Institute and Faculty of Actuaries

April 2024

# Institute and Faculty of Actuaries: Response to DWP's Consultation on *Options for Defined Benefit schemes*

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide and oversee their education at all stages of qualification and development throughout their careers.

The Institute and Faculty of Actuaries (IFoA) is pleased to submit a response to the consultation by the Department for Work and Pensions on the options for defined benefit pension schemes in the UK. Within the actuarial profession we have experts in technical detail, executives in small and large financial institutions, and practitioners working within the financial system itself. Our outlook is rooted in our Royal Charter (dating back to 1884) and in our long history of working with policymakers to effect change. We focus forwards on how we can help individuals and organisations solve financial and risk-related problems in the 21st Century.

***Key points***

- Whilst we support proposals to allow surplus to be more easily extracted for members and sponsors, the IFoA believes it is critical that any provisions protect the security of members' benefits. Subject to appropriate protections being put in place, we support measures to allow trustees and employers to <u>agree</u> how and when surplus should be used to benefit members, regardless of any restrictions in existing scheme rules.

- A key consideration is the minimum level of funding that should be required before any payment of surplus to an employer. The IFoA believes this level should, at the very least, include a buffer over the scheme's low dependency target. If a target below full solvency is adopted, then there should also be additional requirements in relation to employer covenant, demographic and investment risk.

- If changes are made to allow trustees and sponsors to use DB surpluses, we support changes to the tax regime to introduce a new authorised lump sum payment to scheme members. This would more easily allow surpluses to be distributed to members by way of one-off lump sum payments, thus enabling the distribution of surplus without increasing scheme liabilities. HMRC will need to be involved at an early stage, and Finance Bill clauses developed in parallel, so that the tax legislation is ready in time to permit any payments newly allowed by the DWP legislation.

- We note the figures on current levels of funding and solvency in the document are higher than we would expect, based on similar analysis carried out by some of the actuarial firms, so that opportunities may be more limited than the consultation assumes.

- We do not believe that the proposal to increase PPF coverage to 100%, especially at the indicative cost of 0.6% pa, would be feasible or desirable.


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- A public sector consolidator would address the issue of some schemes being unable to buy-out with an insurer or have access to a commercial consolidator. However, we expect this problem may not be as big as the Government believes and our view is that the issue, such as it is, could be solved in other ways. It may also be addressed as the market adapts to deal with smaller schemes. However, if the Government wishes to set up a PSC to address a current issue for some smaller schemes, we agree the PSC works as a means to an end, provided the entry criteria are sufficiently robust and the PSC is only available to those schemes who cannot achieve settlement through other, commercial means.

- The IFoA believes that establishing the PSC on the terms proposed would distort the existing commercial market, potentially significantly. A PSC that was open to a sufficient range of schemes to allow a material increase in investment in productive assets would be of a scale that must by its nature distort the market. Hence, we do not believe the Government can meet its dual aims of increasing productive investment through the consolidation of smaller DB schemes and avoiding distortion of the commercial market.

- Given a PSC must, we believe, have a government guarantee, the question then is whether it might further distort the market if members view the PSC as having a gold-plated government guarantee (even if it doesn't) that is stronger than the security provided by the bulk annuity insurers.

Our detailed responses are shown below. If you have any questions on the response, please contact Caolan Ward (caolan.ward@actuaries.org.uk) in the first instance.

**Chapter 1: Treatment of scheme surplus**

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

Yes, it would make such sharing possible where the trustee and sponsor are in agreement that this is an appropriate course of action, and where the security of member benefits is protected.

**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?**

Recognising that surpluses largely result from excess contributions made by sponsors over many years, it should be possible to allow trustees and sponsors to agree ownership/distribution of a surplus in an ongoing situation, subject to the scheme still being able to meet full benefits as they fall due. Whether the statutory power is to make payments directly, or to be able to amend the scheme rules to make payments (See Q3 for our views on these) we believe the statutory power should be subject to agreement between the trustee and sponsor rather than allowing a sole discretion to either party.

**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?**

We do not believe there is a one-size-fits-all solution for the appropriate balance of powers for extracting surplus and would not favour a statutory override that allowed payments to be made regardless of a scheme's existing balance of powers, or any other contractual arrangements already agreed between the sponsor and trustees for discretionary benefits and/or surplus distribution. Many agreements regarding the use of surplus are a deliberate result of a negotiated package between the sponsor and trustees, so any existing agreement between trustees and sponsor should not be overridden.

