PUBLIC SECTOR CONSOLIDATOR DESIGN – PPF DISCUSSION DOCUMENT

Contents

INTRODUCTION / OVERVIEW

DWP has recently launched a consultation seeking industry views on the design of a Public Sector Consolidator (PSC) to be run by the Board of the PPF. The government has previously committed to establishing the PSC by the end of 2026 and is clear that the consolidator should:

- be for schemes unattractive to commercial providers
- ensure the interests of members of transferring schemes are protected
- increase levels of investment in high-growth UK assets; and
- minimise the potential distortion of the market

The PPF welcomes DWP's consultation. Establishing the best design to improve outcomes for members and deliver the government's other objectives will require input from across the pensions industry. The PPF looks forward to working collaboratively with DWP and a wide range of stakeholders over the course of the consultation period.

To support this process, this document sets out an initial view from the PPF as to how the PSC could be structured. This is not a complete or definitive solution. However, by sharing our early thinking we hope to support an effective debate, including through generating alternative views and challenge that help us refine or change our proposals.

It is important to stress that our thinking has been driven by the government's stated objectives. To deliver all the government's objectives is not straightforward; much will depend on the relative weight given to each objective. To run a substantive allocation to UK productive finance assets requires the PSC to achieve a significant scale. However, the more steps are taken to achieve scale, the greater the potential impact on the market.

The proposal set out in this document is for a design that has different features to existing, commercial models of consolidation. The design aims to provide attractive pricing, terms and member experience to all schemes regardless of size (critically including removing or reducing the price 'premium' that the smallest schemes can face). It also explores ways to ensure large numbers of small schemes could be 'onboarded' in a time and cost-efficient manner. To enable this we are proposing that the PSC provides a range of standard benefits (which will reflect those seen most commonly in schemes) rather than seeking to replicate all bespoke scheme-specific benefits.

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

We think there is a relatively significant 'market' of schemes that could be interested in a transfer to a PSC designed in this way. However, as with any new product being brought to market, there must be significant uncertainty about levels of take up (especially as the commercial market is continuing to develop and innovate). There is therefore a significant risk that the PSC will be unable to achieve scale and will not make a material contribution to the government's wider objectives. To address this, the government would need to accept some greater impact on the commercial market than its objectives currently allow for, and elements of the proposed design would need to change (for example, the government could increase the level of financial support it provides to the PSC, making it a much more attractive destination for schemes). Given the scale of the DB sector we believe there could be space for this while still allowing for a healthy commercial market.

We will engage with stakeholders both on the detailed design of the public sector consolidator and further viable approaches which build on the PPF's platform for public benefit. We recognise that different government objectives could lead to different solutions – the expertise the PPF has built and our proven track record of performance, including in investment management and service to members– mean we are well positioned to support the government to achieve its objectives in any way we can.

We hope this document will be useful in helping others form views in response to DWP's consultation. We'd also be interested in views on the areas we have highlighted within the document, although we are happy to receive comments on any element of this proposition. Please send any comments to externalaffairs@ppf.co.uk.

SUMMARY OF KEY DESIGN FEATURES

In order to achieve the government's objectives we consider that the PSC could have the following key features, some of which are explored in more detail in the sections to follow:

- Established as a statutory fund under the management of the Board of the PPF (as is the case for the Pension Protection Fund and the Fraud Compensation Fund). The PSC will be legally separate from the other funds operated by the Board with no cross subsidy or pooling of funds permitted.
- Operating on a non-sectionalised basis to maximise efficiencies and economies of scale. It will aim to run on (rather than act as a bridge to buy out) enabling the PSC to invest for growth over the medium to long term (within a set risk budget). This will enable the PSC to invest in the full range of asset classes including UK productive finance.
- Required to accept transfers from all schemes that can meet its terms, ensuring it provides a solution for schemes unattractive to commercial providers. This is perhaps comparable to the role of Nest – a public body operating in a competitive market, but with a clear duty to address the possibility of market failure (in Nest's case they are required to allow any employer, regardless of size, to join; and to provide a flat rate per member charge, regardless of pot size or earnings potential).
- Providing members of transferring schemes with the actuarial equivalent of their full scheme benefits but through a number of standardised benefit structures. This will support lower ongoing administration costs and be a key element in the PSC minimising the price penalty faced by small and subscale schemes.
- Required to provide at least the level of security expected of commercial consolidators – providing a secure solution for members. Under current consolidation guidance, this level of security requires a prudent funding basis (current minimum is calculated using gilts +0.75% pa), access to a buffer fund, and in the event of failure, PPF protection. We believe the government would be the most appropriate provider of that buffer for the PSC.
- Allowing entry from schemes with a deficit on the PSC's pricing basis – but would require employers to enter into a payment schedule to close the fixed deficit over time. If the employer becomes insolvent before completing scheduled payments then member benefits would be reduced to reflect this (floored at the equivalent of PPF compensation levels). This approach enables the PSC to offer a solution to schemes with deficits, who are least likely to be able to transact with a commercial provider, while protecting the funding position of the consolidator and the security of other members.
- Making available to trustees the option to appoint panel firms (operating standardised processes) to drive down the costs to schemes of preparing to transact with the PSC.

