PUBLIC SECTOR CONSOLIDATOR DESIGN – PPF PROPOSITION

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INTRODUCTION / OVERVIEW

This document forms part of the PPF's response to DWP's consultation seeking industry views on the design of a public sector consolidator to be run by the Board of the PPF, which ran from 23 February to 19 April 2024. The consultation reiterated the government's previous commitment to establishing the public sector consolidator by the end of 2026 and was 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 continuing to work collaboratively with DWP and a wide range of stakeholders as DWP takes forward the conclusions of the consultation.

We published an earlier version of this document in March. It was intended to support the consultation process, by setting out an initial view from the PPF as to how the consolidator could be structured. It was not a complete or definitive solution. However, by sharing our early thinking we hoped to support an effective debate, including through generating alternative views and challenge that help us refine or change our proposals.

We were therefore pleased that, over the consultation period, we were able to discuss the proposals with a wide range of advisers, trustees, employers and representative groups. We are very grateful for the input we have received. There was clear support for the proposals (members of our SME Forum, for example, urged us to press on with the consolidator design and implementation as quickly as possible) but a strong message that significant care needs to be taken on the detailed design, including to limit barriers to entry for small schemes (including the costs of transactions) and to ensure a role in the market that is distinct from commercial providers. This feedback has informed our thinking, in particular on benefit standardisation and the onboarding process, which is reflected in the relevant sections of this updated document. We know though that more remains to be done, and we are keen to continue working with the government and industry to reflect on consultation responses and finalise the design.

It is important to stress that our thinking continues to be 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, for example, requires the public consolidator to achieve a significant scale. If this objective is prioritised over others, changes to our design proposals are likely to be required.

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). The original version of this document explored a number of ways to ensure large numbers of small schemes could be 'onboarded' in a time and cost-efficient manner; the views we have heard over the consultation period have helped us to shape and put forward a specific proposal, while recognising that this will require further input and development over the coming period. We continue to propose that the consolidator 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, and we have added an appendix on the thinking which has shaped the proposals for the benefits to be offered. A further appendix, with summary conversion examples, is intended to demonstrate the way in which standardisation can be applied.

We believe a consolidator designed along these lines, with similar levels of security 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 will continue to 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, means we are well positioned to support the government to achieve its objectives in any way we can.

Although DWP's consultation has now closed, we continue to be interested in views on the proposition described in this document. 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 public sector consolidator 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 public sector consolidator 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 it to invest for growth over the medium to long term (within a set risk budget). This will enable the consolidator to invest in the full range of asset classes including UK productive finance.
- 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 public consolidator minimising the price penalty faced by small and subscale schemes.
- Required to provide at least an equivalent level of security as that expected of commercial consolidators – providing a secure solution for members. We believe the government would be the most appropriate provider of risk underwriting for the public sector consolidator.
- Allowing entry from schemes with a deficit on the consolidator'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 consolidator 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 public sector consolidator.

ELIGIBILITY AND THE POTENTIAL MARKET FOR THE PUBLIC SECTOR CONSOLIDATOR

The public sector consolidator 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 consolidator 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 also find commercial options are limited or with unattractive terms. We believe schemes in this position are most likely to see the public sector consolidator as an attractive solution.

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

- [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 the public sector consolidator's market. Importantly, the DB universe may have changed significantly by the time the consolidator is set up in 2026.
- All figures have been provided by The Pensions Regulator (TPR) who have estimated buyout funding using the data available on Exchange as at 30 September 2023. Aggregate checks on the data have been completed and where information is missing, default assumptions have been adopted.
- The estimated buyout assets and liabilities are based on the latest buyout funding figures provided to the Regulator following each scheme's latest formal valuation, which on average are approximately 2 ½ years out of date. The submitted figures are adjusted to reflect changes to market indices and rolled forward to a consistent date of 30 September 2023. The buyout liabilities are also adjusted to reflect broad changes in insurer pricing, and changes in future improvements to mortality. Assets are adjusted to make approximate allowance for Deficit Repair Contributions.
- Note that no allowance is made for benefit outgo or additional accrual when calculating the estimated buyout assets and liabilities as at 30 September 2023 – this means that both assets and liabilities will be overstated. However, there would be limited impact on aggregate funding levels as these affect both assets and liabilities in a similar manner. Given the limited data available, the figures also do not reflect any changes to scheme benefits or asset strategies between the latest scheme return information and 30 September 2023. Importantly, the asset roll forward may not reflect the full impact of the LDI episode, or any LDI held by schemes not explicitly included within the asset allocation provided via the scheme return. These limitations may act to overstate the projected assets.
- The scheme status information is based on the data provided to TPR, recorded on Exchange as at 30 September 2023, and then adjusted using the same methodology to that adopted for TPR's 'Occupational defined benefit landscape in the UK 2023', published on 20 February 2024.
- In practice the public sector consolidator 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 provided.

market for the public sector consolidator includes around 2,300 schemes with around £130bn in assets. Of course only a proportion of these schemes will be interested in a transfer to the consolidator, 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 public sector consolidator may only attract transfers from a small proportion of these schemes. 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 consolidator's contribution to the government's wider objectives is more limited. To ensure or guarantee the consolidator will achieve significant scale, changes to the proposition are likely to be needed.

