

Options for Defined Benefit schemes: a call for evidence

Contents

Ministerial Foreword	2
Introduction	3
Who is this call for evidence aimed at?	3
Purpose of the call for evidence	3
Scope	4
Duration.....	4
How to respond to this call for evidence.....	4
Government response.....	4
Feedback on the call for evidence process	4
Freedom of information	5
Background	6
Call for Evidence	6
Building surplus.....	6
Consolidators	7
Pension Protection Fund as a consolidator	8

Ministerial Foreword

The DWP has published a number of documents today, all designed to drive better outcomes for pension savers. These are all part of a wider government agenda to improve opportunity for investment in alternative assets including in high growth businesses and improve saver outcomes. These have the potential to increase overall returns for pensions savers leading to better outcomes in retirement. In addition, we want to ensure that our high-growth businesses of tomorrow can access the capital they need to start up, scale up and list in the UK. DWP have been working closely with HMT on this wider package which was set out by the Chancellor in his Mansion House speech.

As part of the Government's drive to deliver greater economic growth, we want to ensure that pension scheme money is working as effectively as it can for members, sponsoring employers and the UK economy. As part of this, we are considering whether more can be done with the assets of defined benefit (DB) schemes.

DB schemes are great for members as they provide a secure income in retirement, but to do so they hold assets worth around £1.7 trillion. Several suggestions have been made as to how this money could be used more flexibly to benefit pension scheme members and the wider economy.

We want to offer sponsoring employers and scheme trustees more choices going forward. This could include more consolidation options or more choices in how they invest DB assets and help them to generate greater surpluses. However, the Government is acutely aware that changes to how this level of assets are invested can have considerable effects on the economy, both positive and negative, so we will need to go cautiously and understand the impact of any suggestions on the UK economy as a whole. As well as ensuring pensions are protected, we must prioritise having a strong and diversified gilt market and our decisions must strengthen the UK's competitive position as a leading financial centre.

We are keen to explore some of the ideas which suggest ways in which sponsoring employers and DB scheme trustees can invest differently, and the choices we could offer to help them to do this. Please consider responding to this call for evidence on whether there is scope to enable greater flexibility in how DB pension scheme assets are invested with the potential to work harder for members, employers and the economy.

Laura Trott, MBE, MP

Minister for Pensions

Introduction

This call for evidence has been launched by the Department for Work and Pensions (DWP) to support the development of innovative policy options which have the potential to offer more choices for defined benefit (DB) pension scheme sponsoring employers and trustees, increase protection for DB members and also support wider economic initiatives

Nearly ten million people rely on private sector DB pension schemes to support them in retirement. Although many schemes are now closed, they hold around £1.7 trillion¹ worth of funds which is roughly equivalent to 75% of UK annual GDP.

Who is this call for evidence aimed at?

DWP welcome input from:

- Sponsoring employers
- Pension scheme trustees
- Pension scheme providers, other industry bodies and professionals
- Members of the advisory community
- Defined benefit pension scheme members
- Bulk purchase annuity scheme providers
- Any other interested stakeholders

Purpose of the call for evidence

As part of the Government's drive to promote economic growth, DWP are issuing this call for evidence to build an evidence base around how DB pension schemes could use their assets more flexibly, while maintaining appropriate security of the benefits promised and not undermining the fiduciary duties of trustees.

This includes exploring consolidation options and DB's role in investment that provides equity capital and finance for businesses in the UK including start-ups, infrastructure and private equity, as well as longer-term investments, typically in illiquid assets. This has been generically termed investing in "productive finance".

We would like to hear from the pensions industry, and other stakeholders who can offer an informed perspective on how DB schemes engage with productive finance in practice and how that could change. It would be for the schemes themselves to make decisions on asset allocation, as they do now.

¹ While the purplebook indicates that DB schemes hold £1.7 trillion worth of funds as at March 2022, the PPF 7800 index estimates that at the end of May 2023, schemes held around £1.4 trillion in assets.

The responses to this call for evidence and other stakeholder engagement will inform the Government's understanding of these issues and will help inform the development of future policies in these areas.

