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Work and Pensions Committee

Defined benefit pension schemes

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Work and Pensions Committee

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Summary

The funding levels of the majority of defined benefit (DB) schemes have improved. Although there are questions about the extent to which the value of assets fell over 2022 which we think need to be resolved, the change compared to the mid-2010s when the majority were in substantial deficit, is clear. This raises new questions and gives rise to new opportunities and challenges, for example, relating to how DB scheme funding is regulated, how to treat any surplus in pension and compensation schemes and how to ensure scheme members feel their interests are represented in these decisions.

The new Funding Code

One area of focus during our inquiry was the development of a new DB funding regime, which the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR)

propose to introduce for scheme valuations from 22 September 2024. The intention is to require schemes to aim for a position of low dependency on the sponsoring employer by the time they are significantly mature, with investments that are highly resilient to risk. One of the questions we set ourselves at the outset of our inquiry was whether the proposed new arrangements would enable open schemes to thrive. Although they represent a small minority of DB schemes, they are important in providing adequate incomes in retirement and, because they are able to take a longer view, they have greater capacity than closed schemes to invest in the economy. We continued to hear concerns from open schemes that the new funding regime would require them to de-risk inappropriately, potentially leading to their premature closure. Although DWP introduced additional flexibility in the Regulations laid before Parliament in February, it is essential

that TPR works with open schemes to ensure that the remaining concerns are addressed in the final version of the Funding Code.

TPR's approach to regulating scheme funding has been driven by its objective to protect the Pension Protection Fund (PPF). It has prioritised protecting benefits that have been built up, encouraging a de-risking approach which has increased the cost of DB schemes for employers. Given the improved funding position of schemes, and the fact that the PPF now has £12 billion in reserves, this objective is no longer needed. Open and continuing schemes now need confidence that the additional flexibilities that have been promised will be reflected in the actual approach regulators take in future. To signal the change in approach needed for this, TPR's objective to protect the PPF should be replaced with a new objective to protect future, as well as past, service benefits.

Scheme surplus

Many schemes are much closer than they expected to being able to enter a buy-out arrangement with an insurer to secure scheme benefits. Buy-out arrangements are now at record levels and many will want to continue on this road. It is important that trustees and employers are able to see running the scheme on as an attractive and meaningful alternative. This has potential advantages for: scheme members (of, for example, allowing them to continue to receive discretionary increases); the sponsoring employer (able to see a well-funded scheme as an asset); for the UK economy (enabling trustees to take a longer-term view and increase their investment in return-seeking assets); and financial stability (as more schemes would be working towards different long-term objectives).

DWP is consulting on proposals to allow surplus to be extracted in a wider range of

circumstances (it is currently only allowed in schemes funded to buy-out level). This is an important consideration if we want to encourage well-funded schemes to run on. However, these proposals must not put member benefits at risk. Schemes can take steps to improve the security of member benefits. Recent experience has illustrated the volatility in scheme funding levels and the jury is out on whether schemes have locked in their gains. We note the current consultation on the level of funding a scheme would need to have for surplus extraction to be an option. However, strong governance will also be essential. We recommend that DWP should conduct an assessment of the regulatory and governance framework that would be needed to ensure member benefits are safe and take steps to mitigate the risks before proceeding.

Improvements in scheme funding have given new prominence to the question of how

to treat any surplus in the best interests of scheme beneficiaries. Decisions can be for trustees, the employer, or both, in accordance with scheme rules. We heard from scheme members concerned that their interests would be overlooked in this process. We recommend that DWP and TPR explore ways to ensure that scheme members' reasonable expectations for benefit enhancement are met, particularly where there has been a history of discretionary increases. Discretionary increases are particularly important for some scheme members with rights built up before 1997, where their scheme rules do not provide a right to indexation. In some cases, scheme members told us they had not had an increase for some years, resulting in a substantial erosion of their living standards. We recommend that TPR undertake research to understand the extent of the problem.

Governance

While many trustee boards work well, we know that TPR has long had concerns about governance standards in some schemes, particularly smaller ones. It hopes that consolidation will help to address this by reducing the number of small schemes. However, this is not a foregone conclusion: pension Superfunds have faced significant challenges in getting off the ground in the absence of a statutory regulatory framework; and although DWP is consulting on proposals for a public consolidator, the model raises significant questions which are still to be answered. DWP and TPR therefore need to invest in driving high standards of governance across pension schemes. We recommend that DWP legislate to make accreditation mandatory for professional trustees; explore ways to ensure lay trustees have the time and resources to become accredited; and set

out plans for ensuring every trustee board has at least one accredited member, lay or professional, and a timetable for achieving that. It must also ensure that the new trustee register is used to ensure trustees complete TPR's Trustee toolkit.

The PPF reserves

The PPF is now fairly confident that it is secure and able to meet future claims from its existing funds, with £12 billion in reserves. This is a significant achievement which we applaud. It means there is the opportunity to consider how both levy payers and scheme members can benefit from this. DWP should legislate to give the PPF more flexibility to reduce its levy to zero, knowing it can increase it again if needed. It should also legislate to improve PPF compensation levels. We heard that for PPF members, the priority was indexation of pre-1997 benefits, which have had a disproportionate impact on women

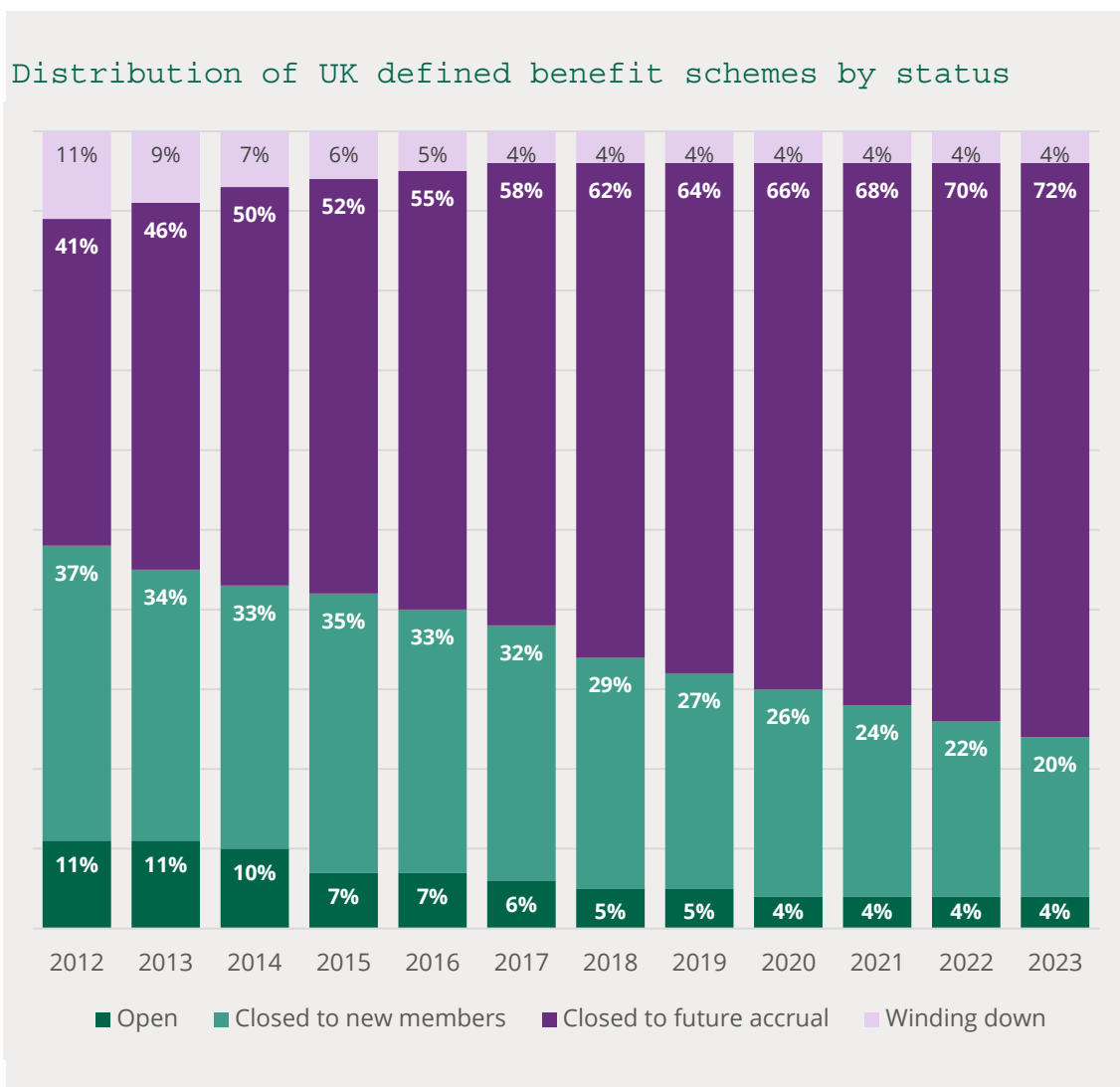
and older scheme members. This should be the first step, before other improvements are considered. The same must apply, funded by the taxpayer, to Financial Assistance Scheme (FAS) members, who tend to have more of their service before 1997.

1 Introduction

A changing landscape

1. Defined benefit (DB) pension schemes promise to pay pension benefits based on salary and length of service. In the private sector the total number of DB schemes is declining steadily: between 2022 and 2023 they fell by 2%, from 5,378 to 5,297. As shown in Figure One, the percentage of those schemes that are closed to future build-up of benefits (accrual) has continued to rise, up from 41% in 2012 to 72% in 2023. The percentage open to new members has continued to fall, down from 11% in 2012 to 4% in 2023.

Figure One: Defined benefit pension schemes by status



Source: The Pensions Regulator, Occupational defined benefit landscape in the UK 2023

2. However, DB schemes remain of critical importance, with around 9.6 million members continuing to rely on DB schemes to help ensure an adequate income in retirement. In our *Saving for Later Life* inquiry, we found that people with access to a DB pension were more likely to be on track for an adequate income in retirement.

3. This report also follows our inquiry, *Defined benefit pensions with Liability Driven Investments (LDI)*, which looked at the events of autumn 2022. The Bank of England needed to intervene then to protect financial stability because the LDI funds in which many DB schemes were invested lacked the resilience to respond to sharp rises in gilt yields following the mini-budget on 23 September 2022. The funds had to recapitalise quickly and, where they were unable to do so, became forced sellers of gilts into a falling market, threatening a downward spiral. In our report we said DB schemes must

never be allowed to jeopardise the economy again and set out some key areas of change that were needed.

4. Our current inquiry follows up on some of the issues raised, for example, about the regulatory framework in which DB schemes operate and standards of governance. However, we look at these in a very different context. We heard from commentators that it was unlikely that we would see a repeat of the events of 2022 given the steps that have been taken to improve the resilience of DB schemes' use of LDI. Pension schemes still face risks, but they are likely to be different ones. There are also new opportunities with an improvement in scheme funding levels over the last year or so.

5. A significant development was the Mansion House speech in July 2023 in which the Chancellor of the Exchequer (Rt Hon Jeremy Hunt MP) laid out plans to “enable our financial services sector to increase returns for

pensioners, improve outcomes for investors and unlock capital growth for our businesses.” This was followed by the long-awaited response to the Department for Work and Pensions (DWP) 2018 consultation on consolidation of DB schemes and calls for evidence on options for DB schemes and trustee skills, capability and culture.

Our inquiry

6. Given the importance of DB pensions to savers and to the UK economy, we decided to launch an inquiry in March 2023 examining these schemes and the challenges and opportunities they pose to scheme members, trustees, employers and The Pensions Regulator (TPR).

7. As part of this inquiry, we held six evidence sessions between June 2023 and January 2024, hearing from scheme members, the pensions industry, pension experts, academics, regulators and Ministers and officials from HM Treasury

and the Department for Work and Pensions. Our findings in this report are also informed by nearly 100 pieces of published written evidence, as well as correspondence we have had with Ministers and others. We are grateful to everybody who has contributed to our inquiry.

8. As mentioned, during the course of this inquiry, the Government announced changes to the regulation of scheme funding, the options for consolidation and measures to improve the governance of DB schemes. We expect further changes to be forthcoming as the Government responds to consultations and launches further consultations.

Aims of this report

9. In this report:

- a) Chapter Two sets out the current funding levels of schemes and how this has changed over time, as well as the impact

of the Liability Driven Investment episode, which we commented on extensively in our previous Report;

- b) Chapter Three examines the new DB funding regime, how it relates to the objectives set out in the Chancellor's Mansion House speech, how regulation should vary for open and closed schemes and TPR's objectives;
- c) Chapter Four looks at objectives for schemes in the long-term, and in particular, at proposals to change the rules on when it is possible to extract surpluses;
- d) Chapter Five explores issues of governance including the regulation and accreditation of trustees, member-nominated trustees, sole trustees, and consolidation;
- e) In Chapter Six we look at the Pension Protection Fund (PPF), including its levy, PPF's reserves and compensation and

indexation for members whose schemes find themselves in the PPF or the Financial Assistance Scheme (FAS); and

- f) Finally, in Chapter Seven we provide a short conclusion.

We refer to a number of a technical terms in this report and have provided a glossary in the annex.

2 The current funding position

10. In this chapter, we look at how the funding position of DB schemes has changed over the last year.

How to measure scheme funding

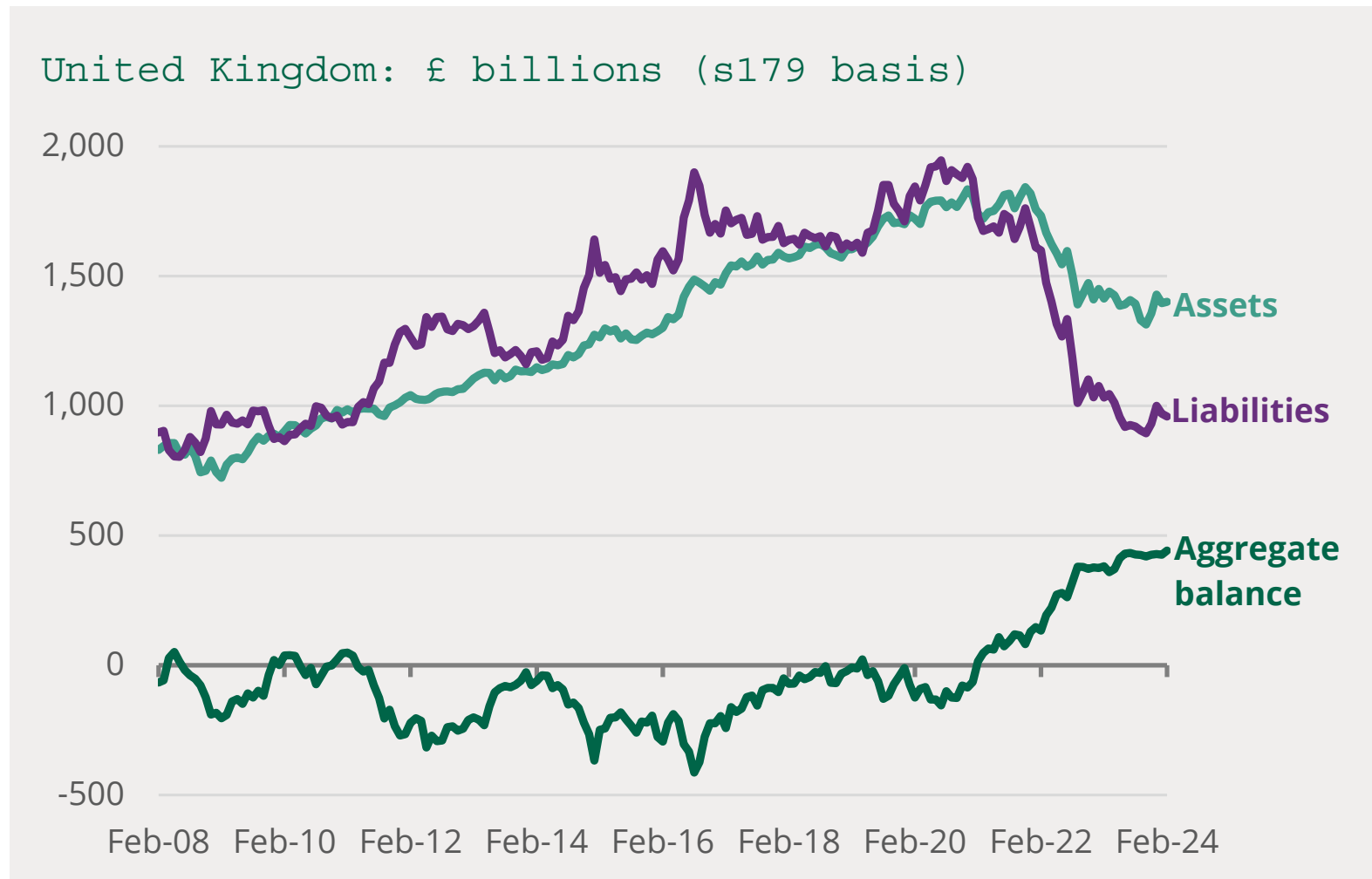
11. There are different approaches to measuring the funding status of schemes, including:

- **Technical provisions (TP)**—a calculation by a scheme's actuary of the assets needed for the scheme to meet the statutory funding objective it is required to set under Part 3 of the Pensions Act 2004;
- **Section 179 basis**—the estimated cost of securing Pension Protection Fund (PPF) compensation levels with an insurer; and
- **Full buy-out**—this tends to be the highest of the three measures, as it is calculated

based on 'prudent' assumptions and represents the cost of insuring full scheme benefits in the private market.