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 public sector consolidator. Overall we think a better approach – in order to achieve the government's objectives – is to establish the consolidator 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 public sector consolidator 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, figures have been rounded (to the nearest 1,000 for total number of members and £1bn for total assets).

<u>Schemes with fewer than 100 members</u> **– We expect the public sector consolidator 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 most commercial providers and that they may be interested in the consolidator at all funding levels. However, schemes with less than 80% funding may find the required payment plan unaffordable.

Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	135	6	1
Between 80% and 100%	314	15	2
Between 100% and 110%	215	10	2
Over 110%	414	16	3
Total	**1,078**	**47**	**8**
Total green	**943**	**41**	**7**

Schemes with more than 100 members and fewer than 1,000 members – 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%	213	72	7
Between 80% and 100%	518	175	24
Between 100% and 110%	266	96	15
Over 110%	446	158	27
Total	**1,443**	**501**	**73**
Total green	**1,230**	**429**	**66**

Schemes with more than 1,000 members and fewer than 10,000 members – *larger* schemes are likely to be the preferred market for most insurers and commercial consolidators. We therefore think the core market for the public sector consolidator 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%	49	139	12
Between 80% and 100%	167	486	61
Between 100% and 110%	92	260	36
Over 110%	154	450	69
Total	**462**	**1,335**	**178**
Total green	**167**	**486**	**61**

Total population of the potential market for the public sector consolidator

Funding range	Number of schemes	Total members (000s)	Total assets (£bn)
Under 80%	0	0	0
Between 80% and 100%	999	676	87
Between 100% and 110%	481	106	17
Over 110%	860	174	30
Total	**2,340**	**956**	**134**

RISK UNDERWRITING

As noted in the summary section above, we believe the public sector consolidator should be able to meet a similar level of security as expected of commercial consolidators. This ensures a high level of protection for members.

To do this – while also maintaining an entry price that is reasonably attractive to schemes – the consolidator will require underwriting from third party capital.

A key question in the design of the public sector consolidator, therefore, is who provides this underwriting.

The consolidator 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 a facility for the public sector consolidator that mimics the effect of a buffer fund – i.e. a level of capital that the consolidator can draw on in pre-determined scenarios.

There are a number of ways such a facility could be structured and the government will need to consider the best approach to support its goals. However, we anticipate this would not need to be a 'real' fund but a finite, contingent liability for the government that the consolidator could draw on in prescribed circumstances.

Drawing on the experience of the PPF's investment performance, the consolidator would aim to build a reserve from its own funds, i.e. through investment returns. This reserve could then be used to reduce the government's contingent liability – i.e. over time the consolidator would build its own capital buffer. Consolidator funds over and above a certain funding level could constitute the return to the government for providing the risk underwriting (in the same way that return is generated for investors in commercial superfunds). The government could then choose how this return is used – one option could be to increase the level of investment in UK growth assets. The government may also wish to consider the possibility of providing discretionary increases to members. It will be important to have specified at the outset, ideally in legislation, what would happen to any surplus that might arise.

A key aspect of the above proposals is that the level of support available is capped (though the total amount available would need to support the desired scale and ensure the required level of security). In this scenario – of finite government support – we believe the PPF will need to be available to the public sector consolidator in the event of its failure. This would give members the same protection as that provided to all DB schemes and commercial consolidators (and so the consolidator 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 public sector consolidator 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 currently 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 public sector consolidator operating at scale.

Longer term, if PPF reserves continue to grow, as they are expected to, this could be an option for the government to consider, with reserves replacing some or all of any government underwriting.

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 the consolidator's 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 it is possible to establish a benefit structure that would allow the following commitments to be made to transferring trustees and members:

- on transfer the consolidator will pay existing pensioners (at least) the same amount of pension as they are already receiving
- the starting amount of a deferred member's pension when they retire is projected to be (at least) 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 dependants

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.

We believe that the above can be achieved through a menu of choices.

