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By email: pensions.surplusconsultation@DWP.gov.uk

Dear DWP,

**Financial Services Consumer Panel response to:
Surplus Flexibilities for Defined Benefit Pension Schemes:
Unlocking Value for Employers and Scheme Members**

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the DWP's consultation paper (the CP) titled Surplus Flexibilities for Defined Benefit Pension Schemes: Unlocking Value for Employers and Scheme Members. The Panel is a statutory body set up under the Financial Services and Markets Act 2000 to represent the interests of financial services consumers (we do not represent individual consumers). 'Consumers' includes private individuals as well as small businesses. We are independent of the Financial Conduct Authority (FCA).

Whilst the Panel's focus is predominantly on the work of the FCA; we also look at the impact on consumers of other bodies' activities and policy where relevant to the FCA's remit. We are strong proponents for ensuring that regulatory treatment is equivalent for the same regulatory risks regardless of regulator. Furthermore, given the critical importance to consumers, pensions and their protections are a key theme for the Panel. For these reasons, we believe it is important for us to respond to this DWP consultation.

We have provided the Panel's responses to the questions in the Annex, however, the below summarises our most important comments and concerns:

- For the valuation of the assets and liabilities of the scheme, the trustees must rely on external advisors who are professionally qualified to provide a valuation of the in-scope assets. For example, the valuation of listed equities requires different qualifications compared to commercial real estate. The advisors must be independent, without conflicts of interest, and they must be formally accountable for the accuracy of their valuations.
- As part of the process of determining the appropriateness of the payment of surplus, the Panel believes that trustees must also review the most

recent audited financial statements of the employer which is being paid. The trustees must assess whether the employer is likely to be financially viable for the foreseeable future. The Panel is very concerned that employers who are in or anticipate financial difficulties will encourage surplus payments. If this is the case, the employer could fail and would not be able to make any necessary contributions to the scheme.

- The Panel believes that surplus payments to enhance member benefits should be given greater emphasis, and we would strongly encourage that an assessment of this option is required as part of the process for any payment of surplus.
- It should be set out that members should be given sufficient information to query or challenge any payment of surplus, and they should automatically be given access to the actuarial certificate when it is complete.
- Given the level of information to be provided to regulators relating to any improvements in member benefits, the Panel also expects the regulators to collect information relating to the employer's use of the surplus payment. The regulators should monitor this to ensure that payments are used in an appropriate manner.
- The Panel believes that the regulators should track future funding levels of schemes that made payments of surplus. Future underfunding should attract intense regulatory scrutiny and regulatory action.
- Whilst there are likely to be instances where schemes are not currently investing in assets that stimulate growth, the Panel would also urge the DWP and FCA to compare the deployment of these assets pre- and post-surplus payment. We have a concern that they may not be used as effectively as envisioned in Chapter 8.

Yours sincerely,

Chris Pond
Chair, Financial Services Consumer Panel

Annex

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

No, the Panel does not agree with the proposed definition of 'appropriate advice'. We believe that the definition should be more specific and rigorous. First and foremost, it must be clear that the person providing the advice has no conflicts of interest relating to the scheme. For listed securities, the person must be authorised by the FCA to provide investment advice. And for any non-listed assets, the advice must be obtained from someone who has the appropriate certification(s) to value the type of assets in question.

Although it is not part of Question 1, but is noted in Chapter 1 paragraphs 2.5 and 2.6, we would also expect that, in all cases, the 'relevant scheme actuary' must hold an appropriate actuarial qualification.

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

The Panel accepts the proposed conditions and constraints limiting the power to pay surplus to the employer. However, we do not believe they go far enough. In addition to an independent actuarial assessment certifying that the scheme is funded at least to its low dependency funding level, we also believe that audited financial statements of the employer should be mandatory to evidence that the employer continues to be financially viable over the foreseeable future.

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

The consultation does not provide enough information for the Panel to provide an informed view on this.

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

Taking note of our response to Question 1, the Panel has no further comments on the considerations of factors to be taken into account for the assessment of assets and liabilities. The proposals seem appropriate.

