LCP's response to the DWP's Call for Evidence on options for Defined Benefit schemes

1 September 2023

This document sets out LCP's response to the Call for Evidence on the options for Defined Benefit schemes published by the Department for Work and Pensions on 11 July 2023.

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,000 people in the UK, including 160 partners and over 300 qualified actuaries.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Our overall thoughts

We have set out in the pages that follow, our answers to the specific questions posed in the Call for Evidence.

We very much welcome this discussion on the role the pensions industry can play in contributing to productive finance investment and we are of the view that more can and should be done to address this.

Current regulations have been developed by successive governments with the best intentions, focussed on protecting the benefits of DB pensioners. However, current regulations have now led to a situation where investment strategies for most DB schemes are increasingly low-risk / low-return. This leads to over £1 trillion of assets in private sector DB schemes being under-utilised. This is not the fault of schemes – it is a feature of the regulatory and policy environment in which they operate. We note that due to the sheer size of the private DB pensions landscape, the way these schemes invest is of systemic importance to the UK economy.

Within our response, we have referred many times to our proposal for an innovative new opt-in system which could:

- Improve the protection afforded to DB pensions, to ensure DB member benefits are paid in full.
- Allow pension scheme investments to target a greater rate of return, thereby expecting to generate material pension scheme surpluses over the longer term.
- Free up pension scheme assets to invest in priority areas, including UK infrastructure, funding the transition to 'net zero' and investing for long-term growth of UK companies.
- Provide additional funds to improve DB member benefits if appropriate, for example by paying discretionary increases in periods of high inflation.
- Facilitate employers paying higher contributions to the DC savings of their current workers, where it has been well-documented that savings rates are likely to be inadequate for a significant proportion of the UK population.

We believe this Call for Evidence provides the industry with an exciting opportunity to consider the benefits of such changes. We note that there have been a number of different ideas proposed around potential new options for DB pension schemes, such as those put forward by the Tony Blair Institute, and we have included comments on the practicalities, effectiveness and fairness of that proposal, about which we have some concerns.

We are happy for LCP to be named as a respondent to the Call for Evidence and happy for our response to be in the public domain.

We are happy for you to reference our comments in any response.

Jonathan Camfield
Partner

+44 (0)1962 872 702
Jonathan.Camfield@lcp.uk.com

Steve Webb
Partner

+44 (0)20 3824 7441
Steve.Webb@lcp.uk.com

Steve Hodder
Partner

+44 (0)1962 672 929
Steve.Hodder@lcp.uk.com

Laasya Shekaran
Consultant

+44 (0)1962 672 950
Laasya.Shekaran@lcp.uk.com

About Lane Clark & Peacock LLP

LCP's response to the questions in the Call for Evidence

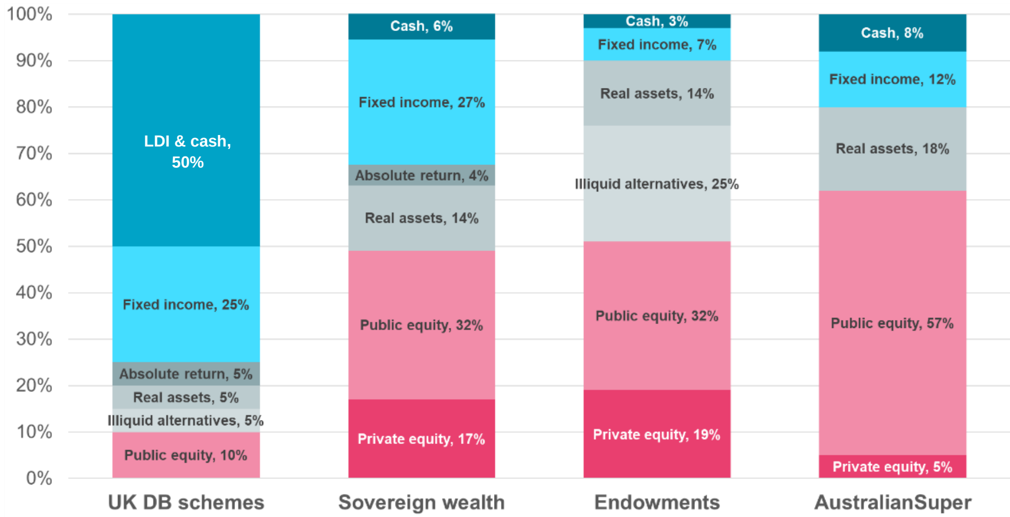
There is some evidence that DB schemes are underinvested in productive assets compared to international comparators:

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

Yes, we agree with this assessment when comparing the investment allocations of UK DB schemes with the allocations of other international institutional investors. We note that this comparison fails to recognise the differing context and regulatory environments of these international comparators vs UK DB pension schemes. The regulatory environment for UK DB pension schemes, and the guaranteed nature of the pension promises they are backing, is a key driver for this divergence in allocation approaches.

The chart below compares how the following types of investment funds are broadly invested:

- UK DB Schemes
- Sovereign Wealth funds
- Endowments
- The Australian Superannuation fund



Source: DB pension allocations derived from PPF Purple Book. Typical allocations for Sovereign Wealth funds and Endowments from LCP Research. AustralianSuper allocation from Bloomberg.

UK DB pension schemes typically have a much lower allocation to asset classes that are typically considered as 'productive assets', including unlisted equities, private market debt, illiquid alternatives, and some real assets, such as infrastructure, compared to some of other large institutional investors we see around the world. Note there is a separate question on whether these global competitors invest heavily in their own country's 'productive finance' – currently UK DB schemes typically invest globally, and have a limited (and diminishing) 'home bias' in the investments. Any proposals looking to drive significant UK 'productive finance' investment would in our view likely require direct incentives or mandating (about which we are highly cautious).

There are good reasons as to why UK DB schemes invest in this way. Trustees ultimately have a duty to ensure that the pensions for their members are secured. The nature of the pension promise is different from the nature of the liabilities and risks of nearly all other global institutional investors (other than the bulk annuity portfolios of insurers). Investing in productive assets, such as unlisted equities, is expected to generate additional returns for investors in the long term, but, of course, this also comes along with taking on additional risk.

If a mature UK DB pension scheme is fully funded (i.e. the value of its assets is equal to a sensible measure of the value of its liabilities) or is even in a surplus, then there is little incentive for the trustees (under the current regulatory framework) to have a strategy that includes an allocation to productive assets, as this will also come with taking on additional risk.

