The Association of Member Nominated Trustees was established in September 2010 to bring together member-nominated trustees, directors and representatives of public and private sector pension schemes to give trustees a collective voice, to provide mutual support and information exchange and to campaign on matters of concern. We have around 800 members from pension funds with collective assets of approximately £1-trillion.

AMNT welcomes the Minister's support for the proposition that "the primary purpose of a pension scheme is that members get the pensions they are expecting" and this lies behind all our following responses.

The purpose of pensions policy must be first and foremost to ensure that working people retire with sufficient pension. The 2004 Pensions Commission established that this, for people earning an average wage, means a pension equivalent to two-thirds of their pay.

Government policies over the last 30 years have forgotten this aim and more and more serious concerns are being raised both in Parliament and by the pensions industry that this has created the conditions for a crisis in the coming years as people reach retirement and discover that they do not have enough pension to live on.

This crisis will cause increasing problems for the Department for Work and Pensions and the Treasury as the government will be required to step in to supplement their incomes.

Whilst this is especially true in DC pensions, the experience of pensioners in DB schemes in the last two years, or over a much longer period for those with pre-1997 pension accrual (where around 24% have no indexation rights) has largely been a significant fall in their pensions in real value for the rest of their lifetime.

This follows on from years in which DB scheme members' contribution levels have been raised and in many cases, accrual rates reduced, as their part of funding a deficit situation, alongside employer deficit contributions. Whilst in law they may have received what they are entitled to, the existence of discretions and inflation caps was surely originally intended to protect the scheme from high inflation when it did not have sufficient funds. To apply caps and refuse discretions when a scheme has a significant surplus is to go against the principles underlying the scheme benefits.

We are therefore concerned that in discussion of a surplus, not only should the security of member benefits be as assured as is possible, but also their income shortfall through lost inflation linking, reduced accrual rates and higher contributions towards lower pensions, which have all helped to build any surplus be recognised and which should be addressed prior to the return of surplus deficit contributions to employers.

The appropriate context for this discussion with the employer will depend on whether the scheme in question is one of the approximately 70% of schemes closed to future accrual, the 20% closed to new members but open to accrual, the 4% of fully open schemes, or one of those in the process of winding up. Different mechanisms of sharing with members should apply in different cases.

Particularly we urge that schemes currently heading towards buyout should be in conversation about the sharing of any surplus with members through discretionary increases. Evidence to the Works and Pension Committee (Third report 2023-24 paras 85 to 87) reveal this is not always the case.

We are also concerned that in the questions about a potential PPF consolidator, most of the questions are expressed in terms of the effect upon the insurance market, and not whether the proposal will result in increased security for the members of schemes struggling to find buyout without a price premium, or even to reach a buyout funding level at all. If the government wants to encourage wider investment in growth/productive assets, it is to their benefit also if small schemes are able to find a way to secure members' benefits more easily than in the current very busy insurance market.

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

It would make it easier than if a change to scheme rules was required. However the existence of a power to share the surplus does not automatically make it an appropriate decision.

The reason for sharing surplus should be based firmly on an assessment of the surplus above a significant safety margin (backed by a low risk investment strategy and insurance where appropriate) to ensure members' benefits are secure.

It would need to be a more significant safety margin than that set out to reduce surpluses within the 1986 Finance Act, which made pension schemes reduce their surpluses to 105% if they wanted to avoid punitive taxation; and one option was to give the surplus to the employer while other options were contribution holidays or increases to benefits. Inevitably, when market conditions worsened, this resulted in deficits materialising as a result of there being little to no cushion that the surpluses would have provided.

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

The power to amend scheme rules to release a surplus should be at the trustees' sole discretion. However the existence of a power does not mean it will or should automatically be used. It should only be used by agreement between trustees and the sponsoring employer.

Scheme sponsors should not be able to unilaterally refuse trustee proposals to share surplus with members in the hope of taking it for the company on a buyout. Also protection needs to exist to ensure a sponsor cannot attempt to dismiss the trustee board in favour of a sole trustee in response to such a proposal to share surplus.

However, following an agreed decision to release surplus the crucial question is how it will be shared equitably between members and sponsor.

Therefore, whichever route to amend rules, there needs to be clear guidance on the need for agreement between trustees and sponsors, with proposals to break the deadlock if agreement cannot be reached. We propose, in accordance with the situation of a deadlock on deficit contribution discussions, that TPR should be the arbiter.

Question 3: If the government were to introduce a statutory override aimed at allowing schemes to share surplus with sponsoring employers, should it do so by introducing a statutory power to amend scheme rules or by introducing a statutory power to make payments?

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Question 4: Should the government introduce a statutory power for trustees to amend rules to enable one-off payments to be made to scheme members, or do schemes already have sufficient powers to make one-off payments?

