Institute and Faculty of Actuaries

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IFOA RESPONSE TO DWP CONSULTATION: Surplus Flexibilities for DB Pension Schemes: Unlocking Value for Employers and Scheme Members

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the DWP's consultation on Surplus Flexibilities for Defined Benefit Pension Schemes: Unlocking Value for Employers and Scheme Members. This response is prepared by the IFoA Pensions Board.

Key points we wish to highlight

- The IFoA is **supportive of efforts to facilitate the release of surplus** from DB schemes, provided members' benefits remain adequately protected, and we support HMRC's related aim of allowing surplus to be shared with members as an authorised surplus lump sum. We expect the ability to provide a member lump sum will make it easier for trustees to agree to release surplus to employers, whilst ensuring members also receive some upside without increasing a scheme's future liabilities or risk. The IFoA notes that this will bring forward tax receipts, both from member lump sums and from payments to employers and help put surplus to use in the UK economy sooner, helping the Government achieve its policy objectives.

- However, to fully achieve its policy objectives**, the Government needs trustees to agree to release surplus** across a wide range of schemes. To do this, the **process for releasing surplus needs to be straightforward**, **trustees need to feel it is safe** to agree to release it, and many **trustees will feel they need to be able to award a share of surplus, if only a small amount, to members**.

- We have some concerns that the proposals may not achieve these aims as well as they could, leading to missed opportunities and more schemes heading to early buy-out than might otherwise be the case.

- The IFoA is concerned that the **actuarial certification process lacks flexibility**, which will reduce the appetite for schemes to run on with a view to investing productively to release surplus to employers on an ongoing basis. The process appears designed for one-off surplus release events, which will limit the take-up and the overall quantum of shared and released surplus.

- We do not see any logic in implementing a surplus regime that sits outside of the current well-tested funding regime and would recommend this be revisited, so that surplus release can be certified in a similar way as a schedule of contributions (which, for a scheme in surplus must be certified such that the scheme is expected, if the assumptions are borne out in practice, to remain fully funded over a five year period). The basis and time period would be different (i.e. low dependency rather than technical provisions and 3 years rather than 5 years), but the principles are the same and we suggest a possible form of wording in our response below.

- The five-day **payment timeline after certification appears impractically tight** and **should not be necessary if the amount payable is defined in very broad terms and the trustees are ultimately responsible for agreeing the amount of each payment**. By “very broad terms”, we mean, for example, as a maximum percentage of total surplus above a given level, or in terms of the objective, such as “the trustees want to maintain funding at 115% of the LDFB and will refund 90% of any excess to the employer(s) with the remaining 10% of that excess being paid to members” or “up to a maximum amount of £xx, subject to the trustees agreeing such an amount, or such lower amount as they may decide is appropriate at the time the payment is due”. In all cases, we expect the trustees to be responsible for deciding to make a payment after obtaining advice from professional advisers regarding any material changes to funding, investment and covenant since the actuarial certification. Our proposal would avoid unnecessary haste due to the risk of having to restart the process from the beginning if the original provisional amount is no longer deemed appropriate, or if the 5 working day deadline cannot be met, and it would put the trustees at the centre of decision-making to protect benefit security, as they are on other aspects of scheme funding.

- The IFoA found the **requirements potentially unhelpful where trustees and employers favour releasing a series of payments**. In practice, this should be a straightforward option, which would be safer and in some cases avoid inappropriately large one-off releases of surplus, or a decision not to release surplus at all. To maximise take-up (and hence tax receipts), there should be a range of practical options open to trustees and employers if the Government wants to achieve widespread and ongoing surplus release.

- We do not agree with the proposals regarding **member communications.** We do not believe it necessary to alert members to precise amounts and timings of a proposed surplus payment to the employer at least 3 months before a payment. Instead, members should be notified of the proposals in broad terms and then a follow-up communication *after* the payment has been made would confirm the exact amount paid to the employer and the payment date. Such a communication is already required within summary funding statements which, for most schemes, are required annually.

- We have some concerns about the specification of a **low dependency funding threshold,** particularly given the draft regulations appear to require “an” LDFB, not “the” LDFB. We recommend that the LDFB used for surplus extraction should be based on the LDFB at the most recent actuarial valuation under the new funding regime, with subsequent adjustments justified by changes in market conditions, funding levels and covenant strength. We expect the existing requirement to review the funding and investment strategy when there is a material change to the scheme or the covenant would in any case require the LDFB to be reviewed, and if necessary revised, ahead of a surplus payment.

