Consultation response: Surplus Flexibilities for Defined Benefit Pension Schemes

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About Independent Governance Group

Independent Governance Group (IGG) is a leading provider of professional pensions trusteeship, governance and communication services.

Operating across the UK, Ireland and beyond, IGG has a total of 500+ appointments with a combined asset value of approximately £322bn. Schemes range in size from the low millions to multi-billions, with over 50 of IGG's schemes being £1bn+.

Widely viewed as a leader in its field, professional pensions trusteeship and scheme governance, risk and compliance services are at the heart of IGG's offering and are delivered through a combination of chair of trustees, co-trustee and professional corporate sole trustee appointments. Around a third of IGG's trustee appointments are to act as professional corporate sole trustee, accounting for 150+ appointments. Pensions support services strengthen the professional trusteeship side of the business, with IGG providing secretarial, pensions managerial and governance solutions for over 140 appointments.

The 220+ team includes pensions expertise drawn from many different backgrounds, such as pensions managers and consultants, lawyers, investment specialists, and actuaries. The team is known for providing diversity of thought and wide-ranging collective experience.

IGG is a multi-award-winning active member of the Association of Professional Pension Trustees (APPT). Members of the group play a prominent part in APPT committees, and all Trustee Directors are fully accredited as professional trustees.

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<u>Executive summary</u>

We support the policy objective of giving trustees of well-funded defined benefit schemes greater flexibility to consider the use of surplus, provided that member security remains the overriding priority and trustee decision-making remains independent, scheme-specific and properly advised.

The draft regulations provide a workable starting point, but further clarity is needed in several areas. In particular, the regulations and supporting guidance should make clear that appropriate advice is advice obtained by the trustees from advisers appointed by them, not advice provided by the employer or its advisers. This is important where employers may be assertive in seeking surplus release.

The low dependency funding basis may be a reasonable statutory minimum, but it should not be presented as the default standard for surplus release in every case. Trustees should continue to assess each proposal in light of the scheme's circumstances, including solvency, buy-out position, covenant, investment strategy, buffers, contingent assets, insured liabilities and the scheme's long-term objective.

The proposed process would benefit from greater practicality. The five working day period for payment following actuarial certification appears too short and should be extended. The regulations should also clarify how the process applies to phased releases, schemes with buy-ins or incomplete true-up processes, deferred authorised member surplus payments and statutory transfer rights.

Separately, the regulations should clarify the purpose and effect of member notification, including whether trustees are expected to consider objections, how any objections should be handled before payment is made, and whether member communications are intended to amount to notification only or a more substantive opportunity to respond.

We are also concerned that trustees could be replaced where they do not agree to, or propose, a surplus release, particularly where their decision does not align with the sponsor's preferred outcome. The Government should consider appropriate safeguards to protect trustee independence, and TPR should set out how it would respond where a surplus release to the sponsor coincides with a change to the trustee board.

Key themes

- Member security should remain the overriding priority, supported by independent, scheme-specific trustee decision-making and advice.
- Appropriate safeguards are needed where trustees could be replaced because they do not agree to, or propose, a surplus release, particularly where this may undermine trustee independence.
- Low dependency may be an appropriate statutory minimum, but should not become the default threshold for releasing surplus.
- The payment timetable and treatment of phased releases, buy-ins, true-ups and deferred payments require greater clarity and flexibility.
- The purpose of notification to members and the handling of objections or representations should be clearly defined.

Overarching comment

We recognise that some of the comments and concerns raised in this response are likely to be better dealt with in TPR guidance rather than the regulations themselves.

The regulations and any TPR guidance should avoid implying that a member payment or benefit enhancement should be made in every case. Trustees may reasonably conclude that no member payment or enhancement is appropriate, depending on the circumstances. Equally, member benefit improvements will be appropriate in some cases and should remain available as part of a balanced trustee decision. If case examples are to be included in TPR's guidance they should illustrate a spectrum of potential outcomes

We have significant concerns that trustees could be replaced where they do not agree to, or propose, a surplus release, or where proposals do not align with the sponsor's own views. We urge the Government to consider what safeguards may be appropriate to protect trustee independence. We believe it would also be helpful for TPR to indicate how it might react where it sees reports of surplus being released only to the sponsor, coinciding with notification of a change of trustee board.

