Government consultation

Options for DB schemes

On Friday 23rd February 2024, the Government launched its consultation on options for DB schemes that it trailed in the Autumn Statement. This includes proposed reforms to make it easier to use surpluses in well-funded schemes to make payments to employers and scheme members. If implemented this would be the most important change for UK DB schemes in over 20 years. The consultation also covers a suggested model for a public sector consolidator.

Use of surplus

The Government aims to support UK DB schemes in investing part of their £1.4 trillion of investments in greater productive assets (e.g. private equity, UK infrastructure). To help achieve this, the Government is proposing to remove practical barriers to surplus extraction such as restrictions in scheme rules and to create a change in mindset by making upside for members a trustee consideration rather than solely focusing on the security of existing benefits. Key elements envisaged under the consultation include:

- A statutory override meaning that surplus can be extracted from all private sector DB schemes irrespective of restrictions under the rules. This is broadly welcomed as it can remove the current "rules lottery", however the legal detail will be important and is yet to follow (e.g. will trustee agreement be required to amend the rules?).
- Changing the tax rules on one-off discretionary payments to members so that they are no longer unauthorised payments. This could allow members' share of surplus to be extracted more easily and without increasing ongoing DB risk (as would be the case for discretionary pension increases).
- Potentially reducing the required funding level for releasing surplus to an employer. Currently this can only be done if the scheme remains fully funded on a buy-out basis after the payment. The consultation puts forward an example of being 105% funded on a low-dependency basis for feedback which might typically be below full buy-out level but will vary depending on scheme maturity and other actuarial assumptions made. Whilst this potentially increases the likelihood of a surplus repayment it could also reduce benefit security, so we expect there will be a range of industry views on what is acceptable.

Overall, the last 20 years of DB pensions regulation has prioritised the security of benefits that have already been built up largely over everything else including future accrual and discretionary benefits. In many cases, this has led to a narrow focus on de-risking and insuring accrued benefits at the earliest opportunity. Irrespective of the debate on whether DB schemes should invest more or less in UK productive assets, the changes being consulted upon could be a big step in making it easier for some schemes to deliver more value for the members and the sponsors that have supported them over many decades.

At Isio, we had already developed a framework for investing beyond full funding on a buy-out basis and gradually sharing surplus between sponsors and members as it emerges, known as Purposeful Run On (PRO). The changes being consulted on will simplify the mechanics of a PRO strategy,and help bring about the change of mindset that it requires. If you are interested, PRO is explained on our website here.

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Alternative safeguard: 100% PPF underpin

The consultation also seeks views on whether there is appetite to allow schemes to pay a 'super' levy to increase the level of protection available from the PPF in the event of employer insolvency whilst being underfunded. This was a potential safeguard raised by some stakeholders during the call for evidence, if a new regime to allow surplus extraction was brought in. The consultation considers at a very high level some of the extra risks this would pose to the PPF including moral hazard risk. At this early stage, our initial view is that there are very significant moral hazard and inequity risks that could arise from a 100% PPF underpin and it would be easier to incorporate other safeguards in the surplus extraction rules.

Public sector consolidator (for private sector schemes)

Lastly, the Government intends to establish a public sector consolidator managed by the PPF by 2026 as part of its aim of supporting greater investment in UK productive assets. The consolidator would provide an alternative endgame solution to insurance and commercial consolidators. It is aimed at smaller schemes and underfunded schemes that cannot access insurance or commercial consolidation and therefore need to run on without the economies of scale and resources necessary to invest in productive assets.

Whilst Government states it is seeking to avoid distorting the commercial market for endgame solutions through restricting the eligibility criteria for a public sector consolidator, it is not clear how this can be achieved on a practical level given a large number of small schemes have managed to access insurance and there are already a wide range of innovative options for schemes (of any size) to consolidate either financially or operationally and access the benefits of greater scale and resources. As such, this may be a solution in search of a problem.

The consultation closes on 19 April.

Please get in touch if you would like to discuss further.

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