PPF consultation response: Surplus Flexibilities for Defined Benefit Pension Schemes

About the PPF

The Pension Protection Fund (PPF) was established to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation. Since inception, we have consolidated over 1,000 DB schemes into the Fund, and now have 285,000 members, to whom we paid £1.2 billion in 2025/26. We protect a further 8.6 million members of DB schemes. The PPF is a statutory fund run by the Board of the PPF, a statutory corporation established under the provisions of the Pensions Act 2004. The PPF became operational on 6 April 2005.

In 2009 the Board of the PPF was also given the responsibility of being the scheme manager for the tax-payer funded Financial Assistance Scheme (FAS). FAS provides assistance to around 135,000 members of around 1,000 eligible underfunded defined benefit schemes that started to wind-up between 1 January 1997 and 5 April 2005, or between 6 April 2005 and 27 March 2014 where an employer insolvency event occurred before 6 April 2005.

The Board of the PPF has also held, managed and applied the – wholly separate – Fraud Compensation Fund (FCF) since 2005. The FCF was set up as a result of the Pensions Act 2004 and provides compensation when a scheme (and as a result an individual member) has lost out financially due to dishonesty.

Introduction and Executive Summary

1. The PPF is pleased to respond to the consultation on *Surplus Flexibilities for Defined Benefit Pension Schemes*. We recognise the positive impacts that surplus flexibilities could have for employers and scheme members.

2. Clearly any use of surplus – by reducing the funding level of the scheme – will increase risk to existing benefits. It is therefore essential that surplus is only released where it is safe to do so to protect member benefits (and by extension mitigate the risk of additional claims on the PPF).

3. Overall our assessment is that the proposals in the consultation (together with the fact that trustees will be the decision makers in relation to any surplus release and with TPR's forthcoming guidance) should provide reasonable and proportionate safeguards.

4. In particular, we consider that – under the proposals - any impact on the size of future PPF claims (at the level of surplus extraction estimated by DWP) will be very limited.

5. However, risk to members of individual schemes will remain. If surplus is extracted then members are exposed if funding falls further and if the employer subsequently

becomes insolvent. In other words, employer strength and future investment / funding risks are key considerations.

6. The regulations propose two key controls that help mitigate these risks (only permitting surplus to be extracted above the low dependency funding basis and the 'three year test').

7. However, the proposed regulations do not set any explicit requirements regarding employer strength. We also note that the "at least as likely" three-year test will be relatively easy to meet (it means surplus extraction could be as likely as not to leave the scheme underfunded at the next valuation).

8. We recognise that the regulations provide minimum criteria and that employer covenant and future investment risks will be considered carefully by trustees. We also expect this will be an area of emphasis in TPR's guidance. Even so, given the importance of the issues, DWP may wish to consider strengthening the regulations. One possibility could be to bring a reference to the employer covenant into the three year test. For example, ensuring the employer is considered capable of making good any shortfall that could arise over the following three years.

Detailed response

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

9. We have no comment on the proposed definition. We agree that actuaries and trustees should be able to use information provided from investment consultants or fund managers to value scheme assets, where recently audited accounts are unavailable, to enable a timely assessment of scheme funding for surplus extraction purposes.

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

10. We have carefully considered the impact of surplus extraction under the proposed funding test. While schemes will define their low dependency differently based on scheme characteristics, we believe the controls within the DB funding code should ensure that low dependency remains a relatively prudent basis. Overall we have concluded that the likely level of surplus extraction poses a low risk in terms of any increase in the size of future claims on the PPF. This is especially the case given DWP's assessment of uptake of surplus release. For example, the Department for Work and Pensions' Impact Assessment estimates £4.2bn in surplus is expected to be extracted over 10 years[1], which is low compared to the level of assets in the DB universe (£1,068bn)[2].