- If the Government is concerned that surplus release will not immediately be permitted for schemes that have not completed a scheme funding valuation under the new funding regime, this could be addressed in transitional provisions.

Question 1: Draft regulation 2 defines 'appropriate advice'. Do you agree with this definition?

- The definition aligns with the requirements in the 2005 Investment Regulations for advice on a statement of investment principles, but with the added requirement of 'knowledge and experience of the management of the liabilities of trust schemes'.
- It is unclear why a single expanded definition is needed or how often a single professional would have the complete set of skills. We suggest regulation 6 should require the trustees to seek advice from a person with the necessary *investment* skills and experience, and regulation 10 (earmarked schemes) should require the trustees to seek advice from a person with “practical experience of financial matters and appropriate knowledge and experience of the management of the *liabilities* of trust schemes”.

Question 2: Is the scope of the power sufficiently clear?

- In terms of the employers that can receive a surplus payment, the draft regulations appear to provide that the employers immediately before a scheme ceased to have active members would be eligible. However, we note that some or all of these employers may subsequently have ceased to be eligible to pay a future debt to the scheme, so we assume they would also not be eligible for a surplus payment.

Question 3: Regulatory own funds schemes were included in the 2006 Regulations; is there a continued need for their inclusion within the Regulations?

- We are not aware of any Regulatory Own Funds schemes, but there is no harm in specifying that they are excluded in the new regulations.

Question 4: Do you have any comment on the considerations of factors to be taken into account for the assessment of assets and liabilities?

- The IFoA is supportive of steps to allow more schemes to release surplus, where members’ benefits remain secure.
- We agree that giving flexibility over the choice of effective date and removing the current requirement for audited accounts at the effective date will be useful.
- However, in practice it seems likely that an actuarial assessment will often be carried out in conjunction with a valuation, particularly where schemes are being consciously run on and planning to build up and release surplus on an ongoing basis.
- We have some concerns that the consultation document suggests that the proposed regulations 6 and 7 will “ensure accuracy”, since the liabilities at a date other than the valuation date are highly likely to be based on an approximate roll-forward. Provided the trustees are final decision-makers for a release of surplus, and are expected to seek additional professional advice, often including covenant advice, before authorising a payment, the lower accuracy should not be a problem, not least since we expect the actuary in many cases will also recommend a “buffer” above full funding on the LDFB. More accurate calculations do take more time, and requiring the assessment to be “accurate” could reduce the ability for it to be “up to date”. However, the Government should be aware that allowing extra flexibility around the effective date for the actuarial assessment and the use of assets that have not been audited *will* introduce additional risks, and the calculations will be less accurate than they would otherwise be.
- Furthermore, an “accurate” assessment of the surplus is not necessary – only that the actuary is reasonably confident that the surplus *exceeds* a stated amount. We suggest that the regulations could usefully allow the actuary to take a deliberately prudent approach in order to complete an assessment more quickly that would otherwise be possible, e.g. disregarding hard-to-value assets or using what is highly likely to be an undervaluation. Similarly, on the liability side, erring to prudence may be a better

use of time and resources than working towards a more exact valuation. However, these issues might be better covered in the expected FRC guidance.

- We also note that there appears to be no limit on the timing of the actuarial assessment, and no limit on the length of time between the assessment and the actuarial certification (though there will be a minimum of three months due to the member notification requirement). In practice, we would expect that the actuarial assessment would be expected to be on or after the effective date of the most recently received actuarial valuation under Pensions Act 2004 Part 3 and that the scheme actuary should be satisfied that the period until the date of certification is not excessive. As noted above, we expect many schemes will commission an actuarial assessment alongside an actuarial valuation under Part 3 for reasons of efficiency.

Question 5: Do you have views on the proposed funding test, based on full funding on the low dependency funding basis?

