing consolidation and buyout providers serve the whole market is a matter of some contention – and we received contrasting views on this matter in the call for evidence. On the one hand, some transactions for small schemes occur. On the other, the number may be too limited to meet the needs of all those that would like to secure their scheme – and successful schemes often have to offer exclusivity to obtain a quote rather than seek competing offers. This makes it difficult to establish hard limits on eligibility for the public sector consolidator by reference to factors such as size or funding level.

47. We expect that setting the consolidator statutory objectives to offer an option specifically for schemes unattractive to commercial consolidation providers will lead to an outcome whereby trustees select into the public sector consolidator where commercial alternatives are not available to them.

48. The approach of using the imposition of public duties on public sector organisations operating in a competitive market is a well-established and successful one. For example, in the defined contribution pensions market NEST provides an alternative to a range of private sector funds, operating under a similar duty to offer a service to all employers, and in export finance UK Export Finance operates alongside commercial lenders.

49. Broad eligibility criteria could still be set alongside these objectives and duties:

    - Entry into the consolidator could also be considered on the basis that a scheme demonstrates an inability to join a commercial consolidator or secure insurance buyout.
    - The government could set an explicit limit on the size to which the consolidator could grow, or limit the annual amount consolidated, if that were considered necessary to avoid concerns about overexpansion.

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

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

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?

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

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

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

Proposed model

Structure

50. The consolidator will have the following key characteristics:

- It will be a public sector vehicle set up for the purposes of effecting consolidation of certain private sector DB pension schemes' liabilities.
- The link between the employer and pension scheme will be severed when the scheme transfers to the consolidator, apart from underfunded schemes where the employer will enter into an obligation to pay off the deficit over time.
- It will operate as an unsegregated fund on a run-on basis.

51. We propose for the consolidator to operate in many respects similarly to a superfund. The key difference between the consolidator and commercial providers will be that the consolidator will not be backed by private sector capital and will be administered in line with legislation. Entry into the consolidator will be voluntary.

52. The consolidator will aim to limit market distortion by design to attract those schemes less well served by commercial consolidators and insurers.

53. There is a key structural question as to whether the consolidator should operate with multiple standalone sections, with ringfenced assets and liabilities, or as a single fund, meaning that all incoming schemes will be

pooled together. The government recognises that there are advantages to both approaches.

54. We propose that the consolidator operate as a pooled fund. This would allow the consolidator to benefit from economies of scale. We also propose that the consolidator operate on a “run on” basis rather than target insurance buyout.

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 and/or operating basis would you propose?

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

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

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

Member benefits

55. A particular challenge for small schemes moving into a commercial consolidator or insurance buyout is the fixed cost of establishing a benefit structure that directly replicates scheme benefits. Whilst this can be cost effective for large schemes the cost can be disproportionate for smaller schemes.

56. We propose 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. The available benefit structures would seek to achieve the optimum balance between reflecting scheme benefit structures and reducing complexity and cost. They would also be designed to ensure no reduction in the headline level of benefits was necessary.

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?

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

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

Governance

57. The intention is that the public sector consolidator will be effectively administered and command public confidence. We propose that the consolidator operate as a statutory fund administered by the Board of the PPF (the "Board"). It will be a distinct function for the Board and the fund will be ring fenced – i.e., the PPF's existing funds and the consolidator funds will be legally separate. This is comparable to the separation of the Board's existing functions in relation to the PPF and the Fraud Compensation Fund.

58. We propose that, in relation to the new consolidator, the Board be subject to a range of requirements, to be set out in legislation, which are likely to align with the authorisation criteria for superfunds. This is consistent with the position for the Board's existing responsibilities where its functions and accountabilities are set out in legislation, with practical oversight arrangements set out in a Cabinet Office framework document, and where the Board is not subject to further external regulation.

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

Question 29: What alternative governance structures should be considered?

