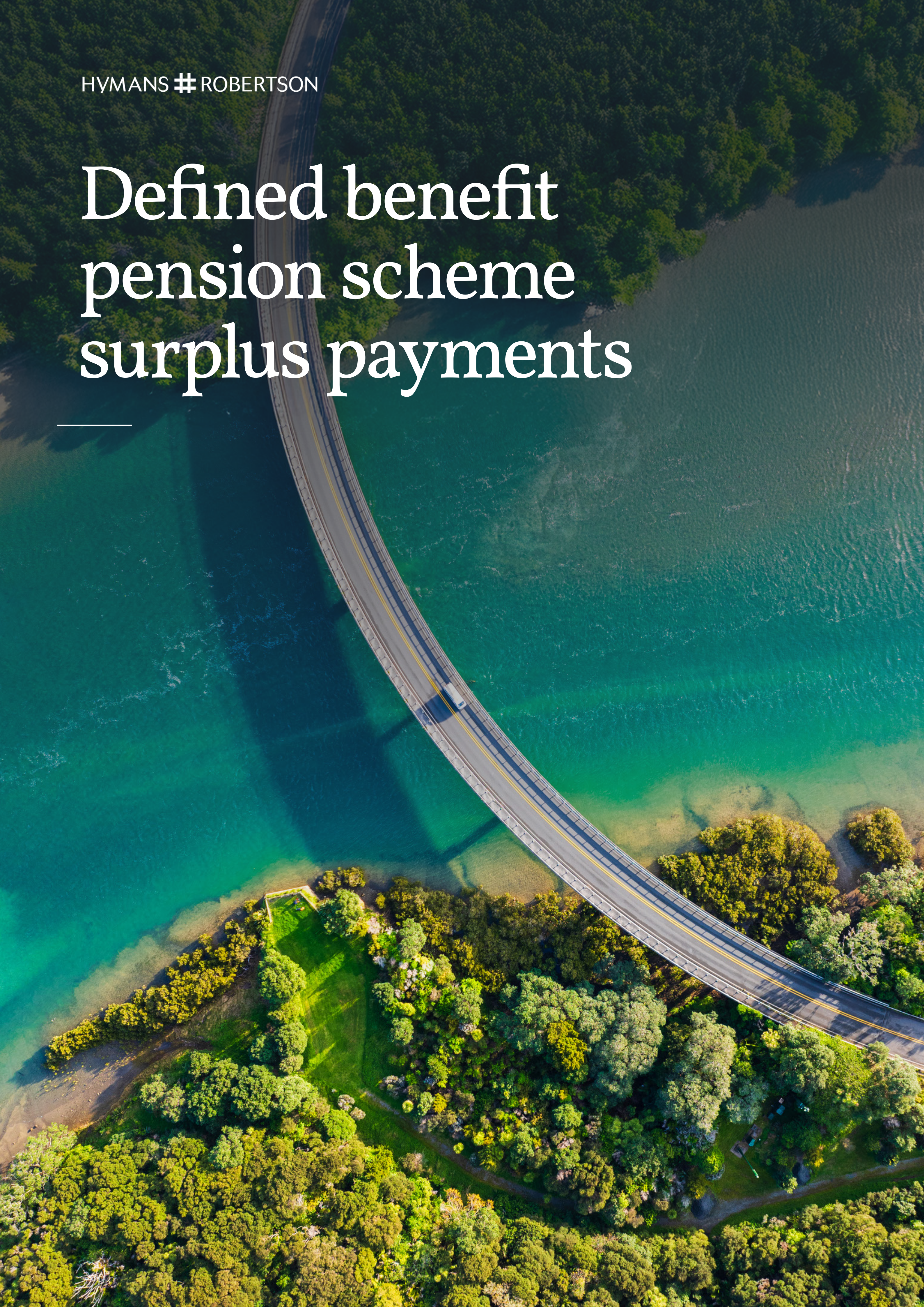
HYMANS # ROBERTSON

Defined benefit pension scheme surplus payments



We welcome the opportunity to comment on the draft Regulations and support the Government's aim of giving well-funded defined benefit pension schemes greater flexibility to use surplus while continuing to protect members' benefits.

