Options for Defined Benefit schemes: public consultation

Response from the Pension Protection Fund

April 2024

About the PPF

The Pension Protection Fund (PPF) was established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation[1]. Since inception, we have consolidated over 1,000 DB schemes into the Fund, and now have around 300,000 members, to whom we paid £1.2 billion in 2022/23. We protect a further 9.6 million members of DB schemes.

The PPF is a statutory fund run by the Board of the PPF, a statutory corporation established under the provisions of the Pensions Act 2004. The PPF became operational on 6 April 2005.

In 2009 the Board of the PPF was also given the responsibility of being the scheme manager for the tax-payer funded Financial Assistance Scheme (FAS). FAS provides assistance to around 142,000 members of around 1,000 eligible underfunded defined benefit schemes that started to wind-up between 1 January 1997 and 5 April 2005, or between 6 April 2005 and 27 March 2014 where an employer insolvency event occurred before 6 April 2005.

The Board of the PPF has also held, managed and applied the – wholly separate - Fraud Compensation Fund (FCF) since 2005. The FCF was set up as a result of the Pensions Act 2004, and provides compensation when a scheme (and as a result an individual member) has lost out financially due to dishonesty.

Key points

- **A public sector consolidator would provide valuable additional choice for pension scheme trustees and their members.** Seventy-five per cent of schemes have assets of less than £100m and can face per member running costs several times higher than their larger counterparts. Existing consolidation solutions – including insurance buyout – are mostly focused on larger schemes. Schemes with poor funding have no consolidation solutions available to them, potentially leading to poorer outcomes for members.
- **The PPF has the right capabilities to run a public sector consolidator.** Our not-for-profit status and member focus, combined with our award-winning investment and member services capabilities, make us uniquely well placed to operate a public sector consolidator. Our existing investment strategy, which is an example of what could be achieved with a well-diversified portfolio, can be scaled to accommodate a significant increase in assets under management. The maturity of our operating model means we can take on an additional role without affecting the successful delivery of our existing functions.
- **Our proposed design would make the public sector consolidator distinct from commercial options.** We think the consolidator should: offer a route for schemes with a

[1] What being a PPF member means | Pension Protection Fund

deficit to transfer; operate a range of standardised benefits; and provide a level of security and an entry price broadly comparable to that of commercial 'superfunds'.

- **The market for the public sector consolidator is immaterial relative to the broader market of defined benefit schemes.** Designed in line with our proposed approach we think schemes with assets totalling £130bn could be interested in a transfer but only a proportion would do so. There are £1.4trn assets in DB schemes and pension risk transfers are in excess of £50bn per annum.
- **Operating at that scale (£130bn) the consolidator could run a material allocation to UK growth assets (c.£10bn) and gilts -** contributing to the government's wider objectives.

General comments

Model for a public sector consolidator

The need for change

We welcome the opportunity to respond to this public consultation. We are strongly of the view that a public sector consolidator, run by the PPF as a separate and independent function, can fulfil an important role, providing an additional and complementary choice for DB scheme trustees and helping secure the best possible outcomes for members.

There is strong evidence that additional choice is needed. The universe of defined benefit schemes in the UK is characterised by a large proportion of small and subscale schemes. 75% of schemes have assets of less than £100m. Around 1500 schemes have assets of less than £10m and just under 1000 have assets of less than £5m. The evidence is clear that smaller schemes face significantly higher costs. Indeed, previous research completed by TPR showed that small scheme per member costs can be five times greater than that of very large schemes. The recent improvements in scheme funding provide a valuable opportunity to move towards a much more consolidated system and deliver better outcomes for members and employers.

However, current market solutions will not provide a complete answer. The insurance sector is responding to increased demand through a welcome mix of increased capacity and innovation. Even so there are clear signs of capacity challenges in the market. Aon's UK Insurer Survey 2023[2] stated that "all insurers identified capacity constraints as one of the key challenges in meeting demand". With limited bandwidth to process deals, many insurers and those consultants who work with them are focusing on larger schemes and those that are best prepared. Hymans Robertson's Risk Transfer Report 2024[3] said that "For an insurer, a small transaction can be as resource-intensive as a large one, so insurers are increasingly focusing on larger transactions when their resources are stretched, as they are now." Other schemes – due to size or complexity in either benefit structure or asset holdings - can face challenges to get a quote, let alone establish a competitive bidding process. And, of course, those schemes not at a buy-out level of funding are locked out of the market altogether.

