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Articles this month:

Surplus 2.0 requirements

The Department for Work and Pensions has published eagerly awaited draft legislation on the conditions for payment of defined-benefit (DB) surplus to employers. It, and a statement from the Pensions Regulator, paint a picture of how the process is expected to work in practice.

The draft secondary legislation, which would become the *Occupational Pension Schemes (Payments to Employer) Regulations 2027*, is being produced under the auspices of reforms contained in the Pension Schemes Act 2026. Subject to the consultation outcome and parliamentary approval, they would come into force on 6 April 2027.

Proposed process

Under the proposals, trustees would commission from their scheme actuary an '*actuarial assessment*', for which they would choose the effective date, of the existence and extent of a surplus. It could be done as part of a scheme funding valuation exercise, or as a standalone assessment.

For the purposes of the assessment, the actuary would determine the value of the scheme's liabilities on a low-dependency funding basis (LDFB), rather than (as applies currently) an estimate of the cost of buying out benefits with an insurance company. The value of the scheme's assets would be determined by the trustees,

after taking advice from someone with suitable expertise in financial matters, and the management of scheme investments and liabilities. The asset value would not have to be audited.

Assuming that the assessment confirms that the scheme is in surplus on the LDFB, the trustees would then take advice from their actuary, and consult with the scheme sponsor on the timing and provisional amount for any employer surplus payment. However, there would be additional conditions to be met and steps to be taken before they could proceed to payment.

The trustees would have to provide scheme members with details and at least three-months' notice of the proposed surplus-payment plans.[1] Those plans would include not only the provisional employer surplus payment, but also details of any proposed benefit augmentations and one-off authorized member surplus payments (more on which later). Notification could be given electronically.

For the employer payment to take place, the actuary would have to provide a certificate giving various details of the scheme and the trustees' plans for the surplus. They would include statements of the actuary's opinion that a LDFB surplus still exists at the certification date, after taking account of asset and liability changes since the original actuarial assessment, plus benefit augmentations and authorized member surplus payments. The actuary would also have to believe there's at least a 50/50 chance that the surplus funding position will persist for three years.

The surplus payment would have to be paid within five working days of the date of the actuary's certificate. The trustees would have to notify the Pensions Regulator about their surplus-release arrangements within a week of the payment to the employer. The surplus-release 'journey' is set out in an annex to the consultation.

Out of scope

The new employer-surplus-payment rules would not apply to schemes benefitting from a Crown guarantee. Nor would they apply to DB superfunds; the DWP consultation document says that separate provision for surplus payments will be made within the new statutory framework for superfunds.

Authorized member surplus payments

The consultation document also confirms the Government's plans to amend the tax legislation to facilitate the making of one-off awards to members out of surplus. Although such '*authorized member surplus payments*' (AMSPs) could be *awarded* to members at any age, they could only be *paid* once those members have reached '*normal minimum pension age*' (currently 55, rising to 57 on 6 April 2028). Deferred AMSPs would be revalued until paid in line with inflation, capped at 2.5% per annum. The Government plans to make the necessary changes to the pensions-tax rules to coincide with the commencement of the new employer-surplus changes, on 6 April 2027.

Next steps

Responses to the consultation proposals should be submitted by 2 September 2026. The Regulator has issued a statement on how trustees can prepare for surplus-release discussions, with factors to consider, and some illustrative case studies. The statement and consultation document say that the Regulator will consult on further supporting guidance later this year, after the DWP has announced the consultation outcome.

[1] This appears to be a *notification*, rather than *consultation*, exercise. There would be no (statutory) requirement to solicit and consider members' views.

A picture of a new surplus-release process begins to emerge. To support run-on as a long-term prospect, it should be as frictionless as possible (albeit with safeguards). However, a reasonable estimate of the time required for the full exercise sketched out in the consultation seems to be around six months. That will naturally constrain the potential frequency of surplus distributions.

The sub-heading for the consultation paper is '*Unlocking Value for Employers and Scheme Members*'. The Regulator's case studies reinforce this message by assuming that sponsors and members will both expect to benefit from any surplus, in proportions influenced by historical factors, on a scheme-specific basis.