ELIGIBILITY AND THE POTENTIAL MARKET FOR THE PSC

The PSC will be one of a range of potential end game options for DB schemes. In considering the best route for their scheme, employers and trustees will be weighing a range of factors including: price and affordability (given the scheme's funding position); the likely timescales for any transaction; the level of security the option provides for members; member experience; and the structure of benefits payable.

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

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

We would welcome input and views on our thinking above.

The tables below[1] - looking at scheme funding position on a buy-out basis – identify in green those categories of scheme that *could* constitute this market (the analysis excludes schemes with over 25% of their assets in annuities, as those schemes might already be on course for a transaction with an insurer, and excludes schemes open to accrual or already in wind-up). This suggests the potential market for the PSC includes around 2,400 schemes with around £120bn in assets. Of course only a proportion of these schemes will be interested in a transfer to the PSC, but it suggests that our proposed design has the *potential* to reach a sufficient scale to run significant investments in UK productive finance (in line with the government's objectives). However, there are clearly risks to this. The market is continuing to develop new and innovative solutions including for small schemes. It is possible, therefore, that the PSC may only attract transfers from a small proportion of these schemes.

- [1] The numbers quoted are approximate and illustrative in nature and designed to give an indication about the potential scale of schemes that could constitute to the PSC's market. Importantly, the DB universe may have changed significantly by the time the PSC is set up in 2026.
- All liabilities and funding levels have been calculated using an approximate calculation methodology and illustrate funding on a buyout basis rolled forward to an effective date of 31 March 2023. The buyout basis is consistent with the s179 basis, but in addition includes an allowance for scheme specific increases. Other simplifications in our calculation methodology include no allowance for benefit outgo (in both our assets and liabilities, broadly cancelling each other out) or actual revaluation and pension increases since each scheme's latest valuation date.
- The asset roll forward is in line with the PPF's current levy methodology. The asset data underlying the calculations is consistent with the Purple Book 2023, and as such the calculations may not reflect the full impact of the LDI crisis, or any unfunded LDI held by schemes but not explicitly included within the asset allocation provided within the scheme return. These limitations may act to overstate the projected assets.
- The scheme status information is in line with TPR's 'Occupational defined benefit landscape in the UK 2023', published on 20 February 2024.
- In practice we may target more attractive pricing than insurers. However, the buy-out basis used is still reasonable for our purposes given s179 is an intentionally optimistic insurer basis which may not reflect all schemes' particular circumstances. True buy-out funding for smaller schemes may therefore be lower than implied by the tables below.
- This analysis was carried out by the PPF, using the data sourced from The Pensions Regulator (TPR) - TPR DB and Hybrid Scheme Return records as of 31 March 2023. The scheme data is consistent with Purple Book 2023 and the latest PPF 7800.

That would still be a success in terms of providing an end game solution for schemes who may otherwise have no alternative end game solution. However, it would mean the PSC is not significantly contributing to the government's wider objectives. To ensure or guarantee the PSC will achieve significant scale, changes to the proposition are likely to be needed (potentially moving the PSC away from focusing just on schemes unattractive to commercial providers).

We do not propose 'harder' eligibility criteria. We think it is hard to set objective criteria for what schemes will or won't be attractive to commercial providers given the range of issues involved. Setting sized based criteria, for example, would ignore the challenges that poorly funded schemes may face or those with complex benefit structures, where particular benefit features can be disproportionately expensive. It is also hard to define exactly what size is or isn't 'unattractive' to commercial providers. On the one hand, commercial transactions with very small schemes do take place, on the other even larger schemes can face issues establishing competitive pricing. We also believe it will be difficult for schemes to evidence they cannot find a suitable commercial alternative to the PSC. Overall we think a better approach – in order to achieve the government's objectives - is to establish the PSC with a distinct design from commercial alternatives and allow scheme trustees freedom to choose the right solution for their scheme and members.

Tables on potential PSC market – these numbers are intended only to provide a guide as to the number of schemes that could potentially be interested in a transfer to the consolidator. It is far from a definitive view (and the splits by scheme size are relatively arbitrary) as noted above there are a range of factors at play that are likely to change over time. Given the illustrative nature of these numbers, all figures have been rounded (to the nearest 10 for number of schemes, 10,000 for total number of members and £10bn for total assets).