Over the consultation period we have sought views from trustees, sponsors and advisers on:

- whether the commitments in the bullet points above 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 with commercial providers is a material advantage as compared with the public sector consolidator proposition
- whether the choices outlined will allow the above commitments to be made; we particularly sought views on the range of pension increases and revaluation offered, and the proposal not to allow partial retirement

So far, we have received generally positive feedback, with most stakeholders agreeing that the proposed menu should allow a very close match for the majority of scheme benefits.

Some respondents have highlighted that the revaluation options in the public sector consolidator are more limited than the range of rates in use by schemes. We explain this element of our proposal in Appendix 1.

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
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 compound applied for months deferred • CPI with a maximum of 2.5% pa compound 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 • All options include 25% children's pensions 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)

[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.

Scheme feature	Options/benefits offered
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

Unmatchable benefits

Although we believe the consolidator will be able to match the vast majority of scheme benefits, there are some that cannot be matched. As well as the above discussion of revaluation rates, other unmatchable benefits include (but are not limited) to:

- inflation-linked increases with less common caps or floors
- increases linked to indices other than CPI or RPI
- underpins
- more generous death benefits such as 10-year guarantees, funeral grants, or dependants’ benefits exceeding 2/3 of pension
- fixed option terms

Where possible, we would expect schemes to convert to the closest available matching consolidator benefit. This may be a combination of consolidator benefits, rather than just one. For example, a scheme that provides RPI increases up to a cap of 4% could construct a combination of RPI 3% and RPI 5% increases that would be expected to have a broadly similar profile to RPI 4% increases.

When approximate matches cannot be found in this way, we expect schemes to value the scheme benefit as they would do when (for instance) calculating a CETV, and purchase a level of an appropriate consolidator benefit that gives at least the same value. In these cases, the overarching conversion principles still apply – in particular, that benefits should be payable from the same age as in the scheme, and that the expected level of pension at the point of retirement should be at least as high as in the scheme. These conditions may, in some cases, result in schemes having to pay more to convert to slightly more valuable consolidator benefits, or in benefits having to be reshaped to maintain actuarial equivalence.

Actuarial equivalence

Where benefits cannot be exactly matched, conversion must be based on assumptions at the point of calculation. However, experience will inevitably diverge from these assumptions, and this could create

a situation in which over a member's lifetime they could receive more benefits from the consolidator than they would have received from their original scheme, and in other cases they could receive less.

We aim to minimise this by providing a menu of options that allows the vast majority of scheme benefits to be very closely replicated in the consolidator. This mitigates a large proportion of this risk.

However, there will be some – usually small – disparities that cannot be avoided. The only way to remove this risk completely would be to replicate fully all schemes' benefits in the consolidator. We believe this would be so onerous as to make the consolidator effectively unviable for the type and number of schemes that we aim to serve.

This issue is not unique to this proposal. It is a feature of almost all regular member options such as early retirement, and options exercises such as pension increase exchanges. In these cases, the member selects the option and therefore may be considered to have actively accepted this risk. However, this is also a feature of non-consensual exercises such as bulk transfers and GMP conversion (perhaps as a part of GMP equalisation), which are existing long-standing mechanisms used to convert members' benefits. We believe that the potential for consolidation to produce significant disparities is low, and no greater than methods used already in the industry.

Examples of converting from scheme benefits to consolidator benefits

We have included in Appendix 2 two hypothetical examples of how conversion might look at a high level.

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 sought detailed industry input throughout the consultation period.

'Stated benefits for stated people'

We propose the public sector consolidator operates in a comparable way to an insurer or commercial consolidator. Trustees will 'buy' benefits for their members from the public sector consolidator, which 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 public sector consolidator) 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 public sector consolidator as any other commercial provider. And thirdly, in order to realise the advantages of benefit standardisation, the public sector consolidator 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 public sector consolidator 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 public sector consolidator, the slower any resulting impact on productive finance investment and gilt holdings will be.

Supporting efficiency and speed

We propose that the public sector consolidator 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:

- transparency on pricing through an online ready reckoner /, including an approximate basis and methodology for pricing - this will enable scheme trustees and advisers to assess readily whether the public sector consolidator is an attractive and viable destination for their scheme
- guidance on the benefit standardisation process
- assurance on the viability of the public sector consolidator – we believe it will be important to establish it 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
- guidance on indicative payment plans

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

We know that 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.

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).

To help us develop a proposition which might address these issues, we engaged extensively with our trustee, advisory and legal panels throughout the consultation process.