12. Figure Two from the House of Commons Library shows scheme funding on a Section 179 basis since 2008. As of February 2024, according to the PPF 7800 index, DB schemes had total assets of £1,400.8 billion and total liabilities of £958.5 billion, resulting in an aggregate balance of £442.3 billion (and a funding ratio of 146.1%). Between March 2006 (when the index began) and February 2021, the series had shown the majority of schemes were in deficit. However, since March 2021 the majority of schemes have been in surplus each month.

Figure Two: Assets and liabilities of defined benefit pension schemes



Source: House of Commons Library, based on PPF 7800 index.

13. One perhaps counter-intuitive outcome of the LDI episode, was that—despite the Bank of England having to intervene to protect financial stability—DB schemes emerged from 2022 with an overall improvement in funding levels, with only a minority of schemes seeing their funding level deteriorate. In our report following the LDI episode, we said that it was important to understand the impact, so that the system could work better in future. In the report it produced in response to our recommendation, TPR said it estimated that funding levels had improved for 87% of schemes on a ‘technical provisions’ basis:

- a) Only 5% of DB schemes experienced both a deterioration in their funding level and either an increase in their existing funding deficit, or a movement from surplus to deficit;

- b) By the end of 2022, 80% of schemes were in surplus on a technical provisions basis and on a buy-out basis; and
- c) About four in ten schemes were estimated to be fully funded at the end of December 2022, compared to fewer than 10% at the end of December 2021.

According to TPR, funding continued to improve over 2023, with the number of schemes funded to 100% or more on a technical provisions basis, having increased to 3,260, up from 2,565 in 2022.

14. The improvement in aggregate funding was welcomed by TPR Chief Executive, Nausicaa Delfas. Joe Dabrowski of the Pension and Lifetime Savings Association (PLSA) said that some of the improvement in funding levels had been “driven by the rise in gilt yields and interest rates”, which were likely to continue, thus meaning the schemes would “continue to be robustly funded” Sir Steve Webb, a former

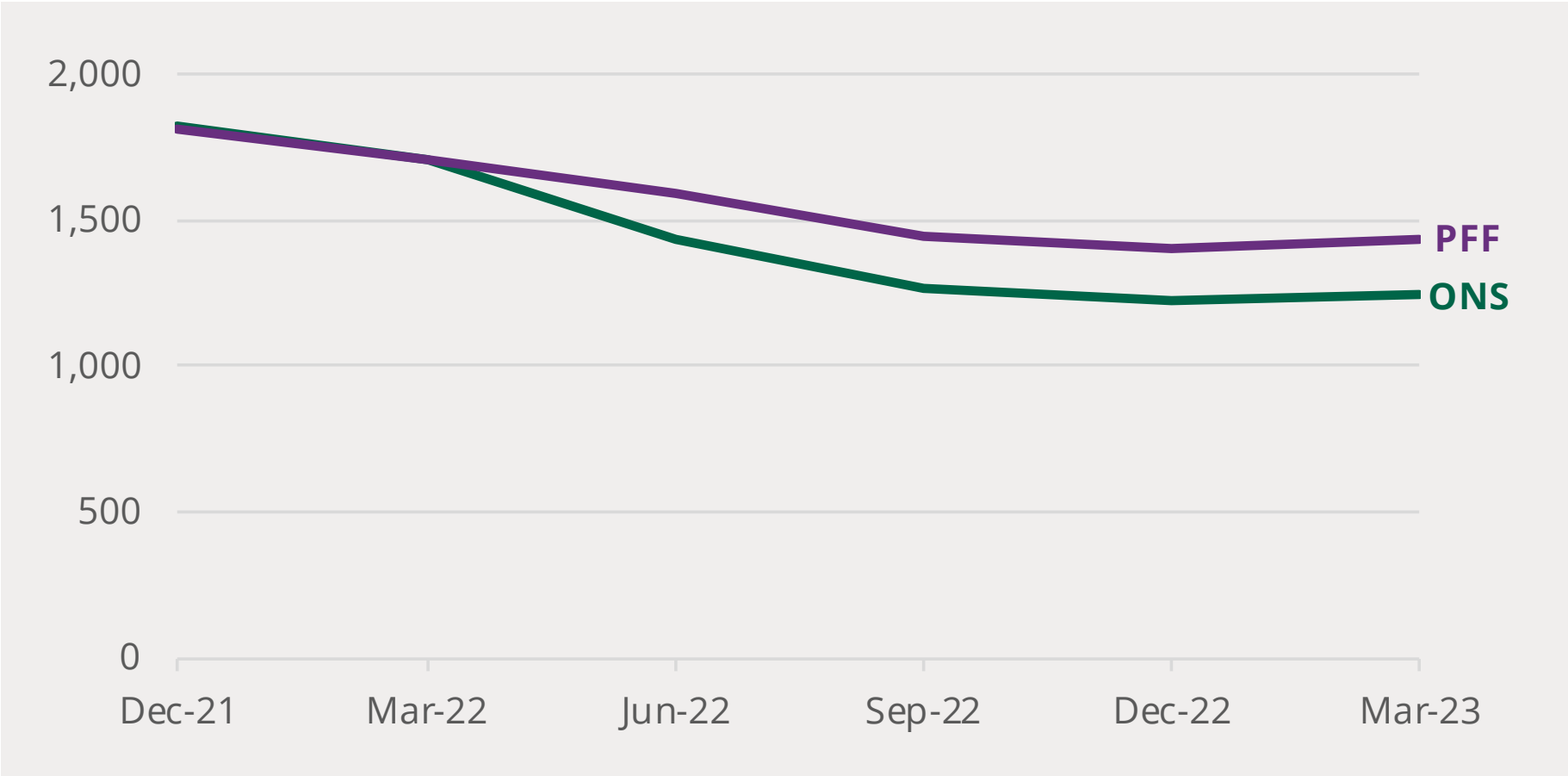
Pensions Minister and currently a partner at pension consultants, Lane, Clark and Peacock, said that, while it was possible to debate the exact numbers, it was important not to lose sight of the fact that different measures pointed in the same direction. Tangible evidence was that the number of schemes now in a position to buy-out with an insurer had increased.

15. However, retired financial analyst, Dr Con Keating, and Professor of pensions and finance at the University of Leeds, Iain Clacher, told us that “much of the apparent improvement in funding ratios is illusory.” They questioned whether the figures produced by the PPF, on the basis of annual scheme returns to TPR, fully reflected the impact of the LDI episode and pointed to figures produced by the Office for National Statistics (ONS), which estimated a steeper decline in the value of assets.

16. The ONS estimates that the value of DB scheme assets fell by £577 billion over

between Q4 2021 and Q1 2023, from £1,821 to £1,244 billion. In contrast, the PPF estimates a reduction of £378 billion from £1,818 to £1,439.8 billion (a reduction around £200 billion less than the ONS has estimated). As shown in Figure Three, in the past the ONS and PPF estimates have been closely aligned, though since the LDI episode in 2022 they have diverged.

Figure Three: Estimated value of DB scheme assets: Figures in £ billions



17. Neil Bull, Head of Investment at TPR, told us that it was comfortable with its estimate of the funding position. Oliver Morley, the then Chief Executive of the Pension Protection Fund (PPF), told us the PPF was keen to understand the differences, but that the data was collected for different purposes. The PPF told us that the divergence between its figures and those from the ONS in 2022 had been “exceptional.” The reasons were that:

- The ONS figures were based on a survey of a sample of schemes which post-dated the LDI market disruption, whereas the PPF’s were based on scheme returns to TPR which largely pre-dated it; and
- The PPF data did not capture the structural changes to asset allocations or the changes in leveraged LDI portfolios—both factors which had been particularly pronounced since March 2022.

18. The PPF told us that even when it had data from post-October 2022 scheme valuations, the number of factors affecting asset and liability estimates meant it would not be possible to form a meaningful estimate of how much of the funding changes had arisen as a result of the LDI market disruption. The ONS confirmed that its data was more recent and captured data on asset allocation. It told us that although it did not currently produce figures for estimated pension liabilities or, therefore, funding levels, it was exploring the possibility of doing so.

19. **We welcome that scheme funding has improved substantially since the mid-2010s. However, the PPF and the ONS have produced different estimates of the extent to which the value of the assets in DB schemes reduced over 2022. The PPF acknowledges that its figures do not fully reflect the effects of market disruption during the LDI episode. It is important to have as accurate a picture of funding as possible. *The Pensions***

Regulator and the Pension Protection Fund should continue to work with the Office for National Statistics to reach an understanding of the funding position of DB schemes and publish the results.

Security of recent improvements

20. We were keen to understand how much of the estimated decline in asset value we should expect to see restored if interest rates started to fall. TPR and the PPF argued that a decline in the value of a scheme's assets was not inherently a bad thing, provided the value of its liabilities had also declined, or declined by more. TPR told us that the improvement in 2022 funding levels reflected the fact that schemes had invested in 'matching assets' (the value of which move in the same direction as the value of the scheme's liabilities), as it had encouraged them to do. It hoped that schemes would protect these funding gains by schemes continuing to match assets. This would create "an all-weather

situation,” broadly protecting the scheme’s funding position as bond yields change again. Barry Kenneth, Chief Investment Officer of the PPF, agreed with this argument and conceded that the “jury was out” on the extent to which they had done so.

21. Estimates of scheme funding show the position at a point in time, based on a set of assumptions. Derek Benstead of actuarial consultancy, First Actuarial LLP, said it was:

important to distinguish carefully between the task of having sufficient assets in a pension scheme to pay benefits as they fall due - that is the real-world activity of a pension scheme with a long-term future - and the modelling world that compares assets with an actuarial value of liabilities.

Steve Hitchiner of the Society of Pension Professionals said that a scheme now in surplus could return to deficit again if financial

circumstances changed. A surplus was only an “expected surplus”, until such time as the scheme had wound up and benefits been bought out with an insurer.

22. There is sufficient evidence of improvement in the funding position of DB schemes to justify a new policy approach. However, it is imperative that there is no return to a world of deficits. Policy changes therefore need careful thought so that they grasp the opportunities offered by improved funding levels, while being agile enough to respond to future challenges. One of the opportunities is to support DB schemes to remain an active feature of the pensions landscape, helping to deliver adequate retirement incomes. *The Government should set out how it plans to promote retirement income adequacy in the future and the role it sees DB schemes, particularly open schemes, playing in this.*

3 The scheme funding regime

23. In this chapter, we look at proposals to introduce a new regime for regulating scheme funding, the likely impact (particularly on open DB schemes) and how it fits with the Chancellor's Mansion House aim to increase pension schemes' investment in UK productive finance.

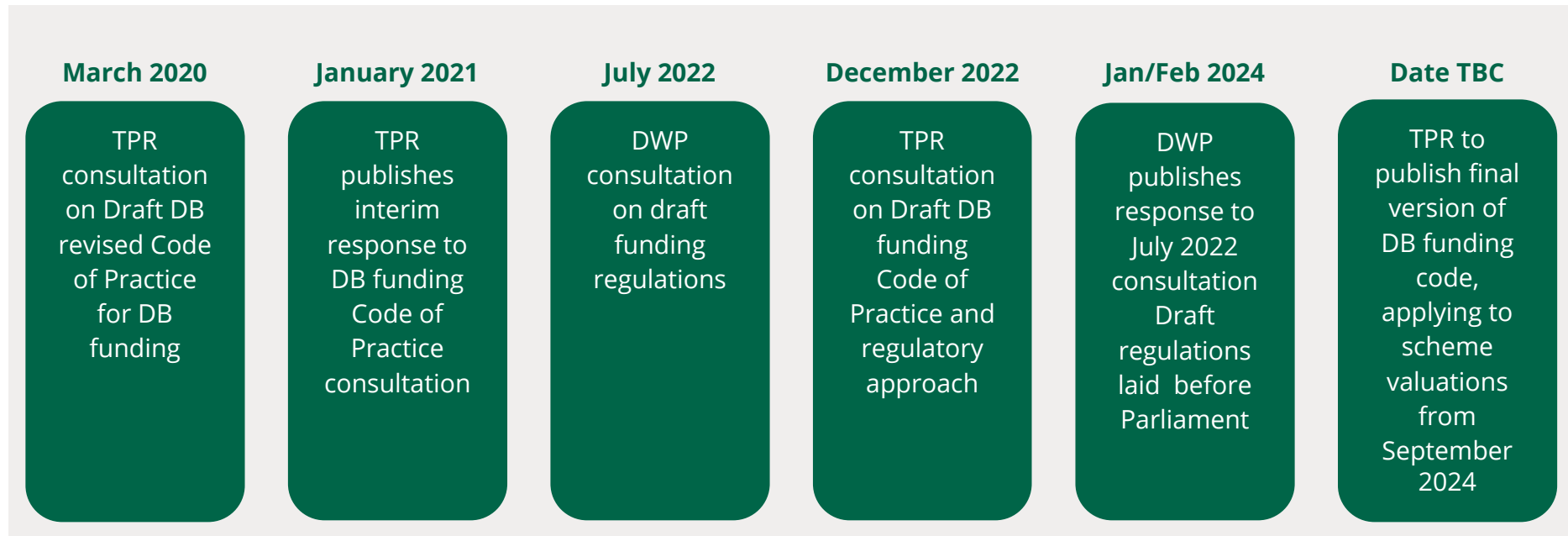
The DB scheme funding regime

24. According to the PPF, private sector DB schemes have an estimated £1,400.8 billion of assets under management. Up until 2012 the majority of assets were invested in equities, but the proportion has since shifted. In 2023, around 69% of assets were invested in bonds compared with 18% invested in equities. In our LDI report, we concluded that factors driving this shift had been a regime for regulating DB scheme funding, in combination with accounting standards. The effect had been to reduce an

important source of capital for the UK economy. We said we would return to the issue of whether more flexibility could be allowed.

25. DWP plans to introduce a new funding regime, effective for scheme valuations from September 2024. The need for it was identified some years ago, when the vast majority of DB schemes (90–95%) were in deficit. The Government wanted to address concerns that: some employers were misusing flexibility in the funding framework at the expense of scheme members; and scheme funding outcomes were affected by poor decision-making, short-term thinking and a lack of accountability. It legislated for the framework for a new regime in Section 123 of the Pension Schemes Act 2021. The detail of the funding regime is in DWP regulations and a TPR Code of Practice, both of which have been subject to detailed consultation as set out in Figure Four:

Figure Four: Timeline of consultation on the DB Funding Code



26. A significant intervention in the debate after most of our written evidence had been received was the Chancellor's Mansion House speech in July 2023, setting out the Government's plan to "enable our financial services sector to increase returns for pensioners, improve outcomes for investors and unlock capital for our growth businesses." In a call for evidence published at the same time, DWP asked whether there was potential for DB schemes to invest in a wider range of asset classes—including UK productive finance—to improve their funding position and alleviate the pressure on sponsoring employers. Given the emphasis in the current funding regime on a low-risk approach, which had contributed to a shift in investments from equities to bonds, we were keen to explore the extent to which the new regime would signal a change of approach in line with the Mansion House objectives.