Timely access to a secure end-game solution on reasonable terms matters. The disproportionately high running costs of small schemes can be a real drain, in terms of money and time, on sponsoring employers. Critically, schemes continue to face funding risks – there is no certainty that all schemes will retain today's strong funding levels several years into the future. This may be a particular concern for schemes with weaker employer covenants. Our

[2] Aon-Risk-Settlement-Insurer-Survey-2023.pdf
[3] Risk Transfer Report 2024 | Hymans Robertson

discussions with small and medium-sized enterprises (SMEs) have highlighted that many sponsors want to move their scheme on as soon as possible.
Against this backdrop it seems clear that a public sector consolidator, designed to focus on those schemes unattractive to commercial providers, while not solving all the problems, would provide an important additional choice for scheme trustees.

The role of the PPF

We believe the PPF is uniquely well placed to manage a public sector consolidator and drive the best possible outcomes for members. We are a not-for-profit organisation with a clear member focus. We have built significant capabilities in the areas that will be central to the success of the consolidator: investment management and member services. Our in-house award-winning investment management team has an exceptional track record in investing across the full range of asset classes to deliver year on year growth in excess of liabilities; our existing investment strategy is an example of what could be achieved with a well-diversified portfolio, and can be scaled to accommodate a significant increase in assets under management. Our member services team is class leading, consistently delivering high levels of member satisfaction, including in relation to vulnerable members. The maturity of our operating model means we can take on an additional role without affecting the successful delivery of our existing functions.

How the public sector consolidator could be structured

We have set out our emerging views – in the attached supplementary document - as to how a public sector consolidator could be designed to meet the government's objectives. Our suggestions are that the consolidator should:

- provide a high level of security for members (at least an equivalent level to that required of commercial consolidators)
- operate a range of standardised benefit structures, mirroring those elements of scheme benefits that are most important to members while providing the basis for the consolidator to operate with reduced set up and running costs
- provide a route for schemes with a deficit (on the consolidator's pricing basis) to join the consolidator
- have access to risk underwriting provided by the government. We suggest this could be in the form of a finite, contingent liability. This contingent liability could be reduced over time as the consolidator builds a reserve from its own investment returns.

We anticipate this approach would lead to pricing comparable to that offered by commercial consolidators. The design would also limit any relative price difference between small and large schemes.

Over the consultation period we have discussed the proposals with a wide range of advisers, trustees, employers and representative groups. We are very grateful for the input we have received and it has helped us refine our thinking. However, it is clear much more remains to be done and we are keen to continue working with the government and industry to reflect on consultation responses and establish the best possible design for the consolidator.

The market for the public sector consolidator

Our view is that a carefully designed public sector consolidator would have a very limited impact on the existing commercial market. For schemes able to access commercial solutions on reasonable terms we believe this would remain the preference of scheme trustees. Both commercial consolidators and insurers would allow schemes to secure their existing benefit structures and insurers would offer a higher level of security for member benefits. As a result the level of interest in the public sector consolidator is likely to be immaterial next to the value of the commercial market.

Our analysis suggests the *potential* market for a public sector consolidator has total assets of around £130bn[4] and only a proportion of these schemes might actually transfer (probably over a period of several years). In contrast, DB schemes have £1.4 trillion assets and the value of risk transfers to insurers in 2023 alone was around £50bn, a level that is forecast to grow in the coming years.

Investing in UK growth assets and supporting the gilt market

We believe a public sector consolidator – investing for growth over the medium to long term – would increase levels of investment in UK growth assets and gilts, certainly compared to the likely investment strategy of small schemes on the path to insurance buy out. However, the materiality of the consolidator's contribution to these government objectives will depend on the scale the consolidator reaches – running a substantive allocation to UK productive finance assets would require the consolidator to achieve a significant scale. Elements of the consolidator's design may need to be adjusted to achieve this. It will be for the government to decide how it prioritises between its different objectives and we stand ready to respond to whichever direction is settled upon.

Treatment of scheme surplus and 100% underpin

Our response also covers proposals for treatment of scheme surplus. We have not commented on the government's consideration of introducing a statutory power either to allow trustees to amend their rules and allow for payments from surplus funding, or to make payments, nor on the consideration of potential further changes to the tax regime. We welcome the consideration of safeguards to protect the security of members' benefits, since any extraction of surplus increases risk to members. We said in our response to the Call for Evidence that we don't think the proposal to offer a PPF underpin of full scheme benefits will materially change the level of investment in productive finance – which was the focus of the call for evidence. But we did identify that there are other benefits it could bring. Being clear on the objectives of any underpin is critical to informing its design. An underpin funded solely from premiums paid by a small number of participants could not provide a 'guarantee' of full benefits without becoming disproportionately expensive. If the underpin is to proceed, trade-offs will be necessary between the level of security provided, eligibility criteria, ongoing controls on participating schemes, and the level of premiums charged.