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

We do not see that the DWP has provided a comparison between the buyout basis and the low dependency funding basis, especially in regard to the potential protections for scheme members. If the low dependency funding basis improves scheme member protections, we would support this change. However, if it does not improve scheme member protections, we would not support the change without further mitigating actions. In addition, the Panel is concerned with the

lack of specifics relating to what could be defined as “low dependency” on the employer.

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? Please provide details.

As we mentioned in our response to Question 2, the Panel believes that the trustees must also examine financial statements of the employer that have been audited within the last 12 months to ensure that the scheme could, if necessary, continue to depend on the employer for the foreseeable future. We are also concerned by the limited attention given to the possibility of enhancing scheme member benefits. We would suggest that this is a mandatory step to ensure that trustees consider this option. Otherwise, the Panel agrees with the payment process established in Regulation 8.

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

The Panel is comfortable with Condition 1, Regulation 9(2) and Condition 2, Regulation 9(3), and we agree that Regulations 9(5) and 9(6) are clear. However, we strongly believe that Regulation 9(4) must be enhanced. Prior to making any surplus payment to the employer, trustees must examine the employer’s most recent audited financial statements to ensure that the scheme can continue to depend on the employer for the foreseeable future.

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

The Panel agrees that the 3-year forward-looking assessment in Condition 2 seems reasonable.

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?

The Panel agrees that the same process must be repeated for each payment. Furthermore, we urge the DWP to closely monitor the payments of surplus and associated metrics (such as member complaints, firm failures, etc.) to ensure that any issues that arise are quickly addressed.

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

The Panel believes that payments of surpluses from earmarked schemes should be subject to the same regulations if there is any risk that surplus benefit payments (or future failure of the employer) might result in any loss of benefits for any scheme member.

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

The Panel agrees that, as stated, the notification requirements in Regulation 11 are clear. We very much appreciate that a three-month period for members to respond is included. However, we believe that the regulation should make it clear that the communications to members must be fully transparent and provide members with all information they would reasonably want to know. The notification must also include the mechanisms for members to query and / or respond to the proposed payment. Furthermore, we do not believe that members should be required to request the actuarial certification; it should be automatically provided (online is acceptable) when it is available (which should reduce administrative efforts).

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

The Panel is not clear as to the application of Regulation 12(f) and would like further explanation.

We are also very surprised that the regulations expect the scheme to fully explain the types and values of member improvements, but the regulations do not require an explanation of the employers intended use of the surplus payment. We believe strongly that this should be added to the notifications to regulators and that the regulators should be tracking and monitoring this data. For example, we would be very opposed to the surplus being used to make payments to executives or shareholders instead of improvements to member benefits.

We also believe that the regulators should be monitoring all instances where there is subsequent underfunding following payments to employers. Any future underfunding should attract intense regulatory scrutiny and the possibility of enforcement action if the payment of surplus is later determined to be suspect.

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

The Panel agrees that Regulation 13(1) and Regulation 13(6) are clear and reasonable. However, Regulation 13(2) to Regulation 13(5) are less clear and / or raise concerns. For these regulations, we believe that practical examples would be helpful to ensure that they are accurately understood.

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

The Panel agrees that the draft regulations clearly exclude schemes where a Minister of the Crown has provided guarantees, approvals, or is similarly involved in the arrangement. However, we think it would be helpful if there was further clarity regarding when this is likely to occur and the potential distinctions between these schemes and non-excluded schemes.

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

and

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

The Panel agrees that the intention of the draft Regulations to ensure that the tax treatment of the payment of surplus to a member is clear; however, we do not have a view as to whether the Regulations are articulated in such a way that the application is clear.

Question 17: 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.

No response.

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

As long as the revocations of Regulations 36 to 39 of the 2014 Regulations do not have any possibility of increasing harm to members, we do not foresee any issues.

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

The Panel believes that the value of the scheme's assets and the amount of the scheme's liabilities at the date of certification, along with a summary of the calculation including adjustments described in sub-paragraphs (e) to (g), should be included in the certificate. This will ensure that there is an audit trail of the amounts and will support any future queries.