Consultation on the new DB Funding Code and regulations

27. A key principle of the proposals for the new regime—set out in the consultations on TPR’s revised Code of Practice (March 2020) and DWP’s draft Funding Regulations (July 2022)—was “a requirement for schemes to be in, at least, a state of low dependency on their sponsoring employer by the time they are significantly mature.” This would require schemes’ assets to be invested in such a way that the cash flow value broadly matches the payments from the scheme and that their value, relative to the value of the scheme’s liabilities, is highly resilient to short-term adverse market changes.

28. In evidence submitted, we heard concerns that the new regime would embed and intensify the current approach, with its emphasis on low-risk investments. While appropriate to mature closed schemes, for schemes that were open

to new members or future accrual, it had the effect of increasing the costs employers were required to make and encouraged scheme closures. We heard some calls for a significant shift in approach. For example, trustee firm, Dalriada proposed measures that would allow schemes to take more investment risk, subject to this being supported by professional risk management. Pensions consultants, Mercer, believed that a funding regime that was more specifically targeted on poorly funded schemes, could help to preserve continuing schemes.

29. However, there was also support for the proposals. The Pension and Lifetime Savings Association (PLSA), for example, said its members were “supportive of the current regulatory framework, which hinges on well-funded schemes supported by employers and should continue to do so.” Leah Evans of the Institute and Faculty of Actuaries said she thought the “direction of travel [was] fine” but

that the industry needed to see the “combined regs and draft code and be able to comment on them.”

30. Sir Steve Webb, questioned whether the new regime was needed, describing the code as “in many ways, from a bygone era.” It was legislation for a “world of big deficits” which “by and large we do not have now.” Asked why it was needed, Louise Davey, Interim Director of Regulatory Policy at TPR, said it would embed good practice and protect against abuse of the flexibilities in the system. The Pension Protection Fund told us it had a role to play for underfunded schemes, or for schemes that might have funding issues in future.

The Government's response to concerns

31. In evidence to the Committee on 10 January 2024, Fiona Frobisher, the then Deputy Director of Defined Benefits Policy at DWP, said that de-risking remained part of the regulations because “the concept is to get to a point of

low dependency when you are at a point of significant maturity—so when you have to start paying your pensioners, you should have the money to do that.” However, DWP had listened to the concerns and had been clear in the revised regulations that “de-risking does not mean no risk.” There would “still be headroom [...] for schemes to take more risk, even at a point of significant maturity, so they will be able to invest in other asset classes.”

32. The Minister for Pensions (Paul Maynard MP) considered that the funding regime should set the tramlines within which trustees could take prudent decisions, to give them confidence in setting a long-term goal, with different routes available to meet it. Economic Secretary to the Treasury (Bim Afolami MP) said that it was “really important that we do not see any contradiction in the need to grow the benefits for members as best we can at the same time as

improving the broader macroeconomic climate, because there are big pools of capital that can be invested in the economy.”

33. DWP published revised draft Regulations on 26 February 2024. They will come into force from April 2024 and apply to scheme valuations from 22 September 2024. The regulations outline the framework, further detail on applying it in practice will be in TPR’s Code of Practice and guidance. TPR is considering consultation responses and changes in market conditions and will publish this alongside the final revised DB Funding Code. This is expected to happen in the summer of 2024. In terms of the expected impact, DWP said that much of the directional shift in DB scheme investments from equities to bonds was likely to have already occurred. The main cost would be to those schemes and employers where there was a need to increase deficit reduction payments.

Response to new funding regulations from industry bodies

34. In a further evidence session on fiduciary duties on 21 February 2024, we asked industry figures if the revised Regulations had met their concerns. We heard the “devil [would] be in the detail” of the final version of TPR’s Funding Code. Rachel Croft of the Association of Professional Pension Trustees said they were waiting to see whether there would be “the flexibility for trustees and sponsors to target a range of different outcomes, including running on the scheme as an alternative to buying out.” Debbie Webb of the Institute and Faculty of Actuaries, while viewing the revised regulations as a significant improvement, questioned how much flexibility there would really be. The requirement that assets were highly resilient to short-term market changes at a point of low dependency would still mean “a pretty low-risk investment strategy and, therefore, a very conservative funding target” for

mature schemes. There would be little incentive for trustees or employers to take additional investment risk because they were “on the hook if it goes wrong.” Furthermore, there was a requirement in the primary legislation to explain if their investments were not in line with their funding strategy and take steps to remedy that. Nigel Peaple of the PLSA told us that, although the regulations were more flexible, there were still “lots of issues to answer and be sure about.”

35. Plans for the new DB funding regime were forged in a different era when the vast majority of DB schemes were in deficit and amidst concern that employers were seeking to evade their responsibility to underfunded schemes. Despite significant changes since then—improved funding levels and what these mean for future policy—the fundamental principles underpinning the new regime are unchanged: schemes are expected to target a position of low dependency at the point of significant

maturity. While we welcome the changes made by DWP and TPR to allow more flexibility in the investment approach, it is unclear what the overall effect will be. Schemes have not yet seen the final version of TPR's Funding Code. It is unfortunate that Parliament has been asked to vote on the Regulations before this was published and stakeholders have had the opportunity to evaluate and comment on the full picture. *In future, DWP should commit to ensuring that Parliament has the material details it needs to make an informed judgement on the legislation it is being asked to vote on.*

The impact on open DB schemes

36. A key concern was the potential impact of the new funding regime on open DB schemes. Although we heard that very few, if any, expected new DB schemes to be opened, it was important not to accelerate the closure of those that remained.

37. Open DB schemes have been in decline in the private sector, falling from an estimated 11% of schemes in 2012 to 4% in 2023 (see Figure One). The 199 remaining open schemes had 1,217,076 members, 446,332 of whom were still actively contributing, and an estimated £165 billion in assets. The landscape is dominated by two schemes, the Universities Superannuation Scheme (USS) and the railway pension schemes (RPS), which account for around seven in ten of the total 1.2 million members of open DB schemes (over 500,000 in the USS and over 350,000 in the RPS). These two schemes are also significant in terms of the assets they hold. The USS had assets of £75.5 billion (31 March 2023) and the RPS over £35 billion (31 December 2022).

38. We heard that the characteristics of open schemes were different to those of closed schemes. Joe Dabrowski of the PLSA told us that where a scheme was still open, this would be the result of active employer choice

over the last 15 to 20 years. They tended to be associated with “highly profitable companies, those that need to recruit and retain highly skilled staff, and those where you have a labour force with strong trade unions or perhaps formerly nationalised industries.” The USS and RPS are both sectoral, multi-employer schemes: with around 330 and 150 contributing employers respectively.

39. Open DB schemes are an important part of the pensions landscape for two reasons. Firstly, as we found in our *Saving for Later Life* Report, access to a defined benefit pension is a significant factor in whether people are likely to achieve an adequate income in retirement. Secondly, they have more capacity than closed schemes to invest in productive finance. This is because they have a flow of new members and contributions from which to pay pensions and have a long time horizon (they expect to be paying pensions well into the future), so are able to tolerate more investment risk. The

RPS had approximately £6.5 billion invested in these types of assets at the end of 2022. They are also able to take climate change risks and impacts into account in their investment decisions.

40. The Society of Pension Professionals told us that the experience of the USS begged the question of whether the current regulatory regime allowed private sector DB schemes to take “a sufficiently long view.” This is because the way in which schemes are required to measure their liabilities makes them very sensitive to changes in gilt yields. The USS had been found to be in deficit in the 2020 valuation, leading to a reduction in benefits in 2022 and sustained industrial action and disruption to students. Recent quarterly funding updates had shown the scheme to have a substantial surplus, resulting in future service benefits being restored to the pre-2022 levels from April 2024.

41. In written evidence to the Committee in spring 2023, we heard concerns from the Pension and Lifetime Savings Association, the USS, the Railway Pension Schemes Trustee Corporation and First Actuarial LLP, that the focus on de-risking proposed for the new regime could inadvertently lead to the premature closure of open schemes, potentially significantly damaging sponsoring employers and the sectors or industries in which they operate, and crucially damaging member outcomes.

42. For USS, a key concern about the new regime was the ‘covenant horizon’ it would be able to assume (the length of time they can be confident they can rely on the sponsoring employers’ capacity and willingness to support the scheme). A 30-year covenant horizon—which its advisers said could be supported—was a “key element in delivering stability of valuation outcomes.” However, TPR had indicated that for future valuations, it might

consider a 20-year horizon more appropriate. TPR told us there was “an inherent risk” that the nature of this sector (or indeed any sector) could change over a 30-year period.

43. In response to the USS concerns, DWP told us it had always intended that open schemes should not be pushed into an inappropriate de-risking journey but was aware this may not have been clear in the initial Regulations it consulted on. It would be explicit in the revised regulations that open schemes could take account of both new entrants and future accruals in setting their funding plans. The need to de-risk would be explicitly linked to the extent to which a scheme was likely to become mature and on the strength of the sponsoring employer. This scheme specific approach would ensure that “if an open scheme is not maturing it would not get close to the point at which it is expected to become significantly mature and will not therefore have to move towards low dependency.” This was provided for in the draft Regulations laid before

Parliament on 26 February 2024. The then Deputy Director of Defined Benefit Policy at DWP, Fiona Frobisher, said that because of the requirement to conduct a valuation every three years, open schemes would “be looking at it afresh every three years. As long as they stay open, they will stay on a similar kind of path.”

44. However, on 21 February 2024, Carol Young, Group Chief Executive of the USS, welcomed the fact that the “unique features of open schemes” had begun to be acknowledged in the regulations but said that the “devil [would] be in the detail, specifically in the detail of the covenant guidance.” The USS remained of the view that a 30-year covenant horizon was integral to their ability to “think long term and invest for the long term.” Anything that shortened that time horizon would have real-world consequences.” The effect of a 20-year horizon would be to increase future service contributions from the higher education sector by three percentage points, meaning “about

£330 million more going into the scheme, basically just to plug the gap arising from the fact that we would not be able to take such a long-term investment horizon.” Debbie Webb of the Institute and Faculty of Actuaries said that schemes were being asked to have ‘reasonable certainty’ when looking at covenant longevity. Most schemes she worked with—even open schemes—did “not have reasonable certainty that lasts beyond five years.” For such schemes, how that got interpreted could be “quite a significant challenge.”

45. Open DB schemes help meet two important objectives: providing adequate incomes in retirement and investing in UK productive finance as they have greater capacity for this than closed schemes. Those responsible for running DB schemes have long expressed concerns that the Funding Code would force them to de-risk unnecessarily, increasing the costs to employers and resulting in their

premature closure. While we welcome the additional flexibility in the revised Funding Regulations, it is essential that DWP and TPR work with open schemes to address the remaining concerns—particularly around the employer covenant horizon—and report back to us on how they have done so before the new Funding Code is laid before Parliament.

TPR's regulatory approach

46. The new funding regime is intended to enable TPR to intervene more effectively to protect members' benefits when needed. While welcoming the additional flexibilities in revised versions of the regulations and code, some witnesses argued that a wider cultural shift would be needed. Pensions consultant, Hymans Robertson, told us that in the past, due to limited resources, TPR had focused on the needs of the 90% of DB schemes that were closed. In this context, it was difficult for schemes to take

a different approach. Actuarial consultancy, First Actuarial LLP, agreed that open DB schemes would not be able to thrive “if the group think is that being open is an aberration.” The USS feared that inappropriate expectations or requirements for the remaining open schemes and their sponsors might be set as mature schemes became the norm.

47. To mitigate the pressure to behave like mature closed schemes, open schemes proposed providing greater clarity within the Funding Code and Regulations that separate requirements applied to open schemes. With respect to open schemes, the Minister for Pensions told us he was “acutely aware” of the importance of taking into account their specific needs. TPR would “ensure that open schemes are more prominently referenced and highlighted in their revised Code.” He did not agree there should be separate arrangements for open

schemes, on the grounds that this would “leave the system open to inappropriate gaming and may not effectively protect members’ benefits.”

TPR’s objectives

48. The Pensions Regulator (TPR) is responsible for regulating the funding of DB schemes in line with its objectives under Section 5 of the Pensions Act 2004, which include protecting the benefits of occupational schemes and reducing the risk of calls on the PPF. In her Independent Review of TPR, published on 19 September 2023, Mary Starks concluded that “TPR’s statutory objective to minimise calls on the PPF may drive it to be overly risk averse, particularly given the PPF’s strong funding position.” Sir Steve Webb of Lane Clark and Peacock said that this was understandable and TPR had “behaved rationally,” given the framework that it had been given.

49. We heard calls for TPR’s objectives to change to reflect the changed DB landscape.

Unite the Union said that TPR's objective to protect the PPF had translated into a general pressure to improve funding levels so that in the event of an employer becoming insolvent, the impact on the PPF would be limited.

Excessive prudence in funding and investment had contributed to an increase in the cost of providing DB pensions and contributed to their demise. It wanted to see TPR promote responsible approaches to managing risk, allowing schemes to focus again on the long term, enabling them to ride out short term fluctuations in markets and invest in more return-seeking assets. The PLSA said that in order for open schemes to thrive, "it would be helpful to give TPR a greater focus on member outcomes as a whole [...] including the continuation of affordable, sustainable and attractive future service benefits." The Railway Pension Scheme Trustee Corporation proposed replacing TPR's objective "to protect the benefits under occupational pension schemes of, or in

respect of, members of such schemes” with an objective to explicitly “protect and promote the provision of past and future service benefits under occupational pension schemes of, or in respect of, members of such schemes.” It thought the objective to protect the PPF should be removed. Pension consultancy, WTW, suggested giving TPR an objective that would have the effect of encouraging it to support future build-up of DB pension rights.

50. We asked the then PPF Chief Executive, Oliver Morley, whether the objective was still needed, given that the PPF has £12 billion in reserves. He responded that that objective was “looking a bit anachronistic now, given the scale of the reserves and the funding level.” While it was “not completely true” that the PPF was now safe in all circumstances, it was looking increasingly likely that it was. He thought it would be worth TPR having an objective “specifically around the protection of DB savers.” He said that the PPF had reached

its target of self-sufficiency (where it expects to be able to pay expected claims from its funds without charging a levy on its members) much more quickly than it had expected. TPR CEO Nausicaa Delfas told us that, from TPR's perspective "whether we have that objective or not our focus is on protecting savers' interests." The objective to support the PPF was "helpful" and "important to support [TPR's] moral hazard powers." The Pensions Minister (Paul Maynard MP) said he wanted the PPF to be there to protect members benefits and expected TPR to "have the stability of the PPF very much uppermost in its mind."

51. If TPR had an objective to protect savers' interests rather than the PPF, this would imply a significant cultural shift and a need to invest in new capabilities and capacity. Chief Executive, Nausicaa Delfas, told us that compared to the Financial Conduct Authority, where she had worked previously, the powers available to TPR were "relatively more constrained and specific."

There were restrictions around the information and data it could gather, for example. TPR was discussing this with DWP and she thought there was scope for TPR's powers to evolve in future.

52. TPR's approach to scheme funding has been driven by its objective to protect the PPF. We agree with those who told us that the objective now looks redundant, given the PPF has £12 billion in reserves. Two decades of regulatory policy caution have almost entirely destroyed the UK's DB system. DWP and TPR need to act urgently to ensure they do not inadvertently finish off what few open schemes remain by further increasing the risk aversion, even while the risks of default have reduced substantially. Open and continuing schemes need confidence that the additional flexibilities that have been promised will be reflected in the actual approach regulators take in future. *To signal the change in approach needed for this, the objective to protect the*

PPF should be replaced with a new objective to protect future, as well as past, service benefits. TPR should work with the pensions industry on what the change would mean in practice and what capabilities it will need to deliver on it effectively.

4 Scheme surplus

53. This chapter looks at the two main long-term objectives available to most DB schemes, which are closed and maturing: i) buying out scheme liabilities with an insurance company; or ii) running the scheme on in a position where dependence on the employer for further contributions is low because investments are highly resilient to risk. It looks at how decisions on surplus and, in particular, the debate on whether it should be easier to return surplus to the employer, while protecting scheme benefits.

Choice of long-term objectives

54. In a buy-out arrangement, trustees pay a premium in return for which an insurer guarantees to pay each scheme beneficiary an income for life which exactly matches the benefits they are due. The improvements in scheme funding over 2022 brought this much closer as a viable option for many schemes. In October 2023, Lane, Clark and Peacock (LCP)

estimated that around 20% of DB schemes, with assets of £275 billion, were estimated to be fully funded on a buy-out basis. It projected that demand for buy-out could reach up to £360 billion over the next five years. In April 2023, TPR advised schemes that were funded to buy-out level to consider whether that was the best way to 'lock in' their funding gains, or whether running on the pension scheme was a better option for their members as it offered them potential to benefit from future surpluses.