We explored a number of approaches:

- providing early assurance on pricing
- a buy-in equivalent, under which the consolidator would have liability for paying the chosen standardised benefits to scheme members from a pricing commitment phase
- a buy-in equivalent, under which the trustees would continue to pay the existing scheme benefits to members for a limited period of time and the consolidator would make scheduled regular payments to the trustees
- full data risk transfer

Further detail on each of these is included in the first version of this design document, which is still available on the PPF's website.

As a result of the input we have received, we have refined our thinking to narrow to a single proposition, as described in the following diagram. We would also note that:

- we envisage, and see real value in offering, that throughout the process it will be open to schemes to use panel firms to drive efficiency and cost
- this is by no means a fixed and final approach; we recognise that it will require further input and development over the coming period, since much of the onboarding process will be contingent on what the government decides about the overall shape of the consolidator. Some elements of the process still need be refined for schemes unable to invest in a price-lock portfolio, for example schemes with material illiquid assets or underfunded schemes
- we recognise the importance of clear member communications throughout the process and – as we do in a PPF assessment period – would work closely with trustees to achieve this

We look forward to working with the government and industry to progress this design work further.

1

Initial feasibility

Allows schemes to assess quickly and easily whether the consolidator is an appropriate destination

Trustees/actuary use self-service tools and information (including on public sector consolidator security, benefits, pricing and indicative payment plans for schemes in deficit)

Trustees engage with sponsor to ensure it supports a potential transfer and (if appropriate) it is happy with the indicative payment plan

2

High level data and benefit work

These steps are intended to mirror those needed to be 'buy-out' ready i.e. no wasted effort

Completion of benefit specification

Review of data to identify (but not resolve until step 4) issues to assess transaction feasibility

Plan GMP rectification and equalisation (but do not complete until step 4)

High level mapping to standardised benefit structure also needed (to allow pricing). The output is a data set reflecting approximate standardised benefits for each member

3

Pricing, price lock, commitment to transact

Trustees provide initial standardised data to the consolidator

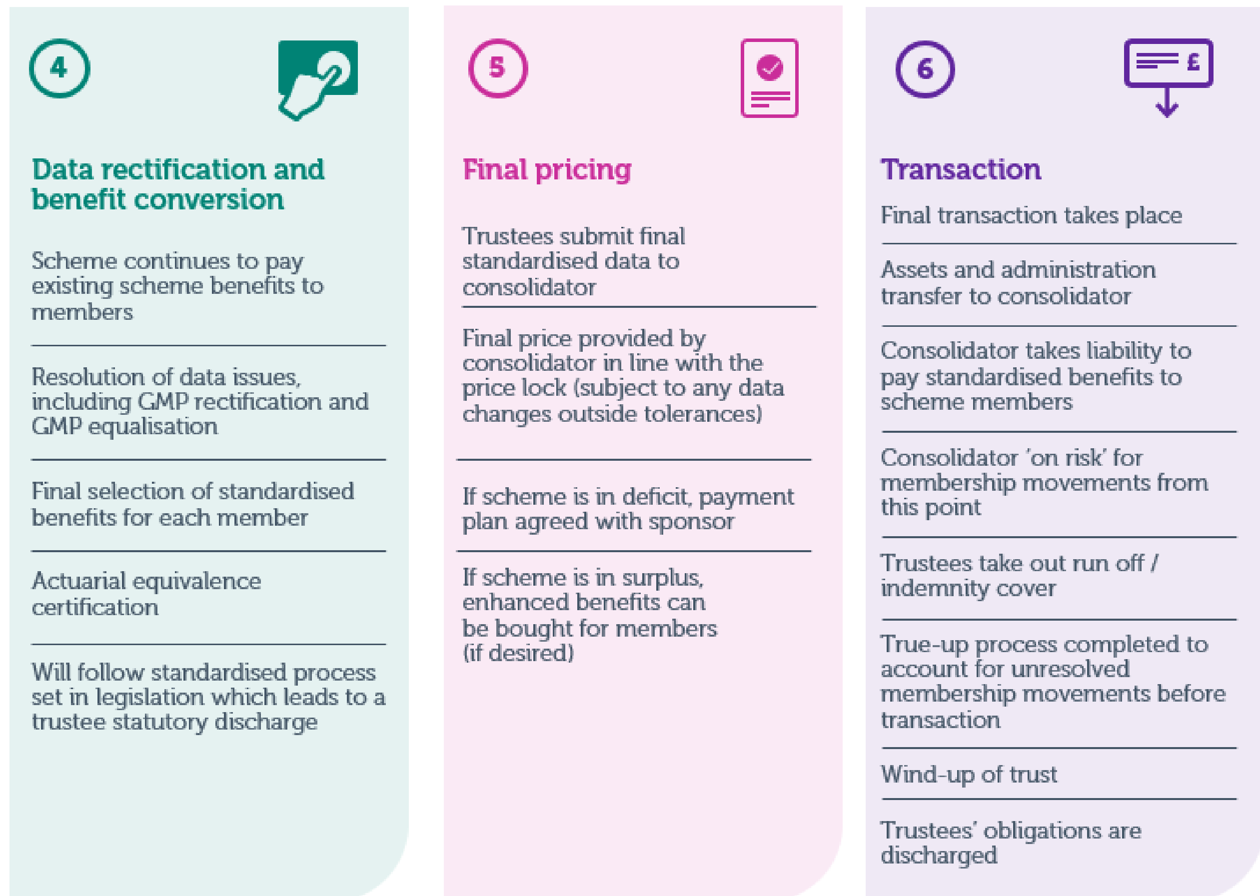
Consolidator provides initial pricing terms (including details on the price lock and an illustrative payment plan)