- We are supportive of using a low dependency funding basis.
- It is unclear whether the LDFB is intended to be based on the most recent new regime valuation – we note the reference in the draft regulations is to "a" LDFB, as opposed to "the" LDFB", although the consultation document refers to "the" LDFB.
- In the IFoA's view, **the surplus release process should be based on the LDFB set at the date of the last new regime actuarial valuation under Part 3 of the Pensions Act 2004, with any subsequent adjustments justified by changes in market conditions, funding levels and covenant strength since that time.**
- However, we would have concerns if schemes that have yet to obtain a new regime funding valuation were ruled out of surplus release until they have obtained a valuation. This could be up to 21 December 2028, i.e. nearly two years after the regulations are intended to come into force. For schemes in that position, we suggest that they should at least be able to release surplus above a solvency basis as a transitional measure, if the scheme rules allow it or the trustees choose to use new the flexibilities to change their rules accordingly.
- The consultation document suggests that not requiring the use of audited assets will support trustees in releasing surplus over a period of years. Given all but the smallest schemes already obtain audited accounts annually, we are not convinced that flexibility over the effective date necessarily supports a gradual release of surplus, particularly compared with the current requirements, which allow a certified maximum surplus amount to remain payable up to 15 months after the effective date of the assessment.
- We note that the proposed certification and notification requirements are also potentially problematic for a gradual release of surplus and are more onerous than they need to be.

Question 6: Do you have any views on the proposed payment process as proposed in the regulations, including whether it is workable in practice and sufficiently clear?

- Members of the IFoA's Pensions Board reached different conclusions regarding whether the provisional amount could be adjusted in the period between its calculation and the actuarial certification. In spite of the consultation document noting that the provisional amount is called provisional because it is not final until certified, the regulations are less clear about whether there is a relationship between the provisional amount and the amount to be paid. Some interpretations were that the provisional amount cannot be adjusted after members are notified of the planned release. This would lead to issues where members have been told about a provisional amount that ultimately cannot be paid (e.g. if the position of the scheme or the sponsor covenant has deteriorated and the scheme actuary cannot reasonably provide a certification). This interpretation also places additional emphasis on the certification, if it must be signed in an "all or nothing" scenario.

- If the intention is that the provisional amount *cannot* be adjusted after being notified to members, and if the *only* possible payment is a payment of the provisional amount whose exact amount has been notified to members, this will put extra pressure on all parties to add a buffer above full funding on the LDFB, to ensure that the proposed amount remains suitable at the certification date and a payment can proceed. This would reduce the overall amount of surplus released compared with what can safely be released and undermine the Government's policy intention. It also risks notifying members of an amount that may not be paid, hence our **strong recommendation (below) that the required member notification should be in broad terms only, to allow downward adjustments to the amount released where appropriate**.
- We recommend the **regulations should clarify that the actuary *can* certify based on a surplus release that is below the provisional amount, and moreover that the trustees *can* also choose to pay less than the amount assumed payable as part of the actuary's certification**, in both cases where they conclude, after seeking professional advice and consulting with the employer, that a lower amount is in the scheme's interests.
- To avoid confusion among members, they **should not need to be told exact surplus release amounts or dates before they are made; instead, notification of a broad plan should be sufficient,** followed up with the final details in the next summary funding statement, as well as in benefit statements or a member newsletter where appropriate. If the amount disclosed to members *can* be different from the amount paid (we believe this should be the case and note that the draft regulations appear to allow the amount disclosed to members (in 11(1)(b)) to be different from the "provisional amount" (in regulation 8), then it could be misleading to notify members in advance of a particular amount; if it *can't* be adjusted, then there is still a risk that the amount can't be certified and hence can't be paid. We assume employers would require that a failed certification would also cancel any proposed surplus share to members, so there is every reason not to be required to inform members of something that might not happen.
- We do not believe it is necessary to require payment within 5 working days of certification, and we would prefer to see trustees making a final decision regarding an appropriate amount to pay in the (longer) period after certification. If the Government is concerned that more than 5 working days would pose risks to the scheme, that suggests the risks being taken cannot be tolerated.

Question 7: Are the regulations clear on the process of obtaining actuarial certification and paying the employer within 5 working days?

- As above, we do not think the regulations are clear regarding the relationship (if any) between the provisional amount and the amount to be paid. We also see the 5 working days as onerous and impractically tight, and it could result in decisions being made and investments being disinvested with undue haste.
- We are also concerned that the 5 working day period does not factor in an integrated risk management approach, where all risks would be required to be considered by the trustees and their advisers before a final decision to proceed is made. Rather, the implication is that the actuary's certification is sufficient to proceed given 5 days may be too short to allow the trustees to reflect on wider circumstances, for example a significant deterioration to the employer's covenant that the actuary is not aware of. It may therefore be helpful to clarify that the actuary's certificate is a necessary but not sufficient component in the process and to remind trustees and the employer to ensure they consider with their advisers and inform the actuary of material developments since the actuarial assessment *before* directing the actuary to proceed with a certification.
- It is also unclear how a 5 working day deadline would, as envisaged in the consultation document, make the process more efficient at releasing funds.

