

How can employers benefit from pension scheme surpluses?

Many defined benefit (DB) pension schemes are better funded than ever before. As part of the new requirements for schemes to set a long-term objective, employers are taking the opportunity to bring surpluses to the discussion and understand how it may be extracted and used.

This edition of XPS Express is the third in a series on setting long-term strategies – read part [one](#) and part [two](#).

At a glance

There is an estimated total surplus of c.£200bn across all UK DB schemes which is expected to grow further in future.¹

The Government has been consulting on the topic of surplus - to potentially make it easier for employers to extract it. This presents opportunities for employers.

Whether you choose to run on in the long-term, or in the short-term ahead of an insurance buyout, employers can consider how to generate surpluses to be extracted and used in an effective way as part of their long-term strategy.

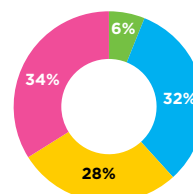
Any surplus extracted can support the employer's wider business objectives and create value for both the employer and scheme members.

How can surplus be used?

Option	Explanation
Use it to subsidise DB or DC costs	Subsidise DB accrual, improve funding for other DB schemes, pay DC contributions
Refund of surplus	Cash is returned to the employer subject to 25% tax
Improve member outcomes	Provide discretionary benefits, enhanced member options, IFA support
Facilitate corporate activity	Support business restructuring, improve creditworthiness

Recent XPS survey:

If you had a material surplus in your DB scheme how would you use it?



Generating value for employers

- With the appropriate strategy it is possible to extract stable amounts of surplus in future years – which can be very valuable to an employer.
- By projecting the potential future surplus over time under different strategies, employers can assess the overall value and risks of running on the scheme, in the context of their own business.
- As an example, a c.£300m scheme could safely extract a steady **£5m pa of surplus over the next 20 years** once an appropriate strategy is implemented.



Actions employers should take

- Determine your scheme's current funding position and how surplus may emerge over time. XPS can produce projections for you to help with this.
- Define your objectives with scheme trustees to agree on how you intend to generate and use the surplus in a risk-controlled way.
- Agree a suitable strategy for surplus extraction within your risk tolerances – consider a surplus framework such as the one overleaf.

¹Source: XPS DB:UK Funding watch, 28 November 2024.

How you can generate and extract surplus

There are many potential routes to extract surplus in the short to medium term, with various interlinking factors to consider. The **sample framework below** helps guide employers to create a **scheme-specific strategy** that meets the objectives of all stakeholders, focusing discussions on the important levers and metrics.

This is broken down into distinct steps to facilitate easy comparisons between different strategies, so employers can **better assess the value** of running on their schemes. Employers can then decide with their trustees how to use this surplus to meet their objectives.

Sample framework



Case study

We helped an employer with a material surplus in their scheme who did not want to use insurance:

Employer's objectives	How we helped	Outcome
- Minimise the risk of having to pay contributions into the scheme again - Consistent level of surplus extracted each year - Fair outcome for company and members	- Compared level of surplus expected to be extracted each year under different investment strategies - Analysed how shock scenarios could cause a deficit and require contributions in 5% of outcomes - Ran a workshop to facilitate discussion with trustees	- Decided a large buffer is needed to manage risks - Agreed to adjust the investment strategy for greater stability and protection against market volatility - Employer and trustee are working together to set up a mechanism to share surplus equitably

Find out more

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