Where the surplus is sufficient to allow increases to restore real value that should be the first priority. However, where the surplus does not allow this, a power to make one-off payments to members would emphasise the requirement to find an appropriate mechanism to have members share in the distribution. However, if a longer running-on to share surplus strategy is planned then pensioner members might be better served by a series of small real value increases for their lifetime rather than a larger one-off payment.

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

It might encourage schemes to run on for longer before buyout, either in the shorter term while one-off surplus distribution options were under discussion, or on a medium-term basis planned with sponsors to return surpluses generated to members and sponsor over a period of years.

However most schemes that are closed to new members and future accrual may be expected to still buy out eventually – but at a lower cost/lower risk transaction because of the increased maturity of the scheme (ie the scheme members are older), which in itself increases the surplus for distribution.

There will be schemes where the surplus is enough to achieve buyout, but sponsor covenant strength is not sufficient to support secure run-on for members. These will therefore still be looking for the traditional buyout route to secure member benefits.

Therefore the insurance market might slow a little from its current increasing pace – but most schemes are still likely to end up there eventually (unless the government takes action to encourage the reopening of DB schemes to new members and future accrual).

We note the Pensions Regulator's occupational defined benefit landscape in the UK 2023 which states that almost a quarter of pension schemes are still open to accrual[1] so the less restrictive funding proposals might encourage those schemes to reopen to new members – which the government should, like the Work and Pensions Select Committee, encourage.

Question 6: What changes to the tax regime would support schemes in delivering surpluses to distribute as enhanced benefits?

We have no specific proposals on the tax regime but would support the ability for trustees to have a wide range of choices on how surpluses could be shared with members to recognise the loss of real value of their pensions, even where a surplus is not sufficient to achieve this in full.

Question 7: Are there any other alternative options or issues the government should consider around the treatment of scheme surplus?

As stated at the introduction to our response, AMNT strongly urges the DWP to recognise that most people in DB schemes are now unlikely to accrue a pension equivalent to two-thirds of their pay after years of reductions in benefits. The younger they are, the less likely they will be to achieve this. It is tempting to assume that DB schemes are the gold standard but they have become tarnished as pension deficits were repaired not only with employer contributions but also by reducing accrual rates which have fallen below what is necessary for scheme members to reach a two-thirds salary pension.

For example, a large number – possibly the majority – of schemes began with 1/60th accrual rates, which would produce a pension of 2/3rds final salary after 40 years (40/60ths), but many have had the accrual rates reduced to 80ths which would mean young scheme members having to work for 50 years with the same employer to achieve the desired pension entitlement.

Further, most schemes have closed to further accrual, so the members cannot accrue a larger pension. Members of closed schemes may have been put into DC schemes with much lower pension entitlement.

In the last two years, and over longer periods too, members' benefits have fallen in real terms despite inflation-proofing being at the heart of most scheme design.

[1] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/occupational-defined-benefit-landscape-in-the-uk-2023

We therefore strongly urge the DWP to make increases to members' benefits an equal or higher priority than payouts to employers, with the aim of returning benefits, as far as possible, to their real value. Without this priority it could enable short-term windfalls for employers at the expense of members' ability to have a reasonable pension and the further expense incurred by the Treasury and the DWP through the benefits system as a result.

Where there are large surpluses, either initially or through longer term run-on, in addition to restoring real value, further targets could be:

- for schemes still open to accrual, to reverse the decreased accrual rates,and/or higher member contribution rates, and

- for closed schemes, to credit additional years to reflect benefits lost through reduced accrual rates.

Question 8: Under what combination of these criteria should surplus extraction be permitted? If you feel alternative criteria should apply, what are they?

There needs to be a significant buffer above low dependency funding calculation for the release of surplus until the final surplus sharing prior to buyout. It seems equitable that the size of the buffer should be linked to actual investment risk in portfolio. We feel that the suggestion of 105% has unfortunate echoes of the 1986 finance act when a 105% funding level was soon found not to be sufficient for a turbulent market and indeed has much to answer for in relation to the destruction of the defined benefit pensions system.

However, much depends upon the prudence levels built into the funding level assessment. Covenant strength is a major part of the risk assessment – and the horizon on which it can reasonably be depended upon taken into account, either in the calculation of low dependency funding, or specifically in the buffer calculation. Low dependency is not no dependency in extreme circumstances.

We recognise that sponsor covenant strength might be improved by surplus sharing, but the interaction of this with the security of members' benefits is a finely balanced equation.

The required buffer could perhaps be lower (but not non-existent) if covenant insurance/PPF 100% levy, or other insurance/downside protection investment structures were included.