VAT now?!

At the beginning of June 2026, His Majesty's Revenue and Customs (HMRC) revised one of its internal manuals, *VAT Input Tax* (VIT), making changes to its policy on the value-added-tax treatment of funded occupational pension schemes. The changes affect, principally, private-sector defined-benefit schemes, and may necessitate changes to the arrangements made for the reclamation of VAT incurred in the course of their operations.

The changes to the VIT manual are a delayed reaction to an announcement that HMRC made in June 2025.[2] Those familiar with the issues will know that the biggest sticking point has always been VAT on investment services, which for a long time was not recoverable. Historically, HMRC required that investment-related scheme costs were itemized separately from other, administrative outlays, and it was only the admin-related element that employers could offset against the VAT that they charged their own customers. Alternatively, as a concession, it accepted a crude apportionment of undifferentiated investment – administration invoices, assuming that 30% was admin-related (and therefore recoverable).

That policy began to change as a result of a European Court of Justice ruling, in 2012, which established that *all* VAT costs, admin- or investment-related, are (at least in principle) deductible by the sponsoring employer. However, HMRC proved somewhat reluctant to relinquish the investment-associated tax. Trustees and employers were advised that they could enter one of a number of more-or-less contrived arrangements to facilitate VAT recovery. Even then, HMRC concluded that investment costs were '*dual-use*', so that employers were still unable fully to deduct the associated VAT.

That was, broadly speaking, the position up until the June 2025 announcement, when HMRC finally conceded that investment costs should no longer be viewed as dual use. However, the specifics of its change of heart, including the practical implications for trustees' and sponsors' VAT processes, remained somewhat unclear.

The updated VIT Manual says that input VAT incurred on services connected to an occupational pension scheme can be fully recovered by the sponsoring employer, regardless of whether the costs relate to administration or investment management. It then moves on to talk about a hypothetical fund-management contract, and how the employer might obtain a VAT deduction in practice.

[2] *Revenue and Customs Brief 4/2025*.

Two methods are prescribed: the first involves invoices that are addressed to (or issued 'care of') the employer. The manual says that in that case the employer can either pay the invoices directly or provide evidence that payment was '*deducted from the pension pot*'.

The other method caters for the scenario in which the fund-management contract is between the manager and the trustees, with invoices settled by the latter. To recover the VAT in those circumstances, says HMRC, the trustees will (assuming they don't have taxable business activities of their own to set against the input tax) need to invoice the costs to the employer, as their charge for operating the scheme on its behalf.

Sections of the manual dealing with previously promoted arrangements for facilitating VAT recovery—for example, involving tripartite contracts—have been archived.

Initial responses to the latest edits to the manual have called for HMRC to provide additional clarification, querying for example whether the new expectations extend to invoices for admin-related services (for which, in the past, an invoice addressed to the employer would have sufficed). Trustees and sponsors should review their tax arrangements to ensure that they will permit convenient pensions-VAT recovery in the future.

Revised terms & conditions apply

The Department for Work and Pensions (DWP) is consulting on proposed changes to the *Conditions for Transfers Regulations*.[3] The Government's press release concentrates on reforms to prevent use of small self-administered schemes (SSASs) as sham transfer destinations; however, the changes would, if made, reach further, and tackle some of the most contentious 'quirks' of the legislation, which have now been affecting transfers for almost five years.

State of play

Under the current version of the Regulations, one of two conditions must be met for a transfer to proceed. The first condition is concerned with the type of scheme to which the member proposes to transfer. Public-sector, master-trust and collective money purchase schemes are all considered to be sufficiently low-risk destinations for transfers to go ahead.

The second condition, which applies when the first condition doesn't, is satisfied if there are no '*red flags*' discernible in the features and circumstances of the proposed transfer. The red flags in question include the member's failure to provide requested evidence or information, the involvement of an unregulated financial adviser, and when there's evidence that the member was cold-called, offered an incentive to transfer, or subjected to pressure.

