BlackRock

19 April 2024

4th Floor, Caxton House
Tothill Street
London
SW1H 9NA

Submitted via email to: pensions.consultations@dwp.gov.uk

RE: Options for Defined Benefit schemes

BlackRock[1] is pleased to have the opportunity to respond to the consultation on options for Defined Benefit (DB) schemes, issued by the Department of Work and Pensions (the '**DWP**').

BlackRock manages the pension savings of over 12 million people in the UK. Our investment approach is rooted in our fiduciary duty: we start with our client's objectives, we seek the best risk adjusted returns, and we underpin our work with research, data, and analytics.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the DWP on this and other topics.

***

BlackRock welcomes the work that the DWP has been undertaking to provide better outcomes for pension savers. As a fiduciary, this is central to everything that we do.

As stated in response to the earlier consultation, the starting point for any conversation on the future of DB schemes must be member outcomes and we welcome the Minister's comments that the primary objective of a pension scheme is to ensure that members benefits are paid.

In line with this, trustees need to find the best investments to meet their liabilities and make investment decisions which meet their members' needs and time horizons. It is crucial that any changes to the system do not threaten this responsibility.

We are also supportive of efforts to ensure that pension scheme money is working as effectively as it can. In the context of DB schemes' current funding position, we agree that the guardrails proposed are needed alongside any changes to the system to ensure member benefits are protected.

Treatment of scheme surplus

We welcome DWP's core propositions that surplus should only be extracted where safe to do so from a member benefit perspective; and that in all cases, trustees will retain responsibility for managing scheme funding levels.

[1] BlackRock is a leading provider of investment, advisory and risk management solutions, and has been active in the UK for over 50 years. Our purpose is to help more and more people experience financial well-being.

When thinking about extracting surplus, it is worth noting the journey that schemes have been on since the beginning of 2021. Three years ago, aggregate deficits in DB schemes were close to £230bn.[2] As of March 2024, the deficit is now £3.9bn, the Funding ratio stands at 146.1%, and the net funding position of DB schemes improved to a surplus of £442.3bn, with more than 80% of schemes in surplus.[3]

While this is a remarkable improvement in funding levels, it is worth noting that market volatility played a part in this, and market volatility may also cause the pendulum to swing backward. There is a danger that if surpluses are extracted and there is a sudden downturn, sponsors may put themselves in a precarious position.

While we see the rationale for and welcome the safeguards put forward in the consultation document, we believe that the introduction of a 100% underpin by the PPF would provide the most reassurance to pension schemes and offers the greatest protection for members benefits, it also avoids adding too much complexity into the system. We believe such an underpin could be an effective catalyst for a wide range of pension schemes to opt to run on for the long term.

However, we would note that attractiveness under this option will likely depend on the level of cost of the "super levy", and whether it is possible to opt back down to the normal levy. How this super levy impacts normal levy payers also needs to be considered. For instance, would the levy from the super levy be ringfenced for those it covers, and how would it impact the PPF assessment process were the employer to become insolvent.

We would also note that scheme rules are typically changed in consultation with trustees and sponsoring employers, and depending on the nature of the change, scheme members. It is unclear in the proposals if trustees would need to consult their membership on this change. There is a risk of undermining scheme members' trust if significant changes were made to scheme rules which alters the likelihood of their benefits being paid, or the structure of those benefits, without their consultation.

One final consideration is the need to share the benefits of generating surplus and its extraction with members. If schemes can generate surplus, while providing sufficient protection to core benefits, it would seem sensible that this is also shared with members.

Model for a public sector consolidator

As we noted in our response to the previous consultation, BlackRock is supportive of DWP's intention to provide an alternative endgame solution for DB schemes unattractive to commercial consolidation providers.

Indeed, in our 2023 paper *UK defined benefit pension schemes – After the storm*, we highlighted that, at the tail end of the market, where schemes have significant deficit and are a long way from self-sufficiency or buy-in, and may also have covenant or governance challenges, there are serious risks to member benefits.[4] Where it is practical to do so, there is a case for further consolidation of these schemes.

A public sector consolidator, administered by the PPF, could help address these challenges. However, significant care is needed to provide a level playing field relative to commercial providers.

[2] https://www.ppf.co.uk/-/media/PPF-Website/Public/Years/2021-12/P/PPF_PurpleBook_2021.pdf
[3] https://www.ppf.co.uk/-/media/PPF-Website/7800/2024/PPF_7800_Update_March_2024.pdf
[4] https://www.blackrock.com/uk/literature/whitepaper/uk-defined-benefit-pension-schemes-after-the-storm-new.pdf

We are supportive of the PPF taking on this role, but believe that it must be clear from the outset that PPF consolidator will only be available to those schemes which are not attractive to commercial entities. In line with this, we support the setting of a statutory objective for a public consolidator to have to offer an option for schemes unattractive to the commercial market. We would also suggest the need for an oversight mechanism to ensure that this intervention is effective in helping to solve for some of the issues highlighted above.

We understand that DWP wants to set a principles-based approach to eligibility, in order to be avoid inadvertently excluding schemes that would otherwise benefit from the public sector consolidator solution. However, we believe that the eligibility criteria need to be more explicitly focused on schemes with funding, governance, or covenant issues. Without this, we would not be supportive of this intervention.

Member benefits

We support the proposal for underfunded schemes to maintain a link with the employer for deficit recovery contributions, through entering into a contract to make good the deficit by instalments over a specified time period. This would provide peace of mind to the scheme members, alleviate the burden on the taxpayer, and ensure moral hazard is mitigated.

Investment strategy

We believe that the investment strategy of the public consolidator should be set independently, and that any calls for further investment in the UK are always balanced against the need to make investment decisions based on the interests of their members.

This is because the nature of the liabilities the consolidator would be managing are long-term, and the investments backing these liabilities would need to be commensurate to the length and risk profile of those liabilities.

As we stressed at the outset of this response, the starting point for any conversation on changes on the DB pensions landscape must be member outcomes. As such, the PPF must be able to make the investment decisions they believe will best meet their members' needs.

***

Conclusion

We are supportive of the work that DWP is doing to drive better outcomes for pensions savers. However, we believe any changes must ensure member benefits are protected.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of the DWP on any issues that may assist in the final outcome. We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Gavin Lewis
Managing Director
Head of UK Institutional Client Business
gavin.lewis@blackrock.com

Muirinn O'Neill
Vice President
Global Public Policy Group
muirinn.oneill@blackrock.com