55. Insurers argued that buy-out remains the 'gold standard': in the best interests of scheme members (securing their benefits) and of sponsoring employers (removing a source of financial risk and allowing them to concentrate on their business). They were sceptical that sponsors of closed and mature schemes would want to reintroduce investment risk and run the scheme on for longer. Yvonne Braun of the Association of British Insurers said that if buy-out was an option it was not in the employer's

interest to re-introduce investment risk and run the scheme on for longer. Some might want to do that but “broadly speaking it does not make a lot of sense.” The Pensions Insurance Corporation challenged assumptions that moving to buy-out meant those funds were essentially lost to the UK economy: insurers had “a proven track record” of investing in new asset classes, providing secure and long-term cashflows to match pension obligations, including “private rental sector, urban regeneration projects, retirement living, and electrified rolling stock.”

56. Pensions industry witnesses told us that most closed DB schemes had been trying to secure their liabilities with insurers. Improvements in funding levels had brought that goal forward and they were looking at how best to secure member benefits. There were a range of ways in which they could do this, including

investing in assets with returns that match the expected pension payments, insurer buy-ins and longevity swaps.

57. We heard from some in the pensions and fund management industries that policymakers needed to take the opportunity to make running on a more attractive option, with potential benefits for employers, scheme members and the UK economy. One argument in support of encouraging more schemes to run-on was that capacity in the buy-out market was constrained, at least in the short-term. For some smaller schemes this meant they were having to work harder to achieve active insurer participation and to get competitive quotes. LDI fund manager, Insight Investment, argued that there was potential for systemic risk associated with the benefits of many pension schemes, backed by different sponsoring employers, moving to a small group of insurance companies. It said this would also lead to increased reliance on the Financial Service Compensation Scheme

(FSCS), which offers protection for pension payments backed by insurers in the event of an insurer default, the potential impact of which needed to be assessed.

58. Insurers told us that the market was dynamic and they did not think there was a capacity issue. However, others pointed to risks associated with too fast an expansion in that market. We heard that, while this was not yet a problem, it should be monitored. In April 2023, the Prudential Regulation Authority, which supervises financial institutions to ensure they operate in a safe and sound way, called on insurers to exercise moderation in the short term and to “scrutinise and take responsibility for their risks.” Insurers said they would “take very careful note” of this advice. Chief Executive, Nausicaa Delfas, acknowledged the importance of TPR having effective market oversight to help enhance the pensions system. It was working

with the Bank of England and Financial Conduct Authority to make sure it had the resources and data for that.

59. Many trustees and scheme sponsors will want to enter an arrangement to buy-out scheme benefits with an insurer and we welcome the security for scheme members this provides. However, not all will be able to do so, at least in the short-term. Well-funded schemes should also be supported to run on as there are potential advantages for scheme members, sponsoring employers and the economy. *As part of its work to take account of financial stability considerations, TPR should monitor trends in demand for buy-out and its alternatives and work with financial regulators to understand the implications.*

Surplus extraction

60. Fiona Frobisher, the then Deputy Director of the Defined Benefit Policy Division, told us DWP

was looking at increasing choice for schemes and wanted to better understand the incentives that drove decision-making. A key proposal to make running a scheme on a more attractive option for employers, was that it should be easier to return surplus in the scheme to them, subject to appropriate safeguards. DWP put out a call for evidence on this in July 2023 and a consultation in February 2024. In Autumn Statement 2023, the Chancellor announced a reduction in the tax charge on surplus repaid to the employer from 35% to 25% from 6 April 2024.

61. The Pension and Lifetime Savings

Association told us that the treatment of a scheme's surplus is usually set out in the scheme's governing provisions (that is the scheme's trust deed and rules) and varies from scheme to scheme. When a scheme is winding up, the rules usually provide for the use of surplus assets at the discretion of the trustees to improve benefits, with any balance thereafter

being returned to the sponsoring employer (although they sometimes provide that any surplus assets should simply be returned to the employer). Currently, schemes are only allowed to distribute surplus to the employer when funding exceeds the level needed to secure a full buy out with an insurer.

Whether it should be easier to extract surplus

62. We heard divergent views on whether surplus extraction should be made easier. One consideration is the very significant amounts that employers have contributed to DB schemes over the years, particularly when deficits were high. The Pension and Lifetime Savings Association made the point that if surplus was trapped in a scheme that had not wound up, this meant that neither employers nor employees could benefit and the aggregate effect was contrary to the Government's desire for more investment in UK productive finance. LCP told

us that many company directors were “frustrated about the perceived ever-increasing prudence and security that is built into the current pension regulatory regime” and “acutely aware of the regulatory asymmetry of being required to fund pension schemes to ‘prudent levels’ (that is, higher than expected to be necessary), but having very limited means to remove any surplus funds.”

63. LCP said there was now an opportunity to allow scheme investments to achieve a greater rate of return, generating scheme surpluses; freeing up assets to invest in priority areas, such as UK infrastructure and the transition to net zero; and providing additional funds to improve member benefits, for example, by paying discretionary increases in periods of high inflation or for transferring to an employer’s DC scheme. Key protections against schemes subsequently falling into deficit would be the requirement for regular prudent actuarial valuations and recovery plans if deficits

emerged. Serkan Bektas of Insight Investment believed there was a “once-in-a generation opportunity” to enhance the role DB schemes play in investing in the UK economy and productive finance. Risk could be contained if schemes backed 100% of their liabilities with high grade assets and gilts. They could then take additional investment risk only with the surplus amount above a set threshold. They could then pursue surplus without putting their members’ benefits at risk and enable them to benefit from a share of the surplus.

64. However, other witnesses stressed the need for caution in considering surplus extraction. The Pensions Insurance Corporation argued for scheme surplus to be “treated as a buffer against future adverse experience” until such time as benefits had been bought out with an insurer. Terry Monk of the Pensions Action Group, which campaigns for compensation for members of DB schemes that have wound up under-funded, said surpluses should “remain

protected in the scheme” as “the past has shown the vulnerability of funding.” Janice Turner of the Association of Member Nominated Trustees said it was important to “exercise caution because we do not know what is around the corner.”

65. Some pension scheme advisers and trustees were sceptical that, in any case, trustees or sponsoring employers would be willing to take additional investment risk. Trustees would fear that risking a deterioration in scheme funding would be in breach of their fiduciary duties and would be looking to “lock in the gains” rather than take additional risk.

Eligibility criteria

66. In November 2023, in its response to the call for evidence on options for DB scheme, DWP said respondents had expressed caution, “frequently expressing concerns regarding the potential for changes in the funding positions of DB schemes and the need for clear regulatory

safeguards around surplus extraction.” It launched a consultation on the treatment of scheme surplus on 23 February 2024. The aims were to support schemes to invest for returns by making it easier to share scheme surplus with employers and scheme members. However, “surplus should only be extracted where safe to do so from a member benefit perspective.” The consultation asked for views on whether there should be a ‘statutory over-ride’, allowing scheme rules to be changed to allow the return of surplus and, if so, whether changing the rules should be at the sole discretion of the trustees, or contingent on an agreement with the sponsoring employer. It asked for views on the eligibility criteria that would need to be met for surplus extraction to be considered. There would need to remain a “very high probability that member benefits will be paid in full” and that this implied that any surplus extraction would “still leave the scheme over 100% funded on a prudent basis.”

67. However, the consultation made clear that the funding level was not the only relevant factor. For example, the level of investment risk and the strength of the sponsoring employer would also have a significant bearing on what level of surplus was ‘safe’ to extract. DWP said there would be “additional guidance for trustees around the considerations required when considering extraction of DB scheme surplus.”

68. In evidence to our inquiry, pensions industry representatives also made the link between governance standards and the plans to support schemes to invest for surplus and share that surplus with employers and scheme members. Steve Hitchiner of the Society of Pension Professions told us that small schemes were unlikely to have the governance structures to run on and it would “impose quite a lot of risk on the sponsor” if they did so. He thought buy-out with an insurance company remained the “gold standard” that most small schemes should continue to target. Dalriada Trustees

suggested that allowing return of surplus direct to sponsoring employer might be more efficient in getting funds into the UK economy than attempting to increase scheme investment in UK productive finance. However, there would need to be experienced risk management within the decision-making trustee body. Adam Saron, co-founder of Clara-Pensions, a pension Superfund, talked about the importance of having the capacity to formulate an investment strategy and the experience and information needed to deliver it, all things that came with scheme consolidation.

69. TPR Chief Executive, Nausicaa Delfas, said that, at the root of the proposal to make surplus extraction easier, was the consideration of how pension assets could be invested in productive finance and the UK economy. For TPR, the key to this was well-run schemes that had the capability and expertise to invest in diverse assets, including productive finance. In its view, the way to achieve this was “a move towards

fewer, larger, well-run schemes.” She added that, both for the regulator and trustees, the priority was to protect savers’ interests.

70. We note the further consultation launched in February on options to support DB schemes. Given that the aim of the funding regime is for schemes to be well-funded when they are significantly mature, some will be in surplus. We agree that if running a scheme on is to be an attractive option, it is important to explore ways in which such surplus could be used to the benefit of the sponsoring employer and scheme members, provided member benefits are protected. However, recent experience has demonstrated the volatility of scheme funding levels and we heard the ‘jury is out’ on the extent funding gains have been ‘locked in’. DWP is consulting on what a ‘safe’ funding level threshold would be. However, it acknowledges that other factors are relevant, such as investment risk and

the strength of the sponsoring employer. These are among the issues on which the trustees would need to take a judgement, before deciding whether surplus extraction is 'safe' in line with their fiduciary duties, so strong governance will also be essential. *DWP should conduct an assessment of the regulatory and governance framework that would be needed to ensure member benefits are safe and take steps to mitigate the risks before proceeding.*

The PPF underpin

71. LCP proposed giving well-funded schemes the option to pay a higher level of PPF levy in return for 100% protection in the event of the employer becoming insolvent. This was to provide trustees with reassurance that member benefits would be protected in the event of employer insolvency.

72. We heard concerns about this proposal. Steve Hitchiner of the Society of Pension

Professionals commented that it could give rise to moral hazard and would be very difficult for the PPF to price. Harus Rai of the Association of Professional Pension Trustees said that trustees had been advised to ignore the existence of the PPF when looking at valuations and investment strategies. He did not think 100% PPF protection would provide them with much comfort as it only applied on insolvency of the employer, which no-one wanted. The then Chief Executive of the PPF, Oliver Morley, said that, while it would be possible to structure the policy to “mitigate some of those risks and make it worthwhile”, it would be complex and seemed to be “quite a complicated hammer to crack a nut.”

73. LCP addressed some of the potential objections to its proposals in supplementary evidence. For example, it said that substantial protections against excessive risk-taking were in the TPR Funding Code and regulations. It thought the additional moral hazard risk of 100% PPF cover was small, because only well-funded

schemes would be able to enter the regime. There were safeguards against excessive risk-taking and potential for “significant benefit to stakeholders and the wider economy.”

74. We remain to be convinced that the PPF underpin would be an effective incentive to trustees to consider increasing their investment risk. *DWP and TPR should consider whether there are changes to the funding regime that could give trustees confidence to take appropriate investment risk.*

Use of surplus

75. TPR’s Interim Director of Regulatory Policy, Louise Davey, explained that “with the distribution of surplus, including payment of discretionary increases, that is largely dictated by what is set out in the individual schemes’ trust deed and rules.” The decision could be solely for the trustee, for the trustee in consultation with the employer, or solely for the

employer. The PLSA told us that in a continuing scheme, the provisions in the trust deed and rules might help to determine what utilisation was appropriate, for example, whether it should be repaid to the employer, used to improve benefits or reduce contributions, or retained in the scheme as a reserve.

76. One of the questions on which we heard evidence was how any surplus should be deployed between employers and scheme members. Investment company and asset manager, Abrdn, argued that it was appropriate for scheme sponsors to expect some refund of surplus after all guaranteed benefits are secured. The Railway Pensions Trustee Corporation noted that there had been “very little discussion of how the improvements in funding levels of DB schemes might benefit members,” particularly important given recent cost of living pressures, and supported consideration of ways to make it easier for schemes to refund or distribute any surplus assets to members.

Janice Turner of the Association of Member Nominated Trustees made the point that it was important to look at the history of a scheme, as in many cases, member contribution rates had gone up over time, and benefits had been reduced. This should be taken into account in decisions on surplus. Steve Hitchiner of the Society of Pension Professionals said there would be interests on both sides, with scheme members looking for benefits to be augmented and employers looking for some return given the risks they had taken in supporting the scheme over time.

77. At wind-up, where return of surplus is allowed, there is some protection for members' rights in the statutory requirements that apply before any surplus can be returned to the employer. These are that: the scheme's liabilities must be fully discharged; any power to augment benefits that exists must have been already exercised, or a decision must have been made not to exercise it; and members

must be given at least three months' notice of the proposal to return the surplus to the sponsoring employer. TPR can take action if an employer has not complied with these requirements. It can also get involved if there is evidence of systemic governance issues within a pension scheme. Scheme members also have the right to complain, first through the scheme's internal disputes process and then to the Pensions Ombudsman, who can look at whether the trustee has followed the correct process in reaching its decision, including taking into account appropriate facts and making a reasonable decision.

Discretionary increases

78. For the scheme members we heard from, a particular concern was whether any scheme surplus would be used to enhance benefits or provide discretionary increases where there was a history of doing so.

79. A statutory requirement to increase pensions in payment in line with prices, subject to a cap, was first introduced under Section 51 of Pensions Act 1995, and applied to rights built up from April 1997. The cap was initially 5% but reduced to 2.5% from 2005. Before 1997, there was no general requirement on DB schemes to increase pensions in payment (except for the requirement to increase the Guaranteed Minimum Pension (GMP) element, which is a requirement for schemes that were contracted out of the State Pension), although it appears many schemes did provide for increases to pre-1997 benefits in their rules, in some cases at the discretion of the trustees. According to the PPF, just over one in five (21%) of DB schemes provide no increases on pre-1997 benefits, around a third (32%) provided fixed increases, just over three in ten (31%) increases in line with inflation but capped, and just under one in ten (9%) uncapped inflation.

80. We heard from pensioner groups concerned at how this discretion was used. The BP Pensioner Group (BPPG) said its scheme rules allowed for increases in line with inflation, capped at 5%. Any increase above that required the consent of the sponsoring employer. The scheme had been closed to new members since 2010 and to future accrual since 2021. The scheme is currently in surplus. However, in 2022 and 2023 pensions had not kept up with inflation. In May 2023, the employer had rejected the recommendation of the trustee to increase the annual pension paid by 9% to (partly) recognise inflationary pressures.

81. The Hewlett Packard Pension Association (HPPA) represents former employees of the Digital Equipment Company Limited (DEC). DEC was acquired by Compaq in 1998, which was then acquired by Hewlett Packard in 2002. They are members of the Digital Pension plan and many have predominantly pre-1997 service. HPPA explained that prior to 2002,

discretionary awards maintained close alignment with RPI inflation but that “since the acquisition by Hewlett Packard in 2002—only three discretionary increases to pre-1997 pensions in payment have been awarded, totalling 5%.” HPPA said this resulted in pensioners “suffering significant financial damage impacting the quality of their lives made worse by the ‘cost of living crisis’ eroding the value of their pensions and buying power even more rapidly.”

82. HPPA was aware of several pensioner groups appealing to their companies and Trustees for better outcomes for pre-97 increases. Its supplementary written evidence included statements from groups associated with other pension schemes—3M UK’s Pension Action Group, Fospen (a pensioners association for members of Foster Wheeler’s Defined Benefits Pension Plan), and the Amex UK Pre-1997 Pensioners Campaign Group—also concerned that scheme members had not received discretionary increases for some years,

resulting in substantial reductions of the real terms value of their pensions. HPPA said it was “difficult to find out the true scale of the problem across the DB landscape” and it called on DWP and TPR to carry out research into practice on discretionary increases. TPR told us that it does not have data on how many schemes had discretion in their rules regarding pre-1997 increases because it does not see individual scheme rules.

