Purposeful Run On

Themes from roundtable dinner for senior executives of corporates sponsoring large UK DB schemes

In June 2024, Isio hosted a private dinner with a group of senior executives from employers sponsoring large UK defined benefit (DB) schemes. We discussed the opportunities and risks from a Purposeful Run On (PRO) of DB schemes. We also explored the changes and environment that would encourage employers to support PRO.

We were also delighted to be joined by Morten Nilsson, Chief Executive of Brightwell and responsible for the management of the BT Pension Scheme and supporting services to other major schemes, and Natalie Mee, Pensions Partner at CMS.

Key themes

The main themes of the discussion are summarised below:

Regulatory regime needs to adapt to the reality of surplus

As a minimum, balanced guidance on surplus release is needed from the Pensions Regulator (tPR). Further instruction from the next government to tPR is likely to be needed to achieve meaningful change in attitudes to DB pensions envisaged by February's DWP consultation on options for DB schemes consistent with tPR's sustainable growth objective for scheme funding.

Need to promote / incentivise more generational fairness

It is recognised that future pension provision levels have necessarily fallen over time as they have become unaffordable. There is an opportunity to make reopening DB schemes or higher contributions to DC more attractive and affordable to employers by funding future benefit costs from DB surplus. A rebalancing of trustee duties and attitudes to release surplus to meet future pension provision for current workers would help effect this. For example, making it easier for trustees to use surplus funds to meet DC contributions for current employees rather than applying pension increases for past generations of DB members.

Flexibilities proposed in the DB options consultation are welcome and important

The legislation changes proposed would significantly increase flexibility and should help to bring about the mindset change that the Government is seeking:

- Overriding legislation for allowing ongoing refunds is the most important change to remove the "rules lottery".
- Allowing (tax efficient) lump sum payments to members is better for members and avoids increasing the DB liability – some stakeholders are particularly concerned with the latter.
- More permissive thresholds for releasing surplus to employers (e.g. low dependency or equivalent rather than buy-out) is preferred and would help to change mindset, with schemes then determining actual levels on a scheme specific basis.

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Flexibility in the existing regime is poorly understood and could be better highlighted

Many trustees could return surplus to their sponsors now, but the "rules lottery" is often poorly understood and even where it is possible it is almost never done. Returning surplus on an ongoing basis under the current regime requires:

1. Ongoing refunds to be allowed under rules with a Section 251 resolution having been passed before the deadline to preserve this power.
2. The Scheme Actuary to certify that the scheme remains more than 100% funded on a buy-out basis after the refund.
3. The Trustees to conclude that paying the refund is in members' best interests – some discretionary benefits for members may therefore be required. Given the balance of downside risks, it was felt that the member share should be smaller than the employer share.

Better understanding and guidance from tPR would help with utilising flexibilities in the existing regime.

Governance structure is crucial for running on with greater transparency over actuarial calculations

A collaborative close working relationship between senior employer stakeholders and trustees is essential for running on (and more generally for 'endgame'). Various models that may achieve this were discussed:

- Appointing a sole Trustee is becoming more common for larger schemes (having originally been more common for smaller schemes). Often the employer has a unilateral power to appoint a sole trustee.
- Collaborative forums to exchange views at executive level.
- There is an opportunity for DB schemes to be managed with similar rigor to an insurance company but still benefit from their regulatory advantage over insurance companies.

There is a lack of clarity and transparency in Scheme Actuaries' liability calculations which can contain "hidden" implicit assumptions. Pension scheme asset valuations are subject to audit but there is no such requirement for liability calculations, so employers may consider commissioning independent calculations when the results are used to inform employer contributions or use of surplus.

Releasing surplus gradually reduces regret risk for all parties

There was wide support for gradual surplus release. This could be thought of as a "reverse recovery plan". Releasing surplus gradually (rather than a large amount in the future) gives employers confidence that running-on has purpose (with upsides for employers not contingent on trustees applying discretions or the regulatory regime years into the future).

The UK should look at pension provision in other countries

The UK regime is an outlier and less balanced than the "with-profits" style models in other countries. Attitudes to reserving and surplus highlight the need for legislative and mindset change. There is an asymmetry in the UK regime with employers being wholly responsible for deficits but potentially unable to access surplus where trustees cannot, or choose not to, return it.

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How to find out more

More information about PRO, including a detailed thought piece on how it works best in practice, is available on our website here.
[Outpacing change - Isio]