We continue to stand ready to help DWP and industry work through this to reach a conclusion as to whether a 100% underpin is a viable and necessary option and, if it is concluded that it is, and will be taken forward, to help establish it.

---

[4] These figures are based on TPR's buy-out estimates as at 30 September 2023. Details of the calculation methodology and limitations are summarised in the supplement to this response in the 'eligibility and the potential market for the public sector consolidator' chapter.

Responses to questions

Chapter 1: treatment of scheme surplus

Statutory override

Question 1: Would a statutory override encourage sharing of scheme surplus?

Question 2: What is the appropriate balance of powers between trustees and employers? Should a statutory override allow trustees to amend scheme rules around surplus at their sole discretion, or should such amendments be contingent on an agreement between trustees and the sponsoring employer?

Question 3: If the government were to introduce a statutory override aimed at allowing schemes to share surplus with sponsoring employers, should it do so by introducing a statutory power to amend scheme rules or by introducing a statutory power to make payments?
Question 4: Should the government introduce a statutory power for trustees to amend rules to enable one-off payments to be made to scheme members, or do schemes already have sufficient powers to make one-off payments?

Question 5: What impact, if any, would additional flexibilities around sharing of surplus have on the insurance buyout market?

We have no comment on these.

Taxation

Questions 6 and 7: What changes to the tax regime would support schemes in delivering surpluses to distribute as enhanced benefits? Are there any other alternative options or issues the government should consider around the treatment of scheme surplus?

We have no comment on these.

Safeguards for member benefits

Question 8: under what combination of criteria should surplus extraction be permitted?

Any extraction of surplus increases risk to members, with the inherent risk that 'too much' money is taken out of the scheme, so safeguards should be in place to ensure the risk of that occurring is very low; in other words, that after surplus extraction the likelihood of paying member benefits in full remains sufficiently high.

But we also recognise that sponsors are required to support schemes where there is a deficit, so it is reasonable to provide opportunities for them to benefit from surplus, where this can be done safely. An appropriate starting point would be that the scheme is fully funded on a low dependency basis – with a risk-based buffer above that basis to reflect the degree of investment risk being taken by the scheme. This would mean that where a scheme is taking limited investment risk, so that the risk of scheme funding declining is minimal, the buffer required would be minimal, but for an investment strategy that was more return seeking the buffer should be sufficient to ensure that the risk of falling below the low dependency basis remained low. We do not think it would be appropriate to allow for the strength of the sponsor – since we have seen first-hand how quickly employer covenant can deteriorate, and there can be limited notice this is occurring.

Questions 9 and 10: What form of guidance for trustees around surplus extraction would be most appropriate and provide the greatest confidence? What might remain to prevent trustees from sharing surplus?

We have no comments on these.

100% PPF underpin

Question 11: would the introduction of a 100% PPF underpin have a material impact on trustees' and sponsors' willingness to extract surplus?

We have no comment on this.

Question 12: are there other benefits to a 100% underpin that the government should consider?

This is an area on which we are very keen to hear industry views. For example, we have heard it discussed that this would support those schemes choosing to run on as their end game solution, providing reassurance to members that adequate security is in place.

Question 13: if a 100% underpin could deliver valuable benefits, what does the government need to prioritise to ensure an effective design? For example, does the way the superlevy is calculated need to ensure that the superlevy is expected to be below a certain level? How high a level of confidence does there need to be that the PPF will be able to pay a 100% level of benefits?

We support the government's position expressed in the consultation that the existing PPF and the superlevy funds should remain separate. Members of the PPF who have transferred to date, and members and sponsors of schemes within the standard PPF structure are unlikely to see it as reasonable to be underwriting the risk posed by those who opt into higher levels of protection.

Some estimates of the premium that could be charged assume access to existing PPF funds / levy payers for tail scenarios. As the government has ruled this out, the underpin must be self-funding in all scenarios. This will necessitate a higher charge than those estimates envisaged (and / or a lower level of security). The fund for the 100% guarantee would need to run for many years and even among investment grade entities we can expect insolvencies if looking over such a long period (e.g. historic default rate for BBB over 10 years is c2.5%). It is plausible that insolvencies (potentially more than one) could occur at a point in the economic cycle when scheme investments have also taken a hit, given the expected return seeking portfolios. To provide adequate protection to members, the premium will need to be large enough to cover negative scenarios like these.