This additional risk currently comes with a clear downside for trustees and the members they represent, as it could affect the security of members' benefits. Currently, there is generally not considered to be any corresponding upside to taking that extra risk, as the scheme has no need to generate additional returns over and above that which is needed for the scheme to be fully funded. As such, under the current regulatory framework, and in the broader environment of UK schemes becoming better and better funded, the risk versus return trade-off of productive finance assets leads the trustees of many UK DB pension schemes away from investing more in productive assets. In our view, the balance of this incentive structure should change, so that there is some upside associated with taking on the risk associated with productive assets and we have set out under Question 2 our proposal as to how this can be done.

As schemes' funding levels continue to improve, we fully expect that most schemes will continue to de-risk, further reducing their allocations to productive asset classes and instead allocating their assets to low-risk, low-return bonds.

This trend is exacerbated by the common desire for pension schemes to ultimately transfer their assets to an insurer (seen as the gold standard of pension protection), and hence hold assets that an insurer will be able to accept at the point of a transaction. Again, this generally means holding liquid assets such as cash, gilts and low-risk corporate bonds (note it is likely the insurer will subsequently sell a significant proportion of the gilts). We are currently seeing a trend of increasing levels of insurance buyout activity, with more DB schemes transferring their assets to an insurer. If this direction of travel continues, as is expected under the current system, there are systemic risks associated with many schemes transferring to an insurer at a similar time, particularly if all these insurers then sell their gilts (as is expected). This could have significant knock-on impacts on gilt markets.

We see this direction of travel in DB investment posing a clear systemic risk to the UK economy, as it means that many pension schemes will not be investing in productive assets, instead concentrating their investments across a few asset classes.

Alongside this we have concerns that UK DB pension schemes will not be providing sufficient investment to the sustainable assets, technology and infrastructure needed to transition the UK to a net zero economy. In our view, the next few years will be crucial to the UK achieving its net zero target, and this will need to be driven by action from a range of parties, including, but not limited to, the Government, consumers, companies, the finance industry and, of course, large investors, such as UK DB pension schemes. Given the sheer scale of the UK DB pension landscape (with c. £1.5trn of assets in private DB pensions), and the amount of investment that is required to facilitate a successful and just transition to a net zero economy, we cannot afford to ignore the role that UK DB pension schemes can, and should, play to achieve this ultimate goal.

We believe that changes to the way in which trustee fiduciary duties operate are likely to be necessary and appropriate to help facilitate this. We have discussed this in more detail in our response to the Department's other ongoing Call for Evidence about Trustee Skills, Capability and Culture, and look forward to these conversations continuing when the Department undertakes its stewardship review in the Autumn.

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?

Our proposal is to create a new 'opt-in' system for *well-funded* DB schemes with two key changes from the current system:

- Pension Protection Fund ("PPF") cover increased to 100% of member benefits (with no transfer of assets into the PPF unless in the case of a sponsor insolvency); and
- The ability to use DB surpluses on an ongoing basis (with suitable protections), as a statutory override to scheme rules.

We believe that these two changes would fundamentally change the incentive structure for those running UK DB pension schemes, delivering:

- Incentives for schemes to invest for growth, including deploying the DB asset base to support the UK economy by investing particularly in sustainable productive assets (for example, in unlisted equity);
- Improved and full protection to DB members' benefits in a more efficient way than continued investment de-risking; and
- Opportunity to generate hundreds of £bns of surpluses to share between DB members, Defined Contribution ("DC") savers and investing in the economy.

Our proposal is designed to balance the needs of supporting economic growth with security of pensions and fairness between generations. Importantly, this proposal is distinct to consolidation proposals. This proposal involves preserving the structure of the current DB system, with pension schemes remaining where they are, and (as per currently) being transferred to the PPF only in the extreme circumstance that the sponsor of a scheme that opts in becomes insolvent and the scheme proves to be underfunded in relation to its PPF coverage. This means much less of a change to the current system is needed, with the benefits being delivered much more quickly, in comparison to consolidation proposals (see later discussion on this).

Further details on our proposal can be found here: https://lcp.com/our-viewpoint/2023/07/lcp-powering-possibility-in-pensions/. In particular, full detail of what we propose, including the benefits and risks for all parties, and the interaction with the current regulatory regime, is covered in this detailed Q&A document: Powering possibility in pensions - FAQ (lcp.com). This includes discussion of related knock-on regulatory changes that would be needed to make this work including opt-in schemes being able to rely on their PPF protection when making decisions. Please consider this Q&A to be part of our response to this Call for Evidence.

We have discussed our proposal with a wide range of market participants and many are very positive about this being explored further as an option for UK pension schemes.

Building surplus:

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

Pension scheme rules differ considerably. A number do, technically, permit a return of surplus other than at wind-up. But in our view this is not particularly relevant to the considerations here. In particular, in practice, we are not aware of a case of a return of surplus in circumstances other than wind-up for many years. This is because explicit overriding legislation, and general trustee fiduciary duties, make such a return of surplus undesirable and impractical. So much so, that trustees and sponsors counterintuitively see surplus as a something to be avoided, and go to considerable effort (e.g. setting up complex escrow and other arrangements, and reducing investment risk) to avoid surplus.

The one exception is where a DC scheme has been set up within the DB trust, with explicit rule powers to enable the sponsor or the trustees to use surplus towards DC contributions. Some such schemes exist, but they are rare. They are also increasingly counter to the policy intention to encourage consolidation of DC schemes (e.g. via Master Trusts). And where such schemes are not already in place, there are hurdles to introducing them. This is because of lack of scale of the DC scheme, trustee concerns about use of surplus, and because they will only ever be a temporary solution until the DB benefits are passed to an insurer (which will generally remain the objective of the trustees).

Our proposal is to introduce legislative change so that DB surpluses can be used to benefit multiple stakeholders on an ongoing basis, whilst at the same time providing enhanced and full protection to existing DB members.

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?

We envisage that a surplus would be permitted to be extracted (and/or used for additional benefits within the sponsor's pension arrangements, including DC benefits, and discretionary increases for DB members) if a high security threshold for surplus was attained (a 'super-surplus'). But this should be permissible only if combined with changes to enhance and provide full PPF protection to member benefits – otherwise, why would the trustees ever agree to extracting surplus?

