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Rt. Hon. Sir Stephen Timms
Chair
Work and Pensions Committee
By email

13 November 2023

Defined Benefit (DB) pension schemes inquiry – points further to 18 October 2023 session

Dear Sir Stephen,

Thank you very much for the opportunity to give evidence to the Committee's session on Defined Benefit (DB) pension schemes on 18 October 2023. I am very glad that the Committee was interested in our comments on the need to broaden out the policy debate on DB schemes and look at the regulator's mandate. I am also grateful for this opportunity to share further points.

Unintended consequences of past pension policies have led the UK's 5,000 DB pension schemes to close and invest their £1.5 trillion of assets defensively. This may be appropriate for delivering the pensions of their ageing members but is sub-optimal for both UK businesses and UK society.

To put this in context, the difference between funding in line with the type of low dependency basis envisaged in the funding code, versus funding a buyout, is in excess of an additional £150 billion of cost across the UK DB universe. That £150 billion is funding the difference between having more than a 99% chance of pensions being paid in full (under the funding code route) vs a "gold standard" buyout. We believe it is legitimate to ask the question: When is enough security enough, such that other societal goals can be considered?

Now is the time to reflect on longer term policy strategy that would intergenerationally reconnect the UK's immense store of pensions wealth, so it delivers pension promises, supports current workers and builds societal prosperity.

The statutory objectives given to the Pensions Regulator ("TPR") should be re-oriented. A better statutory objective for today would balance keeping past benefits secure with offering good quality pensions to current workers.

Regulation should encourage (but not mandate) schemes to generate surpluses. A surplus makes past benefits more secure. It also generates value which businesses can use to subsidise the cost of pensions for current workers. Surpluses should be seen as buffers to enable retirement savings to thrive through uncertainty and create value across generations as well as empowering investment in assets that generate social good.

Whilst the DWP's and TPR's new DB funding regulations and draft code could become a threshold for accessing DB surpluses, a more appropriate measure might be to align any tests/thresholds with those that will be applied to commercial consolidators, when testing for profit extraction. Thus larger schemes, with strong sponsor covenants, will have a consistent framework for evaluating the different options in the market.

We strongly believe there is a major societal opportunity here, with the right policy support. We would be supportive of the establishment of a commission to look at these issues, with a key objective of enabling retirement saving solutions that will improve retirement outcomes whilst supporting wider economic growth.

Many companies are concerned about the level of future retirement provision for their workforce, their employees' exposure to financial and longevity risk and lack of financial education. These employers cannot afford to address this by simply re-opening their legacy DB schemes. The regulatory environment is not yet geared up to support new innovative retirement saving designs.

With appropriate policy support, a spectrum of retirement designs ranging from pure DC, Collective DC, pooling of longevity risk solutions and new "safety net" DB schemes (where all employees could be assured the same base level of retirement provision on top of the state pension) could reinvigorate retirement saving in the UK and create a larger pool of assets to support broader societal aims. Giving businesses shared control (risk and reward) over how pension scheme assets are invested would help to encourage companies to accept more risk.

We envisage future pensions being offered within existing pension trusts. This works for larger schemes, but small schemes will need DB consolidators to offer pensions at scale.

Thoughtful tax incentives could be used to align DB scheme choices with society's wider aims. For example, not applying tax on refunds which are re-invested in UK Productive Finance or in UK climate transition initiatives.

We hope the above comments are of use to the work of the Committee. We would be delighted to carry out more in-depth analysis on some of these concepts for the Committee if this would be helpful.

Yours sincerely,

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for and on behalf of

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