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Next steps - Options for DB schemes

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On 22 November 2023, following the Chancellor of the Exchequer's Autumn Statement 2023, the DWP published the government response to the call for evidence (Options for Defined Benefit schemes) that was published following the Mansion House speech in July.

This document is part of a number of documents published by the DWP designed to "continue to ensure that trustees and those who advise them continue to work to produce the best possible outcome for pension savers".

Background

This government response to the call for evidence was published on the same day as other calls for evidence and responses to those that followed the Mansion House speech.

Our FYI dated 14 July 2023 (Options for DB schemes: How can scheme assets be used more flexibly) explains the proposals put forward by the DWP.

In the Ministerial Foreword to the response, new Minister for Pensions, Paul Maynard (who replaced outgoing Minister, Laura Trott, days before the Autumn Statement), confirms he is "committed to ensuring the UK has a strong DB pensions sector which provides secure retirements for members while also contributing to the wider economy".

92 responses were received to the call for evidence which focused on three areas: investing in productive finance (also known as illiquid assets), extracting surplus, and the potential for a public sector consolidator.

Supporting DB schemes to invest in productive finance

Most respondents to the call for evidence agreed with the government's desire to increase productive finance investment, although there was a clear call for the security of member's benefits to not be undermined by any such move.

The lack of productive finance investment in UK schemes, compared with their international counterparts, was mainly due to the focus of many UK schemes on de-risking in preparation for buy-out, although there was recognition that large, open UK DB schemes did have scope to invest more in productive assets.

Next steps

The DWP will "take measures to increase investment by DB pension schemes in productive finance whilst continuing to prioritise a strong and diversified gilt market".

Building and extracting surplus

There were mixed views from respondents on whether additional surplus flexibilities could benefit productive finance investment in DB schemes. There was a risk that additional flexibilities could prompt riskier investment strategies, albeit not driving investment in UK assets.

The ability to access surplus before a scheme winds up is subject to the provisions of individual scheme rules, and anecdotally it would appear that a majority of schemes do not allow this.

There were also mixed views on introducing additional surplus flexibilities. Although some respondents indicated potential benefits, including via the introduction of a statutory override enabling all schemes to take advantage of changes in this area, there were concerns about the limited incentives for trustees to use them, additional risk to scheme members, and likely limited impact on productive finance allocations.

It was generally felt that additional surplus flexibilities should come with appropriate safeguards, such as relating to the funding level of the scheme and the strength of the employer covenant.

Next steps

The Autumn Statement included the announcement that the tax on authorised surplus payments would be reduced from 35% to 25%. In addition, the DWP's response to the call for evidence confirms that measures will be introduced to ensure surplus can be shared with scheme members. The DWP will launch a consultation on surplus flexibilities this winter.

Public sector consolidation

Many respondents felt that the case for a public consolidator had not yet been made, but it was recognised that if this measure was to be introduced, it would benefit smaller schemes the most.

There was a suggestion that a consolidator would need to compete with the existing market or operate only at the smaller end. The consolidation of smaller schemes would allow them access to economies of scale and to greater in-house expertise which could improve allocation to illiquid investments. Respondents also suggested the government could restrict the remit of a public sector consolidator to schemes who could not obtain service from commercial consolidators. However, it was felt the consolidation of small schemes would have little impact on productive finance.

In terms of the PPF assuming the role of public consolidator, the DWP would need to consider how the PPF would be adapted to ensure fairness between current and future members and future levy calculations. There was also the suggestion it would be inappropriate for the PPF to act as a consolidator on the basis of fairness to large schemes who pay the bulk of the existing PPF levy, but are least likely to enter the PPF compensation fund. Stakeholders indicated more appropriate uses of PPF reserves would be to fund a reduction in levies or a return of levies paid to larger contributors.

Next steps

The DWP believes that the PPF would be well placed to run a public consolidator addressing a specific market failure.

A consultation will be launched this winter to consider the design and eligibility for a public consolidator, which would be expected to support employers with DB schemes while delivering the best possible outcome for members.

A public sector consolidator will be established by 2026, aimed at schemes that are unattractive to commercial providers.

The PPF has responded to the Autumn Statement and the DWP's response to the call for evidence, welcoming the government's commitment to establishing a public sector consolidator and the recognition that "[the PPF has] the necessary skills and experience to take on this separate function in addition to [its] current role".

Comment

Although the DWP's proposals in the summer call for evidence don't appear to have received universal support, this is an area that reflects the changing reality for DB schemes.

The rules of surplus extraction have largely been academic for many years, as DB schemes existed in an era of funding deficits. With improved funding over the past few years, the issue of scheme surpluses – and what to do with them – is now very much a live issue and deserves increased scrutiny.

With the DB consolidation market still in its infancy, the DWP is right to consider the concept of a public consolidator, so that all sizes of DB scheme can consider consolidation as an option going forward.

The promised consultation(s) is now awaited.

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