Other factors will also serve to increase the premium. These include: that the fund would be protecting the top slice of liabilities; that risk will be far more concentrated than for the standard levy (due to the more limited numbers participating and likely size of entrants); material adverse selection risks (especially in regard to any sponsors without a credit rating); investment strategies will be expected to be return oriented, increasing short-term volatility; and that claims may be more correlated than in the universe generally.

It is also important to note that the cost of adverse experience would need to be borne by other participants. If for example a large participant failed, the cost to the fund would need to be spread across the other participants - potentially leading to a sharp increase in the premiums payable.

We think all these issues make the introduction of a self-funding underpin model very challenging. To limit the scale of premiums and reduce risk for participants it is likely that the government will need to consider: limits on the level of security provided; tight criteria for entry (e.g. in terms of minimum funding levels, restrictions on investment risk, and on sponsor strength); ongoing controls (e.g. to tackle any emerging deficits against the entry funding requirements); and potentially arrangements for exit payments if a participant buys out (particularly if the underpin fund is in deficit at that point). An additional challenge in establishing the arrangements would be the need for schemes to commit simultaneously to the new fund, in order to ensure it starts with a pool of schemes.

One further point is that to be able to meet 100% of benefits in adverse scenarios it would be essential to charge a premium in excess of expected costs. We recognise that this could lead, over time, to the establishment of a surplus in excess of that needed to cover the required level of security for the scheme. Drawing from the experience of the existing PPF, it would be sensible to specify in advance what happens to such a surplus.

Question 14: are there other methods outside the PPF that could provide additional security to schemes choosing to run on?

We believe that there are already commercial insurance products being developed through the regulated market which would provide a similar level of assurance to schemes without recourse to the PPF.

Chapter 2: model for a public sector consolidator

Eligibility

We have provided summary answers below; more detail can be found in the supplement to this response in the '*eligibility and the potential market for the public sector consolidator'* chapter.

Question 15: Would the proposed approach to eligibility allow schemes unattractive to commercial providers to access consolidation? Would it be attractive to such schemes?

Based on our experience and feedback we have heard from organisations such as the Association of Professional Pension Trustees, we believe there are schemes which are unattractive to commercial providers. This arises as a result of two main features: i) funding level (if there are insufficient funds to meet the price of commercial solutions, there are currently no options available to schemes); ii) they are relatively unattractive to commercial providers in a high demand market because of scale (meaning schemes face limited choice and a lack of competitive quotes), and complexity of benefits and asset holdings.

We consider therefore that a requirement on the public sector consolidator to accept transfers from all schemes that can meet its terms would be an important feature. However, this would only work if the design also allowed the consolidator to offer an effective solution to these barriers. Namely, it must be able to accommodate schemes with a deficit; it must be designed to limit any price differential between smaller and larger schemes; and be able to accommodate those with complex benefit structures or asset holdings. Designing the public sector consolidator in such a way, with a clear public duty to address the possibility of market failure, supported by panel firms operating standardised processes, would ensure it provides a solution for schemes unattractive to commercial providers.

Question 16: Is setting the consolidator a duty to accept transfers from schemes unattractive to commercial providers and mandating certain design features (e.g., benefit standardisation) and ensuring no unfair advantage sufficient to limit impacts on commercial alternatives? If not, what alternative approaches would you recommend?

We believe that schemes attractive to commercial providers – primarily the larger, well-funded schemes – are likely to continue to prefer existing commercial options (either a buy-out with an insurer or a transaction with a commercial consolidator). This is because they can secure attractive pricing, a relatively rapid transaction, and a benefit structure that matches their existing scheme benefits.

However, smaller schemes may find commercial options are only available at a price which doesn't offer value for money and / or may face long lead times (which may be unattractive to trustees if employer solvency is uncertain, or unattractive to employers if ongoing liability to the scheme constrains employer development). Schemes with weaker funding may have no commercially available option. Schemes with significant illiquid assets may find commercial options are limited or with unattractive terms. We believe schemes in this position are most likely to see the public sector consolidator as an attractive solution.

Our analysis (as set out in the *eligibility and potential market for the public sector consolidator* chapter of our supplementary document) suggests that the **potential** market for the public consolidator includes around 2,300 schemes with around £130bn in assets. We have excluded from our analysis schemes with over 25% of their assets in annuities, as those schemes might already be on course for a transaction with an insurer, and schemes open to accrual or already in wind-up.