[1] DWP, Pension Schemes Bill Impact assessment, summary of impacts, June 2025
[2] PPF, Purple Book 2025

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

11. We note the "at least as likely" three year test will be relatively easy to meet. The possibility of subsequent deterioration in the scheme's funding position is a key risk to member benefits, although as long as the employer remains solvent (and able to make good any deficit) that risk will not crystallise.

12. The regulations do not impose any specific requirement to consider employer covenant. However, we recognise the regulations are a minimum requirement and that trustees will be considering employer strength as part of their assessment of whether surplus release is appropriate and in the best interests of members. Even so, DWP may wish to consider whether some strengthening of the test is appropriate (and can be done in a proportionate way). One approach could be to build employer covenant considerations into the three year test e.g. an assessment that the employer will be able to make good any shortfall that does arise over the following three years. Doing so would also help emphasise the importance of trustees considering covenant strength in reaching their decision. Risks could also be reduced by requiring a funding "buffer" before surplus can be extracted i.e funds must be low dependency plus x%. However, the appropriate percentage (and indeed whether any buffer is required) would vary according to scheme circumstances (e.g. covenant strength, levels of investment risk) and we recognise the risk that strengthening minimum requirements could act to prevent 'safe' surplus extraction.

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

13. Yes, we agree the notification requirements to the regulator are clear.
14. We do, however, believe it would be worth considering the following:
    - Would it also be useful for the notification to report when surplus was extracted to the employer?
    - When would members see any benefit arising from surplus extraction? (e.g Direct payments to pensioners were also made on X date. And member benefits were uplifted on Y date.)

15. In regulation 12, schemes have a duty to notify the regulator. To help monitor the impact on universe risk, and any increase in risk to the PPF, it will be helpful if the PPF can also access the data on the level of surplus extraction and impacts on individual schemes. We would welcome discussion with TPR & DWP on how best to achieve this.

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

16. We note that regulation 15 excludes "superfund schemes" from the regulations, as they have a different regime for extracting surplus. However, DWP may also need to clarify if they would expect schemes without a substantive sponsor (SWOSS) to be able to release surplus under these regulations. As we note the draft regulations do not exclude Schemes "*not supported by a substantive employer covenant*" (defined in s.59 Pension Schemes Bill 2026, covering what the PPF would recognise as a SWOSS).

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

17. We believe there is merit in the certificate having additional details including:
    - Scheme funding at low dependency before surplus extraction and after.
    - Clarification on how much money is going to members - so capturing both direct payments and value of benefit enhancements (not just the employer) making the financial split between member and employer more transparent.

Other issues - Member benefits if a scheme enters the PPF

18. We have reviewed the draft regulations and have identified that while workable with PPF regulations in event of a sponsoring employer insolvency, different categories of members could be treated differently in relation to benefiting from surplus extraction if members are provided an uplift or a direct payment to their benefits. We have set more information out below.

Uplifts

19. In respect of direct payments and pension uplifts which have been awarded but have not fallen due for payment before the AD, we consider that the current legislation will broadly operate as follows:
    - **Pensioner / Postponed Pensioner at AD** – a direct payment and/or uplift to pension payable following AD is likely to be included in the calculation for PPF compensation, except that they may be disregarded where they were awarded in the three-year prior before the AD.
    - **Active Member at AD** – while a direct payment or pension uplift may not be included in the standard formula for calculating PPF compensation, there exists a discretionary provision which could potentially be utilised to capture direct payments and pension uplifts in the calculation of PPF compensation.

    - **Deferred Members at AD**:

        i. Active at award of benefit – direct payments and/or uplift to pensions are likely to be included in the calculation of PPF compensation, except that they may be disregarded where the benefit arises from a rule change made within three years of AD.

        ii. Deferred at award of benefit – direct payments and/or uplifts will not to be included in calculation of PPF compensation because PPF compensation is calculated as at the date of deferment with scheme revaluation applied up to AD and PPF revaluation applied thereafter.

20. If DWP wishes to remove any perceived difference in relation to deferred members and ensure that direct payments are also payable in all circumstances, we think that this could be achieved through changes to secondary legislation.