Response to consultation questions

Question 1: Definition of appropriate advice

We broadly support the definition, but it should be strengthened to make clear that the advice must be obtained by the trustees from advisers appointed by the trustees. It should not be sufficient for trustees to rely on advice provided by the employer or the employer's advisers.

This distinction is important because surplus release involves strong employer interest. Trustees must be able to take independent advice that is directed to their duties and to the interests of members and beneficiaries.

We note, however, that the requirement to take 'appropriate advice' applies only in relation to the valuing of scheme assets and in relation to earmarked schemes.

Question 2: Scope of the power

The scope of the power is clear. However, there may be issues where schemes already have existing powers to use surplus, for example to fund defined contribution sections or in winding up. The interaction between existing scheme rules and the new statutory route should be made as clear as possible to avoid "regime shopping" depending on whether a scheme is ongoing, bought in, moving to buy-out or winding up.

Question 3: Regulatory own funds schemes

We have no comment on this question.

Question 4: Assessment of assets and liabilities

Further clarity would be helpful on how trustees and actuaries should assess assets and liabilities in more complex situations. In particular, guidance should address whether past discretionary increase practice should be reflected.

There are particular questions for schemes that have completed, or are going through, full or partial buy-ins. The regulations or guidance should explain how insured liabilities and related assets should be treated where a scheme is going through a true-up process or where the precise residual liability position is not yet certain. Releasing surplus before final true-up may be risky because residual assets may still be needed to meet balancing premiums or unresolved liabilities.

It would also be helpful to clarify whether legally binding contingent assets agreed as part of a surplus release policy can be taken into account in the actuarial assessment. This may be particularly relevant for surety bonds or other enforceable support arrangements.

Question 5: Proposed funding test

The low dependency test may be a reasonable statutory minimum or "line in the sand". However, it should not become a one-size-fits-all answer or be treated as the standard at which surplus should ordinarily be released.

Trustees should continue to consider scheme-specific factors before agreeing to any release. Relevant factors include the scheme's solvency and buy-out position, covenant strength, investment strategy, appropriate buffers, contingent assets and the scheme's long-term objective. The role of covenant should be made more explicit.

There is a risk that employer advisers may use low dependency as a pressure point, particularly if examples in regulatory materials appear to indicate that it is the expected threshold for release. TPR's guidance will therefore be important in helping trustees build a practical decision-making framework, supported by examples that illustrate principles without creating a default outcome.

Question 6: Proposed payment process

The process is broadly understandable, but it should expressly accommodate practical disinvestment and settlement timing. The concept of a target date should take account of the time needed to realise assets, complete trustee approvals and manage payment logistics.

Further guidance would be helpful on the level of due diligence expected before trustees decide a provisional amount, especially where benefit audits, insurance true-up processes or other data verification exercises remain incomplete.

Question 7: Actuarial certification and payment within five working days

The proposed requirement to make payment within five working days of actuarial certification appears too tight. It may not be workable where trustees need to disinvest assets, complete settlement processes, obtain final approvals or manage payment logistics.

A longer period, such as 28 days, would be more practical while still limiting the risk that actuarial certification becomes stale. This is particularly important given the significant tax implications should the payment be made outside of the five days.

In addition, there should be sufficient flexibility for trustees to pause the process should circumstances change in the window after certification but before payment, which mean that the payment or agreed amount is no longer appropriate. This flexibility should also be reflected in the member notification process, given that the notification requires the target payment date to be included. It may be helpful to allow the payment to be expressed as a percentage of the available surplus rather than a specified monetary amount.

Clarification would be welcome on whether the FRC technical actuarial standards/guidance on payment of surplus will include the "as likely as not" test, including the level of due diligence required for the actuary to sign the certificate.