Our preference is therefore that the Government introduce a statutory power to amend rules. The aim should be to allow trustees and sponsors to agree to remove 'accidental' provisions in the scheme rules – currently, scheme rules regarding the use of surplus tend to be something of a lottery – so they are free to negotiate the use of surplus going forward without being bound by existing rules.

We do note that this approach will mean two separate negotiations, potentially at different times. The first will be to agree the changes to the rules that will permit payment to the employer, and the second will be when such a provision is used in practice.

**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?**

Yes. It is possible to make one-off payments already in many schemes, but not in a tax-efficient way. We would favour a new (and separate) type of authorised payment being introduced to allow authorised one-off payments to actives, deferred pensioners and current pensioners as part of a surplus distribution.

Much of the focus to date has been on augmentations for pensioners, whose payment details and dependant details are known to the trustees, but we believe there also need to be simpler mechanisms to share surplus with actives and deferred members than augmenting their accrued benefits (either by additional pension or lump sums).

One-off, immediate, payments provide cost certainty in respect of pensioners and are likely to have more cost certainty for actives and deferreds than other benefit improvement options. A one-off payment would be more meaningful for individuals than a small pension uplift, allowing schemes to make payments to help with the cost of living and improve member outcomes. For younger members, it might be necessary to allow them to receive a "one-off surplus payment" before their normal minimum pension age (HMRC would need to be involved to make that an authorised payment).

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

The ability to easily share surplus (subject to members' benefits remaining protected) helps to ease concerns about trapped surplus and might see more DB schemes seeking to run on or running off for longer, rather than buying out in the short term. It might therefore slow the flow of schemes to buy-out insurers, although we expect many closed schemes will still proceed to buy-out in the medium to long term. Hence the impact is more likely on the timing of when schemes transfer to insurers rather than on the eventual outcomes.

## Section 2: Taxation

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

We refer to our response to question 4. We favour a new (and separate) type of authorised payment being introduced to the tax regime to allow authorised one-off payments to actives, deferred pensioners, and current pensioners. Much of the focus has been on augmentations for pensioners, whose payment details and dependant details are known to the trustees, but we believe there also need to be mechanisms to share surplus with actives and deferred members.

Overall, if the Government wants to maximise opportunities for DB schemes to share surplus, it needs to provide maximum flexibility for schemes to do so, which would mean removing constraints (including tax constraints) on the form in which surplus can be shared with members. HMRC should be involved at an early stage so that the DWP and Finance Bill legislation is developed in parallel – otherwise there is a risk that HMRC legislation blocks the use of the surplus sharing until the legislation for registered pension schemes catches up.

If the Government wants to encourage schemes to distribute surplus in the form of enhanced member benefits, and not just focus on payments to sponsors, it should consider clarifying this as an expectation, possibly in the guidance TPR will be producing (which has been billed as 'trustee guidance' but could equally cover guidance to sponsors). We assume this guidance will set out the factors trustees and sponsors should consider before deciding to amend scheme rules and before determining a distribution of surplus.

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

In our view, the tax rate applied for the return of surplus should be the same as the employer's marginal tax rate. This would mean that payments of surplus would be broadly cost neutral to the sponsor, reversing the tax relief the sponsor gained when contributing to the scheme. In other words, we do not believe it would be sensible to *incentivise* employers (from a tax perspective) to build up or extract surplus – the tax rate should simply be cost neutral to avoid disincentivising sponsors from adequately funding their schemes due to fears of trapped surplus. We therefore support the reduction of tax from 35% to 25% from April 2024 and would encourage the Government to keep this under review so that it remains broadly cost neutral to sponsors.

There are other issues to consider, but we expect these would largely be covered in TPR's proposed guidance. They include issues with changing the way in which priority orders work for schemes (i.e the priority with which limited assets are used to secure members' benefits on winding-up) if surpluses have been shared with members in the past, and dealing with communications to members if there are insufficient assets to secure members' benefits in full in an insolvency situation after surpluses have been shared.

**Section 3: Safeguards for member benefits**

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

We would expect TPR's proposed guidance to set principles for the use of surplus, with these principles guiding trustees and sponsors in reaching new agreements going forward.

We would not expect the criteria to exceed a 100% buy-out funding level or be below the low dependency funding target agreed as part of the new funding requirement. In practice, the qualitative legal criteria (which might then be supplemented by additional criteria in TPR's guidance) could be represented by either 'low dependency plus' or 'buy-out minus' – we do not have a strong preference for which of these is followed, although 'low dependency plus' could have the advantage of being less subjective.