While it would be up to government, in conjunction with the PPF and TPR, to decide exactly how this high security threshold was set, our thinking is that it could be linked to the regulatory funding requirements and investment stress factors under TPR's current draft Fast Track regime (which in turn are based on the PPF's own stress factors). Alternatively, it could be linked to a simple fixed percentage, e.g. funding at the level of 105% of liabilities calculated on a prescribed low-dependency basis, such as gilts + 0.5% pa.

In practice, we would envisage an employer having the power (subject to any remaining overriding rule provisions, or other agreements reached with the trustees) at least at each triennial valuation, to remove super-surplus from the scheme if they wished. This could be to support business growth, wages and employee benefits; or to spend the surplus on existing or new DC contributions; or to spend on augmenting benefits for existing DB members. Government could also make the return of surplus subject to specific conditions – for example, to fund DC contributions, if there was a specific policy objective in mind.

Note that we also encourage Government to review the tax regime for return of surpluses to ensure that it remains fit for purpose with the current regime and within our proposed regime. In particular, we would like to see the introduction of tax incentives to encourage DB surpluses to be used to improve DC contributions (to bring this situation in line with what is achievable for the few DB schemes that have a DC scheme in the same trust). This is because the PLSA has projected that, based on current levels of DC contributions, most people who will be solely reliant on a DC pension when they retire will not be able to afford a moderate standard of living in retirement, which could pose a huge societal and economic crisis to the country. To avoid this, the gap between DB and DC members should be addressed now, with improved contributions for DC members.

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?

Yes – provided that the security of member's benefits is improved via a 100% PPF guarantee.

Ultimately trustees are responsible for ensuring that the DB pensions that have been promised to their members can be paid as they fall due. From a trustee perspective, in the current system, once a high level of funding has been attained, the risk associated with not being able to meet pensions in full as they fall due is perceived to be greater than the potential reward associated with investing in productive assets which typically have higher risk profiles, such as unlisted equities, even if members are able to potentially access some of the surplus that is then generated by the investment returns from these riskier, more productive, assets.

This is why we have proposed the opt-in PPF system, whereby sponsors and trustees of schemes above a certain funding level can opt in to pay a higher levy, and in return receive 100% protection from the PPF for members' scheme pensions in the event of sponsor failure. Note that under the current PPF system, if a scheme sponsor becomes insolvent and the scheme is underfunded on a full insurance buy-out basis (most are), then members' benefits are cut back – either in the PPF or through reduced insured pensions. Under our proposed opt-in system, if a sponsor of a scheme that had opted in to pay this additional levy became insolvent, the members would retain their full pension entitlements, regardless of the funding position of the scheme.

Trustees would then be able to invest in more productive finance assets (which could be either overseas-based, UK-based or both, depending on where there are attractive investment opportunities), thereby expecting to generate higher returns, knowing that the security of members' benefits would be maintained in the event of any sponsor insolvency, and with the potential for members and others to ultimately benefit from the additional expected returns of these assets on an ongoing basis.

From a legislative perspective, it ultimately sits with the trustees to decide how the pension scheme's investment strategy is set, albeit there is a legislative requirement to consult with the sponsor (and the new funding regulations will require the scheme's long-term investment strategy to be agreed by the trustees and company). However, it is the sponsor who ultimately carries all the risks associated with that strategy. And so, from the perspective of sponsoring employers, the ability to extract surplus will be key to incentivising them to be comfortable taking on the additional risk associated with investing more of their DB pension schemes in productive finance assets.

What would the risks be?

We have discussed the risks associated with our proposal in detail in our Q&A document referenced above in Question 2. We believe the benefits strongly outweigh the risks.

Key risks associated with surplus extraction (but in the context of full PPF protection) include:

- Moral hazard – i.e. that the pension scheme 'opts in' to the regime (meeting the required funding criteria) and then takes on too much risk in its investment strategy, and the assets end up being very volatile or even falling significantly in value; and
- Surplus is extracted too soon and the scheme subsequently falling back into a worse position.

Clearly, in the absence of enhanced PPF protection, these risks are significant and, in our view, should be avoided.

Within the context of our proposal, the first of these risks is managed through the prevailing funding regime and regulatory oversight still being in place and the need for deficit recovery plans to be established, the sponsor still supporting the scheme, and the potential for higher risk-based levies if overly risky strategies are set. Trustees would still have to operate in line with their fiduciary duty and in line with the current investment regulations, which requires trustees to strike an appropriate balance of risk and return when constructing an investment portfolio, mindful of the sponsor's covenant support.

The second of these risks would be managed by introducing sensible criteria for when a surplus can be extracted under the opt-in regime (which we have discussed in Question 4).

Question 6: Would having greater PPF guarantees of benefits result in greater investment in productive finance?

Yes. Greater PPF guarantees (i.e. greater levels of protections covering full scheme benefits for pension schemes in the event the sponsor of the scheme becomes insolvent) will be a critical factor for trustees when deciding whether or not it is appropriate to target a higher risk, and higher returning strategy, by investment in productive finance assets, such as unlisted equities.

Trustees' ultimate fiduciary duty is to protect members' benefits, so we do not believe trustees would be incentivised to invest in a riskier strategy unless they knew that this would not pose additional risk to their members.

By having our proposed opt-in PPF system providing full coverage of members of well-funded schemes, this issue is addressed, and trustees can therefore become comfortable investing more of the pension scheme assets in productive finance while still being able to meet their ultimate duty: to protect member benefits as they fall due.

What would the risks be?

We have discussed the risks associated with our proposal in detail in our Q&A document referenced above in Question 2. We believe the benefits strongly outweigh the risks.

The main risk to the PPF would arise in a situation where the sponsoring employer of a scheme that opts in to this system subsequently becomes insolvent and the scheme proves to be underfunded in relation to its PPF coverage. In this scenario, the PPF would then absorb all the assets of the scheme and pay the benefits as they fall due. In the unlikely event these assets are not sufficient (given the requirement to be a well-funded scheme in order to opt-in to the regime) then the PPF may need to draw upon its reserves/levies. We provide more detail in our Q&A, but at a high level this risk is managed by the fact that:

- The schemes that opt-in to this system will pay an additional risk-based annual levy to the PPF, to help cover this situation.
- The schemes that are able to opt in to this system are also ones that are able to meet the minimum threshold criteria for entry and so would be well funded, and are also likely to have stronger covenant support, making it less likely that the sponsoring employee will become insolvent.
- The PPF is currently in a significant "surplus" (defined by PPF as "strong reserves"), which is expected to grow. This demonstrates the strong track record of the PPF – in our view, increasing cover for the best-funded schemes is unlikely to change this.