A red flag is also waved if a member is required to undergo guidance from the Money and Pensions Service, but fails to prove that he or she has done so. The guidance requirement is triggered by the presence of one or more '*amber flags*' listed in the Regulations. They include—

- where the requested transfer destination is an occupational pension scheme, failure to show that there's an employment link between the member and the sponsor of the receiving scheme;

[3] The *Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021* (SI 2021 No. 1237)

- where the destination is an overseas scheme, failure to show that the member is a resident of the relevant overseas territory;
- incomplete or spurious responses to requests for evidence for or information about the employment or residency links;
- the inclusion of high-risk, unregulated, unorthodox, or overseas investments in the receiving scheme;
- unclear or inordinately high fees; and
- a suspicious spike in the volume of requests for transfers to the same destination or involving the same advisers.

Backlash

Almost as soon as the Regulations were published, in 2021, complaints began about some of the amber flags. In particular, it was pointed out that most schemes have some overseas investments, so that their presence was not a good indicator of an ill-advised transfer request. The DWP and Pensions Regulator encouraged trustees and scheme managers to exercise their discretion to give effect to transfers when there were no concerns about the bona fides of the receiving scheme, but many were reluctant to proceed contrary to a clear statutory obligation. The Government acknowledged commentators' concerns and committed to a review of the effectiveness of the Regulations.

Proposed changes

That brings us more-or-less up to date, as we are now seeing the fruits of the Government's review. It has put forward several proposals for the reform of the Conditions for Transfer Regulations. Draft amending legislation is included as an annex to the consultation document.

The headline change, as announced by the Government's press release, would be to elevate the employment-link (insufficiency thereof) amber flag to a red flag. Recall that red flags stop transfers from proceeding, so there would be no route by which the member could (as now) insist on the transaction after attending a MaPS guidance session. Although the proposal is presented by the Government as a measure designed to stop scammers from using fake SSASs, the draft amendment isn't explicitly targeted at such schemes (it's just easier for the unscrupulous to abuse small-business pension arrangements).

There are other, less-heralded proposals for changes to the Conditions:

- in addition to the existing types of schemes that are white-listed within the first condition, it would also become possible to make transfers to '*any reputable pension scheme*'—it's suggested that the finalized amendments could include a list of factors for trustees and scheme managers to consider when deciding whether a scheme is '*reputable*';
- members wouldn't have to undergo mandatory MaPS guidance more than once per year; and
- the overseas-investment amber flag would be removed.

The Government is intent on keeping the incentives-based red flag. However, it believes that the new 'reputable scheme' route should allow trustees to proceed with transfers that don't give rise to concerns that the member is being duped.

Next steps

Responses to the consultation proposals should be submitted by 21 July 2026. The Government says that the consultation is '*the first step in a wider government programme to tackle pension fraud*', and that more changes (including, perhaps, further legislative amendments) are being developed '*this year*'.

CfE for AQRs

The Department for Work and Pensions (DWP) has called for evidence on the alternative quality requirements for auto-enrolment compliance, as a prelude to a periodic statutory review.

The alternative quality requirements (AQRs) are, in broad terms, ones that allow schemes to be used for auto-enrolment if—

- for a defined benefit (DB) scheme, the cost of accrual;
- for a defined contribution (DC) scheme, employer and total contributions; and
- for a collective DC (CDC) scheme, total contributions

are above the percentages prescribed in regulations, where the percentages vary based on the specifics of the scheme's own pensionable-earnings definition. In essence, they're a way of avoiding the potentially complicated assessments that would otherwise be necessary if the basic auto-enrolment quality requirements, based on the rather-contrived '*qualifying earnings*' band, were to apply.

The call for evidence focuses on the AQRs for DB and CDC schemes. The DWP wants respondents' views on whether the AQRs are providing the desired simplification and flexibility, and whether the applicable tests are appropriate for single-and-connected employer and unconnected multi-employer CDC schemes. It would also like to understand who is performing the relevant assessment for DB schemes.

The deadline for submissions is 27 July 2026.