83. Some pension scheme members are dependent on discretionary increases to ensure their pension payments keep up with the cost of living. Where these have not been awarded the effect has been, over time, to erode their standard of living. This can be particularly the case for those with rights built up before April 1997, when there was no general requirement to index-link pensions in payment. *TPR should undertake research to find out: how many schemes have provision for discretionary increases*

on pre-1997 benefits within their rules; whether the discretion is for the trustee, sponsoring employer or both; the number of years in which they have paid discretionary increases on pre-1997 rights; and in the years they have not done so, the reasons for this.

Decision-making

84. The pension scheme members we spoke to wanted to see their interests represented in decisions on the scheme, including on discretionary increases and whether to enhance benefits in a continuing scheme or in the buy-out process. Where decisions are for the trustees, there is protection for scheme members in the fiduciary duty to act in the best interests of scheme beneficiaries. In addition, the presence of member-nominated trustees or directors on trustee boards are intended to provide greater member involvement in schemes.

85. The BP Pensioner Group (BPPG) was concerned that the BP scheme was being prepared for buy-out and that any remaining surplus once member benefits had been bought out, would be returned to the employer. It believed this was “in conflict with the interests and rights of scheme members” who would have no opportunity to influence the buy-out process. BPPG co-founder, Nick Coleman, told us he thought that the interests of scheme members and employers had been aligned while the scheme remained open but that this had ceased to be the case once the scheme closed to future accrual. While there had been strong member representation, he felt the trustee board now had more regard to the interests of the sponsoring employer.

86. David Carson of the Hewlett Packard Pension Association (HPPA) said that if members’ voices were to be heard, there needed to be engagement with scheme members to understand their issues. The

HPPA had been set up as a campaign group because members felt there was a gap in this respect. As a solution, it proposed an 'ethical code of practice', designed to ensure greater collaboration between sponsor company executives and pension scheme trustees in determining a funding and investment strategy and policy for the treatment of pensioners dependent on discretionary decisions for their pre-1997 service. It was not calling for statutory indexation requirements to be made retrospective.

87. We asked pension professionals whether they thought the existing framework was sufficient. Harus Rai of the Association of Professional Pension Trustees said that, as part of preparing for buy-out, trustees needed to consider whether to use their discretionary power to enhance scheme benefits. If there had been a history of discretionary increases, they would take account of that. There would be an "active, robust conversation [...] between

trustees and sponsors in terms of making sure that members get the right benefit.” Leonard Bowman of Hymans Robertson said these were difficult discussions. Employers might have been “pumping money in [to the scheme] for 20 years” and finally got to a position of surplus, but at the same time, inflation meant there was the impact on scheme members to consider. He agreed with the BPPG that the dynamic changed once a scheme was closed: instead of a “societal contract between workforce and the company” with a shared interest in the scheme, it became all about securing the benefits. Steve Hitchiner of the Society of Pension Professionals said he had a lot of sympathy for scheme members where there had been a long history of providing discretionary benefits. However, it was also important to respect the financial risks scheme sponsors had been exposed to.

88. Nausicaa Delfas, CEO of TPR, considered that there was no role for TPR to intervene. Discretion was a “matter for the trustees and

the scheme design rather than a regulatory issue.” Interim Director of Regulatory Policy, Louise Davey, told us that “as part of the wider discussion about how surpluses could be used ... there could be merit in exploring whether there could be more standardisation around that.” The Minister for Pensions said the Government did not propose amending the rules surrounding discretionary increases but would seek feedback on how changes to surplus sharing could allow for one-off benefit increases to scheme members. This would “allow the opportunity to share any surplus resources of the scheme between members as well as sponsoring employers.”

89. Improvements in scheme funding have given new prominence to the question of how to treat any surplus in the best interests of scheme beneficiaries. For example, there may be discretion after benefits have been secured on buy-out to enhance benefits before returning any remaining surplus to

the employer. There may be options allowing scheme members and employers to benefit from surplus in a continuing scheme.

Decisions can be for trustees, the employer, or both, in accordance with scheme rules.

We heard from scheme members concerns that their interests would be overlooked in this process. *DWP and TPR should explore ways to ensure that scheme members' reasonable expectations for benefit enhancement are met, particularly where there has been a history of discretionary increases.*

5 Governance

90. In this chapter we look at the role of trustees and their fiduciary duties to act in the best interests of scheme beneficiaries. Trustees play an essential role as the ‘first line of defence’ in managing risk and in some important decisions—for example, increases on pre-1997 benefits and how any surplus should be deployed can be subject to their discretion.

Fiduciary duties

91. In his 2023 Mansion House speech, the Chancellor of the Exchequer said that one of the principles underpinning his plans to increase investment in UK productive finance would be “seeking to secure the best possible outcomes for pension savers, with any changes to investment structures putting their needs first and foremost.” In an accompanying call for evidence on trustee skills, capability and culture, DWP asked whether trustees’ fiduciary

duties were discouraging them from investing in alternative asset classes or seeking the best returns for pension savers.

92. We heard that the decisions taken by trustees needed to be looked at through what TPR required of them. Leonard Bowman of Hymans Robertson said that 20 years ago, given the scale of deficits, it was “quite right and proper that the fundamental focus was making sure that the benefits members were promised were secured, with more money going into the schemes.” While funding levels had since improved, in a “closed (DB) world, you are just trying to get to the end of that journey”, so this issue needed to be “revisited.” Harus Rai of the Association of Professional Pension Trustees (APPT) agreed that trustees had been asked by both DWP and TPR to de-risk as schemes matured and had acted accordingly. Janice Turner of the Association of Member-Nominated Trustees thought the “cautious nature” of decisions was entirely down to the kind of

regulation they had been working through, with pressure from TPR to be “de-risking and then de-risking again.” Steve Hitchiner of the Society of Pension Professionals said risk management by scheme sponsors, required to report pension scheme deficits in their accounts, was also key.

93. We also heard that fiduciary duties were an established and well-understood concept. The Association of Pension Lawyers told us that “the complexity came in terms of then applying the fiduciary duties to specific investment proposals or an investment policy when there is a desire (of the Government or the trustees themselves) to make a particular outcome ‘fit’ within the framework.”

94. Witnesses representing pension schemes, trustees and advisers agreed that any attempt to interfere with fiduciary duties, for example, by mandating investment in particular asset classes, would be undesirable. Instead, the

Government's focus should be on creating the right regulatory environment and incentives for investment in the UK.

95. TPR and Ministers confirmed their view that the interests of scheme members should remain paramount and decisions should be made by trustees in line with their fiduciary duties. Nausicaa Delfas, Chief Executive of TPR, said the prime focus for both the regulator and trustees was to protect savers' interests. The Pensions Minister wanted to equip trustees "to feel more confident to ensure that they are always acting in members' best interests." The Economic Secretary to the Treasury (Bim Afolami MP) said that whether to invest more in productive finance would be a judgement for trustees. In the Budget on 6 March 2024, the Chancellor said the Government wanted "to make it easier for pension funds to invest in UK growth opportunities."

96. We welcome confirmation from TPR and Ministers that the interests of pension savers are paramount and that investment decisions are for trustees in line with their fiduciary duties to act in the best interest of scheme beneficiaries. *The Government should continue to work with the industry to create an environment that supports investment in the UK economy.*

Sole professional trustees

97. There is a statutory requirement to ensure arrangements are in place to enable members to nominate at least one third of the trustees. One of the exemptions from this requirement is where “the sole trustee or all of the trustees are independent within the meaning of section 23(3) of the Pensions Act 1995.” A trustee is independent if they have no interest in the assets of the employer or scheme, and no connection with the employer. Such arrangements are usually under the control of

the scheme's sponsor. In a report published in October 2023, Hymans Robertson said the use of corporate sole trustees had grown by 12% in the last year and was expected to continue growing.

98. The Royal Ordnance Pensioners Association (ROPA) was concerned that the requirement for member-nominated trustees could be circumvented altogether by a decision of the sponsoring employer to replace trustee boards comprising of employer and member-nominated directors with a sole professional trustee. It pointed to the experience of the Royal Ordnance Senior Staff Pension Scheme (ROSSPS), the rules of which “provide for the sponsoring employer to decide unilaterally to replace the trustee board with a sole trustee”, without consultation, giving notice or identifying a reason for the decision. It said the provision was put in scheme rules 40 years ago, apparently to allow the scheme to continue if the board of trustees, which could conceivably be

only two people, was incapacitated. However, the rules did not prescribe the circumstances in which it could be used, allowing it, in ROPA's opinion, to be "summarily implemented by an employer in circumstances for which it was not intended." It questioned whether a sole trustee, appointed directly by the employer, was able to provide robust challenge on that employer's decisions in relation to funding valuations and other areas. ROPA suggested changes to the framework, such as:

- making the decision to appoint a sole trustee one for the existing trustee board rather than the employer; and
- increased transparency for scheme members through the establishment of a formal consultative committee, comprising the sole trustee and elected representatives of the active and/or pensioner members.

99. Hymans Robertson said that “the current arrangements were probably not anticipated when member-nominated trustee legislation was framed.” It considered sole trustee arrangements to be useful in some circumstances but not optimal in all. Similarly, the Association of Professional Pension Trustees (APPT) said that for small schemes a sole or professional trustee might be a proportionate approach to better governance. The APPT has created a Code of Practice setting out how firms, including sole trustee services, must act in terms of independence and conflicts of interest, which it thought should be mandatory.

100. Nausicaa Delfas, CEO of TPR, told us that, although for small schemes, sole trustees could bring professionalism, capability and experience to the running of schemes, the risks were that if there was a sole trustee there was a lack of diversity of thought and possible conflicts of interest if that sole trustee’s firm also provided other services to the scheme, among others.

101. The use of sole trustees is increasing. While they can bring knowledge and expertise, there is the potential for conflicts of interest. We are concerned that employers often have a unilateral power to appoint sole trustees in the place of the existing trustee board, including member nominated trustees. *DWP should introduce measures to improve the accountability of sole trustees and to enable scheme members to be involved in their appointment.*

Trustee knowledge and understanding

102. Sections 247 to 249 of the Pensions Act 2004 require trustees to meet certain standards of knowledge and understanding, relating to pension and trust law; the principles of scheme funding and investment, and the rules of their own scheme. TPR provides a Code of Practice

and guidance, setting out what is required. Its Trustee toolkit also provides an online learning programme.

Mandatory accreditation

103. In its evidence to the inquiry, the Association of Professional Pension Trustees (APPT) said it saw a “wide range of trustee board competencies.” Larger schemes tended to have trustee boards that were “technically competent and able to challenge advisers effectively.” Smaller schemes tended to have “a relatively smaller pool of individuals from which to populate a trustee board” and therefore “tend to rely heavily on their advisers.” There are two accreditation processes—one run by the APPT and another by the Pensions Management Institute—both launched in 2019/20. Harus Rai of the APPT told the Committee that 500 professional trustees had voluntarily become accredited but that this should be mandatory for professional trustees.

104. In its paper on the future of pension trusteeship, the Association of Member-Nominated Trustees (AMNT) called for pension schemes to be required to encourage training and accreditation and for TPR to require pension schemes to confirm that trustees have completed its Trustee toolkit. Janice Turner, representing AMNT, argued that there should be at least one accredited trustee on every board, lay or professional. For lay trustees, there should be provision for that to be paid for, rather than them having to cover the costs themselves.

105. Louise Davey of TPR told the Committee that the regulator was very supportive of accreditation but did not have a legislative commitment to mandate it.

106. In its July 2023 call for evidence on trustee skills, capability and culture, DWP asked for views on whether there should be a register of trustees, requirement for a certain number of trustees on a board to be accredited, and

requirement for professional trustees to be accredited. The majority of respondents to the consultation favoured mandatory accreditation for professional trustees, with a “phased approach to ensure trustees have sufficient time to obtain the knowledge and skills required.”

107. The Minister for Pensions told us that there was a lack of supply of professional trustees. The vision of having one on every board was “quite optimistic at this stage”. As supply increased, the department would probably move towards mandating accreditation. He told us that TPR’s new General Code of Practice, published in March 2023, included an expectation that anyone acting as a professional trustee should be accredited. Mandatory accreditation required legislative changes and was something that would be considered as part of DWP’s wider trustee work. The Department planned to engage with key stakeholders on improving trusteeship, including the barriers to increasing accreditation and how to address them.

108. **Despite strong support from TPR and trustee bodies for accreditation as a way to improve governance standards, they can only encourage it. *DWP should set a date by which it intends to make accreditation mandatory for professional trustees.***

109. **Member-nominated trustees play a vital role in representing the interests of scheme members and providing a link to the workforce. *As part of its planned engagement with stakeholders, DWP should explore ways to support lay trustees with the time and costs needed to become accredited and report the results. It should set out plans for ensuring every trustee board has at least one accredited member, lay or professional and a timetable for achieving that.***

The trustee register and the Trustee toolkit

110. TPR's 2022 Defined Benefit (DB) survey showed that nearly a fifth of DB trustees had never used or were not aware of TPR's codes of practice. Research by TPR in 2019 found that although 42% of trustees had accessed its Trustee toolkit in 2018, one in five trustees thought their trustee board either didn't have the knowledge, or access to the knowledge, needed to run the scheme.

111. Janice Turner of the AMNT told us that having a register of trustees would help improve communication because TPR would then be able to communicate directly with trustees, rather than just "hoping that they see" information. She also thought TPR could require trustees to report annually on whether they had completed the Trustee toolkit. Although it was a requirement for every trustee to complete the

Trustee toolkit within six months of becoming a trustee, she was not aware of it ever having been enforced.

112. Louise Davey of TPR said a register would give TPR better oversight, with the “ability to gather more information, including the level of qualification, experience and many other factors.” The Minister for Pensions told us that DWP would work closely with TPR on developing the trustee register, which would “enable better data analysis and targeted support for the trustees who need it most.”

113. We welcome the introduction of a trustee register as a way to improve TPR oversight of trustees and to communicate directly with them. We also welcome TPR’s decision to update the Trustee toolkit. We recommend that TPR should use the register to report annually on the number of trustees who have completed the toolkit.

Consolidation

114. In a DB scheme, the sponsoring employer is responsible for ensuring that the scheme has enough assets to pay the benefits it has promised. Traditionally, a sponsor that wanted to end its liability for a pension scheme had to enter into a buy-out arrangement, paying a premium to do this. This is one form of consolidation. A pension Superfund is an alternative form. Under this model, the Superfund replaces the sponsoring employer, with additional assets held in reserve (a capital buffer). The capital buffer may be provided by investors seeking profit and a payment from the sponsoring employer ending its liability. As will be discussed in paragraph 120, key differences between pension Superfunds and buy-out relate to how they are regulated and the schemes they are aimed at.

115. Proposals for pension Superfunds have been in development for many years. DWP launched its main consultation on consolidation in December 2018. DWP said it envisaged that Superfunds would be classed as a type of DB occupational pension scheme, with the employer covenant replaced by a capital buffer provided by investors. However, it accepted that Superfunds would have a risk profile that differed from that of traditional DB schemes and, as such, additional safeguards would be needed.

116. In his Mansion House speech in July 2023, the Chancellor of the Exchequer said that the Government would set out “plans on introducing a permanent Superfund regulatory regime to provide sponsoring employers and trustees with a new scaled-up way of managing DB liabilities.” DWP then published its response to the 2018 consultation. It said that for sponsors for whom insurer buy-out was out of reach, Superfunds had the potential to improve the

likelihood of members getting their benefits in full, whilst providing employers with a new, affordable way to manage their legacy pension liabilities. Superfunds were also “ideally placed with the benefits of scale, significant new capital and a well-diversified portfolio to contribute to greater investment in assets that support the UK as a whole.” There would be consultation on regulations, which would set out the detail on issues such as the definition of Superfunds and the parameters for profit taking. The Government was committed “to having a permanent regulated regime, as soon as parliamentary time allows.” However, no legislation for this was announced in the King’s speech.

117. On 10 August 2023, TPR updated its DB Superfund Guidance. It would share any developments and its thinking with DWP to assist with future legislation. On 6 November 2023, the Sears Retail Pension Scheme became the subject of the UK’s first pension

Superfund transaction when it transferred to Clara-Pensions. On 14 March 2024, Clara-Pensions announced its second transaction. Members of the Debenhams Retirement Scheme, which had been in a PPF assessment period, would now transfer to Clara, where they would “receive 100 per cent of their promised pensions in retirement.”