The main risk of introducing enhanced PPF protection without also introducing incentives to invest for growth (i.e. earlier return of surpluses) is that the

Government would not achieve its policy objective (as we understand it) of more investment in productive finance.

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?

Currently, any surplus (subject to the scheme's rules) transferred back to the sponsor is subject to a 35% tax charge. Under the existing tax regime, tax receipts from this source are currently expected to be low (as most schemes target not generating scheme surpluses, or using any without incurring this tax charge), and take many years to emerge.

Under our proposed 'opt-in' regime, long-term investment returns can be expected to lead to better funded pension schemes, and sponsors would be able to draw down on surplus sooner (upon meeting certain minimum threshold requirements for surplus extraction), triggering the potential for earlier (and likely larger) tax payments.

In our view, as part of this, the pension surplus tax regime should be reviewed and the tax rate made less penal. For example, DB surplus returned to the sponsor could be subject to tax at the prevailing rate of corporation tax (rather than a higher rate). One approach we would like to be considered is for tax incentives for sponsors in the case where DB surplus is spent on DC contributions, above current auto-enrolment minimums, similar to what may currently be possible where DB and DC benefits are provided through the same trust.

Question 8: In cases where an employer sponsors a DB scheme and contributes to a 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?

Yes, it would be appropriate to use at least part of the additional surplus generated by DB schemes to improve contributions for DC members. Indeed, given the current expected outcomes for DC members in retirement, this kind of action could help protect against a potential retirement crisis as well as more broadly addressing intergenerational inequality.

Although ultimately it would be for the sponsoring employers and trustees to decide where the surplus is allocated (of course within any constraints set by Government and consistent with pension schemes' rules), in our view there are lots of reasons as to why it is appropriate for DC members to be receiving some of this via enhanced contributions.

Like many in the pensions industry, we have deep concerns that contributions to many DC schemes (especially those at auto-enrolment minimums) are currently not adequate to provide reasonable retirement outcomes for members.

We recognise that not all employers with DC schemes have a DB scheme, and vice versa. However, one of the challenges faced by employers over recent decades is that DB pension schemes have been costly to maintain, and amongst other things this has put pressure on budgets for DC contributions.

Our ambition is that our proposed changes to the pensions regime will result in improved contributions to DC schemes. This could happen voluntarily, or via additional incentives / requirements from this and future Governments, in relation to companies whose schemes have opted-in to our proposal, through some or all of these means:

- Companies could be encouraged to transfer some DB surplus to any DC or CDC scheme sponsored by the employer (including Master Trusts) by such a transfer incurring little or ideally no tax charge – this would be a new legal option and would be our preference as it will be the most efficient way forward;
- Companies could be encouraged to introduce a DC section into the DB scheme, to allow surplus to be used to fund (ideally additional) DC contributions;
- Governments could increase auto-enrolment minimum contributions across the board (as DB pensions become less expensive and are better protected through our proposed regime); and
- Governments could require schemes to use some of any surplus that is taken out of the scheme to support additional DC contributions for existing employees.

Note that where we refer to DC schemes, we also include Collective Defined Contribution ("CDC") schemes – which are being developed by Government as a new pension option that we fully support.

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

We have taken the idea of a 'misuse' of scheme funds to mean:

- extracting surpluses and returning them to the sponsor/other stakeholders 'too soon', i.e. before the scheme has a sufficiently large surplus to ensure that money is not needed to protect the scheme; or
- 'moral hazard' risk of the sponsor taking on too much investment risk against the backdrop of the extended PPF protection.

Under our proposal, these risks are mitigated as follows:

- We propose that a sponsoring employer would be able to extract a surplus only once the scheme is sufficiently well funded, for example 105% on a low-dependency basis as set out in the DB funding code, and surpluses would be able to be extracted only over and above this amount. This would protect the scheme by ensuring there remains a buffer by way of the remaining surplus.
- Schemes would still need to operate within the rules of the funding regime, with investment risk that is appropriate in the context of their sponsor's supporting covenant.
- The sponsor would still be responsible for the scheme, and would still be required to pay contributions if required, for example if the scheme's funding position were to significantly worsen. This would disincentivise the sponsor from encouraging the scheme to take on too much risk, or from extracting surpluses too soon.
- Trustees would still have a duty to protect their members and act in line with their fiduciary duty, and this would need to factor into decisions around how to allocate the surplus.

We are therefore comfortable that there are sufficient checks and balances in place to protect against the risk associated with a misuse of scheme funds.

Consolidators

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

There are various forms of consolidation currently in the UK DB market. We are fully supportive of a variety of different consolidator approaches being commercially available to support a variety of pension scheme needs.

When viewed through the lens of investment strategies alone, each form of consolidation differs in their impact on investment in UK productive finance / schemes' asset allocations.

To the extent that any form of consolidation offers trustees and sponsors a viable and commercial alternative to the insurance regime, this may lead to a shift in schemes' asset allocations – as the typical concerns around illiquidity / suitability of assets for transfer to an insurer fall away.

We have set out in the table below the current main forms of consolidation currently available below, along with an outline of the potential impact of high levels of each form of consolidation on scheme asset allocations / UK investment:

Form of consolidation	Characteristics / description	Impact on scheme allocations / UK investment
Superfunds	These vehicles are backed by external third-party capital and may be a route to consolidation for DB schemes which are not sufficiently funded to afford buy-out and there are concerns over the employer covenant (and which meet the gateway tests). The schemes consolidating via this route would also need to be a certain minimum size so as to be commercially attractive to the superfund. This is currently only expected to be a relatively small proportion of UK pension schemes.	Depending on superfund model – there is the potential for greater investment in UK productive finance but to date we have not seen any schemes transact with commercial consolidators. In addition, the only current commercial model in the market to have passed TPR's assessment process (Clara) ultimately targets insurance and so its asset allocation decisions will be taken with that in mind (i.e. ensuring the assets are appropriate for an insurance transaction).
DB Master Trusts (segregated)	Master Trust consolidation typically involves a scheme transferring into a Trust through a bulk transfer of scheme assets and liabilities. Typically, there is no minimum funding requirement here (or the requirement for additional capital) as the schemes/assets are segregated within the Master Trust arrangement and the sponsor remains on the hook. The current case for consolidation via DB Master Trusts is typically centred on administrative cost savings across the schemes in the Master Trust. Current examples include the Deloitte Master Trust, The Pensions Trust and the Citrus Pension Plan.	Consolidation via segregated Master Trusts is unlikely to lead to a step change in schemes' asset allocations / UK investment as there is no 'pooling' of investment or covenant risks as each scheme retains its own legal status. Mass consolidation via a future unsegregated structure could have the potential to lead to a shift in DB schemes' allocations – as under this approach investment and liquidity risks would be shared across the participating schemes (and their sponsors). However, we expect such models will be unattractive to sponsors, given the exposure it introduces to other schemes' sponsors failing (and the associated costs falling on the remaining sponsors).
Superfund with retained sponsor link	We are aware Clara has offered the option to transfer to its structure but keep the sponsor link in place. This is not strictly a superfund transfer, but it intends to treat it as one for all other purposes (i.e. it would provide capital as part of the transfer).	In effect this would operate in a similar way to a DB Master Trust, i.e. with one set of advisers, trustees, etc, but with the benefit of capital being injected by the provider. As per superfunds and DB Master Trusts, such structures will have a limited impact on investment allocations in our view.