TWOC tick for CDC

Amendment Regulations from the Department for Work and Pensions (DWP) will reduce the statutory hurdles for transfer without consent (TWOC[4]) of money-purchase rights into collective defined contribution[5] (CDC) schemes. The approach that will apply for TWOC into CDC schemes will be similar to that which already applies for transfers into DC master trusts, such that there will be no statutory requirement for trustees to obtain written advice from a suitably qualified and independent adviser.

The change was proposed in October 2025 as part of a consultation exercise on 'retirement-CDC' (R-CDC) schemes, which will convert pension pots into income at (as the name suggests) retirement. However, the DWP has indicated in a response to that part of the consultation that R-CDC schemes themselves are to be excluded as a possible destination for the new category of TWOC. The consultation outcome also notes that, although expert independent advice will no longer be statutorily required for TWOC into CDC, trustees are free to take such advice if they consider it necessary or desirable to meet their fiduciary obligations.

The Regulations come into force on 31 July 2026. The DWP has also updated its non-statutory guidance on *Bulk Transfers without Consent of Money Purchase Benefits without Guarantees*.

Commencing countdown, engines on

The Government has begun to bring parts of the *Pension Schemes Act 2026* into force.[6] The first Commencement Regulations activate amendments to the levy rules for the Pension Protection Fund (PPF), giving it freedom to set them at the desired levels (including zero). The changes will come into force on 29 June 2026.

In a little more detail, the amendments that are being activated will—

- make the imposition of a risk-based levy discretionary;
- explicitly allow the PPF to set risk-appropriate levies for schemes '*not supported by a substantive employer covenant*' (e.g. superfunds); and
- allow the PPF to cease and then resume charging levies.

Upon resumption of charging after a hiatus, aggregate levies would be capped at a quarter of the levy ceiling for the previous financial year. For context, the ceiling is currently near to £1.5 billion; it's reviewed annually against the yardstick of earnings inflation.

And we're off! Pace yourselves, though, and take regular sips of water. We're expecting to see a revised version of the DWP's implementation roadmap any time soon; in its current iteration, activity is expected to carry on into the 2030s.

[4] The pensions world doesn't need more acronyms, but this one's quite fun to say. (TWOC, TWOC, TWOC.)

[5] The legally recognized category is '*collective money purchase*', but even those responsible for the legislation refer to it as 'CDC'.

[6] Some provisions were designed to take effect automatically, without Government action.

From RAS to riches

The Government has made amendments to the legislation that empowers and requires His Majesty's Revenue and Customs (HMRC) to resolve the 'net pay anomaly' affecting tax relief for member pensions contributions.[7]

The anomaly

The anomaly arises because of the differences between the two main ways by which legislation grants relief from income tax. If an employee's pension scheme is set up to use 'net pay arrangements' (NPA), member contributions are deducted from salary before the calculation of the tax, so that relief is given immediately and in full, at the employee's marginal rate.

If the scheme instead offers 'relief-at-source' (RAS), contributions are deducted after tax. Once a contribution is paid across to the pension provider, it submits a claim to HMRC for a refund of tax at the basic rate. Higher- and additional-rate taxpayers can obtain the remaining relief that's due to them via self-assessment. Importantly, the ability to recover basic-rate tax applies regardless of the employee's actual income-tax liability—even those who don't earn enough to pay income tax can benefit.

Partial solution

Membership of a RAS scheme therefore offered tax advantages to lower earners that weren't extended to members of NPA schemes. The Government finally addressed the anomaly in the *Finance (No. 2) Act 2023*, which obliges HMRC to make arrangements to pay members of NPA schemes amounts equivalent to basic-rate tax on their contributions. No such payments have yet been made (but see the final section of this article for some news on that front).

The amendments

The Explanatory Notes to the new Net Pay Arrangements Regulations say that they will address remaining disparities between the tax relief afforded via RAS and that given under NPA. Those disparities exist because the remedy in the 2023 Act applies only to those with a total income less than their personal allowance, whereas the anomaly in practice affects a broader category of members.

The amended legislation will require HMRC to make payments to NPA-scheme members equivalent to the difference between the relief that they received and what they would have been given if they had been members of RAS schemes.