Our overarching comment is that the Regulations should be seen as part of a wider surplus decision-making framework. The assessment, notification and certification requirements are important safeguards, but they cannot by themselves determine whether surplus release is appropriate for a particular scheme.

In practice, the key protections will come from the quality of trustee decision-making, professional advice and regulatory guidance sitting around those requirements.

We welcome the greater flexibility the framework is intended to provide, but decisions on surplus release will still need to be made on a scheme-specific basis, reflecting each scheme's strategy, employer covenant and long-term objectives. In that context, we are supportive of moving from a buyout threshold to a low dependency funding basis, recognising that the threshold is only a minimum requirement and not a substitute for wider trustee judgement.

Against that background, our detailed comments focus on practical workability: ensuring the Regulations are clear, proportionate and capable of supporting good governance without creating unnecessary barriers to appropriate surplus release. In particular, we suggest that the Regulations should:

- incorporate more flexibility to support phased surplus release, including the ability for one member notification to cover an intended programme of payments. In particular, it would be helpful if the Regulations allowed surplus to be used to fund regular contributions to a separate arrangement, such as a DC or CDC master trust, without making the process materially more complex than funding contributions within the scheme trust;
- allow as much flexibility as possible in the member notification process, including enabling trustees to give 'reasonable notice' (which could be less than three months where appropriate) using established communication channels (such as summary funding statements or newsletters);
- clarify the relationship between the provisional assessment amount and the final amount certified before payment, including confirming whether the provisional amount operates as a cap such that trustees can proceed with a lower certified amount without restarting the process or whether a formulaic approach would be possible;
- reconsider the proposed five-working-day payment window following actuarial certification and the one-week deadline for notifying The Pensions Regulator, as longer periods would be more practical while still ensuring timely action;
- make clear that the low dependency funding basis used for surplus release should align with the trustees' funding basis, allowing proportionate updates between valuations; and
- tighten the wording of the three-year forward-looking test so that it is clear complex modelling is not required for certification and the test is designed to address known material events. Earlier, wider surplus decisions remain matters for trustee judgement. Clear guidance from The Pensions Regulator will be helpful in setting expectations on surplus strategy, funding buffers and broader risk management, and the supporting modelling, advice and analysis that might be helpful.

We would be pleased to discuss these comments further and to support the development of Regulations and accompanying guidance that deliver the intended flexibility in a clear, practical way while maintaining appropriate protections for members.

See the Open Consulation [here]

Question one

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

It appears reasonable on the understanding the term 'appropriate advice' has been primarily defined to ensure that asset valuations are undertaken by appropriately qualified persons, which may include investment advisers.

Question two

Is the scope of the power sufficiently clear?

Yes.

Question three

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

It seems reasonable for any such arrangements to be excluded from these provisions.

Question four

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

In general, the provisions seem reasonable. However, there are some areas where the drafting could be improved.

It would be helpful for the Regulations to clarify that "a low dependency funding basis" means the trustees' low dependency funding basis for scheme funding purposes. The actuary's assessment should therefore be consistent with that basis as reflected in the most recent statement of strategy, rather than potentially allowing any low dependency basis that may satisfy the scheme funding legislation. This basis could be updated between valuations, for example to reflect the passage of time or emerging longevity experience. For schemes whose first valuation under the new regime has not been completed shortly after the Regulations take effect, it would be reasonable to require trustees to agree a low dependency funding basis before any surplus is released.

It appears at first glance as though the trustees must provide the actuary with the effective date for the asset valuation twice, under both reg. 5(3) and 6(a). However, upon closer examination seems that under 6(a) the trustees are informing the actuary of the date of the asset valuation that they have supplied, whereas under 5(3) they are instructing the actuary of the effective date that is to be used for the liability valuation (actuarial assessment). This view is supported by use of the past tense ('were valued') in regulation 6(a).

That being the case, we believe regulation 5(3) should be amended as follows:

'The trustees must provide the relevant actuary with the date by reference to which the scheme's ~~assets are valued and the amount of its~~ liabilities are <u>to be</u> determined ("the effective date") for <u>the purpose of</u> undertaking the actuarial assessment.'