<u>Schemes with fewer than 100 members</u> **– We expect the PSC proposition to be most compelling for the very smallest schemes** – for example we think only a small proportion of schemes with under 100 members will be attractive to commercial providers and that they may be interested in the PSC at all funding levels. However, schemes with less than 80% funding, although eligible to join the PSC, may find the required repayment schedule unaffordable.

Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	100	10	<5
Between 80% and 100%	260	10	<5
Between 100% and 110%	170	10	<5
Over 110%	560	20	10
Total	**1,090**	**50**	**10**
Total green	**990**	**40**	**10**

<u>Schemes with more than 100 members and fewer than 1,000 members</u> – within this segment we would expect ability to access commercial solutions to increase with size – though availability may vary depending on demand – but that only a proportion of those wanting to secure benefits would be able to do so commercially.

Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	210	80	10
Between 80% and 100%	420	140	20
Between 100% and 110%	280	100	10
Over 110%	520	180	30
Total	**1,430**	**500**	**70**
Total green	**1,220**	**420**	**60**

Schemes with more than 1,000 members and fewer than 10,000 members – *larger* schemes are likely to be the preferred market for insurers and commercial consolidators. We therefore think the core market for the PSC in this size range will probably be among underfunded schemes and potentially those with weaker covenants.

Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	50	120	10
Between 80% and 100%	150	440	50
Between 100% and 110%	90	220	30
Over 110%	170	530	90
Total	**460**	**1,310**	**180**
Total green	**150**	**440**	**50**

Total population of the potential market for the PSC

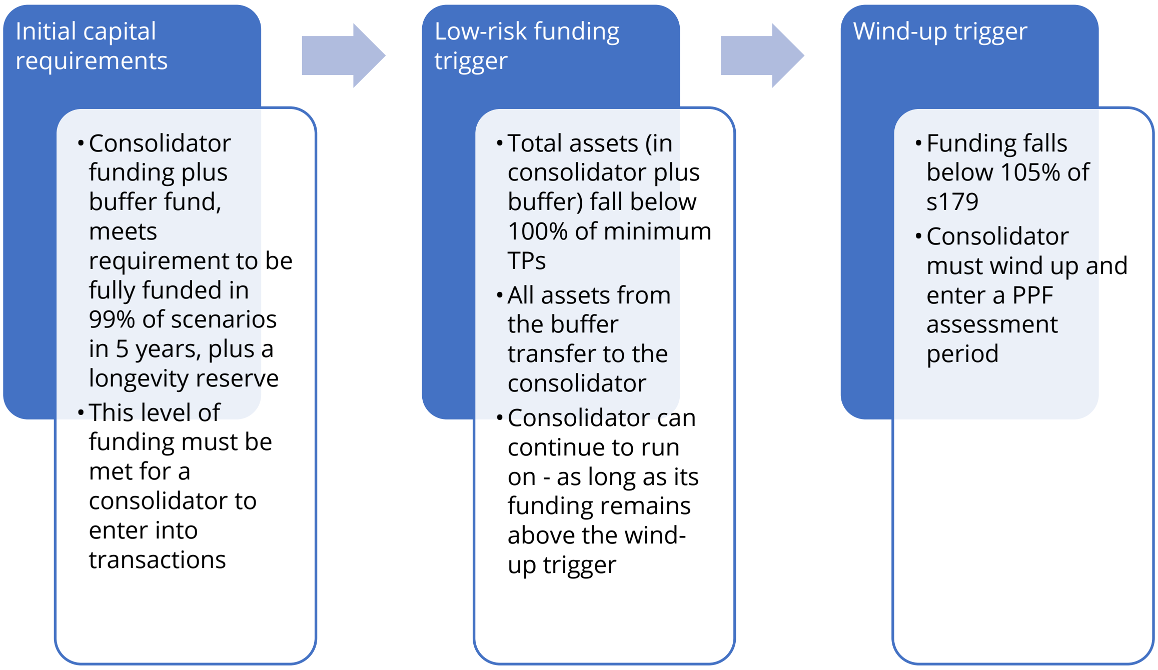
Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	0	0	0
Between 80% and 100%	830	590	70
Between 100% and 110%	450	110	10
Over 110%	1,080	200	40
Total	**2,360**	**900**	**120**

RISK UNDERWRITING

As noted in the summary section above, we believe the PSC should be able to meet at least the same level of security as expected of commercial consolidators. This ensures a high level of protection for members and addresses the risk of unfair competition by putting the PSC's funding requirements on a level playing field with commercial consolidators.