Question 8: Three-year forward-looking assessment

We support the principle of a forward-looking assessment, but further guidance is needed on how the "as likely as not" test should be applied in practice. Guidance should explain the expected approach to covenant, investment risk, future cashflows, contingent assets, market movements and material developments between assessment and certification. There is potential for this process to become complex and costly if, for example, extensive scenario testing or stochastic modelling is expected.

The test should support the trustees' assessment of whether the scheme is expected to remain appropriately funded after the payment, taking account of the scheme's overall risk profile and long-term plan.

Question 9: Phased release of surplus

The draft regulations appear to require certification of each individual payment, but it is unclear whether a single certificate could cover multiple future payment dates. Further clarity is needed, particularly because the five working day payment window may make phased releases difficult unless each payment is separately certified.

If surplus is to be released annually or in a planned series of payments, the process could become onerous. The regulations should clarify whether certification operates by reference to the target date or the actual date of signing, and how trustees should approach repeated certification where the release policy is intended to operate over several years.

Surplus release is effectively the reverse of the recovery plan process, so it would be logical for it to follow the same cycle. Coupled with a surplus release policy, a phased release could be monitored through the annual funding update and suspended if it is no longer appropriate, for example because of adverse investment or covenant conditions. As it stands, the draft regulations set out a process that is more burdensome for surplus release, even though the member risk is greater where a recovery plan is being agreed.

Question 10: Earmarked schemes

We have no comment on this question.

Question 11: Member notification requirements

The requirements are broadly clear, but the practical effect of member notification needs clarification. The regulations or guidance should explain how trustees should deal with member representations, objections or complaints where members disagree with a proposed surplus release. If the requirement is intended to be notification only, the rationale for a three-month period is unclear. Although this reflects existing regulations, it does not follow that the same approach is appropriate here. Member representations, and potentially complaints, could create a significant administrative burden, particularly given the increasing use of AI to generate complaint letters. Trustees' governance and decision-making processes should be sufficient to ensure that the potential outcomes and implications of surplus release for all beneficiaries have been fully considered before members are notified of the decision.

The exemption from notifying deferred members where no current address is held appears practical.

Clear communication will therefore be essential. Notices should explain the trustee decision, the funding position, the rationale for any employer payment, and whether members will receive any benefit improvement or authorised member surplus payment.

Question 12: Notification to the Regulator

The requirements are clear, but the policy intention behind the notification is less clear. It would be helpful to explain whether the information is intended primarily for monitoring, supervisory intervention, market intelligence or another regulatory purpose.

Question 13: Sectionalised schemes and employer consent

The proposed rules may be complicated in practice. Further guidance would be helpful on how surplus, liabilities, employer consent and member outcomes should be assessed where schemes are sectionalised or where employer responsibility is shared or unclear. This is another area where it may be helpful to allow the payment to be expressed as a percentage of the surplus rather than a specified monetary amount.

Question 14: Excluded schemes

We have no specific comments on excluded schemes at this stage.

Question 15: Revaluation of deferred awards

Further clarity would be helpful on the interaction between deferred authorised member surplus payments and normal minimum pension age. In particular, the regulations don't address the position of ill-health retirees under normal minimum pension age where an authorised member surplus payment may be payable immediately. The current reference to normal minimum pension age may not align clearly with that scenario. We note that the HMRC statement does address this.

Question 16: Deferred awards and statutory transfer rights

Some further clarity is needed on this point. It is currently unclear whether an authorised member surplus payment can be included in a transfer out, and how it should be treated on death, divorce or other benefit events. It would also be helpful to clarify whether such a payment can be transferred to another defined benefit arrangement.

Question 17: Transitional provisions

We have no specific comments on transitional provisions at this stage.

Question 18: Revocation of regulations 36 to 39 of the 2014 Regulations

We have no specific comments on this question at this stage.

Question 19: Certificate in the Schedule

We have no specific comments on the form of certificate at this stage, but the certificate should align with any final actuarial guidance on the three-year forward-looking assessment and should be practical for phased payments, disinvestment timing and schemes with insured liabilities or unresolved true-up processes.