In our view, if the required funding level is less than full buy-out funding, there should also be additional requirements that need to be met. In particular:

- The sponsor covenant should be considered sufficient to support the remaining deficit on a solvency basis.
- The sponsor covenant should be considered sufficient to support the level of investment risk being taken.

TPR's guidance could then build upon any legal definition and qualitative legal requirements, whether by imposing additional expectations on top of 'low dependency plus', or by specifying conditions in which 'buy-out minus' could be appropriate (the latter requiring legislation to specify that TPR's guidance needs to be considered for the 'minus' considerations).

Whatever the criteria, we believe any decision to use surplus should be subject to the agreement of the trustees and the sponsor.

We also note that in our previous response to the Options for DB call for evidence we put forward a suggestion that, rather than specifying a particular funding level as the criteria for an extraction of surplus, the requirement should be like the 'funding test' used for determining whether a leaving employer's section 75 debt can be apportioned to a remaining employer.

This proposal would see a payment of surplus being subject to the trustees being satisfied that:

- there is no material worsening in the likelihood that members will receive their benefits in full as they fall due after the payment has been made, considering sponsor covenant and any contingent asset arrangements; and
- they are confident that, should a shortfall arise in future, the sponsor is likely to have the resources to make this good over a relatively short period. Such assessment could also consider the likelihood of future deficits (the greater the current funding cushion, the less this will be a concern).

As we also noted in our previous response, our experience is that many trustees have taken careful and extensive funding and covenant advice, and often also negotiated contingent funding arrangements, as part of the process of agreeing that a section 75 debt need not be met when an employer ceases to be responsible for its obligations to a scheme, and we would expect this to apply to a heightened degree in the case of considerations around a refund of surplus.

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

We would expect clear principles-based guidance, setting out what reasonable trustees and sponsors should consider when deciding on a general surplus policy and individual decisions to release surplus. The guidance would need to be clear on the processes to be followed and factors to be considered in relation to member benefit protection and security. This would provide trustees with the confidence to agree employer payments where appropriate and in line with the legislation and guidance, without fearing that the decision could subsequently be legally challenged by members, if, with the benefit of hindsight, it appeared to be a less than optimal decision.

As noted in Question 8 above, we expect either the legislation or TPR's guidance would include an expectation that trustees would take the sponsor's covenant strength and potentially the scheme's investment strategy into account, especially where any surplus distribution would bring the scheme to less than fully funded on a solvency basis. Given these elements now feature in the Funding & Investment Strategy Regulations, it would be possible to allow for them to a good degree in legislation.

We do not see the guidance as being solely or primarily to encourage trustees to agree to release surplus. However, if the Government expects some trustees to agree to surplus payments where there is still some risk that members' benefits might not be able to be fully secured, and where none of the surplus being extracted is being shared with members, TPR will need to address the general view that trustees need to act in members' best interests at all times.

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

As above, trustees may continue to take the view that payments of surplus to the sponsor cannot be in members' interests unless the members are clearly getting a share of surplus. They may also be very cautious about taking any actions that, with the benefit of hindsight, could be poorly viewed by members or TPR. As noted above, clear guidance from TPR would help to mitigate this concern.

Also, some schemes will have developed their surplus policy over many years and in the context of wider negotiations, so the scheme's history of granting surpluses could deter a change of rationale.

**Section 4: Alternative safeguard: 100% PPF underpin.**

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

No, we don't believe a 100% underpin is necessary to encourage the extraction of surplus. The illustrative costs of 0.6% of buy-out liabilities are expensive – sponsors would be unlikely to want to meet this cost annually, and, if this was to be met by the schemes themselves, who would likely be following substantially derisked strategies already, then material additional investment risk would need to be taken to cover the annual premium, which would be very hard to justify given the very small risk of insolvency in the schemes targeted.  A super levy would also pose a major moral hazard risk – there is a significant contrast with the existing PPF compensation that schemes (including, we assume, the super levy scheme/section itself) cannot rely on.

We note that a cost of 0.6% pa seems high relative to the likely risks being taken on, and that if this was rather more modest – say 0.1% pa – then the issues might be more finely balanced. The moral hazard risk would however remain, and so we are not in favour of this option.

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

No, see above.

**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?**

We do not believe the super levy could provide reasonable benefits at reasonable cost. As noted above, the level would need to be substantially below the 0.6% pa, and the trustees would need very high confidence that 100% of full (replicated) scheme benefits could be provided, to have the confidence to take different decisions to those that they would adopt in the absence of this additional insurance.