Regulation 7(1) should be amended to, *'The ~~amount of the scheme's~~ liabilities to be taken into account…'. The current phrasing is inconsistent with regulation 5(4), which tasks the actuary with determination of the amount of the scheme's liabilities. The suggested, revised phrasing would also be more consistent with similar provisions in, for example, regulation 3(2) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377).*

Question five

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

We support the objective of giving schemes greater flexibility to release surplus while continuing to protect members' benefits. It is appropriate that any surplus distribution should be subject to a minimum funding requirement.

In that context, we are comfortable with replacing the buyout threshold in the 2006 Regulations with a low dependency funding basis as the minimum threshold for surplus release. This gives schemes greater flexibility to make scheme-specific decisions, while maintaining an appropriate baseline for member protection.

Trustees and employers should then determine an appropriate buffer above that minimum, taking account of the scheme's circumstances, strategy, risk appetite and employer covenant. Clear guidance from The Pensions Regulator will therefore be just as important as the threshold itself, supporting trustees and employers in making appropriate surplus decisions without treating the minimum requirement as a target funding level.

Question six

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? Please provide details.

The draft Regulations require trustees to identify a provisional surplus-refund amount at a chosen date under regulation 8 before the actuarial certification process under regulation 9 is completed just prior to payment.

The Regulations should permit the final amount paid to be different from the provisional amount. As drafted, regulation 9(4) appears to permit payment only of the amount provisionally identified at least three months before payment, which creates uncertainty about how changes between notification and certification should be managed.

It should be clear whether the notified provisional amount operates as a cap, and whether any change to the amount would require a fresh notification process. In our view it would be reasonable for trustees to be able to proceed with a lower certified amount, without restarting the process or issuing a further three-month member notification. This flexibility would be particularly helpful if a single notification could cover an intended series of payments over time.

Since member notification is given by reference to a provisional amount before the final calculation and certification have taken place this also potentially creates practical communication challenges. Members may be told about one level of employer payment or member enhancement, only for the final amount to change once the actuarial certificate is obtained. That could cause confusion, generate member queries and encourage schemes to build in larger buffers simply to reduce the risk of communicating figures that later need to be revised.

One option could be to allow a calculation-based notification, that explains how the distributable surplus would be calculated rather than specifying a fixed monetary amount (for example, surplus in excess of a percentage of low dependency). We comment further on the member notification requirements under question 11.

We also note that the effective date for the provisional actuarial assessment may be any date at least three months before the employer payment. This seems reasonable, provided the assessment is not carried out by reference to a date earlier than the effective date of the most recent completed actuarial valuation. Actuarial certification is then completed shortly before payment and must reflect material developments in assets and liabilities. While this implies that stale information should not be used, the Regulations could state more clearly that the actuary should be satisfied that asset values remain appropriate at the calculation date, or that they may be updated or rolled forward from recent available data. In practice, certification cannot rely on fully real-time information and will inevitably use data that is not completely current. Actuaries will need to manage any gap between the latest available data and the certification date.

Finally, as noted below, the proposed five-working-day window for payment after actuarial certification appears unnecessarily short. A longer period – say of at least 10 working days – would be more workable while still keeping payment closely aligned with the certified funding position.

Question seven

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

In our view, the proposed five-working-day period is unnecessarily short and may be difficult to meet in some cases. Practical steps may include finalising actuarial certification, obtaining any necessary approvals and arranging the release and transfer of funds.

A period of around 10 working days would be more practical while still keeping payment closely aligned with the scheme's current funding position.

We recognise that prompt payment helps maintain alignment with asset values and disinvestment activity, but it does not eliminate the risk of subsequent funding deterioration.

See also our answer to question 9 which advocates for more flexibility around phased payments.

Question eight

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

We support including a forward-looking assessment, provided this does not imply that stochastic modelling is required for certification. The Regulations should enable certifications to be undertaken in a proportionate way with flexibility to recognise the amount of surplus being released and the remaining funding margin.