Consolidator commits to transact at the end of the data resolution phase. Trustees commit to progressing data resolution work to agreed timetable (agreed with firms who will lead on the resolution work). If required, sponsor commits to payment plan mechanism

Trustees move the scheme's asset allocation to a price-lock portfolio specified by the consolidator

Price-lock is then guaranteed for an agreed period to resolve data issues (subject to some reasonable boundary conditions giving the consolidator the ability to re-price following extreme market events)

Any data amendments found in later stages will be priced in line with the agreed pricing basis and price-lock mechanism (up to specified limits)



We are very grateful to all our panellists for the time and effort they put into helping us put together this proposition, and for their confirmation that in their opinion "it works well", it is "the broad way in which onboarding should work" and "is a workable process".

Legislative support

Throughout the consultation period we have heard from stakeholders about the need to make the process of onboarding, and moving to standardised benefits, as simple and low cost as possible, if it is not to be a barrier to small schemes. We suggest that, since new legislation will be required to establish the public sector consolidator, the government could use this as an opportunity to craft legislation in a way that supports a straightforward and simple transfer process (while still protecting members' benefits). We would suggest taking the existing 'transfer without consent' requirements in Regulation 12 of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 as a starting point. Specific elements might include:

- providing a statutory override to schemes whose rules do not permit bulk transfers
- expanding the scheme relationship condition in Regulation 12(2) to include a transfer to the public sector consolidator
- providing assurance that converting existing scheme benefits into standardised benefits on the basis of actuarial equivalence, and assumptions and guidance provided by a government body (for example the Government Actuary's Department) or the public consolidator, is sufficient for an actuary to certify the transfer and for the actuary and trustee to discharge their obligations
- expanding the certification process so it could be fulfilled by an appointed actuary, not just the scheme actuary

- providing guidance on when it would (and would not) be appropriate for trustees to decide to transfer member liabilities to the public sector consolidator

We recognise that the government may wish to make appropriate elements of any new legislative provisions available to commercial providers as well as the public sector consolidator.

An alternative approach, if the government were to choose not to legislate in this way, could be to work with the actuarial profession and / or the Government Actuary's Department to develop guidance on how to apply the existing condition that transfer credits in the receiving scheme should be "broadly no less favourable".

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 public sector consolidator can meet its objectives. It will ensure the consolidator can support the schemes least attractive to commercial providers (including schemes with poorer funding).
Incorporating schemes with deficits does, however, present a number of challenges. The design of the consolidator needs to mitigate risks to the funding position of the scheme, and the risk of opening up a mechanism for 'pension dumping' by employers (allowing employers to walk away from their pension liabilities on the cheap).

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 payment plan would be designed to ensure affordability for the employer.

- If the employer becomes insolvent before the payment 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 payment 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 public sector consolidator) contingent security to protect member outcomes in the event of default.

Schemes in surplus

Many schemes transferring to the public sector consolidator 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 public sector consolidator.

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 public sector consolidator. 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 consolidator 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 consolidator system, in essence enabling them to retire online
- members to access their documents, P60, and payslips online
- members to message and send the consolidator 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 public sector consolidator 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 consolidator 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 consolidator 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 consolidator via a BSL interpreter

We would encourage members to tell the consolidator about any areas they struggle with and log this on their record using flags and alerts, so the consolidator can help them in the best way every time they make contact. The consolidator's 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.

