Broadstone

Consultation Response

Options for Defined Benefit Schemes

April 2024

Contents

Executive Summary

We are pleased to provide our thoughts on your "Options for Defined Benefit Schemes" consultation.

Treatment of scheme surplus

In considering the options to make it easier for schemes to pay out surplus assets, we largely welcome the proposals being put forward. Currently, there are some significant barriers to making payments of this kind and these would need to be addressed to achieve your aims.

However, we do question whether paying out surplus assets will be appropriate that often. For many trustees, their schemes are unlikely to generate large enough ongoing surpluses to make this action worthwhile given the lower risk investment strategies generally in place.

Even where permitted under the revised DB funding regime, many employers and trustees will be wary of materially re-risking their investments now given their histories with funding regulation and end-game plans for their scheme. It would take some time for the institutional memory of contribution holidays and benefit improvements followed by record deficits to fade, and for a new culture of sharing surpluses to take hold.

A minimum threshold for starting discussion on surplus extraction would appear most consistent with your stated objectives. However, it would need to be coupled with strong support for trustees in being able to set a higher bar that reflects their scheme specific circumstances. We would want to see clear guidance for trustees from The Pensions Regulator (TPR) and the government as part of any change in pensions regulations.

Introducing a statutory override to enable surplus extraction would be a pragmatic solution to the rules lottery we have at the moment. However, we still see practical barriers to making one-off payments to members, not least the Byzantine tax rules, as more important for government to address than restrictions in scheme rules.

We do not see the 100% PPF underpin to be remotely attractive to schemes if the super levy is anywhere close to that suggested by your initial analysis. Although we understand the reasons why such insurance would be costly, a £300,000 annual premium for a £50m scheme would be unaffordable and employers would likely have better uses for these funds.

Model for a public sector consolidator

We believe that the proposals outlined have merit and that a public sector consolidator would help many of our clients achieve their long-term goals more quickly.

We note that the aims of the consolidator will be to:

- Provide a solution for schemes unattractive to commercial providers
- Ensure members' interests are protected
- Increase levels of investment in high-growth UK assets
- Minimise potential distortions of the commercial provider market

We welcome the focus on those schemes that are unable to freely access the current commercial provider market and the important emphasis on member benefits security.

We understand the wider objectives of the government to encourage investment in UK plc and to not unduly disrupt the current commercial provider market. In our response, we highlight some of the conflicts between these objectives and the significant challenge in balancing these aims.

The key challenge for the consolidator will be in setting the terms of entry, and how schemes are to be excluded, if at all. Whilst we agree that there is a need for a consolidation option for those schemes that cannot currently access this market, we believe the price of entry should be fair.

The proposal to offer standardised benefits is an obvious solution to many of the issues facing schemes looking to transfer to a commercial provider. We would argue that this approach should be an affordable and pragmatic solution for all schemes, irrespective of whether they intend to enter a public sector consolidator or not.

Finally, one of the key factors to determine the success or failure of the consolidator will be the level of underwriting provided and how quickly it can achieve sufficient scale. We do not see any realistic option other than government backing to this project.

We recognise the political risk in asking taxpayers to underwrite private sector DB pensions. This is one of several reasons why we believe that entry for underfunded schemes should be deferred at this stage. However, government underwriting would help achieve its aim of increasing investment in productive finance.

We would welcome the opportunity to discuss our views with you further once proposals reach a more advanced and detailed stage.

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Responses to consultation questions

Chapter 1: Treatment of scheme surplus

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

We would support the introduction of a statutory override and it would help to remove the current ‘rules lottery’ in this regard. An override should have a positive impact on the ability of trustees to decide to share surplus with the employer. However, we would question if it will actively ‘encourage’ the sharing of surplus.

We do not believe that any of our clients have been in a situation where a scheme rules restriction was the sole factor precluding payment of ongoing surplus to the employer. Given trustees’ responsibilities to protect members’ benefits, we do not consider scheme rules to be the most significant issue preventing payment of 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?

Our preference is for a statutory power to make payments rather than amend rules, as set out in our answer to question 3 below.

Either way, we believe it is important that safeguards are in place and it would seem reasonable to require the agreement of both the trustees and the 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?