Of course only a proportion of these schemes will be interested in a transfer to the public consolidator. We also recognise that the market is continuing to develop new and innovative solutions including for small schemes. Nevertheless, current capacity in the market and the likely demand over the coming years suggests that there will remain a significant number of schemes looking for an end game but unable to secure a timely solution from a commercial provider. As illustration:

- Aon's UK Insurer Survey 2023[5] stated that "all insurers identified capacity constraints as one of the key challenges in meeting demand".
- Aon's 2023 risk transfer report[6] found that "many insurers now require exclusivity to engage with any transactions under £100m".
- Hymans Robertson's Risk Transfer Report 2024[7] said that "For an insurer, a small transaction can be as resource-intensive as a large one, so insurers are increasingly focusing on larger transactions when their resources are stretched, as they are now... Some insurers are making exclusivity a condition of quoting for a small scheme... A busy market full of large transactions is stretching insurers' resources, leading to capacity

---

[5] Aon-Risk-Settlement-Insurer-Survey-2023.pdf
[6] Aon-Risk-Settlement-Annual-Review-2023.pdf
[7] Risk Transfer Report 2024 | Hymans Robertson

constraints. Large transactions in particular place demands on pricing, operations, investment and management teams, leading to some insurers unable to commit to the market as a whole".

- A survey of insurance providers by DLA Piper[8] found nearly half of respondents said they had refused to quote on 50% or more of deals.

The lack of capacity now and in the coming years matters. There is no certainty that all schemes will be able to retain their current strong funding positions. This will be a particular worry where there are concerns about sponsor strength. And the impact of running small, inefficient schemes on SME sponsors should not be understated – running costs of small schemes are several times bigger than their larger counterparts. We believe, therefore, that there is a strong case for the additional choice a public sector consolidator would provide alongside a healthy and growing commercial market.

Question 17: Would a limit on the size of the consolidator be needed? If so, how might a limit on the size of the consolidator be set? Would limits on capital and a requirement to meet the same capital adequacy requirements as commercial consolidators suffice, or are there alternatives?

As noted in answer to question 16, we believe the market of schemes interested in the public consolidator will be of very limited materiality compared to the size of the commercial market. Our analysis suggests the combined asset value of schemes that may be interested in the public sector consolidator is approximately £130bn. Of course, only a proportion of these schemes are likely to commit to a transfer, which would take place over a number of years. Against that, UK DB schemes have assets of over £1.4 trillion and in 2023 insurers wrote business of over £50bn (an annual figure that is expected to grow). As such we don't believe there is a need for a limit on the size of the consolidator. However, it would be open to the government to control or limit its overall scale; if the government wanted to take additional steps to reassure the market, we consider a cap on the overall size of the consolidator would be the most appropriate measure. Any limits would of course still need to allow the public consolidator to meet the government's objectives for running an allocation to UK productive finance, which could be done most flexibly by controlling the capital made available, but could also be set in regulations. If the government is interested in this approach, we would stress the need to establish an approach which can be flexed over time, as there are considerable uncertainties about how the market may develop.

Question 18: How in practice might the public sector consolidator assess whether a scheme could access a commercial consolidator?

While there is some evidence from the industry that it is possible for all schemes, including small schemes, to obtain a quote, this in and of itself does not mean that all schemes can access a commercial provider. The quote provided might be excessively high; alternatively a transaction might be possible but due to capacity constraints is not on a suitable timescale for the trustees. We believe it will be difficult for schemes to evidence that they cannot find a suitable commercial alternative – this would require providers to interact with the scheme purely to prove its unattractiveness, which seems implausible. Obtaining such evidence would also add cost and time for the trustees, which for smaller schemes in particular is likely to be problematic.

Overall, we think a better approach to achieving the government's stated objectives is to establish the consolidator with a distinct design from commercial alternatives, and allow trustees freedom to choose the right solution for their schemes. This is in line with the new funding

[8] The UK's bulk annuity market: Our end of year survey | DLA Piper

regime, which allows schemes flexibility to choose the right long-term funding objective for their scheme. For example, a 'bridge to buy-out' model will be right for some schemes but a run-on model (i.e. the proposed basis for the public sector consolidator) will be more appropriate for other schemes.

Question 19: On what basis should the public sector consolidator be entitled to reject schemes from entering?

As per our response to question 15, we believe the consolidator should be required to accept transfers from all schemes that can meet its terms, and only reject those which cannot. We would anticipate that this is most likely to arise with schemes in deficit, for some of whom the terms of the deficit payment plan (duration, interest rate etc) may be unattractive - but these terms will be essential for safeguarding other members of the public consolidator.

The consolidator would also aim to minimise rejections by helping schemes to meet its terms through use of panel firms and providing guidance, including transparency on indicative pricing, through an online ready reckoner or an indicative basis and methodology.