Form of consolidation	Characteristics / description	Impact on scheme allocations / UK investment
Investment platforms / Common Investment Funds	These structures allow schemes to combine assets for investment purposes, potentially providing access to a wider range of investment opportunities and reducing costs/charges, while retaining their separate legal structures. However, investment platforms are more typically used to help provide a lower-governance approach for trustees when implementing fund switches and having all investments on a common platform.	Limited impact on investment strategies as these arrangements are already in place, and trustees will still be operating under the current legislative and regulatory framework.
Operational consolidation / shared service models	This involves sharing advisors and governance models which can provide a means for smaller DB schemes to benefit from economies of scale without the need (and up-front cost of) full consolidation of assets/liabilities. For example, sole trusteeship has been gaining momentum across smaller DB schemes – with a sole trustee simultaneously governing a number of schemes which can achieve efficiency in governance. In a number of these cases, the sole trustee may also appoint a single adviser across the schemes.	Expected limited impact on investment strategies, with these arrangements already relatively prevalent, and trustees will still ultimately be operating under the current legislative and regulatory framework.
Insurers	These are effectively a type of consolidator. The link to the sponsor is broken, and the insurer operates under Solvency II constraints.	Reduced gilt investment compared to pension schemes. Increased investment in productive finance but in relatively narrow areas. Very little equity-type investment. As these portfolios have the potential to become very large scale, there are systemic risks for the UK, including those arising from: Solvency II constraints, concentration of assets with less than 10 insurers and certain re-insurers, and the impact on gilt markets.

Within any consolidation structure, trustees still need to act in line with their fiduciary duties and seek to maximise the security of members' benefits. As such, asset strategies will still ultimately be driven by the same considerations referred to in our answer to Question 5 above. This is unless there is wider legislative / regulatory change which enables trustees of schemes in the mass consolidation vehicle to take comfort that member security is maintained under a 'riskier' investment strategy involving productive finance assets, e.g. under our proposals set out in response to Question 2 above.

Therefore, under the various consolidation models currently in place, we do not see significant shifts in investment in productive assets being likely, and indeed we expect the current derisking trend to continue.

There are good reasons why the above consolidators are appropriate for some schemes, and it is possible that through adjustments to regulations and incentives, faster consolidation could be achieved, which could improve efficiency for smaller schemes. However, the benefits of such consolidation would not in our view include a material shift to investment in productive finance. And if that is a key government policy objective, our view is that the work needed to achieve mass consolidation of smaller schemes would be disproportionate to the output in terms of the impact on schemes' assets / the asset allocation of UK DB schemes, when compared with our proposal set out in response to Question 2 where just one large well-funded scheme could have the same £ impact for investment in UK productive finance as consolidating all c.2,000 of the smallest schemes. See our response to Question 17 for more information.

There may also be an increase in 'herd behaviour' in asset allocation arising from the use of consolidation vehicles. If a large proportion of UK DB scheme assets are similarly invested via a small number of consolidators, the sector could be exposed to a concentration of market risks and on overall reduction in diversification across investors as a result. The potential increased systemic risk warrants careful consideration.

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?

Buy-out

LCP is a leading advisor on buy-outs and consolidator options, has deep up-to-date understanding of this market, and regularly collects data on transactions completed.

A small group of insurers have capacity and streamlined governance processes for quoting on smaller schemes, e.g. those below c.£30m-£100m of assets (depending on insurer). Over the last year, even though there has been a big increase in the number of schemes seeking insurance quotations, we have been pleased with the level of traction our smaller schemes have obtained.

LCP's streamlined service for smaller scheme has seen a big pick-up in demand in the past 12 months with double the normal level of transactions. This includes transactions under c.£10m.

Smaller schemes with unusual benefits or other complexities can face challenges in obtaining quotations from insurers, i.e. where they do not fit readily through the insurer's streamlined process. In such cases they may be forced to take steps to simplify the complexity prior to engaging with insurers (and this may not always be possible). However, this is a minority of schemes.

We are also aware of potential new entrants into the insurance market, some of which intend to target smaller schemes, which may bring additional capacity.

Overall, we do not currently have material concerns with schemes being able to access insurer pricing at the small end of the market. This position may of course change as insurers reassess their appetite and business plans in the context of the current volume of schemes seeking quotations.

Consolidators

In this response, we focus on commercial consolidators rather than any of the other forms of consolidation proposed in Question 10 as scale has not historically been a barrier to entry for the other options in our view and in fact some of those consolidation models (e.g. Master Trusts) have targeted smaller schemes to date.

In theory, the introduction of commercial consolidators and other similar solutions provides more options to smaller DB schemes. However, the associated costs of exploring these largely untested solutions are likely to be seen as disproportionate for smaller schemes. Also, smaller schemes may not have the expertise in place to fully assess the appropriateness of these vehicles.

Additionally, those with less than c.£50m of assets may not be attractive to consolidators, as they prefer larger schemes (particularly with the market in its infancy and consolidators aiming to reach scale quickly).

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

In providing our responses below, we have assumed that a public consolidator would largely operate in the same way as a private consolidator but with the key exception of being backed by the Government rather than by private third-party capital. We have assumed it would operate in a similar way to a Superfund (either with or without the sponsor link being retained). The establishment of a public consolidator could offer benefits to pension scheme members and to wider economic interests depending on the way it is structured, but there are also risks associated with it.

Benefits

A public consolidator would lend credibility to the market. It could also potentially provide more stability and pose less counterparty risk than a commercial consolidator, e.g. if the public consolidator is Government backed and/or if there was a relatively high capital buffer on entry. The introduction of a public consolidator could also potentially contribute to wider economic interests through investments in productive finance.

