Policy Briefing

The outlook's clement for DB schemes—and careful reforms could make it sunnier for all

Calum Cooper
Partner and Head of Pension Policy Innovation

The window for responding to the Department for Work and Pensions' consultation exercise on Options for Defined Benefit Schemes closed (gently, without slamming or risk to incautious digits) on 19 April 2024. You can find our full response here, or read on for a summary of where our thinking's at.

Recap

But first, some scene-setting (cue jaunty background music—and feel free to skip ahead to the *Our views* section if the background is old hat).

The DWP's consultation paper was broadly divided into two sections: funding surpluses and the uses thereof; and a plan to establish a non-commercial, public-sector consolidation vehicle. Those might seem, at first glance, to be somewhat disparate subjects. However, the exercise is part of the Government's 'Mansion House' initiative, which aims to encourage (or at least clear the path for) greater investment of pension scheme resources in 'productive finance': longer-term, less-liquid assets that promote sustainable growth in the wider economy. That's the unifying theme here.

The idea is that, if surpluses are more accessible, and more versatile in their application, trustees and sponsors will be reassured about the wisdom of building them up and running their schemes on (rather than securing their liabilities and 'gittin' the ~~Hell~~ heck[1] out of Dodge' as soon as they're able), and they'll feel liberated to invest some of that surplus in growth assets. And if there's a consolidation vehicle that can sweep up enough of the schemes that are relatively well-funded, but not currently well-served by the commercial consolidation market, and the people running it (in all probability the Board of the Pension Protection Fund) have the requisite investment nous, it too would be able to invest for the long-term, in a way that benefits the UK's economy.

Our views

Surplus

The recent turnaround in the funding fortunes of many DB schemes is clearly for the good, but we think that it has the potential to become profoundly transformative. The existence of a surplus increases the security of accrued benefits, and with the right rules and incentives in place it could be shared in ways that benefit stakeholders more broadly. Most directly, it would be possible to enhance existing defined benefits or make other payments to DB scheme members. Going further, sponsors could re-direct resources to improve pensions

[1] This aims to be a family-friendly policy briefing.

provision for current workers. And trustees and sponsors could have the freedom and confidence to invest longer term in ways that benefit the economy, and for socially beneficial purposes.

Crucially, both sponsors and trustees will need to support this project. So we don't think that any statutory power over scheme surplus rules should be wielded by the trustees alone. On that basis, we are in favour of statutory intervention to permit surplus sharing and one-off payments to members, without triggering penal tax charges or adverse accounting treatment. There's even an opportunity to tweak the taxation system to encourage welcome sponsor behaviours, like reinvestment of refunds to enhance the employer's DC offering, in pursuit of intergenerational equity, or in socially beneficial initiatives.

Of course, security for accrued benefits should be a paramount consideration in any moves to make surplus sharing easier. However, we don't think that the assurance of a 100% PPF underpin is necessary or tenable at the cost that has been suggested; the market is already stepping in to provide alternative solutions.

Public-sector consolidator

We're in favour of the creation of a PPF-run public-sector consolidator (PSC), if done right. Its attractiveness as a solution will depend on the risk of reduced benefits and the extent of government backing. Clarity over those aspects is essential.

To minimize market disruption, the target population needs to be schemes for which commercial solutions are practically unattainable and where there's a risk of benefit reductions. Delivering on this requires clear eligibility criteria and independent oversight.

Benefit restructuring shouldn't be a barrier as long as the PSC errs on the side of rounding upward, and it offers a high level of security. Mind you, we reckon that if the option to simplify benefits—with member safeguards—were available more widely, there would be less need for the PSC.

Achievement of sufficient scale, and sufficient latitude over its investment choices will be crucial to success, both in terms of providing a credible alternative to commercial offerings, and in meeting the Government's Mansion House aspirations. Achieving this whilst balancing the goal of stimulating the commercial markets is a big ask. If prioritisation is required, our view is the emphasis should be on stimulating provision of commercial capital rather than risk nationalisation by the back door.

The foregoing is but a soupçon of our thinking on DB endgames. If we've whetted your appetite, you can read our full response to the DWP consultation exercise here, or for a wider perspective of the possibilities and opportunities, visit our *Excellence in Endgames* insights hub. When you want to discuss the matter, please raise it with your Hymans Robertson consultant.

London | Birmingham | Glasgow | Edinburgh **T** 020 7082 6000 | www.hymans.co.uk