Funding

59. It is essential that the consolidator offer a high level of security to its members. To achieve this and to avoid any unfair competition we expect the public consolidator could be required to meet the same funding standards as commercial consolidators, which will need to comply with forthcoming superfund legislation. Current TPR guidance implies commercial consolidators should be funded on technical provisions (TPs) within the range of gilts +0.5 to gilts +0.75 per cent and should maintain a risk-based capital buffer provided by investors. We would expect the Board to have a role in setting a long-term funding objective which would form part of the funding strategy and would be published.

60. The funding basis will also influence the entry price for schemes. We anticipate setting the entry price in line with the target funding basis. 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.

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?

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?

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

Treatment of entering scheme deficits and surplus

61. Schemes transferring to the public consolidator will either have a deficit or a surplus against the consolidator's pricing basis (it is highly unlikely a scheme would be exactly 100% funded). A key role for the public sector consolidator is to provide a solution for poorly funded schemes. For all schemes transferring (given the expected focus on smaller schemes) ensuring a cost-effective process will be key. We propose that where a scheme is seeking to transfer to the consolidator and:

    (a) has **a deficit measured against the consolidator entry price,** the employer would enter into a contract to make good the deficit by instalments over a specified time period. The aim would be to ensure that – on completion of the repayment schedule – the consolidator is in the position it would expect to be in had the scheme transferred fully funded.

    (b) has a **surplus** measured against the consolidator entry price, employers and trustees could use the available surplus flexibilities to share the surplus alongside entering the consolidator and/or to 'purchase' a higher level of benefits from the consolidator for its members. As noted in the previous section, legislation may be needed to override scheme rules to enable trustees and employers to agree an appropriate approach.

62. We propose that where a scheme with a funding deficit seeks to access the consolidator, the members of the scheme should be separately identifiable by the consolidator. Should the employer become insolvent before the instalments were complete, the members would have their benefits reduced in line with the proportion of instalments made. This would be necessary in order to remove the funding risk to the consolidator and its other members and also to ensure an equivalent outcome for members of schemes that remain outside the consolidator.

63. This could be achieved within the consolidator or by putting the assets and liabilities in respect of members formerly in the employer's scheme through the standard PPF assessment. Therefore, like all other DB scheme members, members of schemes in the public consolidator would receive at least PPF compensation at a minimum if their scheme assets were not to support higher pension payments.

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

Investment Strategy

64. The intention is that the consolidator will maintain an investment strategy that supports a prudent funding basis as well as increasing productive asset allocation. This will benefit members and the broader economy. The

investment strategy of the consolidator will be subject to the scale, form and size of underwriting it receives. The Board will have a key role to play in shaping this strategy and will publish its statement of investment principles. We may also consider more detailed reporting requirements.

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

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

Underwriting

65. TPR currently expects commercial consolidators to have an investment strategy to be fully funded on a prudent technical provisions basis in 99% of scenarios over five years. We would expect the public sector consolidator to follow the same requirement to ensure fair treatment. Commercial consolidators achieve this by using third-party capital to provide a limited 'buffer fund' that the consolidator could draw on should funding drop below certain pre-defined levels.

66. A key question for the design of the public sector consolidator is how to enable the consolidator to provide a similar level of security. It could be done through operating a very prudent funding basis but this could make the 'entry price' unaffordable. The government considers, therefore, that a form of underwriting will be essential. The government would welcome views from stakeholders on different options and their relative merits.

67. Responses to the call for evidence noted two broad possibilities:

- **Government underwriting.** The consolidator is intended to support schemes that would otherwise struggle to access a secure end game solution. This could give more control to Government in setting the investment strategy, including but not limited to, greater drive for investment in UK productive finance, benefitting the economy. Government underwriting would give more authority to allow the Government to set the direction of the consolidator and the level of investment risk. Other options would not support this in the same way. Care would need to be taken to ensure Government underwriting would not create unfair competition. It is likely that any Government support would be limited and scaled to match the level of security that commercial consolidators provide.