Our preference is that the statutory override would simply make payments possible (if done in appropriate circumstances consistent with regulations or regulatory guidance and with the agreement of the trustees and employer). Trustees would still need to consider the funding position and interests of their members and be mindful of any historic scheme-specific restrictions before committing to any payment.

Implementing a statutory override that gives trustees unilateral power to amend their rules to allow payment of surplus generates an extra level of complication and expense. Trustees would still need advice in order to satisfy themselves that it is in the best interest of the scheme. Therefore, it falls short of removing the practical barrier that currently exists and may not be acted upon for a large number of schemes. It certainly does not achieve the stated aim of removing behavioural barriers and making consideration of surplus extraction a standard trustee duty.

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?

The introduction of statutory power may be helpful in some circumstances. However, we believe that more significant barriers relate to tax issues, unauthorised payments and practical issues around making payments to non-pensioner members.

Removing these barriers should make it more likely that surplus is shared with members at the point of extraction (even if only to a notional extent), given employers are generally wary of committing to additional DB benefits with the associated risks.

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

Having less assets (due to surplus extraction) would seem to increase the likelihood of schemes not being sufficiently well funded to secure an insurance deal without additional employer financial support. However, as many companies are keen to remove DB risk and pay a premium to facilitate buyout of their scheme, this may not have much impact.

The additional issue is whether schemes would choose to run on (for much longer, or indefinitely) and not buyout should the realistic option of surplus extraction exist. If so, this would clearly reduce or delay the supply of schemes transferring to the insurance sector. However, we believe that schemes opting for this route would still be a small minority of the c5,000 DB schemes that remain.

For maturing schemes with less than £50m of assets (a large proportion of the above), the ongoing costs of running a DB scheme, the risks (including uncertainty over future insurance pricing and regulatory change) and the limited ability to generate significant additional investment returns suggest that buyout is still likely to be the preferred option. Flexibilities will simply help schemes manage the transition over a longer period – and potentially help insurers manage their pipeline.

We also note that the buyout market is limited to the shrinking population of DB schemes. Therefore, it will have a limited lifespan, unless further measures are taken to encourage alternative risk-sharing schemes. The buyout market may also be substantially impacted by the introduction of a public sector consolidator (see Chapter 2).

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

As stated above, we believe that the main barriers to returning surpluses to members relate to tax issues. Understandably, these rules are in place to ensure that the unique tax status of pension schemes is not abused and to encourage long-term saving for retirement. However, we believe that a new authorised lump sum/pension/increase could be introduced to allow members to receive benefit enhancements. It is important that any change to the existing tax regime allows benefit enhancements for all membership categories so that trustees can treat individuals equitably.

Introducing a new authorised benefit would avoid unintended tax consequences, for example loss of the deferred member carve out for annual allowance purposes, or incurring penalties due to making unauthorised payments. However, we should learn the lessons of the problems experienced by the abolition of the Lifetime Allowance and ensure that this is properly considered with the way benefits could be enhanced alongside HMRC's policy objectives to ensure that there are no obvious areas for abuse.

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

Extracting surplus is only likely to be attractive to trustees if it is of benefit to members. For example, by encouraging greater funding / security within the scheme. We would be wary of complex changes, or rules that encouraged short termism (e.g. employers incentivised to move assets in and out of schemes regularly for tax purposes with pressure on trustees to manage and facilitate this rather than concentrating on longer term scheme management).

The ability to adopt a flexible approach to extraction of surplus, for example by a schedule of payments that can be reduced or removed in the event of adverse experience, may be helpful for trustees.

A further issue to consider is the implications for pension cost accounting in company statutory financial statements. With many schemes now in surplus, the ability of employers to recognise that surplus is determined by the scheme rules and, in some cases, the auditor's interpretation of those rules. Changing the rules around the treatment of surplus would have a knock-on effect on balance sheet positions of many UK companies and analysis should be carried on the impact of this (good or bad) before any changes are made.

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

We consider this should be a scheme-specific decision and the issues around covenant, investment strategy and funding level will all be important considerations.