A public consolidator might offer greater accessibility for schemes that may be unattractive to private consolidators – e.g. smaller, financially weaker, more complicated, or underfunded schemes. In principle, we can see the potential benefit of an approach established towards public interest (i.e. ensuring members' benefits are paid), without the competing demands that private consolidators necessarily have from their capital providers. Any cross-subsidies to more poorly funded schemes by those that are better funded would need to be considered as part of any such structure.

Risks

Depending on how it was structured, the establishment of a public consolidator would disrupt the business model of the insurance market and of existing private consolidators. As such, detailed consideration would need to be given to determining the appropriate target market for a public consolidator and how they could co-exist with current and future private commercial consolidators and insurers.

Consideration would need to be given to who would underwrite the risk associated with a public consolidator and whether any cost arising from supporting a public consolidator would ultimately fall on the UK taxpayer – see response to Question 15.

There is also a risk of moral hazard or adverse selection, depending on how eligibility is determined for schemes sponsored by companies that are more likely to fail.

The introduction of a public consolidator could complicate the regulatory landscape. It might be necessary to consider whether it should be subject to the same regulatory oversight as private consolidators, with one such example being the "gateway" tests applied for Superfund transfers.

Finally, the establishment of a public consolidator could have implications for the gilt market, either reducing demand if the consolidator invests in alternative asset classes, or increasing demand if gilts form part of their asset strategy.

We see that there may be a role for a public consolidator for the smallest schemes in the future, which otherwise may not be able to access competitive insurance pricing. That said, the introduction of a public consolidator would not deliver the same potential benefits to the UK economy and members of UK DB schemes as our proposal set out in response to Question 2. Indeed, under our proposal, just one large well-funded scheme could have the same £ impact for investment in UK productive finance as consolidation of the c.2,000 smallest schemes.

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?

Whether or not a public consolidator would adversely affect the bulk purchase annuity market would hinge on a number of factors relating to the chosen model of the consolidator. For example, whether it operates as a "path to buy-out" model or instead as a "run-off" model, the capital requirements, the proposed pricing structure, the size and financial health of schemes targeted, etc.

If a public consolidator were looking to transact with larger schemes, there would be several concerns surrounding the potential adverse effects on the bulk purchase annuity market. First, a public consolidator might disrupt the market dynamics, leading to reduced business opportunities for insurers. The competitive pricing that a public consolidator might be able to offer (for example due to relaxed capital buffer requirements when compared to Solvency II requirements) could introduce significant price distortions. This may present a challenge for insurers, who might find it difficult to match these prices, potentially resulting in diminished product offerings and stifled innovation in the private sector. If insurers are consistently undercut by the public consolidator's pricing, some may even consider exiting the market. In principle, this impact could be tempered by some extent if the public consolidator feeds the insurance regime with schemes over time, i.e. if it operates as a "path to buy-out" model.

A subtler concern is the potential misconception that a public consolidator would offer a level of protection akin to the established insurance regime, regardless of whether it is Government backed or not. This could make the consolidator an unfairly preferred option, and lead to a degree of moral hazard.

However, it is also important to consider potential benefits. A public consolidator could provide pension schemes with more options, particularly any that are unable to access competitive insurer or commercial consolidator terms. It might also serve to drive more competitive pricing in the commercial consolidator and insurance markets for smaller schemes, albeit we do not have any concerns with this at the current time.

In the round, our view is that the introduction of a public consolidator would require careful consideration of the proposed structure and long-term objectives so as not to adversely impact the well-functioning market in the private sector. It is in all parties' interests to allow end-game solutions (and therefore innovation and the use of third-party capital) to exist and thrive in order to provide secure and good value options to pension schemes.

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

In principle, the introduction of a public consolidator has the potential to catalyse a wider investment in UK productive finance, as a public consolidator may possess both the capacity, desire and legal objectives to make significant investments in illiquid assets and ventures that are emblematic of "UK productive finance." This includes areas like infrastructure, private equity, green energy initiatives, and innovative start-ups. These investments, in turn, can stimulate economic growth and generate employment, thus benefiting the broader economy. Moreover, by channelling funds into such ventures, the consolidator could play a pivotal role in achieving wider social and environmental objectives, such as the improvement of public services or in facilitating the country's transition to a low-carbon economy.

The pooling of assets under a public consolidator could also afford greater access to investment arrangements that might be inaccessible for individual pension schemes. By virtue of its public nature, such a consolidator could prioritise the interests of the UK economy – alongside the benefits payable to scheme members – unlike private consolidators where returns to capital providers are a key consideration.

A further positive impact would be the relief such a consolidator could provide in terms of alleviating the strain of DB schemes on their sponsors, i.e. sponsors might be better poised for growth and innovation, thereby benefiting the UK economy.

However, in our view, the best way for the Government to bring about a material investment in UK productive finance would be to adopt our proposal set out in response to Question 2. Whilst a public consolidator could mitigate the disproportionate governance challenges for the smallest schemes (see our response to Question 17), it would not deliver the same potential benefits to the UK economy and members of UK DB schemes as our proposal. Indeed, under our proposal, just one large well-funded scheme could have the same £ impact for investment in UK productive finance as consolidation of the c.2,000 smallest schemes.

Furthermore, the ability for a public consolidator to invest in UK productive finance at all would depend on several factors relating to the structure of the consolidator:

- Key amongst these is the control over investment strategy: if responsibility for the strategy is managed by an independent third party, the strategy might differ compared to that if the Government assumed direct (or indirect) control.
- If the public consolidator operated within the current trust-based regime, there is a need to consider the Trustees' fiduciary duty of protecting accrued pension benefits. As noted elsewhere in our response, whilst investing in productive finance can offer higher returns, it also brings with it a higher risk profile.
- It would require the public consolidator not to target insurance buy-out in the near term. If insurance buy-out were targeted, then it would likely need to invest in such a way that assets could easily be transferred to an insurer.

The above, however, assumes that there is some incentive for schemes to transact with a public consolidator, such as improved pricing or member security. If such incentives did not exist, moving to a commercial consolidator is unlikely to be attractive to schemes and therefore would not have the desired effect of instigating investment into UK productive finance.