There are some core requirements currently placed on commercial consolidators: to operate with prudent technical provisions; to provide an adequate capital buffer; and maintain funding above a stated level. These are summarised in the diagram below.

Consolidator funding requirements



We propose the PSC should be able to meet similarly stringent requirements, and be designed in a way that appropriately reflects the structure and purpose of the PSC. To do this – while also maintaining an entry price that is reasonably attractive to schemes – the PSC will require underwriting from third party capital (equivalent to the buffer fund available to commercial consolidators).

Providing the PSC buffer fund

A key question in the design of the PSC, therefore, is who provides the required buffer fund. The PSC is designed to achieve government objectives – in particular to provide a secure end game solution for schemes unattractive to commercial providers, and to increase levels of investment in UK productive finance (with the aim of benefitting the UK economy and UK tax payers). We, therefore, believe there is a clear case for the government to provide the buffer for the PSC (or a facility that mimics the effect of a buffer fund – i.e. a level of capital that the PSC can draw on in pre-determined scenarios).

There are a number of ways such a facility could be structured. We do not believe an unlimited guarantee is required, instead the total level of support available could be capped (though the total amount would need to support the desired scale and ensure at least the same level of security as required of commercial consolidators). In this scenario – of finite government support - we believe the PPF will need to be available to the PSC in a failure scenario, giving members the same protection as that provided to all DB schemes and commercial consolidators (and so the PSC would be required to pay a PPF levy).

By underwriting the risk (up to a finite limit) it would be appropriate for the government to determine the level of risk that should be taken in the investment strategy. The government could also legitimately require a certain level of investment in UK productive finance (though the Board of the PPF should remain responsible for independently setting the investment strategy and asset allocation within these parameters). In this way, government backing will enable the PSC to meet the government's productive finance objectives to the fullest extent possible (providing the consolidator can also achieve sufficient scale). In the absence of government backing, investment risk is likely to be more constrained and there could be no requirement to invest a minimum level in UK productive finance.

The PPF Board does not consider use of PPF reserves to be a viable alternative (and clearly without legislative change this would not be possible). PPF reserves exist to protect the PPF's current and future members against longevity risk and claims risk, and to reduce the likelihood of needing to raise the PPF levy should risks materialise. The PPF's funding is now at a level where some loss to the reserves could be sustained while maintaining a high level of financial security (with limited risk that a levy would need to be raised in response). However, there are multiple factors for the government to consider in relation to how PPF reserves might be utilised, including the impact on and position of levy payers and members. The PPF Board is supportive of DWP's work to review compensation levels. The Board also believes any use of reserves should not require a change in the PPF's plans to move to a zero levy (when enabled to do so by legislative change). As such, we do not consider the level of PPF reserve that could be made available for a buffer fund is sufficient – at least at the present time – to support a PSC operating at scale.

BENEFIT STRUCTURE

We propose that the consolidator will offer a range of standard, streamlined benefit structures, while mirroring the elements of scheme benefits that are likely to be most important to members. We consider this is important in reducing running and onboarding costs compared with establishing specific benefit structures for each transferring scheme. As a result this should help ensure the consolidator can minimise the price penalty that small schemes can face.

We recognise that any move away from the specific benefits offered by a scheme is likely to be of some concern to transferring trustees and members. However, we believe there could be benefits to members from standardisation, ie benefits which are easier to understand and predict, and we believe it is possible to establish an approach which will help mitigate concerns while retaining the benefits of standardisation.

We believe we will be able to commit to trustees and members that:

- on transfer the consolidator will pay existing pensioners (at least) the same amount of pension as they are already receiving
- the starting value of a deferred member's pension when they retire is projected to be the same as they would have expected to receive under their scheme
- the consolidator will match the Normal Pension Age (NPA) of the original scheme – it will pay people at the age they would have expected to retire
- in most cases* the consolidator will broadly match the annual increases that the scheme would have provided – many members will only see a change in the date the annual increase is calculated and paid
- the consolidator will pay generous benefits to surviving spouses, partners, or other dependents

*In the event of unusual scheme-specific deviations which can't be mapped exactly onto the consolidator's structures, the scheme will need to consider pragmatic changes to deliver a broadly equivalent outcome for the member. The scheme (or its advisers) will also need to convert GMP into non-GMP pension as part of the standardisation exercise.

Our initial thinking is that the above can be achieved through the menu of choices in the table below. We are keen to learn from industry expertise in this area, to build on this starting point, and would welcome discussion and input to develop this further. In particular, we would welcome views on:

- whether the above commitments are sufficient to reassure trustees and members and ensure the consolidator will be seen as a reasonable option, and the extent to which the ability to secure scheme-specific benefits is a material advantage as compared with the PSC proposition
- whether the choices outlined in the table below will allow the above commitments to be made; we would particularly welcome views on the range of pension increases and revaluation offered, including whether there should be any fixed-rate revaluation offered, and the proposal not to allow partial retirement.