If there is a genuine desire to encourage behavioural change and consideration of such issues, then the minimum hurdle should be relatively low, with emphasis on (and support for) trustees considering what higher bar would actually be appropriate in their own scheme circumstances. A simplistic measure such as >105% funded on a low dependency basis would then seem most appropriate as a trigger for such conversations.

We are less keen on the suggestion of eligibility criteria based on investment strategy as this could limit the trustees' (and employer's) options when reviewing the asset allocation in the future. It could also lead to the situation whereby a surplus may not be payable one day but would be payable the next day following a change in invested assets, despite the funding level being unchanged.

If there is an expectation that satisfying the minimum eligibility should result in extraction in a large proportion of cases, then additional safeguards would be needed to ensure it was more likely to be appropriate. These would include restrictions on investment risk exposure and employer covenant. We are concerned that funding surpluses and covenant strength can fluctuate. Ultimately many schemes will be focused on an end game solution rather than run on.

Undue pressure on trustees to allow surplus extraction as soon as any statutory minimum hurdle was met would not be appropriate and would present a risk to the ultimate benefit security of members. Perhaps a requirement that the test has been satisfied for a period of time or is expected to remain so, rather than a one-off assessment if market conditions are potentially volatile.

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

We believe this is a crucial area and so inclusion in a TPR code of practice would be most appropriate.

We can see arguments for this to form part of the DB funding code (particularly if it is to be a decision as part of the valuation process) or be part of the general code for trustees (particularly if this is to be a rolling assessment, more akin to decisions around discretionary benefits).

Trustees considering this option will need to ensure they have the appropriate knowledge and understanding, and that any assessment/payment of a surplus is included in their effective system of governance framework.

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

The options considered cover the main practical barriers to trustees sharing a surplus. However, if we are considering sharing surplus as part of their ongoing operations (rather than following a full buyout), then statutory and fiduciary duties, plus a regulatory regime focused on low risk, mean that any theoretically shareable surplus might be small relative to uncertainties around future liabilities.

In addition, whilst insurer pricing (and in particular the buyout ‘premium’ relative to other funding measures) might be expected to fall over time, there are no guarantees that will happen. Insurer costs fluctuate and regulations (as well as elements such as life expectancy) could change in future. As a result, any payment out (without a compelling reason from the employer, such as legally binding guarantees that it would make this good again in future if needed), means that trustees will potentially be risking their ability to buyout at some point in the future and fully secure members’ promised benefits. Coupled with emphasis from TPR that few covenants are genuinely reliable over the very long term (e.g. to fund ongoing running costs), this would appear an unattractive proposition in advance of fully securing member benefits.

A clear time horizon to buyout would prevent trustees from sharing a surplus. Why would they want to risk the security of members’ benefits at this crucial time and also when the surplus can be more easily paid when benefits have been secured. The risk and cost of paying a surplus would need to be factored into that decision making process and would, without a strong case from the employer, be a compelling reason to retain the surplus until the benefits are secured.

There will be exceptions – perhaps a very immature scheme that has made a huge investment gain, or a relatively small scheme where a key member dies young with no dependant, but these are expected to be a small minority.

Member (or wider public) perception will also play a part.

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?

Yes, in theory, but we do not see the proposal as attractive. We strongly question whether an employer is going to want to make a long-term open-ended commitment to an ongoing super levy over which they have limited control, in exchange for a one-off immediate cash refund from the scheme.

Based on the approximate analysis undertaken, a £50m scheme would be paying an annual super levy of £300,000 each year. If the super levy amounts are as high as this initial assessment suggests, then the ability for a scheme to take sufficient investment risk (within the regulations) to cover the cost of this super levy, with reliable surplus over and above this year on year, seems implausible.

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

Whilst not necessarily a benefit, we note that such a scheme (if the super levy was attractive) could disrupt the current market and the transfer of assets to insurers. To the extent that more assets within a PPF super-vehicle and/or continued DB schemes is preferable to the government (in a productive finance context) than investment with insurers, this might be a consideration.

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?

Current figures would not make it attractive. Employers would probably be looking for reassurance around potential future changes in these levies and/or the ability to opt out. In any case, there would need to be very high confidence from trustees that this would provide 100% cover, otherwise its value as a security blanket and justifying extraction of scheme funds is very much reduced.