Role in improving governance

118. We heard that Superfunds had an important role to play in improving governance standards. Chief Executive, Nausicaa Delfas told us that TPR was “very supportive of consolidation in schemes,” on the basis that “larger well-run schemes deliver better outcomes for savers.” It typically saw poorer governance standards in smaller schemes, which was also the end of the market that was much harder for it to engage with. Asked what means were available to it to encourage consolidation, TPR acknowledged that the considerations were

less straightforward for DB schemes than they were for DC schemes, where the new the Value for Money framework encouraged schemes to improve or consolidate into a better performing scheme. TPR was working with industry to “help to facilitate appropriate innovation in the interest of savers” and would publish guidance in relation to “different models and consolidation options for DB schemes: these include financial arrangements such as capital backed journey plans, governance arrangements such as master and multi-trusts and Superfunds.”

Concerns

119. Although there was support for commercial Superfunds, we heard that there were detailed issues still to be resolved, to provide confidence that member benefits would be secure. The PLSA said that the industry needed to move beyond the interim regime to a statutory framework. It would be important that this

“ensured at least the same level of protection to scheme members as does the DB funding regime.”

120. The Government expects schemes that are 70 to 90% funded on a buy-out basis to be the most suitable for transfer into a Superfund, as they are less likely to reach buy-out in the foreseeable future. There will be a regulatory gateway to ensure that those who can afford to secure members' benefits with insurers do so. Legislation would ensure they have taken appropriate legal, actuarial, investment and covenant advice. A concern for insurers was the potential for regulatory arbitrage (creating an incentive for schemes that could have achieved the higher standard of financial security represented by buy-out, to transfer instead to a Superfund). Yvonne Braun of the ABI said it would be important to “make sure that there is a very, very clear distinction between what Superfunds can offer and what buy-out insurers can offer.” A lot of that had to

do with the so-called gateway to how schemes access the Superfund. The regulatory regime for insurers was “a great deal more robust” than that currently in place for Superfunds. She said what was needed was “a legislative regime” and answers on TPR’s powers for enforcement, the legislative definition of Superfunds and how the gateway would operate.

121. In its contribution to the 2018 consultation, the Prudential Regulation Authority set out its concerns. It thought that the risk of regulatory arbitrage could be reduced by requiring Superfunds to act as a bridge to buy-out. However, in its 2023 response to the consultation, DWP said it had decided not to require this, on the grounds that it was not a requirement for individual schemes. We wrote to the PRA to ask whether its 2018 concerns had been allayed in the Government’s 2023 proposals. The PRA replied that an alternative way of mitigating the risk of regulatory arbitrage would be “by a robust gateway governing which

schemes may transfer to a Superfund.” It said that DWP had “opted for a gateway approach”, but it did not comment on whether it was sufficiently robust. The Economic Secretary to the Treasury told us that the gateway was “a mechanism that will ensure pension schemes that can afford to secure members’ benefits with insurers do so and are excluded from superfund consolidation.” It would “do this by requiring trustees to have taken appropriate legal, actuarial, investment and covenant advice when determining the suitability of consolidation into a Superfund.” The gateway would “need to provide a balance of scheme member protection and recognition of market dynamics and Government policy.”

122. The PRA also told us that because “economically, Superfunds would be similar to life insurers that write annuities”, TPR would “need to be alert to the same key areas that the PRA considers in its regulation of life insurers: capital, liquidity, governance and

risk management, reporting and disclosure (to facilitate market discipline) and resolvability.”

Nausicaa Delfas told us that TPR had built up its resources to address this.

The need for legislation

123. Chief Executive of Clara-Pensions, Simon True, told us that the guidance had been very helpful, giving it confidence in the long-term future but, ideally, he wanted to see legislation enacted as soon as possible, as clarity about the requirements would give trustees confidence. Luke Webster, Chief Executive of the Pension Superfund, agreed saying it would also give “a lot more confidence to investors and those involved in delivering those proposals.”

Adam Saron, co-founder of Clara-Pensions, told us that there had been some advantages in the delay. Valuable lessons had been learned from operating under an interim regime, so that when the legislation did come it would be right.

124. Despite general agreement that primary legislation was needed to provide a safe and durable framework for Superfunds, and the Chancellor saying in his Mansion House speech that the Government intended to introduce a permanent statutory framework, there was no Pensions Bill in the King's Speech on 7 November 2023 and there was no mention of one in the Autumn Statement.

125. **TPR sees consolidation, including through Superfunds, as one of the main ways to improve governance, providing advantages of scale in terms of investment and governance. The Government committed to legislating for this in Mansion House as did DWP's 2023 response to the consultation on pension Superfunds but there was no Bill in the King's Speech at the start of this parliamentary session. It will be challenging for Superfunds to get off the ground without legislation. *The Government should consult on the detailed proposals***

of the Superfunds legislative framework to protect member benefits and then introduce primary legislation for pension Superfunds as soon as possible.

PPF as public consolidator

126. In its written evidence, the PPF said that while the DB Funding Code would help ensure many bigger schemes were appropriately funded, challenges of a more structural nature remained. These related in particular to smaller schemes and a subset of stressed schemes:

- Small schemes lacked the economies of scale, and so could face greater challenges planning and executing the best possible investment strategies. They also faced barriers to accessing buy-out. The PPF thought there was merit in considering the role consolidation might play for such schemes; and

- Stressed schemes were defined as having a combination of poor funding and weak sponsors. The PPF estimated there were around 240 schemes that were less than 80% funded (on a s179 basis) and had sponsors in levy band 8 or worse (indicating a high risk of making a claim on the PPF). There was a “high risk that they would be unable to reach a secure endgame for their members.” Any solution would likely require compromises, including potentially on member benefits, but the alternative was to wait until, in all likelihood, they eventually claimed on the PPF.

127. In its July 2023 Call for Evidence on DB schemes, DWP asked a range of questions about a potential role for the PPF in consolidation, including: what are the potential risks and benefits of the PPF acting as a consolidator for some schemes; and 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.

128. The PPF told us it could help to provide scale and address the needs of schemes that were not attractive to commercial consolidators. This would have the advantage of removing them from the balance sheet of the sponsoring employer and allowing the schemes access to a longer time horizon, scale and professional management, letting them “lose governance cost and invest in diversified asset pools that should give them better outcomes.” The PPF argued that they had a strong track record of delivering against their current remit, having transferred 1,000 schemes into the PPF and a further 1,000 into the Financial Assistance Scheme. They did not want to encroach on areas where there was no market dysfunction.

129. Witnesses told us that there were key questions to address with PPF's proposal, including:

- *Winners and losers:* Neil Walsh of the trade union, Prospect, said its members would want to understand the impact on them, how their outcomes might be protected or improved and how it would work in practice. Harus Rai of the Association of Professional Pension Trustees said trustees would need to consider carefully what they were signing up to for their members.
- *Who would underwrite the risk* (particularly if the aim was to invest in riskier assets): Then CEO Oliver Morley told us that “within a very large-scale, diverse portfolio, there would be more opportunity for productive finance without increasing the overall risk of that portfolio considerably.” However, there was still a question as to whether the

taxpayer or the PPF levy payer would be 'on the hook' if something went wrong. We heard from Steve Hitchiner of the Society of Pension Professionals, for example, that it would be important to keep any role as consolidator separate from the existing compensation scheme because that had been funded by levies paid for a specific purpose. Fiona Frobisher, the then Deputy Director of DB policy at DWP, told us that current PPF levy payers would be completely ringfenced from any consolidator.

- *Whether there was evidence of market dysfunction to justify an intervention of this sort:* Steve Hitchiner said the case had not yet been made as small schemes could access the buy-out market as long as they were well prepared. There was also a risk of creating moral hazard if small schemes could access a public consolidator free of charge. In addition,

if a scheme was consolidated into the PPF, there was a question of who would pay to top up any underfunding in the scheme and to sort out all the data and documentation. Conversely, Janice Turner said the Association of Member Nominated Trustees was supportive of having a not-for-profit consolidator.

- *The changes that would be needed to PPF's systems, capabilities and ways of working:* Joe Dabrowski of the PLSA said that the “PPF does not have direct experience in paying scheme benefits—its experience, and systems are set up to pay PPF compensation, which is, by design, a much simpler version of the typical benefit structure of a DB scheme—which may have dozens of variations due to rule changes over decades, scheme mergers and in some cases will contain specialised member protections.”

DWP launched a consultation on 23 February which asked for views on the model for a public consolidator.

130. There may be a good case for a public consolidator. However, there are complex issues to address, particularly in relation to who would underwrite the risk, the impact on member benefits and how its introduction would be justified. *In response to this report, the Government should explain whether the core aim of a public consolidator is to rescue stressed schemes likely to enter the PPF in any case, or is it for small schemes who may face challenges accessing the buy-out market.*

Conclusion

131. Given the improvements in scheme funding, trustees must ensure they secure benefits for members, be that through consolidation, buy-out or letting schemes run on. TPR should be proactive in

encouraging trustees to assess the potential costs and benefits of different options rather than assuming this assessment is taking place. *TPR should consider requiring schemes to set out why they have pursued a particular approach and why it is in the best interests of scheme members.*

6 Pension Protection Fund and Financial Assistance Scheme

132. This chapter looks at what an improved funding position means for occupational pension schemes and PPF and FAS members.

The role of the PPF

133. The Pension Protection Fund (PPF) was set up under the Pensions Act 2004 to pay compensation to members of defined benefit pension schemes where an employer has become insolvent, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation. The PPF commenced operations on 6 April 2005 and applies to schemes whose sponsoring employer became insolvent after that date. In 2022–23, it had 295,528 members—193,218 with pensions in payment and 102,310 deferred members. The PPF is funded by a combination of an annual levy on eligible schemes, the assets of schemes transferred to it, investment returns on those

assets and recoveries of money from those schemes' insolvent employers. As of 31 March 2023, the PPF had:

- total consolidated reserves of £12.1 billion, an increase of £0.4 billion from 2022; and
- a funding ratio of 156%, an increase of 18.1% year-on-year.

Further, its modelling suggests that in the majority of scenarios, DB funding should continue to improve over time. It set itself a target to become self-sufficient by 2030 (meaning its funds would be sufficient to pay compensation to members and protect against future risks) but as we explained earlier had reached this more quickly than expected and was now looking at long-term sustainability. Its then CEO, Oliver Morley, told us that potential claims were still out there but “looking less likely.” While it was “not completely true that the PPF is safe under all circumstances [...] it is looking much more likely that we are.”

The PPF levy

134. One of the key funding elements in the early years of the PPF was the levy on eligible schemes. The levy has two components: a scheme-based levy, based on a scheme's liabilities to members; and a risk-based levy, assessed according to the sponsoring employer's insolvency risk and the scheme's underfunding risk. Under the Pensions Act 2004, the risk-based levy must make up at least 80% of the annual levy total and the levy cannot increase by more than 25% year-on-year. The improvement in outlook had allowed the PPF to significantly reduce the levy in recent years.

135. The Railway Pension Scheme Trustee Corporation told us that the Railway Pension Schemes had paid levies to the PPF of around £600 million since the PPF was established, equivalent to over £1,700 for each of the 350,000 current members. The nature of the levy calculation meant that, over time,

the proportion paid by open schemes would increase. Given the improved outlook for the PPF, it “strongly [believed] that the PPF should not currently need to receive a levy from schemes.”

136. The PPF warned in its September 2022 consultation that larger schemes might be required to pay higher levies. The USS, another large open DB scheme, said that while it posed a minimal risk to the PPF, the levies it had already paid were significant. It commented that “larger schemes will have already made the largest contribution to the PPF’s current reserves and given their circumstances are very unlikely to need to call on the PPF in future.”

137. The PPF is now entering a new phase of its funding journey—its ‘maturing’ phase—where its focus will “increasingly shift from building to maintaining [its] financial resilience.” It concluded that it could now actively reduce the levy without risking the long-term security of member

benefits. Oliver Morley told us that it had made “very significant strides in reducing” the levy in stages, from £620 million (2020–21) to £100 million (2024–25). He said that if PPF had the right legislative framework, which allowed it to put up the levy again if needed, then it would be able to reduce the levy to zero over time.

138. The 2022 Departmental Review recommended that DWP and PPF work together to ensure that changes be made to allow the PPF to reduce the levy and then reintroduce or raise it again if needed. The Pensions Minister told us that he was “well aware of the PPF’s requirement around the levy.” He wanted to address it and was keen to have a Pensions Bill as soon as possible.

139. ***The Government should find an early legislative opportunity to give the PPF more flexibility in how it sets the levy, allowing it to reduce it to zero and then increase it again if necessary.***

The PPF's reserves

140. A further question is what should happen with the £12bn in PPF reserves. The 2022 Departmental Review identified a “risk that the PPF may find itself with more money than it ultimately needs in future” and recommended that DWP and the PPF plan ahead for any legislative changes that might be needed; for example, to address what happens to any funding which is surplus to requirements.

141. We heard that there was a case for distributing a proportion of the PPF's reserves to scheme members and to sponsoring employers—an issue we cover in more detail later in this chapter. The Pension and Lifetime Savings Association called for the industry to be engaged in discussions on the best course of action, given that “a significant part” of the PPF's funding had come from DB schemes and sponsoring employers. The trade union, Prospect, said that unlike levy payers, who had seen their levy reduced, PPF members had not benefitted from the improved funding levels. It said there was a “strong case” “for immediate improvements in compensation to reflect the improved funding position.” Oliver Morley thought decisions should be made by the Government, taking account of the wider considerations, including the treatment of the reserves in Government accounts.

142. **We applaud the fact that the PPF is now reasonably confident that it has the**

funds it needs to meet potential claims on it. This is a significant achievement. There is now an opportunity to consider how the £12 billion in PPF reserves can be used to the benefit of PPF levy payers and scheme members. For scheme members, the priority is indexation on pre-1997 rights. *DWP should bring forward its promised consultation on levy changes and PPF compensation levels without delay.*

PPF compensation

143. The PPF provides two levels of compensation: 100% to people who have reached pension age or were in receipt of an ill health or survivor's pension at the time the scheme entered a PPF assessment period and, in other cases, 90%. Previously, the 90% was subject to a cap, but this was ruled unlawful on grounds of age discrimination by the Court of Appeal in July 2021.

Indexation rules

144. There are other ways in which PPF compensation does not necessarily match what individuals would have got from their pension scheme had it not wound up. In particular, indexation is provided in line with inflation, capped at 2.5%, but only on rights built up from April 1997. Court rulings have set minimum levels on compensation paid from the PPF. In September 2018, the Court of Justice of the European Union (CJEU) ruled in the case of Hampshire v PPF that compensation was subject to a minimum level of 50% of the value of accrued old age pension in the former scheme. The PPF said the vast majority of PPF members already received compensation in excess of 50% of their accrued old age benefits and made plans to meet the requirements for those who did not.

145. We heard calls for improvements in PPF compensation levels, with a consensus

that the priority was a change to the rules which provided no indexation on rights built up before 1997.

146. The original policy justification was that the PPF should not provide more generous benefits than pension schemes themselves (not all of which provide indexation on pre-1997 benefits). The then Government said that the decision was the result of “hard choices.” Trade-offs had to be made between compensation levels, indexation rates and the amount of the PPF levy eligible schemes would have to pay. The Government had to get the “right balance between the employers’ responsibilities and levies and contributions and what pensioners can reasonably expect.”

147. The Deprived Pensioners Association, a group set up to bring about a change in the pre-1997 non-indexation rule, described it as “unjust and unfair” and discriminatory against those who “received no indexation at all on the PPF

compensation at a time when inflation [was] running at 10%.” Roger Sainsbury, a member of the group, described the rule as “definitely age discriminatory” and “very damaging to members of the Pension Protection Fund.” He had yet to hear “anybody tell me of one single merit that this clause delivers.”

148. The trade union, Prospect, questioned the Government’s justification on the grounds that the majority of schemes provided indexation on pre-1997 benefits voluntarily. According to the 2023 Purple Book, more than three quarters of schemes do this. Prospect argued that the freezing of compensation had had a devastating impact on scheme members over time. A related issue was that the PPF has discretion to increase compensation in respect of post-1997 rights above the current 2.5% cap but had not used it. However, Prospect agreed with other witnesses that “the lack of indexation in relation to compensation for benefits accrued before 1997 has to be the priority.” About 80,000

PPF members received no compensation increases and “at a time of a cost of living crisis, to have such a large element of their income frozen is terrible for them.” He thought the PPF should have done more to point out to the then Government the impact of this provision on members in line with its duty of care to PPF members. It had resulted in a 50% drop in purchasing power since 2006.