Question 20: Do you have additional views on the expected characteristics of the consolidator outlined above?

In our engagement with trustees and advisers, it has emerged clearly that the design of the consolidator needs to focus on supporting the onboarding of schemes in the most cost-effective way possible for it to be available to small schemes. One key aspect in delivering this will be supporting a smooth transition process, and we would emphasise the importance of using legislation to support this. We discuss this in more detail in our supplementary document.

Structure

Question 21: Do you agree that the consolidator should run as a single pooled fund and operate on a "run on" basis rather than target insurance buyout? If not, what alternative structure and/or operating basis would you propose?

We agree that the consolidator should operate on a non-sectionalised basis to maximise efficiencies and economies of scale. It should aim to run on (rather than act as a bridge to buy out) enabling it to invest for growth over the medium to long term (within a set risk budget). This will enable the consolidator to invest in the full range of asset classes including UK productive finance.

For clarity, we believe it will be critical for the consolidator's funds to be ringfenced and legally separate from that of the PPF. The consolidator's investment strategy will also be different reflecting the different goals and funding positions of the two funds.

Question 22: Should underfunded schemes be segregated to avoid potential cross-subsidy with other schemes?

We believe accepting transfers from schemes with a deficit (on the consolidator's pricing basis) will be a critical part of ensuring the public consolidator can meet its objectives. It will ensure the consolidator can support the schemes least attractive to commercial providers (including schemes with poorer funding). Incorporating schemes with deficits does, however, present a number of challenges. The design of the consolidator needs to mitigate risks to the funding position of the scheme, and the risk of opening up a mechanism for 'pension dumping' by employers (allowing employers to walk away from their pension liabilities on the cheap). Critical to this is ensuring that if an employer becomes insolvent before completing a deficit payment plan then member benefits can be reduced. This could be done through segregation (potentially extracting the relevant section and moving it into a PPF assessment period). However, that is not essential – a workable alternative could be to reduce benefits within the consolidator and this approach may support better member outcomes.

We outline our proposed approach to protect against cross-subsidy in our supplementary document in the chapter '*treatment of scheme deficit and surplus'.*

Question 23: Would schemes unattractive to commercial consolidators be attracted to a public sector consolidator given the model proposed above?

We believe a consolidator designed along these lines, with similar levels of security and funding to commercial consolidators, would be attractive to schemes and members. However, where schemes can access commercially available solutions on reasonable terms, we believe this is likely to remain their preference, including because of the ability to obtain scheme specific benefits. In this way, the design delivers on the government's commitment to focus on schemes 'unattractive to commercial providers'.

Our discussions with representatives of the Association of Member Nominated Trustees and Association of Professional Pension Trustees have indicated that there is support for a public sector consolidator in the menu of choices available to trustees, with the AMNT commenting that "The priority in these discussions is the security of member benefits. This includes small schemes with limited or unaffordable options in the current consolidation/buy-out market, which feel it is not in members' interests to run on. This gives scope for a different form of consolidation, which we believe is vital". The APPT expressed cautious interest dependent on the final design. There also appears to be broad support – at a high level – among those groups for our proposed design. Members of our SME Forum were supportive of the proposals but emphasised that the attractiveness of the proposition to their schemes would depend on price of entry. To that end, Forum members urged us and the government to press on with the consolidator design as quickly as possible. One member said, "nobody will take my underfunded scheme off my hands, the price is too high" and "every year that goes past is more money down a black hole and would be better spent on running my business".

Question 24: Should open private sector DB schemes be eligible to enter the consolidator? Should the focus be on closed schemes specifically?

It is undoubtedly in members' interests for open DB schemes to remain open and run on. We do not see the same market failure in the context of open schemes. It may be possible for the consolidator to provide a solution in the longer term to open schemes, but it would require material amendments to a consolidator designed for closed schemes. We would though be interested to understand from industry if there is demand for open schemes to be eligible.

Member benefits

We have provided summary answers below; more detail can be found in the supplement to this response in the '*benefit structure'* chapter.

Question 25: Will this achieve the right balance between limiting the cost of transactions whilst remaining reasonably attractive to scheme trustees and their members? Are there certain elements of schemes' benefits that should always be retained?

We propose that the consolidator would offer a range of standard, streamlined benefit structures. We believe these benefit structures should mirror the elements of scheme benefits that are likely to be most important to members. The consolidator benefits would not necessarily conform to the structure of certain statutory minimum benefits in occupational schemes, e.g. GMP. However, the consolidator benefits would be (at least) equal in value to the original scheme benefits, which themselves would already reflect statutory minima by design. We consider streamlining benefits is important in reducing running and onboarding costs compared with establishing specific benefit structures for each transferring scheme. As a result this should help ensure the consolidator can minimise the price penalty that small schemes can face.