One option to make it more attractive would be for the super levy to be reclaimed in some way, rather than a sunk cost. It could be that the super levy is held by the PPF and the capital returned in the event that the scheme buys out or is offset against the entry premium to join a public sector consolidator. As we have seen with the discussion around the PPF surplus and calls from some quarters for this to be returned to levy payers, some mechanism to return some or all of the super levy if it is not ultimately needed may make this option more attractive.

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

We have not considered this question.

Chapter 2: Model for a public sector consolidator ("PSC")

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

We can see this option being very attractive to such schemes.

The rationale of being open only to those who cannot access a commercial provider appears sensible. The challenge will be in designing rules and pricing that will not unduly disrupt the market and still facilitate entry for those schemes who you have identified as being the target market.

We recognise the potential temptation to manage this situation by making the criteria as inclusive as possible and the potential benefits of courting larger schemes in the interest of more quickly building scale. Consideration should be given to prioritising entry opportunities for those who are genuinely buyout ready but unable to get a timely or competitive price in the current market.

There are likely to be resourcing constraints in terms of the number of schemes taken onboard in the first year or two and it is important that these schemes are not still left on the outside looking in.

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

We would agree in principle that the criteria are sufficient to limit the impact on commercial consolidators. Also, in our view, a key aim in consolidating is improving outcomes for members, and it may be that some limited market disruption would be of benefit in this respect.

The challenge will be in the terms used in setting the criteria. We believe that the key concern is time. It is likely that almost all schemes will eventually be taken on by a consolidator of some form (in the absence of incentives to set up new schemes), but a new PSC could (materially) hasten the consolidation timeline. This acceleration may indirectly support the government's productive finance / UK growth aim by saving sponsoring employers scheme running costs which can instead be invested in their business.

We assume that a new PSC is not intended to stifle private sector growth and note that the pricing/competitive advantage question is important here. There are potential new entrants to the insurance and (we would hope) consolidator markets, with other private sector initiatives being considered. Therefore, it is possible (albeit unlikely in the short term) that the market for a PSC could be squeezed, thereby limiting its ultimate scale. For example, if a new entrant (or entrants) similarly reduced the pricing differential for small schemes and had sufficient capacity to meet demand.

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?

We believe that a limit may be required, depending on the underwriting of risk although it may be a second order issue following proof of concept and deals being struck.

It could be argued that applying a limit on the consolidator size is counter-productive. One of the major barriers to accessing buyout at present is market capacity because of insurers' ability to access capital and recruit personnel with relevant experience. Limiting the size of growth could replicate the issues the market is currently facing.

Concerns about asset size could potentially be addressed by simply segregating and starting a new iteration when a specific level is reached. This may also help to keep the administration of the consolidator to manageable levels. However, it would be important that it was clear that a new fund would be made available once one was full so that this did not become a limited time opportunity.

There may also need to be practical limits on the rate of growth in terms of managing the transition of schemes into the consolidator.

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

We believe this to be a significant challenge for any PSC, as it could be argued that all schemes should be able to access a commercial provider if they are willing to pay a high enough premium or wait long enough. Therefore, it will be necessary to set some criteria for entry consistent with the PSC's objectives, including the aim of minimising market distortion.

This could be achieved in a similar way to the gateway test currently used for private consolidators, who need to demonstrate that they are unable to buyout with an insurance company in the medium term.

We note the PPF's view in its design proposal document that setting 'harder' eligibility criteria would be difficult, and that it would also be challenging for schemes to demonstrate they cannot find an alternative consolidator.

Therefore, we would agree that establishing a PSC with a distinct design, that is not at a deliberate competitive advantage across the market compared to the current commercial offerings, would be sufficient to ensure that those trustees that do select the PSC are doing so because it is the best option for their scheme.

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

In principle, rejection should only be in extreme circumstances. In practical terms, entry to the PSC may be limited by resource capacity, both within the consolidator and specialist partner firms.

Therefore, we would expect that the PSC would need to operate a triage system whereby it prioritises the most appropriate schemes first. To our mind, this should be those schemes who have undertaken the usual data and benefit audits required to transact smoothly but are unattractive to commercial providers.