Read literally, Condition 2 appears to require only that the scheme is at least as likely as not to remain fully funded on the low dependency basis at each point over the next three years (not that it is expected to remain above the threshold every day of the period). Nevertheless, for clarity, we suggest it would be helpful to reframe it closer to the drafting used for schedules of contributions, where actuarial certification is generally based on whether the statutory funding objective is 'expected' to continue to be met over the relevant period. This would take away the risk that complex modelling is determined to be required for certification.

The broader questions about surplus strategy, funding buffers and risk management all remain wider trustee decisions. In that context we note that the three-year test operates as a relatively limited safeguard rather than a test of full resilience. In many cases, it would allow surplus to be released down to around 100% low dependency funding without requiring a material additional buffer, except where there is expected funding drag, such as using scheme assets to support accrual or expenses, or materially higher uncertainty. The test focuses on the probability of remaining above 100% funded, but not on the scale of potential downside if funding deteriorates nor on the available covenant support. This reinforces the importance of robust professional advice and TPR guidance in helping trustees address those wider questions first and foremost.

Question nine

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?

Phased release of surplus over months or years may be appropriate where, for example, spreading payments helps manage risk to the scheme. The process appears capable of supporting phased surplus releases over several years. However, it is unclear whether trustees would need to repeat the full three-month member notification process before each instalment.

Requiring a fresh three-month notification before each payment could make the process unnecessarily slow and burdensome. Therefore, each payment could still remain subject to actuarial certification confirming that the scheme remains sufficiently funded, but there should be greater flexibility to allow a single member notification to cover an intended payment programme where appropriate. Current summary funding statement requirements already include retrospective reporting of employer payments. This would help avoid any unintended incentive for schemes to release more surplus in one tranche simply to reduce governance and notification burdens.

One phased-release scenario is where a sponsoring employer wants to use surplus to fund regular contributions to a separate arrangement, such as a DC or CDC master trust. Although this may be possible under existing legislation, the governance process envisaged in this consultation appears to point towards extracting lump sums, holding them in escrow (for example) and drawing them down monthly, because once notification and certification have taken place the money must be paid out within a short period. A more direct route would be preferable.

This would require member notifications and actuarial certifications to be capable of covering an intended payment programme where appropriate, for example through a single member notification supported by periodic, perhaps annual, actuarial certifications before payments continue. In practice, we would expect this to be supplemented by schemes' own governance and ongoing monitoring, including the ability to pause payments if circumstances change. This seems an acceptable trade-off: slightly longer certification and payment periods would be balanced by the practical benefit of releasing surplus gradually, rather than forcing payments that are intended to be spread over time to be made as a lump sum.

It would be undesirable if using surplus to fund contributions to a separate arrangement were made materially more complex than funding contributions within the scheme trust. That could create unintended incentives to bring DC provision back within trust at a time when the Government is encouraging consolidation. While that may be the right outcome for some schemes, it should not be driven by avoidable governance complexity.

Question ten

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

No comment.

Question eleven

Do you think the notification requirements [to members] in regulation 11 are sufficiently clear?

While the notification requirements are broadly clear, they raise practical challenges. We would support as much flexibility as possible in the member notification process, including allowing trustees to shorten the three-month period where appropriate, use one notification for an intended programme of payments, and rely on established scheme communication channels.

- Trustees should be able to set an appropriate notification period, reflecting the nature of the proposed payment and the need to give members sufficient time to engage. While requiring notification may provide members with reassurance, the key safeguard is that any surplus release remains a trustee decision, supported by appropriate governance and professional advice. One option might be for the Regulations to refer to "reasonable notice", with the Regulator setting expectations in guidance.
- As noted under question 9, further clarity would also help schemes planning multiple surplus payments over several years. In particular, the Regulations should confirm whether a single notification can cover an intended programme of surplus releases, especially if the three-month period is to be mandatory.
- There is also a risk of confusion in member communications. Because the notification would be based on a provisional amount before final calculation and certification, members may need to be updated if the payment does not proceed as notified, either because no payment is made or because the final amount changes. As noted under question 6, a calculation-based notification explaining how the distributable surplus would be calculated, rather than specifying a fixed monetary amount, may help address this. Existing summary funding statement requirements already require members to be informed of any payments to the employer and this is likely to be the best route to confirm what has actually happened.
- More generally, we support the position that written notification should not need to be issued as a mandatory standalone communication. Allowing trustees to use existing channels, such as summary funding statements or annual newsletters, would be a more proportionate way to inform members, reduce concern and confusion, and avoid unnecessary queries. It would be helpful for the consultation response to explicitly endorse this approach.