APPENDIX 1

The revaluation debate

We have received feedback from some stakeholders that the proposed rates of revaluation do not offer as comprehensive coverage of external scheme benefit structures as, for instance, the proposed pension increases do. The primary reason for this is our objective to maintain simplicity, wherever possible, while still providing benefits that are valued and expected by members. While pension increases change benefits in payment, revaluation rates in deferment are more academic, provided that the eventual benefit at retirement is expected to match the scheme benefit that would have been payable at that date. We have therefore prioritised simplicity over an exact match to scheme rates.

RPI revaluation

Where revaluation is in line with inflation, the rates cannot be guaranteed, and to that extent there may be a mismatch between (e.g.) RPI revaluation in schemes and CPI revaluation in the consolidator, which could result in differences over time. However, we expect that (especially as RPI and CPI will mostly converge from 2030, and barring significant unexpected fluctuations in the RPI-CPI wedge) the impact of any mismatch as a result of converting RPI to CPI revaluation is likely to be small. We therefore think that the two CPI-based revaluation rates on offer should broadly provide a close enough match for the majority of CPI- or RPI-linked revaluation rates in use by schemes.

Fixed-rate revaluation

With fixed-rate or nil revaluation, the benefit at retirement is known and therefore the rate of revaluation used to (effectively) discount it back to a given calculation date is largely academic. We therefore think it is reasonable to provide only a single fixed rate revaluation option, to match the nature (rather than the level) of revaluation for such benefits.

The question is therefore the level at which that rate should be set. A lower rate means a higher initial deferred pension in the consolidator than in the scheme, and vice versa. We believe it is preferable, from a member's point of view, to provide a higher initial pension in the consolidator where possible. We have therefore opted to offer a fixed rate of 3% revaluation, as it is lower than most fixed revaluation rates in use. We have not set this rate at zero, because it may be difficult to communicate to members that a previously revaluing benefit is now non-revaluing – even with a corresponding increase in the initial amount – and we believe non-revaluing benefits are rare.

Non-revaluing benefits primarily consist of a) pre-1986 excess over GMP for members who left their scheme before 1991, b) pre-1975 historic contracted-out benefits called Equivalent Pension Benefits or EPBs, and/or c) certain transferred-in benefits. In all cases, we believe these benefits are largely historic, relatively small and increasingly rare among members who still have not retired by 2026. For any that do remain, the period of revaluation is likely to be very short – so the effect of conversion will be small. For these reasons, we do not see a strong need to provide an additional nil revaluation option.

Death in deferment

The main exception to all of the arguments above is the case of death in deferment benefits. These are usually based on the member's benefit revalued to death, so the rate of revaluation is relevant. Where revaluation cannot be matched exactly, the closest rates offered by the consolidator are expected to be generally slightly lower than the corresponding scheme rates (other than in the rare cases of non-

revaluing scheme benefits). Therefore, the death in deferment benefit will generally be correspondingly higher than the scheme equivalent (if, indeed, the scheme provides death in deferment benefits on the same basis as the consolidator in the first place). However, death in deferment is relatively uncommon and much more likely to occur closer to retirement age – in which case the projected revaluation period, and therefore the effect of conversion, should be relatively small.

We appreciate that stakeholders may have different views on this, and continue to welcome feedback on these points.

APPENDIX 2

Examples of converting from scheme benefits to consolidator benefits

This section sets out how conversion might look at a high level in two hypothetical examples, in line with our principles that:

- scheme benefits should be mapped to the closest available type of consolidator benefit
- the 'headline' annual benefit amount provided by the consolidator should be at least as high as the annual benefit amount payable from the scheme, as at:
  - normal pension age, for deferred members who are under normal pension age at the point of transfer, or
  - the date of transfer, for deferred members over normal pension age and pensioners/dependants in payment
- consolidator benefits will be payable from the same normal pension age as the scheme benefits

Both of these examples relate to deferred members. The process for pensioner members would be similar, except that:

- no revaluation projection is required – the level of the immediate consolidator benefit must match or exceed the level of the current benefit in payment.
- any contingent dependant's benefit relating to a pension in payment would be mapped directly to a corresponding actuarially equivalent dependant's benefit in the consolidator, rather than the consolidator dependant's benefit being a fixed proportion of the consolidator member's benefit.

Each example shows two sets of figures – 'projected pension at normal pension age' and 'current deferred pension quoted at transfer'.

Under the 'projected pension at normal pension age' heading, we show what the member is projected to receive when they reach the normal pension age (NPA) for each tranche of benefits. Different tranches of benefits may have different NPAs. The projection is based on assumptions about levels of inflation, and on the revaluation rules under both the original scheme and the consolidator.