We strongly believe that given this expected focus, there should be no need for the PSC to take on open schemes or those in deficit until a much later stage (by which point shortfalls may have been addressed) at the expense of denying others entry. We would encourage you to defer consideration of the complications surrounding such schemes and focus on designing and facilitating the process for your target market first.

If the PSC is to reject schemes from entering in the longer term, then it should be on a risk-based principle. In other words, they would only be rejecting schemes that could place undue risk on the funding or management of the other schemes already in the PSC (or who might be expected to enter in the future).

Examples could include schemes that have not undergone a data cleanse exercise or a legal review of the scheme benefits, or where at the time of transacting the premium is unaffordable due to market movements. This is entirely consistent with the private consolidator market and is not, in our view, creating inappropriate barriers to entry.

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

The Government has stated that the aims of a PSC should be to:

- Provide a solution for schemes unattractive to commercial providers
- Ensure members' interests are protected
- Increase levels of investment in high-growth UK assets
- Minimise potential distortions of the commercial provider market

We believe these objectives are reasonable. However, we do would question the possibility of achieving them all and some compromises seem inevitable.

Limiting eligibility will delay the period until the PSC reaches scale and can materially invest in high-growth UK assets. Reducing the entry hurdle to admit underfunded schemes could impact member security. Relaxing admission requirements in a way that made the PSC appealing to those schemes already attractive to commercial providers would delay access (due to lack of short-term resource) for those schemes unattractive to commercial providers and result in market distortions.

We believe that protecting members' interests is paramount and that all other outcomes should have that aim in mind.

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

We can see arguments for and against either approach.

Operating on a run on basis will better enable the PSC to invest in productive assets as its overall investments should be significantly higher and available for longer.

However, in order to minimise market distortion, it could be argued that the PSC should not be the final destination and schemes are ultimately transferred to the insurance market (a similar approach to the Clara model). This would help decrease the long-tail risk associated with managing schemes indefinitely, which should reduce both the underwriting risk to the sponsor and the initial premium schemes will pay to transfer to the PSC.

Issues with targeting insurance buyout include:

- the potential weakening of member security when transferring away from something that is potentially backed by government;
- the PSC could potentially be seen as making a (relatively short term) profit from the member transfers (in a way that would be more visible than under the run on scenario); and
- the possibility of cross subsidy from assets not needed but used to benefit other members (again, this may also be true to some extent in a run on scenario but it is more transparent if settlement of a scheme's benefits is crystallised in the short/medium term).

We see the first of these as particularly problematic and something that would need to be made very clear to trustees before they decide to transfer a scheme into the PSC.

On balance, our view is that the PSC is better served by operating on a run on basis.

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

As set out previously, we would encourage you to defer the potential entry of underfunded schemes until a later stage of development of the PSC.

However, if such schemes are accepted initially, then we believe they would need to be segregated until the point at which the employer has made the last payment under the agreed payment plan. This approach would enable them to be moved into the PPF (for example) if needed.

For the longer term, if transfer to the insurance market is targeted, then it would make sense to segregate and ensure that better funded schemes get passed on first. However, if the intention is to run on in perpetuity, then there seems little benefit in segregation as all schemes will have met the entry requirements. The bigger question remains under what conditions it is appropriate for them to enter in the first place (and whether such terms would be attractive to employers).

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

We believe that these schemes would be attracted to a PSC. The opportunity to break the employer link and certainty of benefits will be a strong draw, assuming pricing and the onboarding process appear reasonable.

The main issue with benefit standardisation is the creation of winners and losers. This situation would be an additional risk for trustees and may mean that some feel obliged to wait their turn with a commercial provider.

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

The main benefit for employers of transfer to a consolidator, in whatever form, is to sever the link with their scheme. We do not believe this would be possible with an open scheme. In addition, currently open schemes are not generally considering transferring to a commercial consolidator, and it is unlikely that they would be the target market for any PSC.

So, whilst there would unlikely be any practical barriers to allowing entry to open schemes, the additional complexity in allowing them access will have very little real benefit and may lead to unnecessary delays in setting up the PSC. Therefore, we firmly believe that your focus should be on closed schemes initially.