Proposed benefit choice menu

Scheme feature	**Options/benefits offered**
Form of benefit	• Pension and/or separate lump sum, in the same form as the benefits accrued within the original scheme
Normal Pension Age	• Allow any NPA from the ceding scheme's structure; no partial retirement

Scheme feature	Options/benefits offered
Pension increases	Options for annual increases of: • **Fixed:** 0%, 2.5%, 3%, or 5% pa • **CPI-linked:** Floored at 0% and capped at 2.5%, 3%, 5%, or uncapped; or floored at 3% and capped at 5% pa • **RPI-linked:** Floored at 0% and capped at 2.5%, 3%, 5%, or uncapped; or floored at 3% and capped at 5% pa For each member, the trustee would decide the amount of benefit to buy in each of the above tranches.
Revaluation	Options of: • CPI[2] with a maximum of 5% pa on a compound basis applied for months deferred • CPI with a maximum of 2.5% pa on a compound basis applied for months deferred • Fixed rate of 3% pa
Death benefits	Partner (as defined by HMRC[3]) pensions[4]: • Deferreds: a choice of 50% or two-thirds of member's pension revalued to death • Pensioners who retire in the consolidator: a choice of 50% or two-thirds of member's pre-commutation pension[5] • Pensioners who retire before entry to the consolidator: separately converted dependant's pension equivalent in value to ceding scheme's dependant's pension Lump sums: • 5-year guarantee (pensioners) – no account taken of projected post-death pension increases, no offsets for dependants' pensions • 5x pension lump sum (deferreds) (optional)
Options	• Transfers out - member eligible up to (highest) NPA, provided benefits are not yet in payment (with protections and processes in place to protect both transferring and remaining members) • Commutation up to 25% of value of benefit at retirement or in line with prevailing legislation on commutation limits for private sector occupational pension schemes • Trivial commutation and small pot commutation for members with suitably low benefits • Early retirement from normal minimum pension age (NMPA), or lower where required (eg members with a protected pension age of 50) • Late retirement
Ill-health retirement	• Member unable to work in any capacity: allow retirement before NMPA on a reduced basis • Life expectancy less than 12 months: full commutation of the member's part of the benefit
Divorce	• Ex-spouses may opt for membership of the public sector consolidator or transfer benefits out

[2] 2020 PPI research suggests the majority of private sector schemes revalue deferred benefits in line with CPI rather than RPI.
[3] The HMRC definition includes spouses, civil partners, a person who is dependent on the member due to physical or mental impairment, a person who is financially dependent on the member, or a person who was in a financial relationship with the member which was one of mutual dependence.
[4] 2019 ONS data suggests that 86% of pensions in payment from private sector schemes include a contingent pension that can be paid to unmarried partners on death, usually at trustee discretion.
[5] The above ONS data also suggests that 88% of pensions in payment from private sector schemes include a dependant's pension based on pre-commutation pension, rather than post-commutation.

ONBOARDING

How schemes are brought into the consolidator will be key - we want to establish a process that gives members a positive experience, and has the potential to onboard a large number of small schemes cost effectively and over a relatively short period of time. This is obviously a significant challenge, although an area where we have a significant track record through developing the PPF's assessment period processes, and is one of the areas on which we would welcome industry input. We have set out below our early thoughts on how this could work and some of the key challenges.

'Stated benefits for stated people'

We propose the PSC operates in a comparable way to an insurer or commercial consolidator. Trustees will 'buy' benefits for their members from the PSC. The PSC will then have full liability for paying what has been purchased but will not take on liability for anything trustees haven't bought (certainly not to any material degree). This is sometimes described as 'paying stated benefits, for stated people' and this approach reflects a number of important principles. Firstly, we think scheme trustees (rather than the PSC) should determine the benefits their members are to receive (including discussions about use of any surplus). Secondly, certainty on liabilities (i.e. minimising data risks) will be as key to the PSC as any other commercial provider. And thirdly, in order to realise the advantages of benefit standardisation the PSC should not be required to understand individual scheme benefits (for example, to assess the impact of data corrections). As with most insurance transactions, this means that if any data is incorrect members may need to look to the trustees for redress. Trustees currently manage this risk by taking out run off / trustee indemnity cover or an employer indemnity and the same approach is likely to be appropriate here.