149. The rules could be changed in different ways: indexation could be provided only for those whose schemes would have provided for it; it could be provided for the future only for all members; or it could be made retrospective for all PPF members. Roger Sainsbury thought people should “get what they paid for”—saying that “commitments that had been made should be met”. As to whether indexation should only be paid in future or retrospectively, he said the PPF would need to “make a decision as to whether they are really, fully recognising the damage made, or only partially doing so.” Neil

Walsh of Prospect said that “everybody in the PPF or FAS is suffering greatly [...] Whether their original rules provided for some minimum indexation, or not, they are still suffering and I think there is a strong case to be made for doing something for them.” He argued that action was needed urgently, given the age of those affected.

150. The PPF provided estimated costings of a range of changes to compensation and indexation as at 31 March 2023. These show, for example, that indexing pre-1997 benefits, for the future, in line with the CPI subject to a cap of 2.5%, would increase the PPF’s liabilities by £2.6 billion, and reduce its funding level by 17 percentage points (from 156% to 139%). Making this change only where scheme rules provided for it, would result in an increase in the PPF’s liabilities of £2 billion and reduce its funding level by 13 percentage points to 143%. Oliver Morley, the then Chief Executive of the PPF, said the PPF had made representations to those

in Government. While he thought the decision was one for politicians, he said there was “a good case on equity grounds” for changing the rules on pre-1997 indexation. In its February 2024 consultation on options for DB schemes, the Government said it would be “consulting in the coming months on levy changes, and PPF compensation levels.”

151. Non-indexation of pre-1997 benefits has had a significant impact on PPF members and disproportionately on older members and women, reducing the value of their compensation in real terms. Given the £12 billion in PPF reserves, the potential impact on levy payers is no justification for continuing this policy. We welcome the fact that the Government will be consulting on levy changes and PPF compensation levels. *It should legislate to provide indexation on compensation in respect of pre-1997 rights where scheme rules provided for that. It should work with the PPF to consider other*

changes to compensation—such as raising the cap on indexation of post-1997 benefits above 2.5%—as part of its forthcoming consultation on levy changes and PPF compensation levels.

The Financial Assistance Scheme

Background

152. The Financial Assistance Scheme (FAS) was set up under the Pensions Act 2004 to provide compensation to members of occupational pension schemes that wound up underfunded between 1 January 1997 and 6 April 2005 (and so were not eligible for the PPF). It now has some 142,127 FAS members, of which 84,176 are receiving payments and 57,951 are deferred members.

153. The FAS has been the focus of a long campaign, by the Pensions Action Group (PAG) and others, to bring its compensation at least into line with that of the PPF. The

PAG was formed in 2003, following the collapse of the Allied Steel and Wire (ASW) pension scheme, which “left thousands of workers without employment or their promised occupational pension.” They were not covered by the PPF. Provision was made for a separate compensation scheme, the Financial Assistance Scheme, in an amendment to the Pensions Bill 2003–04 at Report Stage in the Commons.

154. In its original form the FAS only covered those members of qualifying pension schemes closest to retirement age and provided compensation of up to 80 per cent of “expected core pension,” subject to a cap of £12,000 per year. A long campaign followed, led by Baroness Altmann and the Pensions Action Group. A key development was a report by the Parliamentary and Health Service Ombudsman (PHSO) in March 2006, which found maladministration, in the form of “misleading information” by the Government, that had led scheme members to the “belief their pensions were entirely safe”

when they were not. The PHSO recommended that the Government should consider whether to restore full pensions to those affected. Increases to FAS compensation were then announced in three stages. The Government said that the third, which was announced in December 2007, resulted in FAS assistance being “broadly comparable to compensation paid under the PPF.” The FAS now provided all members with compensation equal to a maximum of 90% of their expected pension, subject to a cap (£41,818 in 2023/24).

155. FAS members have benefitted from only some of the gains PPF members have seen as a result of court judgments. The CJEU ruling in Hampshire (see paragraph 144 for a summary of the case) applied to FAS members, although unlike PPF members, they received no interest on arrears. The Hughes ruling (which removed the compensation cap from the PPF) did not apply to the FAS. And 41,000 workers from solvent company schemes were excluded.

A member of the Pensions Action Group, Terry Monk, described the FAS as, increasingly, the PPF's "poor relation."

156. Like the Deprived Pensioners' Association and Prospect, the Pensions Action Group said that indexation on pre-1997 benefits is its priority. Most FAS members have the majority of their service before 1997 and most were in schemes that provided for indexation of between 3 and 5% on all members' pensionable service. Non-indexation of benefits before April 1997 means the average FAS award (£2,700) is progressively lower than the amount expected from the original pension schemes. Terry Monk said: "people should get what they paid for—end of story. If people paid for it, they should get it." Richard Nicholl of the Pensions Action Group said "people paid extra effectively, for full indexation ... it is only fair that it goes to those who have paid for it."

157. We have written to Ministers over the years questioning the difference in treatment of FAS and PPF members. A reason given by the Government in response is that “the FAS is funded by the taxpayer, so we must strike a balance between protecting members’ interests and managing public money.” The Pensions Action Group pointed out that in 2007, the remaining assets in FAS schemes were transferred to the Government. The Young Review said there were two alternative approaches: a fund-based model, like the PPF; or the Government taking the residual scheme assets and paying the entire FAS assistance. However, the Government did not agree that taking on investment risk represented value for money. In December 2007, the Government announced that it would absorb the residual FAS assets, and match the extra value identified by the Young Review, with the goal of moving towards 90% assistance.

158. In recent correspondence, Ministers have argued that the Government has made provision for FAS liabilities in excess of the value of the assets transferred and that the assets were not ringfenced for the purpose of FAS payments. The Pensions Action Group said that the “strong performance and success of the PPF investment and management team” should provide scope for the PAG’s recommendations to be implemented. Further, it advocated that it would be the moral thing to do, in line with the recommendations of the PHSO and court judgments. It called for a full review of the FAS, which given the age of FAS members would need to be “swiftly conducted, reported and acted on.”

159. The PPF provided us with estimates of the cost of changing the pension increases on FAS assistance. It told us, for example, that providing indexation on pre-1997 benefits at 2.5%, subject to a cap, would cost £5m in year

one, rising to £17m in year 5: a total of £57 million in years 1 to 5, and £122 million in years 6 to 10.

160. We wrote to the Minister for Pensions asking him to meet the Pensions Action Group and were very pleased that he did so. He told us that he was reflecting on what he had heard and had commissioned “quite an extensive piece of work” on the issue from officials. In response to a PQ, the Minister said he would not publish this advice. DWP would “continue to consider this issue, determining the scope and time required for full consideration. The Minister told us that he saw FAS and the PPF as “interlinked in terms of the subject matter and the interplay between them ... I do not think I can look at one without looking at the other.”

161. **Financial Assistance Scheme (FAS) members are likely to have more of their service before 1997, so are particularly likely to be affected by non-indexation of**

pre-1997 benefits. Any improvements for PPF members should also apply to FAS members. *Given the age of many FAS members, the Government should legislate as a matter of urgency to provide indexation on FAS compensation for pre-1997 rights, where their schemes provided for this, funded by the taxpayer. The Government should review the Financial Assistance Scheme, including looking at the case for removing other discrepancies in FAS compensation, compared to the PPF, such as the continued application of the compensation cap and lack of interest on arrears.*

Atomic Energy Agency Technology (AEAT) pensions

162. Non-indexation of pre-1997 benefits was an issue that had affected members of the AEAT pension scheme when it entered the Pension Protection Fund. They had chosen to

transfer into that scheme from their existing public service pension scheme. They had been provided with information to support that decision, including by the Government Actuary's Department. In a report in June 2023, the Public Accounts Committee (PAC) said the Atomic Energy Agency Technology (AEAT) pension case had highlighted "gaps in the routes of appeal available for people raising complaints about their pensions, and is another case of government not giving people enough time or support to make complex financial decisions."

163. The PAC concluded that people who transferred their accrued pension benefits to AEAT on privatisation had done so based on "incomplete information from government" and had "ended up losing money as a result". The information provided—including the note from the Government Actuary's Department (GAD) which was intended to outline main factors to consider—did not make it clear that the AEAT scheme, as a private sector DB scheme, offered

less security than staying in their existing public sector scheme. Nearly 90% transferred to the new scheme.

164. When AEAT went into administration in 2012 and the scheme entered the PPF, scheme members lost money in real terms, in particular because of the indexation rules. The PAC said that the Government had not commissioned any independent review into the complaints by scheme members and “all the relevant ombudsman services have said they cannot investigate the information government provided in 1996.” We wrote to the then Minister for Pensions in September 2023, asking her to support the recommendation of the Public Accounts Committee that “the Government should ensure that members’ complaints about the AEAT pension case can be independently reviewed, for example by a relevant ombudsman.” In response, the current Minister said that a forthcoming independent review of The Pensions Ombudsman provided an

opportunity to look at this recommendation. He was engaging with other Departments in relation to wider ombudsmen powers. The Minister also said that the Government accepted the PAC's recommendations in principle. DWP officials were talking to those in the Cabinet Office on "how to ensure people have adequate means of redress." He was aware "how important ombudsmen are for a sense of justice and fairness, but also how infernally complex they seem to be." He confirmed that the specific case of the AEAT pension scheme would be part of the discussions.

165. We support the recommendation of the Public Accounts Committee that the Government should "ensure that members' complaints about the AEAT pension case can be independently reviewed, for example by a relevant ombudsman." We agree with the Pensions Minister that it is important for a sense of justice and fairness that people should have an adequate means of redress.

The Government should report back to us by the summer recess on how it intends to ensure an adequate means of redress for AEAT pension scheme members.

7 Conclusion

166. Effectively functioning DB pensions can support the UK economy, and importantly can ensure that people have adequate savings for retirement and receive the pension they have saved for. Improved funding for the majority of defined benefit schemes compared to the mid-2010s, when most were in deficit, presents new opportunities, but also new challenges. In this Report we have made a number of recommendations for how the Government and TPR might respond to this new world. Fundamental to the success of the various measures we have proposed will be good governance and an appropriate funding code. We look forward to receiving the Government and TPR's responses to our proposals.

Annex: Glossary

Technical provisions—The liabilities of the scheme calculated using assumptions set by the trustees, following actuarial advice. The assumptions used are scheme specific but have to be “prudent”. Technical provisions valuations are required by legislation (Pensions Act 2004) and need to be undertaken at least every three years. Technical provisions liabilities are used to calculate the deficit for determining whether a recovery plan needs to be prepared.

Buy-out—A buy-out transaction is one where the liabilities of the scheme are transferred to an insurance company for a lump sum premium. The cost of buy-out is not known until the actual transaction is completed. However, there is a requirement for the Scheme Actuary to provide an estimate of the cost of buy-out as part of the valuation process. Generally, buy-out

is the most prudent basis, given that insurance companies need a reserve in line with Solvency II regulations.

Low dependency—This basis was proposed as part of the *draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024*. This is a set of assumptions that once a scheme is fully funded on this basis, in combination with a low dependency investment strategy there is minimal reliance on the employer covenant to provide further support.

Hedging—A strategy aimed at ensuring that the value of assets move in the same way as the value of liabilities. The main focus is hedging the interest rate risks (that is the gilt curve) but some schemes hedge other factors such as longevity. Different schemes hedge different levels of assets and liabilities and the basis they

are trying to hedge against, as it is not the case that all funding bases will move in the same way or to the same degree.

Funding level—The value of assets as a proportion of the value of liabilities.

Fully funded—When the assets of the scheme are equal in value to or greater than the liabilities of the scheme.

Under-funded—When the value of the assets of the scheme are less than the value of its liabilities.

Deficit—A scheme is in deficit when it is underfunded

Surplus—A scheme is in surplus when its funding level is more than 100%.

Employer covenant—The willingness and capacity of the sponsoring employer to support a pension scheme.

Conclusions and recommendations

The current funding position

1. We welcome that scheme funding has improved substantially since the mid-2010s. However, the PPF and the ONS have produced different estimates of the extent to which the value of the assets in DB schemes reduced over 2022. The PPF acknowledges that its figures do not fully reflect the effects of market disruption during the LDI episode. It is important to have as accurate a picture of funding as possible. *The Pensions Regulator and the Pension Protection Fund should continue to work with the Office for National Statistics to reach an understanding of the funding position of DB schemes and publish the results.* (Paragraph 19)
2. There is sufficient evidence of improvement in the funding position of DB schemes to justify a new policy approach. However, it is imperative that there is no return to a

world of deficits. Policy changes therefore need careful thought so that they grasp the opportunities offered by improved funding levels, while being agile enough to respond to future challenges. One of the opportunities is to support DB schemes to remain an active feature of the pensions landscape, helping to deliver adequate retirement incomes. *The Government should set out how it plans to promote retirement income adequacy in the future and the role it sees DB schemes, particularly open schemes, playing in this.* (Paragraph 22)

The scheme funding regime

3. Plans for the new DB funding regime were forged in a different era when the vast majority of DB schemes were in deficit and amidst concern that employers were seeking to evade their responsibility to underfunded schemes. Despite significant changes since then—improved funding levels and

what these mean for future policy—the fundamental principles underpinning the new regime are unchanged: schemes are expected to target a position of low dependency at the point of significant maturity. While we welcome the changes made by DWP and TPR to allow more flexibility in the investment approach, it is unclear what the overall effect will be. Schemes have not yet seen the final version of TPR’s Funding Code. It is unfortunate that Parliament has been asked to vote on the Regulations before this was published and stakeholders have had the opportunity to evaluate and comment on the full picture. *In future, DWP should commit to ensuring that Parliament has the material details it needs to make an informed judgement on the legislation it is being asked to vote on.* (Paragraph 35)

4. Open DB schemes help meet two important objectives: providing adequate incomes in

retirement and investing in UK productive finance as they have greater capacity for this than closed schemes. Those responsible for running DB schemes have long expressed concerns that the Funding Code would force them to de-risk unnecessarily, increasing the costs to employers and resulting in their premature closure. *While we welcome the additional flexibility in the revised Funding Regulations, it is essential that DWP and TPR work with open schemes to address the remaining concerns—particularly around the employer covenant horizon—and report back to us on how they have done so before the new Funding Code is laid before Parliament.* (Paragraph 45)

5. TPR's approach to scheme funding has been driven by its objective to protect the PPF. We agree with those who told us that the objective now looks redundant, given the PPF has £12 billion in reserves. Two decades of regulatory policy caution have

almost entirely destroyed the UK's DB system. DWP and TPR need to act urgently to ensure they do not inadvertently finish off what few open schemes remain by further increasing the risk aversion, even while the risks of default have reduced substantially. Open and continuing schemes need confidence that the additional flexibilities that have been promised will be reflected in the actual approach regulators take in future. *To signal the change in approach needed for this, the objective to protect the PPF should be replaced with a new objective to protect future, as well as past, service benefits. TPR should work with the pensions industry on what the change would mean in practice and what capabilities it will need to deliver on it effectively.* (Paragraph 52)

Scheme surplus

6. Many trustees and scheme sponsors will want to enter an arrangement to buy-out

scheme benefits with an insurer and we welcome the security for scheme members this provides. However, not all will be able to do so, at least in the short-term. Well-funded schemes should also be supported to run on as there are potential advantages for scheme members, sponsoring employers and the economy. *As part of its work to take account of financial stability considerations, TPR should monitor trends in demand for buy-out and its alternatives and work with financial regulators to understand the implications.* (Paragraph 59)

7. We note the further consultation launched in February on options to support DB schemes. Given that the aim of the funding regime is for schemes to be well-funded when they are significantly mature, some will be in surplus. We agree that if running a scheme on is to be an attractive option, it is important to explore ways in which such surplus could be used to the benefit

of the sponsoring employer and scheme members, provided member benefits are protected. However, recent experience has demonstrated the volatility of scheme funding levels and we heard the ‘jury is out’ on the extent funding gains have been ‘locked in’. DWP is consulting on what a ‘safe’ funding level threshold would be. However, it acknowledges that other factors are relevant, such as investment risk and the strength of the sponsoring employer. These are among the issues on which the trustees would need to take a judgement, before deciding whether surplus extraction is ‘safe’ in line with their fiduciary duties, so strong governance will also be essential. *DWP should conduct an assessment of the regulatory and governance framework that would be needed to ensure member benefits are safe and take steps to mitigate the risks before proceeding.* (Paragraph 70)

8. We remain to be convinced that the PPF underpin would be an effective incentive to trustees to consider increasing their investment risk. *DWP and TPR should consider whether there are changes to the funding regime that could give trustees confidence to take appropriate investment risk.* (Paragraph 74)
9. Some pension scheme members are dependent on discretionary increases to ensure their pension payments keep up with the cost of living. Where these have not been awarded the effect has been, over time, to erode their standard of living. This can be particularly the case for those with rights built up before April 1997, when there was no general requirement to index-link pensions in payment. *TPR should undertake research to find out: how many schemes have provision for discretionary increases on pre-1997 benefits within their rules; whether the discretion is for the trustee, sponsoring*

employer or both; the number of years in which they have paid discretionary increases on pre-1997 rights; and in the years they have not done so, the reasons for this.