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

In order to appropriately underwrite the risks associated with a public consolidator, there are a number of levels of protection that could be offered. Initially, the public consolidator will need to ensure that there are adequate capital reserves to underwrite unforeseen losses arising from certain stress scenarios. In practice, this would mean ensuring that pension schemes wishing to transact meet specified minimum funding requirements, thereby reducing the potential number of schemes able to access the public consolidator. Another option would be to consider whether it would be appropriate to raise external capital to fund the transactions and any capital reserves held, meaning the entity would operate as a pseudo-public consolidator.

Target schemes / scheme selection is another key consideration; the consolidator should be discerning about the pension schemes it absorbs, only taking on those that have undergone appropriate due diligence and fit the target funding and risk profiles.

On an ongoing basis, the public consolidator would also be required to have a robust risk management framework, enabling the consolidator to adeptly identify, assess and manage its risks. The governance of the consolidator must be underpinned by a proper persons assessment, ensuring that those in charge are fit for the role and advised appropriately. The risks in the investment strategy should be appropriately managed and monitored.

Depending on the structure, the consolidator could also consider charging fees or levies to pension scheme sponsors within the structure to maintain capital buffers.

In the event of sponsor insolvency (under a structure whereby the consolidator maintains the sponsor link), one option for underwriting the risk would be the Government itself. This fallback option would bolster confidence in the public consolidator; however, this comes with the caveat of burdening taxpayers, who would bear the associated costs and the intergenerational risks.

Another option would be to seek reinsurance, transferring a portion of the risks to a private third party. This arrangement could provide an additional layer of protection, especially against the long tail of losses, subject to additional costs (and complexity). However, it would also likely reduce investment flexibility and could increase costs.

Lastly, the PPF could provide an added safety net. Given the current robust funding position of the PPF, it could potentially accommodate additional schemes, especially if they are relatively well-funded.

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

Gleaning insights from international experiences of consolidation can be helpful in shaping the UK's understanding of pension scheme consolidation and the underwriting of the associated risks. However, it is important to recognise that pensions legislation, market structures, and other intricacies vary extensively across countries. Therefore, any lessons derived need to be interpreted within the context of these differences. Some examples follow below.

Netherlands: the Dutch system boasts a highly consolidated pensions market. Their approach necessitates that pension schemes maintain buffers against both investment and longevity risks, underscoring the importance of rigorous regulations. Furthermore, the Dutch system permits the application of a 'haircut' on benefits, an intervention that could offset some of the risk. This, however, is not permitted in the UK and would in our view be inappropriate to introduce and politically unpalatable.

Canada: the Canadian system offers another perspective, where public sector pension schemes are renowned for their sheer scale and sophistication. Interestingly, these Canadian assets are predominantly managed in-house and have a notable investment bias towards alternative assets. This model exemplifies the potential advantages of economies of scale and the strategic deployment of illiquid investments.

Australia: the Superannuation scheme provides a case study in the merits of consolidation to enhance member outcomes. This scheme has witnessed significant amalgamation and operates under the watchful eye of ARPA, ensuring schemes adhere to established standards and retain financial robustness. The Australian system is DC, not DB.

Sweden: the country has instituted a state-administered pension scheme that functions in tandem with private provisions. This dual structure guarantees a foundational level of retirement provision, effectively underwriting risk on a national scale.

Synthesizing insights from these diverse systems, some recurrent themes emerge: the indispensability of a clear and robust regulatory framework; the inherent benefits of consolidating resources (to also facilitate risk diversification); the latitude to adjust benefits or contribution rates as exigencies dictate (unpalatable in the UK context); and the nurturing of an environment that values and rewards innovation and competition within the pensions sector.

Pension Protection Fund as a Consolidator

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

We note that there is a related consideration, namely *for which* schemes the PPF would be acting as a consolidator. We have answered this question under the assumption that the PPF would not act as a consolidator for large schemes, given that they already have the scale that consolidation seeks to achieve and these schemes have no problems accessing the insurance market (which is effectively already a consolidation option). Consolidating large schemes into the PPF would also introduce considerable challenges in terms of competition with the insurance and commercial consolidator markets.

The potential benefits of the general principle behind consolidating smaller schemes are based on economies of scale. Such economies can allow for a more efficient investment approach, including the ability to invest in productive finance assets which may otherwise not be accessible for smaller schemes. Also, for smaller schemes, running costs can be disproportionate and so consolidation could offer a route for sharing of fixed costs for smaller schemes as well as leveraging greater 'buying power'.

We have therefore focussed our answer to this question on the idea of the PPF acting as a consolidator for small schemes in the market. We have also assumed that consolidation could be achieved only by providing members with full benefits through the consolidator (i.e. that members' pensions could not be reduced).

We note that a lot of the discussion around small scheme consolidation has focussed on a belief that these schemes are unable to access the insurance market. In our experience, this is not the case for the time being at least. Across the schemes that LCP advises, well-funded and well-prepared small schemes can very much transact with an insurer, and therefore effectively be consolidated on the open market.

In our view, there may be a sensible role for a PPF / public consolidator to play for the very smallest (micro, e.g. sub £10m) schemes. The key reason for doing so would be to mitigate the disproportionate governance challenges for these schemes. The PPF has a long track record in designing processes to assist with such governance challenges.

It is worth noting that there would be no material macroeconomic impact for the UK from this type of consolidation in terms of investment in productive finance. This is because the assets under management amongst these schemes is small compared to the DB universe as a whole. Based on the PPF Purple Book on DB pension schemes, the smallest c.2,000 UK DB schemes amount to under £20bn of assets, which is small compared to the total £1.5tn of DB assets. Such consolidation would therefore be unlikely to 'move the dial' on the amount of investment in productive finance as compared with a proposal which addresses the larger schemes. Indeed, under our proposal set out in response to Question 2, just one large well-funded scheme could have the same £ impact for investment in UK productive finance as the c.2,000 smallest schemes put together.

It is also the case that:

- Conducting such consolidation in a fair way to all members would be a complex undertaking, requiring the views of multiple stakeholders to be considered.
- Careful consideration would be required if PPF consolidation were to focus on less well funded smaller schemes, i.e. those that may not otherwise currently be in a position to transact with an insurer. There is a significant risk that this could inadvertently reward schemes that are less well-funded than others, and whose sponsors have not been as diligent in paying in contributions. This cross-subsidy is likely to be seen as unfair by many.

It is fair to say that that there would be a number of practical and challenging barriers to this type of consolidation:

1) Benefit structures
   Each DB scheme has its own unique benefit structure, so consolidating all of, say, the smallest c.2,000 schemes into one vehicle would still require having different sections that each pay each scheme's unique benefits. Consolidation therefore would not reduce scheme administration costs (and there would arguably be an increased risk of administration error, although this could be managed through high-quality processes). The differences in scheme detail should not be underestimated and cannot be simply waved away.