The onboarding challenge

To reach a transaction on the basis described above, the following tasks need to be completed by the trustees:

- cleanse data and ensure clarity on the scheme benefits due to individual members
- agree the standardised benefits to be bought for the members
- agree a price
- transfer assets / member data (etc)

However, in supporting the trustees to work through these steps it is critical that the PSC establishes a process that prioritises cost effectiveness, driving down costs; and one that can accommodate potentially large numbers of schemes over a limited period. We also note that the greater the elapsed time before assets are taken on by the PSC, the slower any resulting impact on productive finance investment and gilt holdings will be.

The consolidator also faces challenges that are common to insurers and commercial providers:

- As we are not expecting the PSC to take on data risk, ceding scheme trustees will want to be highly confident in their data – but this can be expensive and involve long time frames to work through individual member records.
- Closely linked to this are concerns about 'execution risk'. Schemes will be hesitant to incur significant expenditure on preparatory work if there is a risk that the transaction will not take place. The particular concern is that changes in pricing or asset values will make the transaction unaffordable. The PSC's process will need to address this risk.

Supporting efficiency and speed

We propose that the PSC should make significant use of standardised processes, for example contracts and data templates (supported where necessary by legislation), and provide schemes with access to expert panel firms who can undertake the required processes as cost-effectively as possible. This will build on the work the PPF has done to drive efficiency in PPF assessment periods. In particular, the consolidator will make available to trustees:

- an online ready reckoner / transparency on pricing, including an approximate basis and methodology for pricing - this will enable scheme trustees and advisers to assess readily whether the PSC is an attractive and viable destination for their scheme
- guidance on the benefit standardisation process
- assurance on the viability of the PSC – we believe it will be important to establish the PSC in a way that minimises the need for time-consuming and costly due diligence, through clear funding and capital standards required by legislation, strong risk processes and readily available material demonstrating those standards have been met
- guidance on the required standard of data cleansing and key pieces of legal advice required prior to transfer
- guidance on certifying actuarial equivalence – given the need for legislation to establish the consolidator, this provides the opportunity to make the transfer and standardisation process as simple an option for schemes (and scheme actuaries) as possible.

We would be interested to hear whether there is anything further that would be helpful to trustees.

At a very high level the onboarding process could therefore look as follows:

3

Pricing

Trustees submit scheme details and standardised data to PSC for formal pricing

Formal price provided by PSC

If scheme is in deficit, schedule of contributions agreed with sponsor

If scheme is in surplus, enhanced benefits can be purchased for members (if desired)

4

Transaction

Final transaction takes place

Assets and administration pass to PSC

PSC pay standardised benefits

Trustees' obligations are discharged

We would welcome industry views on how to make the process as smooth and cost-effective as possible.

Alternative options to address 'execution risk'

However, the data work and benefit selection phase can be a lengthy process, carrying associated costs that can be significant, particularly for smaller schemes. We understand that typical time periods to complete the required data work (perhaps equivalent to completing a buy-out transaction) can be considerable, often measured in years rather than months. We think the use of standardisation and panel firms can reduce timescales and, certainly for small schemes (given the smaller number of records), there is the potential to progress much more quickly. We believe there may be the potential for time-consuming processes such as GMP equalisation to be streamlined by combining it with the benefit standardisation process. We would welcome industry feedback on this point in particular, or any other efficiencies that could be realised.

However, we recognise there are limits to what can be achieved; there will be capacity constraints amongst administrators and advisory firms, and costs will remain. We understand trustees and sponsors may be reluctant to undertake this work if there is a risk that the transaction won't happen at the end of the process (because of shifts in pricing).

1. Providing early assurance on pricing

One way this execution risk could be mitigated is through the consolidator providing some commitment on pricing at an early stage. This pricing commitment could be provided once all material data issues have been identified and costed and an initial benefit selection has been completed. The speed at which this could be done will be very much dependent on the extent to which the quality of the scheme's data is 'market ready'.

Assurance on pricing is however only one element. The other issue is volatility in the value of the scheme's assets against the PSC's pricing basis. This could be mitigated by the trustees moving asset allocation into a specified portfolio designed to match the pricing basis (a broadly similar approach to what happens in a PPF assessment period). There is a possibility of the consolidator making pooled funds available to facilitate this process. (The initial pricing commitment point and investment in an appropriate fund could – therefore – be the formal trigger for the start of the PSC's role in relation to a scheme. It may be helpful to introduce legislation enabling the PSC to invest assets on behalf of the scheme while working towards a formal transfer).