We also are strongly of the view that none of the existing PPF surplus should be used to support this additional insurance. Current PPF surplus should be for the benefit of PPF levy payers and, potentially, those already in the PPF who have received lower compensation than the full benefits they would have received from their predecessor schemes.

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

Yes – a master trust solution could be appropriate for schemes choosing to run on and has the advantage (for members) that the sponsor link is not broken. There are also other consolidation options for assets, liabilities and/or governance, all intended to improve security. More generally, the incoming new funding regime will clarify the requirements for maturing schemes, and we expect the requirements of schemes, particularly those seeking to run on, will not need to be further strengthened to improve the security of members' benefits.

An important caveat here is that the new rules around extraction of surplus and TPR's accompanying guidance do have the potential ability to reduce the security of members' benefits, so these must be drafted carefully and the Government and TPR must ensure they balance the need to keep members' benefits secure against the Government's clear wish for schemes to invest productively with a view to generating surpluses.

**Chapter 2: Model for a public sector consolidator**

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

Yes, it would potentially allow schemes unattractive to commercial providers access to a consolidation option. However, we note that 'unattractive to a commercial provider' is not necessarily the same as 'unable to obtain terms from a commercial provider'. It is not clear how a scheme would demonstrate inability to obtain a quote, whereas 'unattractive' suggests simply that less favourable terms might be offered by a commercial provider than for other schemes. If the eligibility criteria covered such schemes, then in our view the public consolidator would have very significant advantages over commercial providers, and be attractive to a potentially wide range of schemes – as we explain further in question 16 below. This would be likely to distort the commercial market.

In our view, a key entry criterion would need to be 'inability to obtain terms' not merely that the terms were unattractive (or that current funding made it unachievable, in circumstances where the employer had the ability to continue to support the scheme to reach full solvency funding over time). We note the PPF itself already has a mechanism for assessing whether commercial buyout terms are available to a scheme as part of the process it oversees for schemes emerging from a PPF assessment period where the section 143 funding level exceeds 100% and could use this as a precedent.

**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?**

We agree the PSC should be required to accept schemes meeting the eligibility criteria. However, as noted above, these eligibility criteria need to be very tightly defined to avoid the PSC having significant unfair advantages over commercial providers.

For example, a menu of standard benefit structures would enable the PSC to operate at significantly lower cost than commercial providers who need to replicate the detailed benefits of each scheme. The Government propose that the PSC pay the actuarial equivalent of full scheme benefits to the transferring members but using standard benefit structures. Therefore, this envisages the transferring trustees agree to transfer-in credits for their members in the PSC that provide different benefits to the members' accrued rights. In our experience, trustees and their legal advisors usually set a high bar to benefit changes. Therefore, in practice, the trustees would need particular legal assurance that it was more appropriate to change members' benefit structures on transfer to the PSC than it might be for a transfer to any other scheme or commercial consolidator. That might require a specific form of legal discharge to be created. However, this particular feature would give the PSC a material commercial advantage over commercial consolidators.

If the Government considers it appropriate that trustees could be allowed to agree to the restructuring (on transfer) of benefits to a standard structure chosen from a menu, then this should be permitted for transfers to the commercial sector too (including superfunds and insurers) – indeed, allowing an element of benefit standardisation is likely to bring down pricing for commercial consolidators too, so the aim of consolidating could potentially be achieved within the existing commercial market. That would require a review of the existing transfer without consent provisions, including how they are understood and applied by trustees, legal advisors, and scheme actuaries.

Transformation of benefits to an actuarial equivalent form, *prior to transfer*, is already permissible in law, but restricted by virtue of section 67 of the Pensions Act 1995. Some trustees will find benefit transformation difficult or impossible to agree because of the scheme rules and/or the 'losers' in the conversion. Allowing a PSC to give benefits that would not be possible or cost effective under a commercial consolidation option or allowing it to override the difficulties of converting benefits under section 67, would simply mean that the PSC is being given an advantage over the commercial consolidators.

Looking at benefit standardisation from a member perspective, we note there will always be 'winners' and 'losers' and we encourage the Government to require strong consideration by trustees and employers of the individual winners and losers, and robust communication to members if trustees agree a transfer to the PSC that would require benefit standardisation. Standardisation should not be seen as a cost-effective way to consolidate if some members' outcomes could be materially worsened as a result. It will also be important that additional safeguarding principles be put in place to limit the extent to which benefits can be reshaped – for example, not allowing increasing pension to be converted in full to non-increasing pension.