Stakeholders have stressed to us the need to use legislation to make the process of moving to standard benefits as simple (and low cost) as possible, if it is not to be a barrier to small schemes.

Question 26: If standardised benefit structures are applied, what should these benefit structures be?

We have provided a suggested menu of choices in tabular form in the '*benefit structure'* chapter of our supplementary document.

Question 27: What effect will this have on the existing market of commercial consolidators?

As we say in our answer to question 23 above, we consider that where schemes are able to access commercially available solutions on reasonable terms, this is likely to remain their preference, including because of the ability to obtain scheme specific benefits.

However, to avoid any perception of unfair advantage for the public consolidator, we would also support any move by the government to make appropriate elements of any new legislative provisions (to facilitate the move to standardised benefits) available to commercial providers as well as the public consolidator. Wider market innovation can only be to the benefit of members, and as such we support the market's continued development of new and innovative solutions.

Governance

Questions 28 and 29: Will this proposed governance structure achieve effective administration and public confidence in the public sector consolidator? What alternative governance structures should be considered?

We agree that the public consolidator should be established as a statutory fund under the management of the Board of the PPF (as is the case for the Pension Protection Fund and the Fraud Compensation Fund). The consolidator should be legally separate from the other funds operated by the PPF Board with no cross subsidy or pooling of funds permitted. Thought will also need to be given to the structure of administration funding.

The approach proposed mirrors that already in place for the Board's responsibilities in respect of the PPF and the Fraud Compensation Fund, both legally separate funds run by the Board of the

PPF. The Board also operates the Financial Assistance Scheme as a separate function on behalf of DWP.

As we said in our response to the Call for Evidence, published September 2023, we have the skills and experience to take on an additional, separate function to act as a public consolidator and improve outcomes for members and support the government's productive finance agenda. We have a proven track record of delivering on investment objectives and outperforming investment targets. We have significant experience of preparing schemes for transfer to the PPF or an insurer, and have successfully driven down the time it takes to do so. Having successfully insourced much of our investment work and all of our (award-winning) member services, taken on the scheme manager role for the Financial Assistance Scheme, and dealt with an entirely new class of claims on the Fraud Compensation Fund, we have shown that we are well able to respond to the challenge of major change.

We acknowledge there would be operational risks involved in both the set up and running phases. We have a proven track record of setting up and running new and significant operations, and a Risk Management Framework which we would use to identify, manage, and monitor these risks.

Anecdotal evidence from our SME Forum demonstrated general support for the PPF as a public consolidator, with one member calling it a "brilliant idea".

Funding

Question 30: Is the proposed funding basis appropriate to achieve the consolidator's aims and in particular its aim to maintain the security of member benefits?

We agree that the consolidator should be able to provide at least an equivalent level of security as expected of commercial consolidators. This ensures an appropriate level of protection for members and may address the perception of unfair competition.

The public consolidator should be able to meet the principles behind the core, stringent requirements currently placed on commercial consolidators, ie to operate with prudent technical provisions, to provide an adequate capital buffer, and to maintain funding above a stated level.

Question 31: Is the proposed entry price approach using the technical provisions basis feasible? What alternative entry pricing approach might appeal to the consolidator's target market whilst still meeting the overall aims?

The pricing terms will be influenced by the final design of the public consolidator, including the government's decision on underwriting. Setting and maintaining pricing terms that are equal to the technical provision basis may not always be in the best interests of schemes wishing to enter the consolidator. It may also adversely impact the financial soundness of the consolidator. For these reasons it would be desirable for the consolidator's pricing terms to reflect scheme-specific characteristics and financial conditions at the point of transfer. Such an approach would be more likely to ensure that the consolidator is able to provide, on an ongoing basis, a high level of security to both existing and new entrants. It would also reduce the risk of self-selection, where schemes are more likely to enter the public consolidator when the pricing terms for transferring into the consolidator underestimates their level of risk. And so, while the technical provisions basis should be a consideration when setting the entry pricing terms, our view is that it should not be the primary driver.

We would be interested to hear from scheme trustees on the second part of this question.

Question 32: How should any surplus generated by the consolidator be treated?

We agree that it is important to have specified at the outset what would happen to any surplus that might arise; we anticipate that the answer to this question will be informed by the decision on how the public consolidator is underwritten.