- **Use of PPF reserves**. The PPF has established reserves of over £12 billion. A proportion of these reserves could be used to underwrite the public sector consolidator. Finite and limited funds could be provided in the form of an investment or loan from the PPF with the PPF remunerated for the investment (as investors in a commercial consolidator would receive a return on their investment), which if those returns are achieved, could (in upside scenarios) further strengthen the PPF's financial

resilience. However, given the limited nature of the funds available, in the short term, scale could be challenging. The government also recognises that there are other challenges with this approach. The PPF reserves exist to protect the PPF's current and future members and levy payers against future risks (for example, claims and longevity risks). Any call on PPF reserves earmarked to underwrite the consolidator will weaken the PPF's financial position and raise the risk of the PPF levy having to increase in the future. Government will be consulting in the coming months on levy changes, and PPF compensation levels.

68. It is envisaged that any underwriting would be finite in nature. We expect that as with commercial consolidators, this means that in a failure scenario, the members would need to have recourse to the existing PPF compensation. This means the consolidator would be expected to pay the PPF levy (again this ensures a 'level playing field' with commercial consolidators).

69. The remit of the consolidator will be taken into account when considering the suitable level and provider of underwriting. The consolidator is targeting smaller schemes (average assets less than £10 billion), and we are aware the endgame process can often be measured in years. Substantial levels of underwriting are not expected to be required in the short-term, and are instead expected to slowly ramp up over the medium-term (5-10 years) as schemes transact.

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

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

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

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

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

Chapter 3: Potential take-up and impacts

Survey for DB schemes

70. Below is a short survey for DB schemes aimed at gathering information on the level of DB schemes' interest in these new policies to inform the policy design. We are interested in understanding if there are any barriers to schemes accessing commercial consolidators or insurers and the impact the policies may have on your scheme. To better understand the potential take-up and the potential costs for schemes, we welcome feedback in addition to any further evidence or analysis you would like to share about the issues under discussion in this consultation.

71. We understand that the requested data is sensitive. We will treat this information as commercially confidential, where appropriate, and not seek to pass the information outside government.

General Scheme information:

Question 41: Can you provide an overview of the size of your scheme (assets, liabilities (preferably on a buy-out basis), and number of members)?

Scheme interest (Treatment of scheme surplus and 100% PPF underpin):

Question 42: Has your scheme previously had a surplus extracted? Was this accessed for a specific purpose?

Question 43: To what extent do you think your scheme would extract a surplus under the changes discussed in this consultation?

Question 44: Would your scheme be likely to change investment strategies as a result of being able to access a surplus easier? To what extent would this be dependent on the PPF 100% underpin?

Question 45: As outlined in the consultation, the PPF previously conducted analysis suggesting a super levy of 0.6% of liabilities would be required to support a 100% PPF underpin. Do you consider this an appropriate cost? Is there a particular point which would make this more or less attractive to your scheme?

Scheme interest (Public Sector Consolidator Model)

Question 46: To what extent would your scheme be interested in entering a Public Sector consolidator as outlined in the consultation?

Question 47: Has your scheme faced any challenges in trying to buy-out with an insurer?

Question 48: Were you to take part in the public sector consolidator, what would be the estimated savings of entering a public sector consolidator? Do you envisage any costs and if so, can you provide an estimate of what the costs are likely to be?

Question 49: Do you have any wider concerns about the impact a public sector consolidator could have on the insurance or superfund market?

Annex: Analysis for eligibility criteria of a public sector consolidator (Buyout basis)

72. These figures highlight how many schemes could be in scope for consolidation, however this is not adjusted for take-up.

73. The table below indicates the number of schemes by scheme size and funding level on a **buyout basis**, as well as total assets within these same categories as at **September 2023**[10]. **The existing market for consolidation/buyout has been highlighted below** (through superfunds or insurance buy-outs).