Question 9: What form of guidance for trustees around surplus extraction would be most appropriate and provide the greatest confidence?

First and foremost the guidance must be for trustees and sponsors and include a requirement for agreement before any surplus can be released, including finally on buyout. A process for breaking deadlock should also therefore be included, which we propose to be TPR.

Whether a code, or a Toolkit module, it should include:

- Guidance on member needs alongside employers – eg making good recent increases below real terms as well as those disadvantaged by pre-97 scheme rules over a longer period. This is the starting point and recognition of members' share of "deficit funding" through reduced accrual rates and higher contribution levels need to be key ingredients in a discussion about appropriate sharing with the employer.
- Guidance on appropriate investment strategies/risks – eg in a longer term run-on a quite small increase in risk budget will still enable sponsors and members to benefit significantly over a number of years.
- Guidance on how to set wishes/targets between employer and trustees for future planned increase sharing which do not create a guarantee/liability should there be adverse market conditions.
- Should longer term run-on evolve, a process for reviewing end-game planning at specified intervals to determine whether to continue to generate surpluses, or move to buyout or consolidation.

Question 10: What might remain to prevent trustees from sharing surplus?

Primarily an inability to agree sharing proposals with employer or to agree on the quantity of surplus available above the funding and buffer needed to protect member benefits.

Trustees should always be able to **decide not to** share surplus at a given point – providing that they can give good reason why they believe this is necessary for member security, and have a plan to address sharing before buy out.

Employers should not be able to block surplus sharing in the hope that it will all be returned to them on buyout.

Trustees with concern over covenant need to be able to consider insurance or other factors to give comfort before releasing surplus if they have concerns about member security.

Question 11: Would the introduction of a 100% underpin have a material impact on trustees' and sponsors' willingness to extract surplus? If so, why and to what extent?

Given that the paramount concern in these discussions is the security of member benefits then this would be an additional security for trustees in deciding to run on. Covenant insurance might be a partial alternative, but only exists for strong covenants. The need is to protect against the risk of a material market shock coinciding with loss of covenant strength.

Pricing of the underpin seems high, but its existence may enable a lower buffer.

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

A 100% underpin might be instrumental in encouraging members to support the running on of schemes rather than the perceived security of an insurance transaction. Members will rightly be focussed on their pension security and will need to see safety measures to protect against failure as well as the potential for improved, or real value restored, benefits.

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

To be effective there needs to be a very high level of confidence that the promised 100% benefits will be paid, otherwise the whole idea would be pointless.

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

Covenant security insurance transactions, although these should to some extent mirror the PPF super levy costs

Downside protection investment strategies in addition to the traditional hedging

Continuing to hold a larger surplus than required by the buffer calculations, and choosing to invest that portion for return – which can then be shared.

The rules of the PPF, which has an enormous surplus, should be amended to enable scheme members entering the lifeboat fund to be paid their full pensions.

Chapter 2: Model for a public sector consolidator

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

The rationale for a public service consolidator is to assist in ensuring members receive their accrued benefits. The structure therefore needs to be viewed from the perspective of helping schemes unable to achieve buyout because of a price premium, inability to find a willing insurer, or indeed to afford buyout at all.

Schemes should not have to "prove" they are unable to join a commercial consolidator – what criteria exist to prove a negative? By analogy, employers do not have to prove that no other supplier will accept their pension scheme before joining NEST. However the benefits can be simple, with those able and willing to pay a premium for greater flexibility over timing and benefit design able to do so.

A public sector consolidator is unlikely to be able to accept huge numbers of schemes (attractive to insurers or not) at a stroke, but it may reduce those unable to get access to the market. With record values of insurance transactions in recent years, such that new insurers are entering the market, there exists the space for a public sector consolidator.

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

The PPF consolidator will be constrained by the volumes of schemes it can onboard each year, as is currently the insurance market, and this will naturally limit the annual amount consolidated.

While there are understandable concerns for the insurance market, it is important to remember that this is not about financial markets or the business interests of commercial alternatives, but the security of members' benefits. This should be the priority.

The consultation states that one of the aims of the PPF consolidator is to maintain the security of members' benefits by ensuring that members' interests are protected. We very strongly emphasise that there should be no reduction in members' benefits under the guise of standardisation. Any reduction in members' benefits will kill off the PPF consolidator before it begins. We emphasise that these are not schemes in a desperate plight. They have the alternative option of continuing to run on. We cannot see how any board of trustees could consider the PPF consolidator attractive if it is reducing members' benefits.

If benefit standardisation is an attempt to create a disincentive to approach the consolidator then this would be a mistake. Members' benefits should be secure on transfer – with any standardisation effects of complicated benefit mechanisms erring on the side of the member. Member administration service levels also need to be paramount and not "cut price".