Schemes in deficit and surplus

Question 33: Are these arrangements for schemes transferring into the consolidator sufficient to achieve the consolidator aims outlined above? If not, what alternative arrangements would you propose?

We support the arrangements as described, and have provided further detail in the '*treatment of scheme deficit and surplus*' chapter of our supplementary document.

Investment strategy

Question 34: Is the proposed investment approach appropriate to achieve the consolidator's aims as set out above?

We consider the proposed goals look reasonable and we believe they can be achieved. However, as the consultation notes, the exact strategy will depend on the consolidator's final design, the scale of the assets under management, and the level and form of underwriting.

We would stress again that our response has been driven by the government's stated objectives. To run a substantive allocation to UK productive finance assets would require the public sector consolidator to achieve a significant scale.

Question 35: Will the proposed approach also allow the consolidator to reach a scale at which it can operate effectively?

The public consolidator will need to reach substantial scale to run a material allocation to UK productive assets. Although we believe that the proposed design could achieve this, there remains a risk that it will not be able to do so. The government will have levers available to address this, including via the level of security it provides in underwriting the consolidator, depending on the underwriting approach the government decides to take (see next section).

If the government's mandate for the public sector consolidator includes a requirement for investment in UK productive finance, we would caution against too prescriptive an approach. We believe it will be essential to retain the Board's independence in setting the investment strategy (and asset allocation) to achieve the government's objectives.

Underwriting

We have provided summary answers below; more detail can be found in the supplement to this response in the '*risk underwriting*' chapter.

Question 36: What method of underwriting would be most appropriate to achieve the aims of the consolidator, given the expected capital requirements and timescales?

The public consolidator is designed to achieve government objectives, including to provide a solution for those schemes that aren't currently able to find it in the commercial market. We, therefore, believe there is a clear case for the government to provide risk underwriting.

We do not believe unlimited underwriting is required. Instead the government could provide underwriting in the form of a limited, contingent liability (with the size of that liability scaled to provide the required level of security given the consolidator's intended investment strategy). The contingent liability could then be drawn on by the consolidator if and when needed. Over time, drawing on the experience of the PPF's investment performance, we would expect the consolidator to build a reserve from its own investment returns. This reserve could reduce and eventually replace the government's contingent liability forming the consolidator's own capital buffer. We expect the consolidator to adopt a prudent funding strategy which, combined with the PPF's professional asset management approach, means the risk of any claim on the government's contingent liability would be low. However, in this scenario – of finite government support - we believe the PPF will need to be available to the public consolidator in the unlikely event of a failure scenario, mirroring the structure in place for commercial consolidators (and so the consolidator would be required to pay a PPF levy).

Question 37: Are there other options that the government should consider to provide underwriting for the consolidator?

The PPF Board does not consider use of PPF reserves to be a currently viable alternative. PPF reserves exist to protect the PPF's current and future members against longevity risk and claims risk, and to reduce the likelihood of needing to raise the PPF levy should risks materialise. There are multiple factors for the government to consider in relation to how PPF reserves might be utilised, including the impact on and position of levy payers and members (noting the government's commitment within the consultation document to consult in the coming months on levy changes and PPF compensation levels), and the need for legislative change (transferring PPF reserves for a separate function is not currently permitted by the PPF's governing legislation). The Board also believes any use of reserves should not require a change in the PPF's plans to move to a zero levy (when enabled to do so by legislative change). As such, we do not consider the level of PPF reserve that could be made available for a buffer fund is sufficient – at least at the present time – to support a public consolidator operating at scale. Longer term, if PPF reserves continue to grow as they are expected to, this could be an option for the government to consider, with reserves replacing some or all of any government underwriting.

Question 38: Should the government underwrite the consolidator and set the investment strategy?

By underwriting the risk (up to a finite limit), it would be appropriate for the government to determine the level of risk that should be taken in the investment strategy. The government could also legitimately require a certain level of investment in UK productive finance (though the Board of the PPF should remain responsible for independently setting the investment strategy and asset allocation within these parameters).

Question 39: How could any government underwriting be structured to support the aims of the consolidator whilst limiting risks to the taxpayer?

As noted above, we do not believe unlimited underwriting is required. Instead the total level of support available could be capped (though the total amount would need to support the desired scale and level of security). In a scenario of finite government support, we believe the PPF will need to be available to the public consolidator were it to fail, giving members the same protection as that provided to all DB schemes and commercial consolidators. The public consolidator would therefore be required to pay a PPF levy.

Question 40: What conditions ought to be met for the PPF reserves to be considered as a source of underwriting?

See our response to question 37 above.