The direction of future policy is not yet decided; any evidence we gather will be used to develop policy which is firmly based on evidence and fact. Any future policy development will be guided by three key principles. First, the Government will seek to ensure fairness for DB pension members. Second, we will always prioritise a strong and well diversified gilt market because those who invest in our gilts are helping to fund vital public services. Third, any decisions must strengthen the UK's competitive position as a leading financial centre able to fund our public services.

Scope

This call for evidence applies to Great Britain as pensions are devolved to Northern Ireland. However, as we are aware some DB pension schemes are UK not GB wide, we also welcome evidence from organisations and individuals based in Northern Ireland.

Duration

This call for evidence will run for 8 weeks, starting on 11 July 2023, and ending on 5 September 2023. Please ensure your response reaches us by that date as any replies received later may not be taken into account.

How to respond to this call for evidence

Please send your responses by email to: caxtonhouse.dbcfe@dwpgov.uk

Note: When responding please indicate whether you are responding as an individual or representing the views of an organisation; whether you are content for your response to be quoted in a future response the government issues; and whether you would prefer this to be anonymous.

We are happy to keep responses confidential where requested, recognising that some respondents may prefer their response to not be published.

Government response

We will publish our response to this call for evidence on the GOV.UK website in line with normal government practice.

Feedback on the call for evidence process

We value your feedback on how well we seek evidence. If you have any comments on the process of this call for evidence (as opposed to comments about the issues which are the subject of the call for evidence), please address them to:

DWP Consultation Co-ordinator: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the DWP, published in a summary of responses received and referred to in the published government response.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of freedom of information and how it is applied within DWP, please contact the Central Freedom of Information team: freedom-of-information-request@dwp.gov.uk

The Central Freedom of Information team cannot advise on a specific call for evidence exercise, only on freedom of information issues. Read more information about [Freedom of Information Act](#).

Background

1. There has been a material shift in the way DB schemes invest over the last few decades. As highlighted in the recent report from the Resolution Foundation², DB schemes have moved significantly into bonds and away from equities. They have also at the same time diversified away from UK equities to a more global equity allocation. This trend can be traced back to before the turn of this century.
2. A number of factors have influenced and driven this. With most schemes closed to new entrants, the pensions landscape is maturing, and trustees and employers are seeking to limit risk and volatility as the time horizons for their schemes reduce. Many will be seeking to progress along a path to secure member benefits on the insurance market or to enter a consolidator. However, the Government believes there may be potential for the assets held by DB schemes to work harder for members, employers and the economy.
3. At the moment, there are limited options for companies who want to move their DB pension liabilities off their balance sheet unless they meet the insurance threshold. And there are limited incentives for closed DB schemes to invest in productive assets.
4. In the rest of this document, we set out some of the areas we would like to understand better. This includes:
 - DB asset allocation and incentives around investment strategies
 - Current rules and barriers around surplus
 - Exploring the potential for consolidation options

Call for Evidence

5. There is some evidence that DB schemes are underinvested in productive assets compared to international comparators

Question 1: Do you agree with the assessment of the position? Is there evidence to the contrary?

Question 2: What changes might incentivise more trustees and sponsors of DB schemes to consider investing in productive assets while maintaining appropriate security of the benefits promised and meeting their other duties?

Building surplus

6. Incentives for employers to invest for surplus are currently quite weak. Employers have little to gain from any surplus, their access to which is strictly limited, and they are entirely responsible for any deficit that might emerge if investment does

² [Beyond-boosterism.pdf \(resolutionfoundation.org\)](https://www.resolutionfoundation.org/publications/beyond-boosterism/)

not perform well. Any deficit would have to be filled by additional employer contributions and would have to be reported on the company Balance Sheet. This could affect the company's market capitalisation, and the company's ability to borrow and attract the investment needed to grow.

7. There are similar issues with incentives for trustees. There are many varied drivers that lead trustees to decide how much risk to take with pension scheme investments. Scheme trustees are concerned with ensuring members get the benefits they have been promised and will want to limit risk that could threaten members' interests; they may therefore prefer contributions from the employer to relying on uncertain investment returns. There is little incentive to invest to drive funding to a higher level than is needed to meet the pension promises.
8. For businesses which are running both a DB and DC fund, there is currently limited ability to transfer surpluses to help bolster DC funds whilst protecting the member benefits for the DB funds.

