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60-second summary

Freeing DB to do better

The Department for Work and Pensions (DWP) has launched a further consultation on [Options for Defined Benefit Schemes](). The consultation document ranges over various subjects, from amendment of the rules for surplus extraction, including the possibility of establishing a new Pension Protection Fund (PPF) compensation tier that would pay out members' full entitlements, through to confirmation of the Government's plans to put the authorization and supervision regime for DB superfunds on a statutory footing, and creation of a publicly operated consolidation vehicle. The consultation period runs from 23 February to 19 April 2024.

Surplus extraction

The Government is looking to remove barriers—both practical and behavioural—to the accumulation and extraction of surplus, by making it easier to share it with employers and scheme members. It believes that this will support its aim of enabling some schemes to run-on, investing the surplus in productive assets.

The Government plans to set clear rules for surplus extraction, with member protection at the forefront of its thinking. Responsibility for managing funding will continue to lie with trustees. Access to surplus will not be conditional on the use(s) to which the surplus is put. The Pensions Regulator will produce guidance for trustees, though the form that this will take (an addendum to the DB funding Code of Practice or something separate) has yet to be decided.

There are four proposed areas of change:

1. *Statutory intervention*: The DWP is considering options for statutory intervention to remove barriers in scheme rules. It could empower trustees to amend their rules if they currently have no power to make surplus payments, or the intervention could be more direct, in the form of a statutory override permitting surplus distributions.
2. *Taxation:* As announced in last year's Autumn Statement, the Government intends to reduce the authorised surplus payments charge from 35% to 25%, with effect from 6 April 2024. The consultation document says that it is also planning to change the tax rules so that it is easier to pay surplus to members, for example as one-off payments.
3. *Safeguarding a minimum funding level for any surplus extraction*: The Government is also considering changes to the buy-out-based funding condition that must currently be met before surplus payments can be made out of ongoing schemes. It may base it instead on a scheme's low-dependency funding basis, plus a fixed or variable margin; it may also introduce covenant-related considerations, though that '*is... not* [the DWP's] *preferred option.*'
4. *Super-levy for super-compensation:* The consultation document seeks views on the desirability of establishing a '100% PPF underpin', for schemes that choose to pay a higher levy. The idea is that this might give trustees (and their sponsors) the confidence to make more growth-seeking investments. The PPF estimates that the price would need to be high: perhaps more than 0.6% of a scheme's buy-out liabilities each year (or more if take-up is low). The Government is clear that the funds resulting from the super-levy would be held separately from those arising out of the ordinary pension protection levies, and there would be no cross-subsidy between the new 'underpin' and existing 'lifeboat' functions.

Public consolidator

The Government plans to give the PPF Board, by 2026, a new role as the operator of a public DB consolidation vehicle. It is anticipated to appeal mostly (though not necessarily exclusively) to the smaller and less-well-funded schemes that are unattractive to the commercial consolidation market. Entry would be voluntary.

The public consolidator would operate as a pooled fund, ring-fenced from the PPF proper, with the intention that it would run on rather than aspiring to buy out its liabilities. It would be subject to the same funding standards as commercial superfunds, which will influence the price of entry. To keep entry costs down, there would be some standardization of benefit structures on transfer into the new consolidator, on the basis of actuarial value.

The consultation document asks whether the Government should limit the growth or overall size of the public consolidator (to allay concerns about over-expansion), and about the eligibility criteria, including how to assess schemes' access to commercial consolidation. Trustees may need to show that they are unable to transfer into a commercial consolidator or buy out with an insurer.

Transfer into the public consolidator would sever the employer link, except when it is in the process of paying off a deficit. If a funding surplus exists at the time of transfer, it could be shared with the employer and (by way of higher benefits) the members. If the scheme enters the consolidator whilst in deficit, and the employer goes insolvent before that deficit is eliminated, members' benefits would be reduced, but not below PPF-compensation levels.

The PPF-run consolidator would be expected to provide a high level of security, so the Government anticipates that a form of 'underwriting' will be required (noting that commercial consolidators use third-party capital 'buffers'). The consolidator's investment strategy is likely to depend on how the need for underwriting is met. If liabilities are underwritten by the UK government, it would, in return, expect to have more say over investment policy. However, the consultation document says that the underwriting could come instead from the reserves that the PPF has accumulated in its existing 'lifeboat' role; if that route is taken, it would necessitate the PPF Board as operator of the public consolidator paying PPF levies to itself as the manager of the compensation fund.

The consultation document includes a survey designed to gauge interest in the creation of the proposed public-sector consolidation vehicle.

We're pleased that the consultation starts the ball rolling on the package of pension reforms announced in November's Autumn Statement. It will be interesting to see how the looming General Election affects the next steps. Given the improvements in DB scheme funding levels, there is a significant opportunity for the next government—whoever forms it—to make some positive changes.

The consultation asks sensible questions. We're pleased to see the Government agreeing our call for surplus extraction to be conditional upon funding levels and the security of members' benefits. However, there are still a lot of options on the table and details to be worked through in both areas at this early stage.

We will be responding to the consultation, which closes on 19 April, and sharing more on our views and insights over the coming months.

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