Question eleven continued

Do you think the notification requirements [to members] in regulation 11 are sufficiently clear?

We also question whether regulation 11(1)(c) is needed. In practice, trustees are likely to communicate any agreed improvements to member benefits, particularly where the employer payment is significant. Prescribing this in regulation may add little, while creating an expectation that detailed benefit-improvement information must be included in the initial notification. Leaving this to trustee judgement would allow schemes to decide how best to communicate in the circumstances. This is particularly important given the practical challenges of notifying members in advance: while provisional and final employer lump sum payments can be adjusted, member uplifts may often need to be fixed or agreed before being communicated.

In terms of the drafting, the sequencing of the requirements would also be clearer if the member notification obligation appeared immediately after regulation 8, which deals with the provisional surplus amount. Notification logically sits between the decision on the provisional amount and the later decision to proceed to payment.

If retained, Regulation 11(1)(c) could also refer to any authorised member surplus payments that trustees have decided to make, or a separate sub-paragraph should be added for that purpose. This would align regulation 11 with regulation 12, which requires notification to the Pensions Regulator of both benefit-improvement decisions and authorised member surplus payment decisions.

Paragraph 3.23 of the consultation document states that members may request a copy of any actuarial certificate produced after the member notification is issued. It would be helpful to have clarification about whether the Government intends to include that certificate in the list of documents members are entitled to receive on request.

Question twelve

Do you think the notification requirements [to the Regulator] in regulation 12 are sufficiently clear?

The Regulations should make clear that the information required under regulation 12(a), (b) and (c) is intended to be drawn from the actuarial assessment carried out under draft regulation 5.

We also suggest reconsidering the proposed one-week notification period. Although compliance should usually be possible, it is not clear why such a short deadline is needed or what regulatory purpose it serves.

For funding submissions and related reporting, legislation more commonly requires documents or notifications to be provided “as soon as reasonably practicable” or within a “reasonable period”.

As a minimum, a 10-working-day period would be more practical while still ensuring timely notification. It would also be helpful to explain how the Regulator expects to review the information provided and what level of engagement schemes should anticipate.

Practical guidance will also be needed on how notification should be made, including whether it will be submitted through Exchange using a prescribed form or process. We note that the consultation confirms the Regulator will publish further guidance for trustees in Spring 2027.

Question thirteen

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

These seem reasonable.

Multi-employer scenarios may raise additional complexities, but these are likely to relate primarily to agreeing surplus payments between the relevant parties rather than to the regulatory framework itself.

Question fourteen

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

No comment.

Question fifteen

Are the draft Regulations clear on revaluation of deferred awards?

The drafting reflects the proposed restriction on surplus payments to members below Normal Minimum Pension Age. We would encourage DWP to work with HMRC to find a practical route that enables lump sum distributions to be made to those members below Normal Minimum Pension Age, so that payments can be made to all members at the same time.

In terms of the current drafting, the legislation should require statutory revaluation up to the date the lump sum is paid, rather than only to Normal Minimum Pension Age. We also suggest clarifying the cross-reference in new regulation 5A(1): it refers to "Chapter 2 of the Act" without specifying which Chapter 2 is intended. The intended reference appears more likely to be Chapter II of Part IV of the Pension Schemes Act 1993, which deals with revaluation of accrued benefits.

Question sixteen

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

No comment.

Question seventeen

Do you foresee any issues or concerns arising from proceeding without transitional provisions following the revocation of the 2006 Regulations? If so, please provide details.

As the government has been clear on the anticipated timelines for these surplus changes, we would agree that additional transitional arrangements do not appear necessary.

Question eighteen

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

No comment.

Question nineteen

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

It would be helpful for the Schedule to include a certificate template, rather than only listing the required information. This would be more consistent with the approach taken for other certificates.

Hymans Robertson expertise

If you'd like to discuss any of the points raised in this paper please contact us.

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