The PSC would also have other material advantages over commercial providers:

- it would effectively have a government guarantee. Even if this was structured as a limited guarantee the belief would be that the government would not let the scheme fail
- it would be able to accept underfunded schemes, which is not the current practice for superfunds or insurers
- especially taking into account the government guarantee, the cost of entry, if at the levels being proposed, would be significantly below the costs of full buy-out.

For these reasons, as noted above, we believe eligibility should be restricted to very small schemes and those with very weak covenants, with a relatively high bar for proving that a commercial solution is not viable.

**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?**

If the Government does not seek to distort the commercial market, we believe there needs to be a level playing field, which would mean requiring the same capital adequacy requirements, pricing on the same terms, and having the same criteria around the benefits to be secured. We do not see a need for a particular limit on the size of the PSC, although we note we do not believe it is possible for the PSC to grow beyond the very small schemes, and the less well-funded schemes of weak employers, without distorting the commercial market – see our response to Q16.

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

The existing mechanism for schemes leaving a PPF assessment period could be employed. Otherwise the test would need to be relatively simple, perhaps corroborated by a commercial provider. As noted above though, it should be clear that the criterion should be that no commercial solution can be found, rather than that commercial terms are not particularly attractive. Similarly, schemes that do not yet have sufficient assets to meet commercial terms but who could reasonably be expected to do so in future (because the employer is able to continue to support the scheme) should not be considered eligible for the PSC if it is not to distort the market.

Finally, it is not difficult to envisage conflicts if the PSC were to be solely responsible for deciding if a scheme can access a commercial consolidator, and hence if the PSC eligibility criteria are met.

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

It should be required (not just entitled) to reject schemes that can obtain at least one viable commercial buy-out or superfund quote and schemes that have a strong enough covenant to continue to support the scheme, or to improve funding such that commercial requirements could be met in future. The PSC should not become a vehicle to allow sponsors who are able to continue to support their schemes to sever their ties with a scheme at a material discount to an insurer buy-out premium.

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

If and to the extent the commercial market in future struggles to provide sufficient options at the smaller end of the market, we agree the PSC will provide a useful and important public service. However, we do not believe the PSC should have significant advantages when compared with the commercial market, effectively underwritten by UK tax payers. As noted above, allowing benefit consolidation (with appropriate safeguards) for all types of settlement activity could lower commercial costs for smaller schemes and already provide an attractive solution for some smaller schemes.

We note that the characteristics of the PSC suggest it is effectively a superfund. Given the superfund market is itself in its earliest stages, we would note that one alternative option would be for the Government to further encourage superfunds and to put a permanent legislative framework into place. It seems possible that with some tweaks a solution to issues for smaller schemes could emerge by that route, with no need for a government-underwritten PSC.

**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?**

Yes, we agree it should run as a single pooled fund and operate on a 'run on' basis.

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

No. It needs to be clear what level of benefits has been bought for a member on entering the PSC, and clear what level of benefits has so far been secured for members whose sponsor is meeting a 'recovery plan' to pay off a deficit within the PSC, but we see no reason to segregate schemes.

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

Yes, as noted above, the issue for us is that the PSC would be seen as significantly more attractive than commercial options, and therefore have a negative impact on the current superfund and buy-out market.

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

No. The focus should be on closed schemes. We do not see why an open scheme should be able to sever the link with the employer covenant, nor why it would want to, given that ongoing accrual implies a continued and committed relationship between the sponsor and scheme.

**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?**

Trustees will need to be confident that they have secured the best outcome available for their members. As noted in Question 16, being able to reshape benefits will make running the PSC viable and cost effective. However, it will mean that there will be winners and losers in any actuarial equivalence approach. We therefore do believe that there should be some safeguarding principles on the extent to which benefits can be converted, for example:

- normal retirement ages should largely be preserved
- benefits which revalue or increase in payment should be mapped to standardised benefits with similar levels of increase
- consideration should be given to whether there should be any limitations on converting between member and spouse benefits
- consideration may need to be given to how member option terms will be reflected in the process.

As noted above, trustees will need to receive appropriate advice on this, and communications to members will need to be very clear on how the benefits are changing.