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

If the schemes joining the public consolidator are those which the market is less willing to accept, and where the consolidation is an important step in securing member benefits, then an artificial limit, above that naturally occurring due to the onboarding process demands, is to suggest that the market is more important than the member.

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

This is looking the wrong way through the lens. The priority is to consolidate schemes that are closed to new members and accrual and would prefer not to run on. They may prefer to join a public sector consolidator rather than a private sector alternative. The need to provide security for the members is paramount. Surely in a free market the trustees should have the choice of consolidator.

If the PPF takes the weaker schemes as the priority, then the stronger, better funded schemes would be lower priority for onboarding, so further down the queue, which might encourage them to look at the other options.

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

We do not believe they should be able to reject a scheme – though they should be able to defer acceptance to a strong scheme in favour of schemes where member benefits are more at risk. (Such a deferred scheme is then more likely to explore other markets – and only return if they genuinely cannot find a commercial consolidator.)

They will also need to have a process for allocating appropriate services to schemes which are struggling – but funded above the terms of the traditional PPF, and not actually with the sponsor failing.

In essence, if the consolidator can absorb schemes with better current valuations than they have had historically, then there will be fewer schemes to fall into the traditional PPF lifeboat in the event of market disaster.

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

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

Although the existing commercial consolidator is targeting longer term insurance buyout, this is designed for larger schemes. This is probably not appropriate for small schemes on a cost-benefit basis as the pricing difference for buyout after some years in consolidation is unlikely to be as great for smaller schemes because of their price premium.

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

The same pooled investment fund should be used for all schemes as otherwise it would put the weakest schemes at a size disadvantage.

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

Schemes which are unattractive to commercial consolidators need to take the decisions about running on in the same way as all others. When running on is not seen to be able to provide member security it is necessary for them to find an alternative route to security for the sake of members. If they are unable to afford the commercial price premium for unattractive schemes, or be unable to find a commercial alternative at all then other options need to be available.

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

Open DB schemes seem an unlikely candidate for this process. If a scheme is open to accrual then both the employer and the members will continue to be paying their contributions. This would mean that TPR would have to set up a whole mechanism for this, for carrying out triennial reviews and negotiating with the employer how much the PPF is requiring them to pay for the next three years.

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

The important question is whether scheme members will be adversely affected by standardisation. Their benefits should always be rounded up not down. This particularly applies to inflation increase structures. We emphasise that if member benefits are not rounded up then this will kill off the PPF consolidator before it starts.

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

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

We emphasise again that the key consideration is securing optimum outcomes for members, not protecting the interests of the financial services industry.

Question 28: Will this proposed governance structure achieve effective administration and public confidence in the public sector consolidator?

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Question 29: What alternative governance structures should be considered?

We propose that the inclusion of the member nominated trustees on the board would create greater diversity for decision making and command greater confidence of members.

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

The entry price needs to be at a level to enable struggling schemes to access it, possibly with the option for deferred employer payments, as for underfunded schemes, where the price is a limiting factor in achieving member security.

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

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

Since the aim of the consolidator is to secure member benefits then any surplus might firstly be used to make up any real reductions suffered by members though standardised inflation caps and similar limits. Pre-97 indexation could also be addressed, which will be particularly appropriate to the consolidator since over 40% of small schemes have no pre-97 indexation, against an average of 24% of all schemes.

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

To be fair to members and schemes this assessment should not be purely on proportion of instalments, but also take account of a due share of any funding improvements generated by the consolidator. In addition the members should be eligible to share in any subsequent (Question 32) surplus allocation.

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

To avoid members of the schemes within the consolidator becoming a political experiment the consolidator should retain the ability to decide on the appropriate productive asset allocation for the security of members' benefits. Until the consolidator reaches significant scale the issues of risk and liquidity might mean this allocation is lower than the long term target.

We emphasise, again, that unlike the PPF lifeboat, trustees have a choice about whether they wish to approach the PPF consolidator. If the investment approach breaks with trustees' fiduciary duty and instead prioritises government priorities it will make itself unattractive and this will impact on its ability to attract pension schemes which in turn would undermine the government's intentions.

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

The preponderance of small schemes needing help could mean that the onboarding process time means reaching scale will take longer than an equivalent insurer accepting fewer larger schemes. However, rather than favouring larger schemes to reach this point the aim for a public consolidator should be to secure the benefits for those members least likely to otherwise achieve it.

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

Given that one aim of this consolidator, besides that of securing member benefits, is to invest in productive capital for the benefit of the economy it would seem logical for government to provide the underwriting, albeit on the same basis as required for other consolidators.

It is essential that there is complete separation between the PPF's existing activities and the proposed consolidator.

Chapter 3: Potential take-up and impacts

N/A