Question 8: Do you have any comments on the proposed 3-year forward-looking assessment in Condition 2?

- The forward-looking test needs clarification as it is not clear whether a stochastic or deterministic methodology is envisaged. **We recommend the regulations should be clear that a stochastic method is NOT required**, to avoid imposing additional barriers and costs to surplus release, particularly for smaller schemes.
- The "as least as likely as not" form of wording strikes us as unusual and unnecessary. **We highly recommend using a form of certification and wording that members, sponsors and trustees are familiar with** – the wording in a schedule of contributions that full funding (i.e. lack of reliance on the sponsor) can be expected to continue to be met for the period for which the schedule is to be in force, which in this case could take the form of **"full funding on a low dependency funding basis is expected, after the proposed surplus release, to continue to be met for the three year period following the date of certification"**. In practice, from a risk management perspective this additional part of the certification adds little, but we understand why the DWP would want this to be included.

Question 9: Do you agree that the process proposed in the regulations is sufficiently flexible to enable a phased release of scheme surplus over a number of years, while preserving member benefits via certification of each individual payment?

- Whilst we think the process *could* potentially be used to support phased surplus release, we feel the process favours single significant releases of surplus and leads to a more cumbersome process where gradual release is preferred.
- The draft regulations propose that the member notification would state the proposed amounts and dates of payment, which would be inflexible for a stream of payments. This is another reason for the IFoA recommending that members should only be notified in broad terms that the trustees propose to make surplus payments to the employer, without the need to specify the precise timing and amounts in advance. This would then enable a single notification whilst retaining future flexibility for the trustees to make appropriate releases of surplus. See our further comments under question 6 on this point.
- We believe a general principle should be that phased (slower) release should be no more difficult to achieve than one-off payments. If anything, it is safer and should therefore be easier to put in place than a large one-off surplus release.

Question 10: Should earmarked schemes be included in the scope of these regulations?

- We support their inclusion in scope and note they were included in the existing regulations.

Question 11: Do you think the notification requirements in regulation 11 are sufficiently clear?

- The requirements are clear but, as we explain above under questions 6 and 9, they are not practical and would have a number of unintended adverse consequences. Instead, we recommend the notification should be made in broad terms and that the amounts released should be confirmed in the subsequent summary funding statement, in line with existing disclosure requirements.
- We note that the draft regulations do not require the detail of any decision to share surplus with members to be included in the notification and we agree with this, although clearly the trustees *will* need to communicate any additional payments or improvements to members in due course (and in some cases – e.g. where a member surplus lump sum is being paid after NMPA and before retirement - bank account details will need to be obtained).

- It is also not clear to us what the purpose of the member notification is. We note this is planned as a disclosure, rather than a consultation, and it is questionable whether any member could object or respond (as they could for surplus payments in wind-up).

Question 12: Do you think the notification requirements in regulation 12 are sufficiently clear?

- It is questionable why TPR needs to be informed so promptly *after* a surplus payment, since if there was significant concern, the notification would be required in advance (although we do not think this is necessary). We do not favour strict timing requirements if the purpose is simply to measure the success of the Government's policy, rather than for the purposes of TPR regulating schemes. A more suitable timing requirement would be "as soon as reasonably practicable after the payment has been made". Ideally there would be a streamlined process for the notification, for example by completing a short form in TPR's Exchange system, similar to the Notifiable Events process.
- The regulations need to clarify the effective date of the requirements in draft regulation 12(a) and 12(b). We assume they are intended to be as at the date of the actuarial assessment referred to in 12(c) (which is likely to be a roll forward from a valuation), but they could be interpreted as the amounts at the certification date, which might be a roll forward of a roll forward. If the latter, it should also be clarified whether 12(a) and 12(b) allow for known benefit improvements and surplus payments.
- The requirement to include details of any benefit improvements that have been agreed *in connection with* the surplus release to the employer is potentially subjective. Clearly, the trustees (and the scheme actuary) must consider all expected payments and sources of liability increase, including, for example, a discretionary pension increase that has already been agreed, but it may be questionable whether the discretionary increase was agreed "in connection" with the surplus release.

Question 13: Are the proposed rules for sectionalised schemes and employer consent workable and clear?

- We agree with the addition of a power to pay surplus to the employer to each section of a fully sectionalised scheme as if each section were a separate scheme. However, we will defer to the legal profession to determine if the regulations work as intended.