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

They need to be capable of actuarial certification and must have regard to all elements of the benefit structure (including dependants) and, where possible, minimise losers in the conversion. Regard should be had to any past pension increase exercises (PIEs) and there may also need to be recourse to a statutory override of scheme rules that do not allow for any conversion. Please also see Q25 above, where we note that safeguarding principles to limit the extent of "winners" and "losers" in the conversion process will be necessary.

As noted above, if these flexibilities are introduced for the PSC, they should also be made available to commercial consolidators.

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

If the PSC is not competing on a level playing field with other commercial providers, and indeed if it has a number of distinct advantages over them, then we expect there would be an impact on the existing market.

As noted in question 16, the proposed differentiators are:

- Ability to standardise benefits
- Ability to take an underfunded scheme subject to the sponsor meeting the shortfall in fixed amounts over time.
- Possible streamlined GMP conversion.
- Government guarantee that may be perceived to be stronger than an insurer but available on significantly cheaper terms than an insurer could offer, with those terms being more in line with superfund pricing.

As we have already set out, it is therefore important that the gateway tests for entry into the PSC are very clear and narrow. In our view they should be limited to:

- Schemes that are simply unable to secure a commercial transaction, for example because they are very small
- Schemes that are not well funded and have very weak employers unable to improve their funding and/or support the level of investment risk needed to improve funding.

Trustees may also find themselves believing that a government guarantee, however limited this may be presented as, is stronger than an insurer guarantee. Indeed, it is difficult to see the Government allowing the PSC to fail.

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

To provide effective governance and public trust, we suggest consideration is given to independent oversight of the PSC, rather than the oversight of the PPF Board. There are inherent differences between a PPF funded by ongoing schemes that needs to be protected and for which entry is automatic, and a PSC designed to effectively rescue underfunded schemes that cannot (or no longer want to) access a public consolidator or insurer.

We agree the PSC's funds should be segregated from the PPF's funds.

**Question 29: What alternative governance structures should be considered?**

As above, we suggest consideration should be given to oversight independent of the PPF Board.

**Question 29: What effect will this have on the existing market of commercial consolidators?**

See our response to question 27. While it is not clear how the market would evolve, we see risks for schemes who currently have to ignore the presence of the PPF when setting their funding and investment strategy suddenly doing this in the knowledge of the PSC.

**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?**

We agree the PSC needs to offer a high level of security to its members. However there is a question of whether it should offer a higher level of security then commercial competitors (due to a government guarantee) and whether gilts+0.5% to 0.75% is a strong enough funding basis when there will be no formal capital buffer on top of this, as would be the case for a superfund or an insurer. We would expect the PSC should be under lower pressure to yield high returns than a commercial consolidator, so believe gilts + 0.5% could be appropriate. Another possibility would be to link the funding to a percentage of insurance company rates.

**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?**

See question 30.

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

We expect it would be returned to the state, since it would underwrite the consolidator.

**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?**

The proposal to allow schemes to enter the PSC with a shortfall that an employer would make up via a fixed recovery plan is a possible way forward, but it seems to us that this would allow employers of underfunded schemes to sever their link with the scheme rather more easily than under the current situation, and we query whether this is the policy intent where employers remain able to support their scheme.

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

*No comment*

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

*No comment*

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

We believe that only government underwriting is viable or appropriate. However, this will effectively mean current and future UK taxpayers supporting DB schemes, when most have no opportunities to access such benefits themselves. As previously outlined, this is another reason why there should be a high bar for eligibility for the PSC. As previously noted, we also question whether, in a scenario where the government was the underwriter, they would politically be able to actually follow through with a finite commitment and, in the event of a significant PSC deficit, allow it to fall into the PPF. This seems a highly unlikely scenario to us.

We do not support the use of existing PPF reserves to underwrite the PSC. In our view the current PPF reserves should benefit current levy payers and their scheme members and, potentially, those currently receiving PPF compensation whose benefits were cut back on entry to the PPF.

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

No.

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

We expect the investment strategy would need to be set by the governing board, but if the government is underwriting the risk then it would be appropriate for the government to have some influence over the investment strategy adopted.

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

As noted above, eligibility to enter the PSC should be carefully restricted. This will mean that the PSC does not become too big, or take on the schemes which can be supported by existing employers, commercial consolidators or insurers. This would be the most effective way to ensure that risks to UK taxpayers are limited.

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

We do not believe the PPF's reserves should be used for this purpose, as set out in Q36. This would be particularly unreasonable from the perspective of open schemes, who are the ones least likely to use the PSC but most likely to be on the hook for continuing to pay PPF levies in future.

END