A Hymans Robertson White Paper
Realigning Defined Benefit Pensions with UK Society's Aims

Unintended consequences of past pension policies have led the UK's 5,000 Defined Benefit ('DB') pension schemes to close and invest their £1.5 trillion assets defensively. This is appropriate for delivering the pensions of their ageing members but is sub-optimal for both UK businesses and UK society.

New policies must not appropriate or misdirect DB assets. Assets in private pensions cannot be nationalised to do government's work. Instead, visionary policies should intergenerationally reconnect the UK's immense store of pensions wealth, so it delivers past pension promises, supports current workers and builds societal prosperity.

The statutory objectives given to The Pensions Regulator ('TPR') should be re-oriented. The current statutory objective to prioritise security of past pensions has led to closed pension schemes, that are well-funded and defensively invested. A better statutory objective would balance keeping past benefits secure with offering good quality pensions to current workers. Re-opening DB schemes would lead them to invest to generate long-term value, in the form of surpluses that can subsidise pension costs for current workers or be refunded to business.

The UK's DB schemes were created through tax incentives. New, thoughtful tax incentives and safeguards are needed to create compelling options for schemes to generate value from their assets. Using tax incentives would avoid inappropriate mandating of how scheme assets are invested and would be in keeping with the "societal contract" on which pension schemes were set-up.

We are not alone in re-examining the UK's DB conundrum. Today's public policy debate is welcome and overdue. Financial security in later life, in a prosperous UK society, is something worth encouraging people to save for.

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Two Policy Changes, to Realign DB with UK Society's Aims

Policy One: TPR's statutory objective balances past & future pensions	TPR's statutory objective has been to prioritise the security of past benefits. This has regulated DB schemes out of existence in the UK private sector, aside from 498 open schemes. This needs to be reset, to balance keeping past benefits secure with offering good quality pensions for current workers. Re-opening DB schemes would reorient their investments from the current defensive investing that prioritises past pensions. It would encourage schemes to invest for long-term growth and generate surpluses, which can be used to subsidise better pensions for current workers.
Policy Two: PPF offers future pensions accrual	The Pension Protection Fund ('PPF') is compulsory co-insurance for pension schemes. Appropriating its assets for political ends is wholly unacceptable. Instead, changing the PPF to offer future pension accrual on a voluntary basis would transform it into a pension scheme consolidator. This would offer DB at scale for smaller schemes and businesses and support open schemes. Opening to future accrual would reorient what the PPF does with its £39 billion of assets from low risk to growth. Rather than giving the PPF a tax-payer guarantee, the PPF should be used to stimulate a competitive private sector DB consolidator market (akin to the role of NEST for DC pensions).

Two Incentives and Two Safeguards, to Realign DB with UK Society's Aims

Incentive One: Generate DB surpluses	Changing TPR's statutory objective to balance keeping past pensions secure with offering good quality pensions to current workers would re-orient their investments to long-term growth. This would realign DB scheme aims (to provide for their members) with societal aims (to invest for long-term growth and provide adequate pensions) and manage the costs for business. Regulation should encourage (but not mandate) schemes to generate surpluses. A surplus makes past benefits more secure. It also generates value which businesses can use to subsidise the cost of pensions for current workers. Using DB surpluses for contribution holidays isn't a new idea. But building on today's platform of strong DB funding is fundamentally different.
Safeguard One: Better future pensions	DB surpluses could subsidise better pensions than the auto-enrolment minimum, without adding cost to business. Safeguards on the format of future pensions may be needed, alongside allowing DB surpluses to pay pension costs (like minimum quality benefits or offering all staff the same pensions). The format of future pensions could be DB (employers bear the risks), DC (members bear the risks), or shared risk (like Collective DC or longevity pooling). Giving businesses shared control over how pension scheme assets are invested would help to encourage businesses to accept more risk. We envisage future pensions being offered within existing pension trusts. This works for large schemes, but small schemes will need DB consolidators to offer pensions at scale. The PPF can stimulate a DB consolidator market.
Incentive Two: Tax incentives on DB surpluses	The current 35% tax on surplus refunds deters businesses from keeping DB schemes going. Reducing or removing this tax disincentive would re-orient DB scheme towards investing for growth, with the aim of generating surpluses that can be accessed in tax effective ways to do useful things. Thoughtful tax incentives could be used to align DB scheme choices with society's wider aims. For example: not applying a tax on refunds which are re-invested in UK Productive Finance or in UK climate transition initiatives. Using tax to direct behaviour is better than mandating DB assets to be invested to a political agenda. It also aligns with the "societal contract" of favourable tax treatment on which DB schemes were created.
Safeguard Two: Keep past benefits secure	DWP's and TPR's new DB funding regulations and draft code could become a threshold for accessing DB surpluses. Together with the PPF supporting future accrual, this would avoid undermining the security of past pensions. As a minimum the new funding regulations should be changed to enable open DB schemes to thrive and encourage closed DB schemes to re-open. An idea to make simplify how pension schemes are managed is to align funding with company pension accounting, with explicit reserves for sponsor default risk and future pension costs before surpluses can be used.