   Potential steps to address this could include simplification of benefit structures and/or providing a level of standardised benefits with equivalent actuarial value to the benefits that the member would have received in the scheme. However, this would lead to significant additional up-front complexity in going through the process of 'standardising' scheme benefits in this way (and checking the complex actuarial calculations member by member), as well as the fact that some members would end up being 'winners' and some 'losers' (and this would vary over time) when compared to the level of benefit they would have otherwise have received from the scheme had it continued outside the consolidator. Communicating this to members, and dealing with complaints and potential legal challenge, would be complex and costly.

2) Timescales for transfer to PPF
   The process of transferring a scheme to a consolidating vehicle takes time – from our experience of transferring schemes to an insurer, it can take around a year or longer to complete this process. Schemes that currently enter the PPF can take 2-3 years to go through that process. Each transfer is also an expensive and resource-hungry process, and so any mass consolidation would need to be staggered over many years.

   Therefore there is a practical question around the feasibility of consolidating so many schemes into the PPF (or indeed, elsewhere) in a timely manner. In our view this could take many years to achieve.

3) Required legislative change
   There would be a wide range of legislative changes required to establish a transfer process to the PPF for these schemes. Further guidance would also be needed for trustees and employers for this process.

4) Market disruption
   This type of consolidation would largely disrupt a number of markets including trustee, investment, insurance, advisory and administration markets.

Finally, one obvious question regarding any consolidation model is "who gets the surplus?". In our view (see our answer to Question 3) surpluses from well-funded schemes should benefit members of those schemes, those schemes' sponsoring employers and the current employees of those businesses who are largely receiving DC pension provision. Consolidation models, including to the PPF and insurers, make this sort of surplus sharing very challenging at best.

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

The PPF Board does have a considerable number of the skills and expertise in place to act as a consolidator for the type of schemes referred to in our response to Question 17. However, we see two challenges:

- The PPF currently administers a single set of benefits under a single set of rules (or legislation). All members are treated the same in that regard. Administration is highly streamlined. The PPF does not currently have the experience and resource of being an administrator to a very wide range of different benefit rules, with a wide range of communication approaches being required for members. This is expertise that a small number of third-party administration providers currently have, but not at the scale (in terms of scheme numbers and small scheme sizes) required for mass consolidation.
- The PPF does not have the resource to dramatically increase the pace of consolidation, and this resource does not exist within the pensions industry. Much of the industry experience in this area is already very busy moving schemes to insurers at a record pace.

Whilst the PPF could seek to bolster its resources in these areas, the key question is how many schemes should be consolidated, and how practical this is.

Overall, whilst we do not see it being practical to consolidate thousands of small schemes into any public consolidator over any meaningful short enough period, there could be a role for the PPF based on a targeted approach for the smallest schemes. As noted in our response to Question 17, the key reason for doing so would be to mitigate the disproportionate governance challenges for these schemes; and it should be recognised that there would be no material macroeconomic impact for the UK from this type of consolidation in terms of investment in productive finance.

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?

The main way to complement rather than compete would be to target a different set of DB schemes, e.g. the smallest schemes, less well funded schemes, and those with weaker covenants. However, the policy objectives corresponding to targeting such schemes would necessarily be focussed on reducing governance burdens, protecting member benefits and rescuing struggling businesses, rather than having a material impact on investment in productive finance.

If the PPF was to be explored as a consolidator for such schemes, there would need to be careful thought given to detailed criteria for and guidance on “entry requirements”, so that there would be minimal impact on other consolidation models (if this was the policy objective). In turn, this would create challenges and moral hazard risks where schemes are on the cusp of the entry requirements. This has already been seen as challenging when setting up and designing the Superfund regulatory regime.

In practice, other than for the smallest schemes, we think it would be very difficult to introduce a new option for PPF consolidation on full benefits and for this not to compete with other consolidation models.

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?

We do not believe that voluntary entry to the PPF as a consolidator should be permitted with a cut to member benefits. This would introduce too many moral hazard risks for all participants.

Any consolidation should be done on a “fair price” (perhaps akin to the pricing the PPF currently sets for entry, which is broadly based on buyout pricing levels from time to time). Therefore, if a scheme is in deficit on that basis (and most will be), the sponsor will need to find the additional top up funds. The PPF would have an advantage over insurers as it would not (we assume) be constrained by Solvency II requirements, and therefore it could potentially offer more flexible payment terms to employers (e.g. payments spread over many years), and could potentially choose to take credit risk in the meantime. This may, however, be seen as unfair by insurers. In particular, it is not normal for a public body to accept credit risk in this type of situation.

In our view, the idea of a PPF run consolidator should be considered only for smaller, more challenged schemes, and only if the private market solutions do not work for that group (e.g. micro schemes, sub £10m). This would lead to specific (detailed, potentially gameable) entry requirements.

If the PPF does price transactions in the way we envisage, the price will be broadly similar to the price of insurance. Assuming PPF consolidation would be voluntary for schemes, many smaller schemes would then of course choose not to transact, in particular because their sponsoring employers may believe that over time the pensions can be paid from their own pension scheme for less money.

There is a consideration around the use of the PPF’s currently accumulated strong reserves. Whilst, in principle, this could be used to support setting up a consolidator for smaller and less well funded schemes, we think this would be seen as unfair and uncompetitive by many. The reserves have arisen from the levy payments made by well-managed larger pension schemes over many years. An ability to use reserves in this way would be a market advantage for the PPF compared to insurers.

To ensure investment in UK productive finance would require specific legal objectives, we believe. A general fiduciary duty in relation to investment is likely to (sensibly) lead to a wide range of assets as held by the PPF now, which would be constrained by what assets are available and we would see no specific UK bias.

The question about the gilt market is important and should be carefully considered under all the options being put forward. In our view, the option that best maintains the highest level of pension scheme gilt ownership for the longest time is our proposal. Other proposals (and the status quo) could lead to significant shifts in gilt ownership and demand over the coming years. Whilst a PPF run consolidator presumably could, by statute or by statutory objectives, be effectively required to hold gilts over the long term, if the Government wished, doing so would mean the PPF would likely base its consolidator pricing on gilts which is in contrast to how insurers and commercial consolidators price (and would likely be more expensive and therefore less attractive for schemes).