Following the pricing assurance, the trustees would have time to work through the remaining data issues prior to the final transaction. The high-level process could therefore look as follows:

1 Feasibility

- Trustees/actuary use online information and tools to conduct initial feasibility assessment of price
- Trustees decide whether to proceed (with sponsor if appropriate)

2 Initial data work and benefit selection

- Trustees identify and cost data issues
- Trustees/actuary map uncleansed individual benefits onto standardised benefits structure

3 Pricing commitment

- Trustees submit scheme details and uncleansed standardised data to PSC for pricing
- PSC provides price commitment
- Trustees commit to transfer and move assets into portfolio made available by PSC
- Trustees continue to pay scheme benefits

4 Further data work

- Trustees cleanse data to appropriate standard
- Trustees/actuary map any amended benefits onto the standardised benefits structure
- Actuarial equivalence certification

5 Final pricing

- Trustees submit final standardised data to PSC for final pricing
- Final price provided by PSC in line with price commitment
- If scheme is in deficit, schedule of contributions agreed with sponsor
- If scheme is in surplus, enhanced benefits can be bought for members (if desired)

6 Transaction

- Final transaction takes place
- Assets and administration pass to PSC
- PSC pays standardised benefits
- Trustees' obligations are discharged

In the section above we have avoided being too prescriptive about how the pricing commitment mechanism could be achieved in practice, as we do not want to narrow down options at too early a stage. We would welcome the industry's thoughts on potential mechanisms to meet trustees' and the PSC's needs and aims best.

2. A buy-in equivalent

To some extent, insurers address these challenges through a two-stage process, with a buy-in transaction first, before proceeding to full buy-out. The buy-in can be done with less data cleansing (sufficient to identify but not necessarily resolve the issues) and confirmation that key legal issues have been understood. The insurer will agree to pay the benefits bought under the buy-in, but responsibility for paying members' benefits remains with the trustees. The buy-in locks in the 'price' and removes the majority of the execution risk. The scheme then has time to work through and resolve the data issues, either in a specified data true-up period following the buy-in or before moving to full a buy-out.

We think there is potential for the PSC to offer something similar. However, there are specific challenges – in particular the move to standardised benefits which means the 'buy-in' process cannot be easily replicated. Under an insurance buy-in the trustees remain responsible for payment of scheme benefits but have contracted with an insurer to cover the cost of paying for those benefits. Trustees will be contracting with the PSC to pay standardised benefits – but until they fully transfer to the PSC scheme benefits may need to be paid.

Possible ways to address this would be by using legislation to establish a variant of the buy-in process. Some ways this could work include:

- *Buy-in option 1* - a transaction at the pricing commitment phase (i.e. after initial data work and benefit selection is completed). Assets would transfer to the PSC and – from that point on – the consolidator would have liability for paying the chosen, standardised benefits to scheme members. The trustees would be discharged from the majority of their responsibilities but would retain responsibility to finalise scheme data and amend what has been bought from the consolidator.
- *Buy-in option 2* - a transaction at the pricing commitment phase (i.e. after initial data work and benefit selection is completed). Assets would transfer to the PSC and – from that point on - the consolidator pays scheduled regular payments based on a set of expected cashflows provided by the scheme. The trustees will still have responsibility for paying the full scheme benefits to members and the consolidator could provide a contingency fund during this period to protect against unexpected cashflows (which the scheme has to pay back at the end of the schedule). In the meantime, the trustees would finalise scheme data and agree the finalised standardised benefits to purchase.

With both of these options, we recognise there are issues to think through in the event that the transaction does not proceed.

As an illustration, the high-level process below shows how the buy-in option 1 could work in practice.

1 Feasibility

- Trustees/actuary use online information and tools to conduct initial feasibility assessment of price
- Trustees decide whether to proceed (with sponsor if appropriate)

2 Initial data work and benefit selection

- Trustees identify and cost data issues
- Trustees/actuary map uncleansed individual benefits onto standardised benefits structure
- Actuarial equivalence certification

3 Initial transaction

- Trustees submit scheme details and uncleansed standardised data to PSC for pricing
- PSC provides price for initial transaction
- Trustees agree to transaction and issue member comms
- Assets and administration pass to PSC
- PSC pays standardised benefits based on the uncleansed data
- Trustee retains responsibility for data cleanse

4 Further data work

- Trustees cleanse data to appropriate standard
- Trustees/actuary map any amended benefits onto the standardised benefits structure
- Actuarial equivalence certification

5 Final pricing

- Trustees submit any data amendments to PSC for final pricing
- Price for revised benefits provided by PSC
- If scheme is in deficit, schedule of contributions agreed with sponsor
- If scheme is in surplus, enhanced benefits can be bought for members (if desired)

6 Transaction

- Final transaction takes place
- True-up assets pass to PSC
- PSC pays revised standardised benefits
- Trustees' obligations are discharged

3. *Full data risk transfer*

A further option could be to transfer data risks to the consolidator, which would allow a transaction to be completed at the early phase, with an allowance for the unresolved data risks built into the pricing. However, as described above, we don't think that it is an attractive solution to take on this risk - in order to realise the advantages of benefit standardisation we believe the PSC should not be required to understand scheme benefits, which would be necessary in order to assess the impact of data corrections.