As mentioned in a previous question on managing scale, and in the interests of providing transparency, a potential approach would involve setting up an initial PSC (tranche 1) that focuses on closed schemes, and a later tranche may increase its scope to allow open schemes if deemed of interest.

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?

We believe that the approach outlined is reasonable. However, if trustees consider a key element of their scheme's benefit structure would be lost, then this may make the PSC unattractive.

The challenge for trustees will be how the equivalent benefit structure is implemented and how this change is communicated to members. We have seen this with GMP equalisation, where advisory costs have been significant with little material impact on member benefits. We are encouraged by the PPF's PSC design discussion document which suggests that most major benefit features may be retained, with the notable exception of GMP. Although, schemes are of course already able to harmonise this benefit themselves.

Given that there will inevitably be winners and losers, we would expect trustees to ask if members may be allowed to opt out, potentially selecting against the PSC. Also, will advice or guidance be provided to members to ensure they understand the impact of any changes in their benefits? That may be deemed to be less important if the existing benefit structure can be broadly replicated, but member communication will remain key.

Changing a scheme's benefit structure is risky, as seen by extensive legal cases, so it may also be necessary to provide trustees and employers with some form of indemnity against future claims by members. Run-off insurance may adapt to cover this if there is demand, and reasonable safeguards in legislation.

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

We have seen the PPF's thoughts in this area and support the proposed structures, which seem reasonable. We certainly agree with having a menu of multiple benefit features that trustees can choose from to best match their scheme's current structure.

We have noted the two different options suggested by the PPF for implementation, before the initial transaction or during the data cleaning phase. We believe that a standardised benefit structure should be implemented before transacting so that the inevitable benefit and data issues can be dealt with before any premium is paid. However, we recognise that there are complications in gaining sufficient understanding of the likely transaction cost and determining it to be appropriate prior to incurring the significant time and cost involved in a benefit restructuring exercise.

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

The commercial consolidators will be better placed to answer this question. However, it does appear to generate a potential market distortion, particularly if the simplification of benefits is materially easier under PSC entry than it is otherwise.

One way to address this issue would be to make it simpler for all trustees to change benefit structures prior to moving to any consolidator (whether in the public or private sector).

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

We believe that the proposed structure outlined appears reasonable.

Question 29: What alternative governance structures should be considered?

Under the proposed governance structure, ongoing DB schemes come under the remit of the Pensions Regulator, the insurance market by the FCA, and PSC by a new body. Workplace defined contribution schemes are then overseen by a separate regime.

While this situation is generally understood by the pensions industry, and has been in place for many years, it can be confusing to members and even trustees.

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 believe that the high-level basis as set out, and assuming suitable underwriting, is reasonable and broadly consistent with the current regime for commercial consolidators.

The insurance market would be better placed to comment on the appropriate of this basis relative to buyout pricing.

Our understanding is that the funding basis would be used to determine the initial premium to enter the PSC, although it is not entirely clear what adjustments or margins may be applied. As mentioned earlier, the entry price should be set so that it is not materially 'cheaper' than securing benefits with an insurer for typical schemes (other than any differential pricing an insurer may choose to target a particular market). Otherwise, it may result in demand from schemes that have access to a commercial consolidator but are tempted by the lower price of the PSC.

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?

Yes, we believe a technical provisions basis based on gilts plus a margin (and some allowance for expenses and maintenance of a capital buffer) to set the entry price is reasonable at the current time.

The key issue is how the technical provisions are set to ensure entry is affordable whilst also maintaining member security and managing the risk of calling on the buffer fund.

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

If we come from a starting point that member security is paramount, then any surplus should be retained in the PSC to ensure that benefits remain safe.

Whilst there is an argument that surplus could be used to top up benefits, presumably it would only apply to members at that time. Previous members (i.e. those that have died or transferred out) would not share in this windfall.

It would also not seem appropriate to pass any surplus back to former employers, as this would be inconsistent with the current commercial consolidator market.

Ultimately, the treatment of any surplus should be consistent with the treatment of any shortfall. If, in the event of a shortfall, member benefits would be cut or even former employers asked for more money, then it is fair to share any upside risk with those parties. However, if the PSC's provider of buffer capital would meet any shortfall, then it should share in any surplus (as long as this is managed in a responsible, long-term manner).