Question 3: How many DB schemes' rules permit a return of surplus other than at wind up?

Question 4 What should be the conditions, including level of surplus that a scheme should have, be before extended criteria for extracting surplus might apply?

Question 5: Would enabling trustees and employers to extract surplus at a point before wind-up encourage more risk to be taken in DB investment strategies and enable greater investment in UK assets, including productive finance assets? What would the risks be?

Question 6: Would having greater PPF guarantees of benefits result in greater investment in productive finance? What would the risks be?

Question 7: What tax changes might be needed to make paying a surplus to the sponsoring employer attractive to employers and scheme trustees, whilst ensuring returned surpluses are taxed appropriately?

Question 8: In cases where an employer sponsors a DB scheme and contributes to a defined contribution (DC) pensions scheme, would it be appropriate for additional surplus generated by the DB scheme to be used to provide additional contributions over and above statutory minimum contributions for auto enrolment for DC members?

Question 9: Could options to allow easier access to scheme surpluses lead to misuse of scheme funds?

Consolidators

9. For sponsoring employers who want to move their defined benefit scheme off their balance sheet, there are currently limited options other than going to

insurance buyout. However, the insurance buyout market is not within reach of all schemes. We want to gather evidence around possible options for the entire spectrum of DB schemes, whilst recognising the important role played by insurers in offering buy-outs to improve security for pension fund members in this market.

10. The Government is supporting the development of superfunds for those schemes for whom there is no realistic prospect of buying out on the insurance market. In this call for evidence the Government is exploring the potential benefits and drawbacks of a public sector consolidator. Through the design of a public consolidator the Government may be able both to ensure investment objectives are met and promote long-term investment timeframes that would support investment in UK productive finance.

Question 10: What impact would higher levels of consolidation in the DB market have on scheme's asset allocations? What forms of consolidation should Government consider?

Question 11: To what extent are existing private sector buy-out/consolidator markets providing sufficient access to schemes that are below scale but fully funded?

Question 12: What are the potential risks and benefits of establishing a public consolidator to operate alongside commercial consolidators?

Question 13: Would the inception of a public consolidator adversely affect the existing bulk purchase annuity market to the overall detriment of the pension provision landscape?

Question 14: Could a public consolidator result in wider investment in "UK productive finance" and benefit the UK economy?

Question 15: What are the options for underwriting the risk of a public consolidator?

Question 16: To what extent can we learn from international experience of consolidation and how risk is underwritten?

Pension Protection Fund as a consolidator

11. The Pension Protection Fund (PPF) has a track record of investing for long-term objectives. It is a credible option for a body to run a public consolidator for any schemes that could benefit
12. One idea is to consolidate some schemes into a fund managed by the Board of the PPF. This would address incentives by breaking the employer link, and it would also drive scale, enabling a more sophisticated and productive long term investment approach.

13. The Departmental review of the PPF recently recommended that Government consider extending the Board of the PPF's remit to include "acting as a consolidator or provider of aggregated services for schemes which would benefit from this, but which are not attractive to commercial consolidators".³ The Department is therefore collecting evidence on whether the PPF's remit could be expanded to allow it to act as a public consolidator.

Question 17: What are the potential risks and benefits of the PPF acting as a consolidator for some schemes?

Question 18: Would the Board of the PPF be an appropriate choice to operate a public consolidator?

Question 19: How could a PPF consolidator be designed so as to complement and not compete with other consolidation models, including the existing bulk purchase annuity market?

Question 20: What options might be considered for the structure and entry requirements of a PPF-run public consolidator for example:

- Are there options that could allow schemes in deficit to join the consolidator?
- What principles should there be to govern the relationship between the consolidator and the Pension Protection Fund?
- Should entry be limited to schemes of particular size and / or should the overall size of the consolidator be capped?
- How could the fund be structured and run to ensure wider investment in UK productive finance?
- How to support continued effective functioning of the gilt market?

³ <https://www.gov.uk/government/publications/departmental-review-of-the-pension-protection-fund-ppf/departmental-review-of-the-pension-protection-fund-ppf>