Implementation

The June issue of HMRC's *Employer Bulletin* says that it will begin contacting those eligible for a '*low earner's pension payment*' (this is HMRC's name for the remedy for the anomaly; it doesn't appear in the legislation) in August 2026.

[7] The *Registered Pension Schemes (Net Pay Arrangements) Regulations 2026* (SI 2026 No. 671).

Examining the FAAs track for signs of cracks

The Government announced its intention to review the legislation on '*flexible apportionment arrangements*' (FAAs) in connection with multi-employer defined-benefit (DB) pension schemes. It wants to explore whether additional safeguards are desirable when FAAs are used for purposes not anticipated when the legislation was introduced, back in 2012. The statement follows the use of an FAA as part of last year's ground-breaking risk-transfer agreement involving the Stagecoach and Aberdeen corporate groups.

The Government's rationale for the review is that FAAs are being put to novel uses, in a funding environment that is very different from the one for which they were crafted. In essence, they were about who would take over responsibility for pensions liabilities accrued toward employees of a particular company that was, for one reason or another, seeking to terminate its sponsorship of a DB scheme, without triggering payment of an immediate, buy-out-based employer debt.

When the FAA option was introduced, it was almost always the case that the schemes to which it applied were in deficit. Those who drafted the legislation didn't anticipate its application to a scheme with a substantial buy-out surplus, to allow a commercial transaction in which the original sponsor is divested of responsibility and a new entity agrees to support the scheme running on, for the benefit of the members, in return for a share of anticipated investment gains.

The Pensions Regulator responded to the Government's announcement by describing its perspective on the Stagecoach–Aberdeen deal. It had been involved by the trustee at an early stage, and was able to satisfy itself that security of members' interests was preserved, that the trustee's due-diligence and decision-making processes were thorough, and that the funding tests for use of an FAA were met.

The DB environment has been transformed by the turnaround in funding fortunes in recent years. That has prompted prudent trustees to review their situations and ultimate goals for their schemes. It's only proper that the Government should take the opportunity to re-evaluate aspects of the legislative structure that were built to operate in a very different milieu.

Convert zeal

His Majesty's Revenue and Customs is holding a technical consultation exercise on draft amendments to the calculation of annual-allowance pension input amounts following guaranteed minimum pension (GMP) conversion. In essence, the draft changes would mean that pension increases resulting from GMP conversion would no longer trigger loss of the 'deferred-member carve-out'.

The consultation period is 8 June to 13 July 2026.

The proposed amendments to the tax rules would remove one practical hurdle in the use of conversion. We note, however, that the draft legislation only appears to cover increases directly resulting from the use of conversion to equalize for GMP differences, and not any ancillary benefit changes that trustees may decide to make as a consequence of, or to facilitate, conversion. The statutory power to modify scheme rules to enable GMP conversion also extends to that wider category of amendments.

‘Final’ lifetime-allowance abolition fixes

The Treasury laid before Parliament Regulations making further changes to the tax rules connected with the abolition of the lifetime allowance. The *Pensions (Abolition of Lifetime Allowance Charge etc) Regulations 2026*[8] came into force on 25 June 2026. They cover matters such as the treatment of transfers to, and lump sums from, overseas pension schemes; and changes to the calculation of protected pension commencement lump sums and the lump sum and death benefit allowances.

There have already been three sets of regulations, dating from 2024, with similar titles. An Explanatory Memorandum laid in Parliament alongside the 2026 Regulations indicates that they are the ‘*final set of technical amendments*’ to the rules.

HMRC news: June 2026

Pension Schemes Newsletter 182, from His Majesty's Revenue and Customs (HMRC), contains information on—

- recent changes to its ID-verification process for scheme administrators and practitioners;
- consultation on draft Regulations about the annual-allowance treatment of benefit adjustments arising from GMP conversion (see article in this issue);
- some relief-at-source news, including a delay in switching over to digital processing of claims; and
- clarification and guidance in HMRC's June 2026 *Employer Bulletin* about the reporting of employee pension contributions, correcting a mistake in the August 2023 issue of the *Bulletin*.

[8] SI 2026 No. 698.