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?

Yes, we believe these arrangements are sufficient and seem logical.

We are fully supportive of the concept of a PSC, but your consultation has highlighted some of the practical issues that need to be overcome to make it a reality. In order to achieve the 2026 deadline, it may be prudent to focus on the cohort of closed, well-funded schemes that are unable to access a commercial consolidator on competitive terms before considering dealing with open or poorly funded schemes.

We note that, in the event of the insolvency of an employer paying instalments to remove a deficit, the end outcome could be either be reduced benefits in the PSC or entry into the PPF. There are likely to be schemes currently in PPF assessment that may benefit from the PSC option and we would welcome a design that supports this.

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

Maintaining an investment strategy that supports a prudent funding basis and also allows an increase in investment in productive assets is certainly possible.

As stated, the key will be reaching sufficient scale to operate efficiently and having the level of underwriting to facilitate the investment in productive assets, while maintaining the security of member benefits.

Your consultation states that the Board will have a key role in shaping the strategy. We would expect that it would be ultimately responsible for setting the strategy, subject to consultation with the body that provides the underwriting.

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

This is not a straightforward question to answer without knowing what scale is required to allow the PSC to operate effectively. There is also likely to be a conflict between being attractive to a wider range of schemes, including larger schemes, while not disrupting the existing market, in the time allocated to achieve this goal.

Provided the pricing (allowing for the additional costs involved in entry) and level of member security are attractive, then schemes will want to enter the PSC. If achieving the scale required means distortion to the current market, the government will need to consider the extent to which that is acceptable.

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

A government guarantee, whereby any shortfalls are picked up by the taxpayer as and when they arise, may be the most appropriate approach. It could be justified on the basis that it relieves UK business from running DB pension schemes and frees up assets to invest in productive assets. A consolidator backed by the government would also provide comfort to trustees that benefits are secure.

Limits or caps placed on the underwriting will limit the growth of the PSC and dent confidence in the security of benefits to members.

However, as seen with current unfunded public sector pensions, the risk can be significant. Consideration will need to be given as to why the taxpayer should support schemes where the employer has chosen to transfer the risk. This would suggest that pricing which materially undercuts the insurance market and/or allowing the entry of underfunded schemes both present significant political risks if taxpayer funding is needed in future.

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

Government underwriting is not an area we feel comfortable commenting on.

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

It is reasonable for the government to provide input when setting the investment strategy if it is underwriting the PSC. This contribution could include determining the level of investment risk it is willing to underwrite. It is also reasonable for the government to set a minimum level of investment in productive assets in that context.

However, the investment strategy should ultimately be determined by the body responsible running the PSC, to avoid the perception of political pressure to alter the investment strategy as circumstances change.

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

The risk to the taxpayer is best managed by ensuring that the PSC is set up with a clear goal in mind. That it is run effectively and competently, that risks are monitored and managed and that financial support is only provided when needed.

A good example of this in practice is the PPF, which receives limited government financial support and whose funding position has improved over time and now has a healthy surplus.

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

We are uncomfortable with this concept and understand that the PPF also has significant concerns.

Chapter 3: Potential take-up and impacts

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

Broadstone is an independent benefits consultancy firm that provides services to over 500 DB pension scheme clients. Schemes range from less than a £1m in size to over £500m and of various funding levels.

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

We are unable to provide specific details of the schemes that we manage.

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

We are unable to provide specific details of the schemes that we manage.

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?

We are unable to provide specific details of the schemes that we manage.

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?

We are unable to provide specific details of the schemes that we manage, however as noted earlier in our response, we do not anticipate this would be an attractive proposition to most (if any) schemes at this pricing point.

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

We are unable to provide specific details of the schemes that we manage.

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

We are unable to provide specific details of the schemes that we manage.

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?

We are unable to provide specific details of the schemes that we manage. However, we do foresee significant costs in obtaining advice in relation to entry to a PSC as well as in the advice around restructuring benefits. We also see opportunities for those costs to be streamlined.

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

We are unable to provide specific details of the schemes that we manage.

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