The 'current deferred pension quoted at transfer' shows what the member would be quoted as their current rate of preserved benefits at the date that the scheme transfers to the consolidator, before allowing for projected revaluation between transfer and NPA.

It should also be noted that:

- The projected pension at NPA in the consolidator must be (at least) as high as the projected pension in the scheme. Therefore, if the consolidator provides **lower** revaluation than the scheme, the initial deferred pension in the consolidator must be **higher** than it is in the scheme, and vice versa.
- If the consolidator pays pension increases later than the original scheme, then the initial pension in the consolidator should be increased to compensate for the difference in timing. This is shown in the "Member 2" example below.
- In some cases, the actuarial value of the consolidator benefits may be slightly higher than the actuarial value of the scheme benefits, due to the relatively generous survivors' benefits from

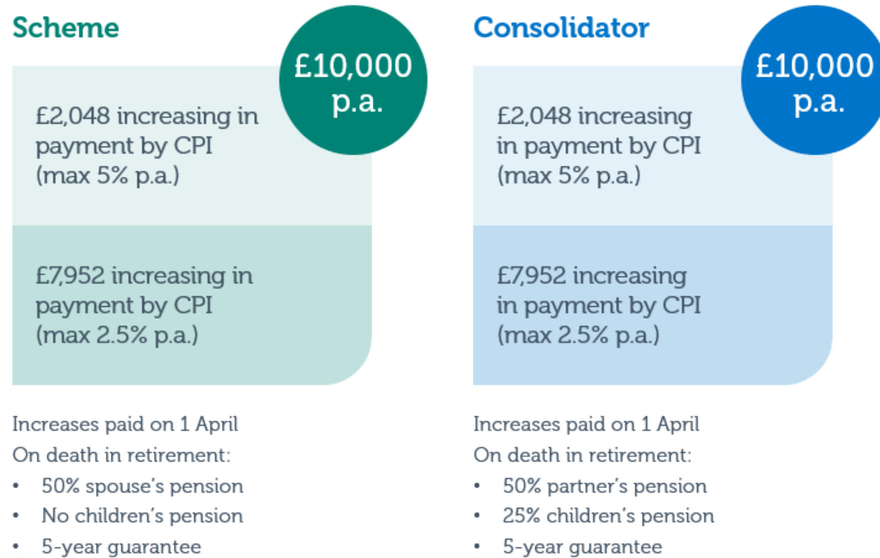
the consolidator. In most cases we expect any excess of value to be small (in our examples below, the increases in value are c.2% and less than 1% respectively), and therefore schemes may choose simply to pay for the slightly more valuable consolidator benefits. Our examples below assume that this approach is taken. Alternatively, the scheme could choose slightly less costly consolidator benefits – e.g. with slightly lower pension increases overall – to offset the cost of any enhancement to survivors' benefits.

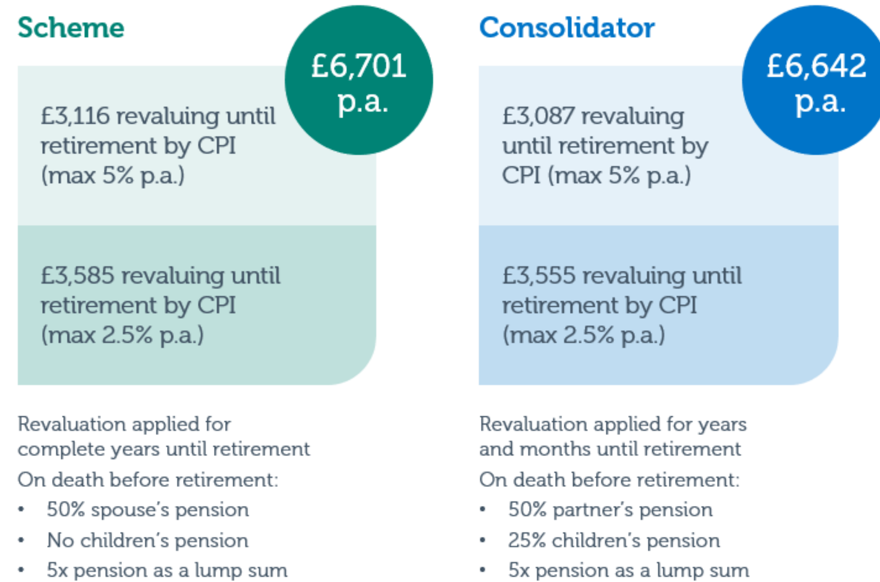
- Where a member has multiple tranches of benefits with different NPAs, they must take all their benefits at a single retirement date. This would mean taking at least part of their benefits earlier or later than the NPA for that tranche, with a corresponding reduction or increase to that part of their benefit. The member can choose at which date to retire. This does not affect the conversion process, which will be based on the tranche NPA for each tranche of benefits (or the date of transfer, where the member has already retired and/or is over tranche NPA).