In conclusion

We are keen to learn from industry expertise in this area, and would welcome discussion and input to develop a suitable, smooth and cost-effective onboarding process, in particular for sub-scale schemes, and how legislation can best support this.

TREATMENT OF SCHEME DEFICIT AND SURPLUS

Schemes with a deficit

We believe accepting transfers from schemes with a deficit (on the consolidator's pricing basis) is likely to be an important part of ensuring the PSC can meet its objectives. It will ensure the consolidator can support the schemes least attractive to commercial providers (including schemes with poorer funding). Incorporating schemes with deficits does, however, present a number of challenges. The design of the consolidator needs to mitigate risks to the funding position of the scheme, and the risk of opening up a mechanism for 'pension dumping' by employers (allowing employers to walk away from their pension liabilities on the cheap).

We are therefore proposing that:

- Where schemes with a deficit transfer to the consolidator, the ceding employer is required to enter into a contractually binding payment plan to pay off the deficit (calculated on the consolidator's pricing basis at the point of entry) plus an 'interest' charge (this could be designed to reflect the impact the deficit has on the consolidator, e.g. to reflect additional costs or 'lost' investment returns). The length of the repayment plan would be designed to ensure affordability for the employer.

- If the employer becomes insolvent before the repayment plan is paid off then member benefits would be reduced:

    - An asset share would be calculated for the affected members (reflecting initial assets transferred, payments received from the employer, recoveries from insolvency and adjusted to allow for investment returns (actual investment returns could be used but we think there is merit in considering alternatives – such as expected returns – to avoid impacts of short-term volatility)).

    - Benefit reductions could be applied within the consolidator (benefits paid would reflect the value of benefits that the asset share equates to using the consolidator's pricing basis). Alternatively, the members could be transferred out – with the asset share - into a PPF assessment period, with benefits then calculated in the normal way.

We will be assessing this proposition to check whether further constraints or safeguards are necessary to address issues that incorporating schemes with a deficit could bring, in particular how the repayment plan is structured and the legal protections that exist, including access to recoveries in insolvency scenarios. We anticipate that trustees of transferring schemes with a deficit may also want to establish (and transfer to the PSC) contingent security to protect member outcomes in the event of default.

Schemes in surplus

Many schemes transferring to the PSC are likely to be in surplus on the consolidator's pricing basis. Trustees and employers will need to determine, reflecting schemes rules, how that surplus is used. It will be possible for the scheme to purchase higher levels of benefit from the consolidator. Any surplus not used in this way could be returned to the employer on completion of a transaction with the PSC. Scheme rules can be problematic, presenting barriers to trustees and employers in reaching decisions on use of surplus. We note that the government is consulting on introducing a statutory power either to allow trustees to amend their rules and allow for payments from surplus funding, or to make payments.

MEMBER EXPERIENCE

As we said in the onboarding section above, we want to establish a process that gives members a positive experience. That commitment will follow through for the duration that the member remains with the PSC. We anticipate a service offering which draws on the extensive, award-winning experience and admin expertise within the PPF.

Digital offering

We would envisage providing a digital service to PSC members, reflecting the high-quality digital offering that the PPF's members have access to. This would include a real-time member website that enables members to self-service where possible, for example to make changes to key information such as their beneficiary, straightforward address changes, deferring pension date, nominating a beneficiary, and bereavement processing.

The website would enable:

- members to see estimates of their benefits, before allowing them to choose a quote and retire function - this would be directly transactional on the PSC system, in essence enabling them to retire online
- members to access their documents, P60, and payslips online
- members to message and send the PSC key documents required for administration
- those with Power of Attorney for a member to register, so they can act on a member's behalf online

Additional help for members who need extra support

Building on the experience of the PPF, the PSC would make available a number of services and tools to help members who need extra support, including:

- providing Letters of Authority for members who need, or prefer, to have a representative contact the PSC on their behalf
- providing letters and other communications in large print or Braille, in alliance with the Royal National Institute of Blind People
- enabling members who have a hearing or speech impairment to communicate with the PSC using RelayUK, a service regulated by Ofcom and which is fully compliant with the General Data Protection Regulation
- enabling members who use British Sign Language (BSL) to speak to the PSC via a BSL interpreter

We would encourage members to tell the PSC about any areas they struggle with and log this on their record using flags and alerts, so the PSC can help them in the best way every time they make contact. The PSC contact centre staff will be trained as Dementia Friends, so they all understand the potential challenges members face when living with dementia, and additionally trained to provide supportive conversations and know how best to help members experiencing mental health issues.