Number of Schemes by Scheme Size and Funding Level (Buyout Basis)					
Members/ Funding Level	0-99	100-999	1,000-4,999	Above 5,000	Total
Above 100%	1070	1120	370	210	2770
95-100%	140	200	60	30	430
90-95%	150	200	60	20	430
85-90%	110	170	50	20	360
80-85%	90	160	40	10	290
75-80%	50	110	20	10	190
70-75%	60	70	30	10	170
Below 70%	130	130	30	<10	290
Total	1,790	2160	660	320	4,930

Total Assets by Scheme Size and Funding Level (Buyout Basis)					
Members/ Funding Level	0--99	100-999	1,000-4,999	Above 5,000	Total
Above 100%	£10bn	£70bn	£150bn	£690bn	£920bn
95-100%	<£10bn	£10bn	£20bn	£90bn	£120bn
90-95%	<£10bn	£10bn	£20bn	£140bn	£170bn
85-90%	<£10bn	£10bn	£20bn	£60bn	£80bn
80-85%	<£10bn	£10bn	£10bn	£10bn	£30bn
75-80%	<£10bn	<£10bn	<£10bn	£10bn	£20bn
70-75%	<£10bn	<£10bn	£10bn	£10bn	£20bn
Below 70%	<£10bn	<£10bn	£10bn	£10bn	£20bn
Total	£10bn	£120bn	£230bn	£1,010bn	£1,370bn

[10] Estimates provided by TPR as at September 2023, rounded to the nearest 10. These estimates are based on the information available - true figures may differ from these. The true cost of buyout for individual schemes cannot be ascertained until we have approached the market etc. Figures may not sum due to rounding.

:

- **Schemes in scope for buyout have been highlighted in blue -** We assume schemes above 95% funding on a buyout basis would be in scope for buyout with an insurer, except in the case of very small schemes (<100 members).
- **Schemes in scope for superfunds (orange)** (over 70% funded on a buyout basis, and with more than 100 members)
  ➔ Combined, this is around 3,000 schemes, with £1.3tn in assets.

74. Given the existing market,

- If all very small schemes (<100 members) were to consolidate, this would mean around **1,800 schemes were in scope, with £10 billion in assets** (on a buyout basis).
- If all schemes <70% funded were to consolidate, this would mean **around 300 schemes were in scope, with £20 billion in assets** (on a buyout basis)**.**
  The table below indicates the number of schemes in each covenant group by funding size on a buyout basis. Schemes in scope for superfund
  consolidation or buyout with an insurer are highlighted.

75. Excluding those in scope for buyout or commercial consolidation (as highlighted), if all schemes with weak to very weak covenant groups were to consolidate this would mean around **800 schemes were in scope with £80 billion in total assets**.

76. Covenant Group Definitions[11]

- covenant group 1: strong
- covenant group 2: tending to strong
- covenant group 3: tending to weak
- covenant group 4: weak

[11] Covenant gradings as assessed at the latest actuarial valuations. The gradings for schemes may differ over time but we expect the broad pattern to be similar.

Number of Schemes by Covenant Group and Funding Level (Buyout Basis)					
Covenant Group/ Funding Level	**CG1**	**CG2**	**CG3**	**CG4**	**Total**
Above 100%	600	1330	430	410	2770
95-100%	80	200	80	60	430
90-95%	70	190	90	70	430
85-90%	60	160	80	70	360
80-85%	50	120	80	50	290
75-80%	40	80	40	30	190
70-75%	20	60	50	50	170
Below 70%	50	90	80	80	290
Total	970	2,220	930	810	4,930

Total Assets by Covenant Group and Funding Level (Buyout Basis)					
Covenant Group/ Funding Level	**CG1**	**CG2**	**CG3**	**CG4**	**Total**
Above 100%	£240bn	£460bn	£150bn	£70bn	£920bn
95-100%	£30bn	£40bn	£30bn	£10bn	£120bn
90-95%	£50bn	£100bn	£10bn	£10bn	£170bn
85-90%	<£10bn	£40bn	£20bn	£20bn	£80bn
80-85%	£10bn	£10bn	£10bn	<£10bn	£30bn
75-80%	<£10bn	£10bn	<£10bn	<£10bn	£20bn
70-75%	<£10bn	£10bn	£10bn	<£10bn	£20bn
Below 70%	<£10bn	£10bn	<£10bn	<£10bn	£20bn
Total	£340bn	£690bn	£230bn	£110bn	£1,370bn