We would be happy to provide further detail on the conversion examples; please send any requests to externalaffairs@ppf.co.uk.

Member 1: currently aged 49, normal pension age 65

The diagram below shows a straightforward example of how a member's scheme benefits could be mapped to consolidator benefits.





Key observations:

- Projected pension at normal pension age is the same in both the ceding scheme and the consolidator
- All increases in retirement at the same rates and on the same date
- Therefore, the projected benefits for the member at and throughout retirement are the same in the consolidator as in the original scheme.
- Death benefits are slightly more generous in the consolidator than in the ceding scheme (consolidator pays pensions to unmarried partners as well as spouses, and also has a separate provision for children's pensions)
- Current deferred pension at date of transfer is slightly (around 1%) **lower** in the consolidator than in the ceding scheme…
- … this is because the consolidator applies revaluation for a longer period (as it uses years and months, rather than rounding the revaluation period down to complete years), so the total amount of revaluation is **higher** in the consolidator than in the scheme
- This has minor implications for the survivor benefits if the member were to die before retirement, as these are based on revaluation to the date of death, and would consequently also be slightly lower in the consolidator than the scheme.

Member 2: currently aged 58, normal pension age 60 (for benefits accrued before 6 April 1997) or 65 (for benefits accrued from 6 April 1997)

The diagram below shows a more complex conversion example. The headline benefits would appear as follows:

Projected pension at normal pension age(s)

Scheme — £10,000 p.a.

- £2,029 increasing in payment by RPI (max 5% p.a.) – payable from 60
- £1,461 increasing in payment by CPI (max 3% p.a.) - payable from 60
- £4,617 increasing in payment by RPI (max 5% p.a.) - payable from 65
- £1,893 increasing in payment by RPI (max 4% p.a.) - payable from 65

Increases paid on 1 January, other than second tranche where increase is paid on 6 April

On death in retirement:

- 50% partner's pension
- 25% children's pension
- No guarantee

Consolidator — £10,079 p.a.

- £2,048 increasing in payment by RPI (max 5% p.a.) – payable from 60
- £1,461 increasing in payment by CPI (max 3% p.a.) - payable from 60
- £5,863 increasing in payment by RPI (max 5% p.a.) - payable from 65
- £707 increasing in payment by RPI (max 3% p.a.) - payable from 65

Increases paid on 1 April

On death in retirement:

- 50% partner's pension
- 25% children's pension
- 5-year guarantee

Current deferred pension quoted at transfer

Scheme — £8,553 p.a.

- £1,954 revaluing until age 60 by RPI (max 5% p.a.)
- £1,405 revaluing until age 60 by a fixed rate of 4% p.a.
- £5,194 revaluing until age 65 by RPI (max 5% p.a.)

Revaluation applied for complete years until retirement

On death before retirement:

- 50% partner's pension
- 25% children's pension
- 5x pension as a lump sum

Consolidator — £8,890 p.a.

- £1,980 revaluing until age 60 by CPI (max 5% p.a.)
- £1,412 revaluing until age 60 by a fixed rate of 3% p.a.
- £5,498 revaluing until age 65 by CPI (max 5% p.a.)

Revaluation applied for years and months until retirement

On death before retirement:

- 50% partner's pension
- 25% children's pension
- 5x pension as a lump sum

Key observations:

- Projected pension at normal pension age is slightly higher in the consolidator than in the scheme…
- … to compensate for the fact that the consolidator pays pension increases later than the scheme for some benefits – so the expected amount of pension paid over the first year of retirement is the same under both arrangements
- Some of the scheme benefits increase in payment at a rate of RPI capped at 4%, which cannot be directly matched by the consolidator…
- … instead, this tranche has been mapped to a mixture of RPI (max 5%) and RPI (max 3%) benefits in a ratio that is expected to produce very similar pension increases to RPI (max 4%) over the member's lifetime
- The consolidator pays a 5-year guarantee, whereas the scheme doesn't; other death benefits are the same in the scheme and consolidator
- Deferred pension at date of transfer is slightly (around 4%) **higher** in the consolidator than in the ceding scheme…
- … this is because revaluation rates in the consolidator are **lower** than revaluation rates in the scheme
- As with the previous example, this has minor implications for the survivor benefits if the member were to die before retirement, as these are based on revaluation to the date of death, and would consequently also be slightly higher in the consolidator than the scheme.