Question 14: Are the draft regulations clear for excluded schemes? If not, where would further clarity be helpful?

- Yes, this is clear.
- We note superfunds are excluded from section 37 and assume this is because the surplus release requirements for superfunds will be addressed separately.

Question 15: Are the draft Regulations clear on revaluation of deferred awards?

We will respond to HMRC on its own consultation but have included some general HMRC-related points here alongside our comments on the proposed changes to the revaluation regulations. It is important the two pieces of legislation work well together.

- Administration would be simpler if schemes were given maximum flexibility to choose to revalue a deferred surplus lump sum using one of the permitted methods for revaluing early leaver benefits, to avoid necessarily creating an additional tranche of benefit and for consistency with the revaluation method applied to other benefits in the scheme.

- Similarly, we would recommend that HMRC allows maximum flexibility regarding the payment date of a surplus lump sum, albeit we understand HMRC's position that it needs to be on or after NMPA. For example, trustees may not have payment details for members who are between NMPA and retirement date, or those members may not want a payment that could prejudice other benefits or adversely affect their tax position, so trustees should have the flexibility to continue revaluing the deferred lump sum until the member's retirement date, at least.
- There should be clarity around the authorised tax treatment of a deferred lump sum if the member dies before receiving it and it is paid to the estate or another beneficiary other than a "dependant".
- Whilst it is a legal point, we would note that, to the extent feasible, it should be possible for schemes to avail themselves of member surplus lump sums without needing to agree and make changes to their scheme rules.
- We are concerned at the suggestion that a member surplus lump sum must be capable of being an authorised lump sum if it were paid to the employer, suggesting potentially that member surplus lump sums will fall into the surplus certification regime. We do not believe this should be necessary and question whether this was in fact intended by the drafter, or whether they did not connect the condition with the proposed requirements for member notification and actuarial certification.
- We do not see any reason why a member surplus lump sum could not also be awarded when a scheme is winding-up (noting that we believe the existing drafting would allow awards to be given before a scheme commences winding-up and paid after commencing wind-up, provided the member is at or past NMPA at the payment date). A taxable lump sum accelerates tax revenue (by comparison with a pension in payment) and it will generally be more efficient for trustees to pay a lump sum instead of adjusting pension payments, particularly for schemes that have already secured a buy-in or buy-out, so awards of member surplus lump sums for schemes in wind-up appear to the IFoA to be generally desirable. They also allow more surplus to be returned immediately to the employer and the economy without increasing risk.

Question 16: Are the draft Regulations clear on how deferred awards affect members' statutory right to take a transfer value?

- The draft regulations appear clear.

Question 17: Do you foresee any issues or concerns arising from proceeding without transitional provisions following the revocation of the 2006 Regulations?

- We can envisage scenarios where an employer surplus payment has been planned and notified to members before the regulations come into effect, and where the new process would presumably apply to a payment after the regulations are effective. This suggests an actuarial assessment and a certification would be required, which would require completion of an actuarial valuation under the new funding regime before the surplus payment could proceed. This could significantly delay a safe release of surplus for schemes that have not yet obtained such a valuation.
- If the Government is concerned about delays, transitional provisions might potentially continue to be based on the existing regime, including releases above full funding on a solvency basis but with the flexibility for trustees to agree to change their rules under the new section 36B to allow surplus to be released to the employer.
- Separately, it is not clear to us to what extent, if any, the actuarial assessment, the member notification and the Conditions in regulation 9 could be met by actions taken prior to the regulations coming into force. For example, could any part of the assessments or notifications to members take place between the regulations being "final" and coming into force? In theory, what is the earliest date a payment under regulation 9 could be made – 6 April 2027 or 3 months later?

- We suggest that the regulations could explicitly recognise and validate steps taken before they come into force, similar to the “retrospective confirmation” provisions of the Pension Schemes Act 2026, which provide for actuarial confirmations prior to the legislation coming into force to be valid.

Question 18: Do you foresee any issues with revoking regulations 36 to 39 of the 2014 Regulations?

- We see this primarily as a matter for the legal profession.

Question 19: Does the proposed certificate in the Schedule capture all the relevant details that will be required?

- As covered earlier, we have some concerns about differentiating between benefit improvements made “in connection with” a surplus payment and other discretionary benefit improvements, since all decisions to use the surplus (by reducing the assets or increasing the liabilities) should be relevant to the actuarial certification.
- It may be useful to clarify if the date of the certificate is the date the scheme actuary signs it (we expect it would be).