(Paragraph 83)

10. Improvements in scheme funding have given new prominence to the question of how to treat any surplus in the best interests of scheme beneficiaries. For example, there may be discretion after benefits have been secured on buy-out to enhance benefits before returning any remaining surplus to the employer. There may be options allowing scheme members and employers to benefit from surplus in a continuing scheme. Decisions can be for trustees, the employer, or both, in accordance with scheme rules. We heard from scheme members concerns that their interests would be overlooked in this process. *DWP and TPR should explore ways to ensure that scheme members' reasonable expectations for benefit*

enhancement are met, particularly where there has been a history of discretionary increases. (Paragraph 89)

Governance

11. We welcome confirmation from TPR and Ministers that the interests of pension savers are paramount and that investment decisions are for trustees in line with their fiduciary duties to act in the best interest of scheme beneficiaries. *The Government should continue to work with the industry to create an environment that supports investment in the UK economy. (Paragraph 96)*
12. The use of sole trustees is increasing. While they can bring knowledge and expertise, there is the potential for conflicts of interest. We are concerned that employers often have a unilateral power to appoint sole trustees in the place of the existing trustee board, including member nominated trustees. *DWP should introduce measures to improve the*

accountability of sole trustees and to enable scheme members to be involved in their appointment. (Paragraph 101)

13. Despite strong support from TPR and trustee bodies for accreditation as a way to improve governance standards, they can only encourage it. *DWP should set a date by which it intends to make accreditation mandatory for professional trustees.*
(Paragraph 108)

14. Member-nominated trustees play a vital role in representing the interests of scheme members and providing a link to the workforce. *As part of its planned engagement with stakeholders, DWP should explore ways to support lay trustees with the time and costs needed to become accredited and report the results. It should set out plans for ensuring every trustee board has*

at least one accredited member, lay or professional and a timetable for achieving that. (Paragraph 109)

15. We welcome the introduction of a trustee register as a way to improve TPR oversight of trustees and to communicate directly with them. We also welcome TPR's decision to update the Trustee toolkit. *We recommend that TPR should use the register to report annually on the number of trustees who have completed the toolkit.* (Paragraph 113)

16. TPR sees consolidation, including through Superfunds, as one of the main ways to improve governance, providing advantages of scale in terms of investment and governance. The Government committed to legislating for this in Mansion House as did DWP's 2023 response to the consultation on pension Superfunds but there was no Bill in the King's Speech at the start of this parliamentary session. It will be challenging for Superfunds

to get off the ground without legislation. *The Government should consult on the detailed proposals of the Superfunds legislative framework to protect member benefits and then introduce primary legislation for pension Superfunds as soon as possible.* (Paragraph 125)

17. There may be a good case for a public consolidator. However, there are complex issues to address, particularly in relation to who would underwrite the risk, the impact on member benefits and how its introduction would be justified. *In response to this report, the Government should explain whether the core aim of a public consolidator is to rescue stressed schemes likely to enter the PPF in any case, or is it for small schemes who may face challenges accessing the buy-out market.* (Paragraph 130)

18. Given the improvements in scheme funding, trustees must ensure they secure benefits

for members, be that through consolidation, buy-out or letting schemes run on. TPR should be proactive in encouraging trustees to assess the potential costs and benefits of different options rather than assuming this assessment is taking place. *TPR should consider requiring schemes to set out why they have pursued a particular approach and why it is in the best interests of scheme members.* (Paragraph 131)

Pension Protection Fund and Financial Assistance Scheme

19. *The Government should find an early legislative opportunity to give the PPF more flexibility in how it sets the levy, allowing it to reduce it to zero and then increase it again if necessary.* (Paragraph 139)
20. We applaud the fact that the PPF is now reasonably confident that it has the funds it needs to meet potential claims on it. This is a significant achievement. There is now

an opportunity to consider how the £12 billion in PPF reserves can be used to the benefit of PPF levy payers and scheme members. For scheme members, the priority is indexation on pre-1997 rights. *DWP should bring forward its promised consultation on levy changes and PPF compensation levels without delay.* (Paragraph 142)

21. Non-indexation of pre-1997 benefits has had a significant impact on PPF members and disproportionately on older members and women, reducing the value of their compensation in real terms. Given the £12 billion in PPF reserves, the potential impact on levy payers is no justification for continuing this policy. We welcome the fact that the Government will be consulting on levy changes and PPF compensation levels. *It should legislate to provide indexation on compensation in respect of pre-1997 rights where scheme rules provided for that. It should work with the PPF to consider other*

changes to compensation—such as raising the cap on indexation of post-1997 benefits above 2.5%—as part of its forthcoming consultation on levy changes and PPF compensation levels. (Paragraph 151)

22. Financial Assistance Scheme (FAS)

members are likely to have more of their service before 1997, so are particularly likely to be affected by non-indexation of pre-1997 benefits. Any improvements for PPF members should also apply to FAS members. *Given the age of many FAS members, the Government should legislate as a matter of urgency to provide indexation on FAS compensation for pre-1997 rights, where their schemes provided for this, funded by the taxpayer. The Government should review the Financial Assistance Scheme, including looking at the case for removing other discrepancies in FAS compensation, compared to the PPF,*

such as the continued application of the compensation cap and lack of interest on arrears. (Paragraph 161)

23. We support the recommendation of the Public Accounts Committee that the Government should “ensure that members’ complaints about the AEAT pension case can be independently reviewed, for example by a relevant ombudsman.” We agree with the Pensions Minister that it is important for a sense of justice and fairness that people should have an adequate means of redress. *The Government should report back to us by the summer recess on how it intends to ensure an adequate means of redress for AEAT pension scheme members. (Paragraph 165)*

Formal minutes

Wednesday 20 March 2024

Members present

Sir Stephen Timms, in the Chair

Debbie Abrahams

Nigel Mills

Selaine Saxby

Sir Desmond Swayne

Defined benefit pension schemes

Defined benefit pension schemes Draft Report
(*Defined benefit pension schemes*), proposed by
the Chair, brought up and read.

Ordered, That the draft Report be read a second
time, paragraph by paragraph.

Paragraphs 1 to 166 read and agreed to.

Annex and Summary agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available (Standing Order No. 134).

Adjournment

Adjourned till Tuesday 26 March 2024 at 9.15 am

Witnesses

The following witnesses gave evidence.
Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 21 June 2023

Professor Iain Clacher, Professor of Pensions & Finance and Director, Centre for Financial Technology and Innovation, University of Leeds; **Sir Steve Webb**, Partner, Lane, Clark & Peacock; **Joe Dabrowski**, Deputy Director of Policy, Pensions and Lifetime Savings Association; **Dr Con Keating** Q1–20

Mr Martin Hunter, Head of Integrated Funding, Railpen; **Leah Evans**, Chair of Pensions Board, Institute and Faculty of Actuaries; **Mr John Ralfe**, John Ralfe Consulting; **Mr Derek Benstead**, Senior Consultant, First Actuarial LLP Q21–32

Wednesday 6 September 2023

Yvonne Braun, Director of Policy, Long Term Savings and Protection, Association of British Insurers; **Tracy Blackwell**, CEO, Pension Insurance Corporation plc; **Serkan Bektas**, Head of Client Solutions Group, Insight Investment; **Brian Denyer**, Senior Solutions Director – Pensions, Abrdn Q33–62

Luke Webster, CEO, The Pension Superfund; **Simon True**, CEO, Clara-Pensions Limited; **Adam Saron**, Co-founder and former CEO of Clara-Pensions Q63–90

Wednesday 18 October 2023

Robert Smith, Member of Council, Royal Ordnance Pensioners Association; **Nick Coleman**, Member, BP Pensioner Group;

David Carson, Member of Steering Committee, Hewlett Packard Pension Association (HPPA) Q91–119

Harus Rai, Chair, Association of Professional Pension Trustees; **Janice Turner**, Founding co-chair, Association of Member Nominated Trustees; **Steve Hitchiner**, President, Society of Pension Professionals; **Leonard Bowman**, Partner and Head of Corporate DB Endgame Strategy, Hymans Robertson Q120–152

Wednesday 8 November 2023

Terry Monk, Member of the Executive Committee, Pensions Action Group; **Roger Sainsbury**, Founder, Deprived Pensioners Association; **Neil Walsh**, Pensions Officer, Prospect; **Richard Nicholl**, Member of the Executive Committee, Pensions Action Group Q153–165

Oliver Morley, Chief Executive, Pension Protection Fund; **Barry Kenneth**, Chief Investment Officer, Pension Protection Fund; **Sara Protheroe**, Chief Customer Officer, Pension Protection Fund Q166–213

Wednesday 29 November 2023

Nausicaa Delfas, Chief Executive Officer, The Pensions Regulator; **Louise Davey**, Interim Director of Regulatory Policy, Analysis and Advice, The Pensions Regulator; **Neil Bull**, Head of Investment, The Pensions Regulator Q214–290

Wednesday 10 January 2024

Paul Maynard MP, Minister for Pensions, Department for Work and Pensions; **Fiona Frobisher**, Deputy Director, Defined Benefit Policy Division, Department for Work and Pensions; **Bim Afolami MP**, Economic Secretary to the

Treasury, HM Treasury; **Laura Webster**,

Director of the Personal Taxes, Welfare

and Pensions, HM Treasury

Q291–342

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

DBP numbers are generated by the evidence processing system and so may not be complete.

- 1 Abrdn (DBP0047), (DBP0086)
- 2 American Express (DBP0095)
- 3 Anonymised (DBP0070)
- 4 Aon (DBP0062)
- 5 Ario Advisory (DBP0026)
- 6 Association of British Insurers (DBP0059)
- 7 Association of Consulting Actuaries
(DBP0052)
- 8 Association of Pension Lawyers (DBP0048)
- 9 Association of Professional Pension
Trustees (DBP0039), (DBP0089)
- 10 BP Pensioner Group (DBP0080),
(DBP0090)

- 11 Benson, John and Jones, Phil (DBP0098)
- 12 Brightwell (DBP0067)
- 13 Broadstone (DBP0058)
- 14 C-Suite Pension Strategies Ltd (DBP0040)
- 15 Cardano (DBP0065)
- 16 Clacher, Professor Iain, Keating, Dr Con
(DBP0032), (DBP0082)
- 17 Clara-Pensions Limited (DBP0051)
- 18 Community Union (DBP0042)
- 19 Dalriada Trustees Limited (DBP0096)
- 20 Delaney, Mr Arnold Thomas (DBP0011)
- 21 Deloitte Pensions Services Limited
(DBP0064)
- 22 Denham, Michael (DBP0028)
- 23 First Actuarial LLP (DBP0060)
- 24 Griffiths, David (DBP0024)
- 25 Hancox, Dr Neil (DBP0021)
- 26 Hatswell, Mr David (DBP0014)

- 27 Hewlett Packard Pension Association
(HPPA) (DBP0029), (DBP0091), (DBP0101)
- 28 Hutchings, Prof. Michael (DBP0022)
- 29 Hutt, Jane (DBP0100)
- 30 Hymans Robertson LLP (DBP0045),
(DBP0092)
- 31 Insight Investment (DBP0044), (DBP0085)
- 32 Institute and Faculty of Actuaries
(DBP0077)
- 33 Institute for Family Business (DBP0057)
- 34 Isio (DBP0061)
- 35 Kaufman, J B (DBP0084)
- 36 Knowa Limited (DBP0003)
- 37 LCP (DBP0056)
- 38 Lancefield, Mr Andrew (DBP0046)
- 39 Lane Clark and Peacock (DBP0099)
- 40 Lapinskas, Dr Peter (DBP0037)
- 41 Lee, Mr Richard (DBP0033)

- 42 Leech, Mr David (Retired, Streamline Holdings PLC); Thompson-Hill, Richard ; Pirret, Gordon ; Pratap, Davendra ; Delaney, Arnold ; Hatswell, David ; Saunders, Clive ; Harper, Michael ; Kirkwood, Colin ; and Johnston, Paris (DBP0008)
- 43 Levy, Mr Rodney (DBP0006)
- 44 Mercer (DBP0055)
- 45 Monk, Mr Terry (DBP0015), (DBP0031)
- 46 Nicholl, Richard (DBP0087)
- 47 O'Neill, Mr Con (DBP0019)
- 48 Owen MS, Rhys ab (DBP0072)
- 49 Pension Insurance Corporation plc (DBP0073)
- 50 Pension Protection Fund (DBP0050)
- 51 Pensions Action Group (DBP0016), (DBP0094)
- 52 Pensions and Lifetime Savings Association (PLSA) (DBP0054), (DBP0083)

- 53 Prospect (DBP0036)
- 54 Punter Southall Pension Solutions Limited (DBP0013)
- 55 Raffel, Alistair (DBP0004)
- 56 Railways Pension Trustee Company Limited (RPTCL) (DBP0063), (DBP0081)
- 57 Ralfe, Mr John (DBP0066)
- 58 Reading, Mr Anthony (DBP0020)
- 59 Rodda MP, Matt (DBP0079)
- 60 Royal Ordnance Pensioners Association (DBP0034), (DBP0093)
- 61 Saron, Mr Adam (DBP0069)
- 62 Saunders, Mr Clive Spencer Gifford (DBP0017)
- 63 Smith, Michael (DBP0005)
- 64 Snowdon OBE, Mrs Margaret (DBP0038)
- 65 Society of Pension Professionals (DBP0043)
- 66 TPT Retirement Solutions (DBP0068)

- 67 The Deprived Pensioners Association (DBP0053), (DBP0088)
- 68 The Pensions Regulator (DBP0071), (DBP0097)
- 69 Thompson-Hill, Mr Richard (DBP0025)
- 70 Turner, Dr Andrew (DBP0030)
- 71 UNISON (DBP0075)
- 72 Unite the Union (DBP0035)
- 73 Universities Superannuation Scheme (DBP0078)
- 74 University and College Union (UCU) (DBP0074)
- 75 WTW (DBP0076)
- 76 Whitford MP, Dr Philippa (DBP0012)
- 77 Wilson, Mr Alan (DBP0018)
- 78 XPS Pensions Group (DBP0041)

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All publications from the Committee are available on the publications page of the Committee's website.

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2nd	Benefit levels in the UK	HC 142
1st	Defined benefit pensions with Liability Driven Investments:	HC 259
Special	Government Response to Committee's Seventh Report of Session 2022–23	

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Special	payments: Government Response to the Committee's First Report of Session 2023–24	

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2nd	The cost of living	HC 129
3rd	Protecting pension savers – five years on from the pension freedoms: Saving for later life	HC 126

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7th	Defined benefit pensions with Liability Driven Investments	HC 826
8th	Plan for Jobs and employment support	HC 600
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3rd	The cost of living:	HC 671
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4th	Protecting pension	HC 1057
Special	savers—five years on from the pension freedoms: Saving for later life: Government, Financial Conduct Authority and Money and Pensions Service Responses to the Committee's Third Report of Session 2022–23	
5th	Universal Credit	HC 1266
Special	and childcare costs: Government Response to the Committee's Fourth Report of Session 2022–23	

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6th	Health assessments	HC 1558
Special	for benefits: Government response to Committee's Fifth Report of Session 2022–23	
7th	Children in poverty:	HC 1675
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2nd	The appointment of Dr Stephen Brien as the Chair of the Social Security Advisory Committee	HC 733
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6th	The appointment of Sarah Smart as Chair of the Pensions Regulator	HC 1358