

Government confirms plans to reform DB surplus rules

What you need to know

- On 28 January 2025, the Government confirmed its plans to change the legislation on releasing surplus from defined benefit (DB) pension schemes, as part of its drive to boost UK economic growth and improve pension outcomes for members.
- On 29 January 2025, the Chancellor delivered a speech which included the following statement: *“We will introduce new flexibilities for well-funded defined benefit schemes to release surplus funds where it is safe to do so, generating even more investment into some of our fastest growing industries.”*
- We still await clarity on what the new rules will look like in practice, but the policy intent is crystal clear. It is expected that the Government will confirm the details on this in its response to the Department for Work and Pensions’ (DWP’s) February 2024 ‘Options for DB schemes’ consultation. This response is expected in spring 2025.

Actions you can take

- Review your scheme’s current position**, particularly the funding level and covenant support that is in place or could further be provided.
- Objectively assess what the right strategy path is** for your scheme – securing benefits with a third party, running on or a hybrid of the two.
- Explore what a long-term run-on strategy with surplus release might look like for your scheme** – for example, what additional benefits could be provided to members or employers, and what safeguards would be needed to ensure security of benefits?
- Understand how your strategy fits** in with the new Funding and Investment Strategy regulations in advance.

Key points from the February 2024 ‘Options for DB schemes’ consultation

Key element of DB surplus framework	Options considered
1. Form of statutory override to allow DB surplus release	Two options: either a blanket power to allow payments to be made, or a power for trustees and employers to agree to amend their rules to allow payments.
2. Tax treatment of payments made from DB surplus	The consultation sought views on changes that could help with making one-off payments to members from surplus, given concerns such payments may be unauthorised.
3. Funding level threshold for surplus extraction	A key safeguard is having an appropriate threshold above which surplus can be extracted. Four potential options were considered. Three were different flavours of ‘low dependency plus a margin’ (with the margin linked in some way to either investment risk, covenant risk or a fixed amount); the fourth option was linked to the insurance buyout funding level.
4. Other safeguards for member benefits	An additional code of practice or guidance for trustees (for example, a new ‘surplus module’ within The Pension Regulator’s funding code). An underpin whereby schemes would ‘opt in’ to 100% of member benefits being protected by the Pension Protection Fund in exchange for a ‘super-levy’ payment.

The finer detail: Recap of where we stand on DB surplus flexibilities, and what next?

Why might employers choose to run on to build and use DB surplus?

From an employer perspective, reasons for choosing to run the scheme on include:

- Using DB surplus to fund other benefits, such as enhancing discretionary benefits for members, providing DB accrual, or funding DC contributions for the wider workforce.
- Aversion to insurance buyout (for example due to negative accounting impact or passing on 'profit').
- 'Natural' default state of running on, for example being open to future accrual or having an employer with financial/risk management expertise (e.g. a bank, asset manager, or insurance provider).

What is needed from the new rules to support trustees?

From a trustee perspective, the key objective is to deliver members' benefits. Any new rules on DB surplus release must go hand-in-hand with detailed regulatory guidance that gives trustees a blueprint for running schemes on for surplus and comfort that this is an appropriate exercise of their trustee duties. This will need to cover the key risks of running a scheme on and how to manage those, as well as when and how to distribute surplus.

What is possible under the current DB surplus rules?

There are limited circumstances in which surplus can be paid from DB schemes under current legislation. The main ones are: (1) on wind-up, if there is a surplus left over after all member benefits have been secured through an insurance buyout; or (2) before wind-up, provided the scheme is fully funded on an insurance buyout basis, it is considered in members' interests to do so, and certain practical conditions are met (e.g. the rules of the scheme permit it and notices are provided to members). In practice, the latter is rare.

What are we waiting for?

Whilst there have been some cases of schemes running on for surplus in the past, these have been limited due to the challenges in doing this within the current surplus rules. However, there is evidence that trustees and employers would consider running their schemes on to build and use surplus, if there were more flexibilities on the use of DB surplus. Key elements that we are waiting for from the new DB surplus rules are how a statutory override would be structured and the safeguards that would be in place to protect member benefits (for example, the threshold for extracting surplus, and regulatory guidance for trustees).

How does this fit with the new Funding and Investment Strategy regulations?

The essence of the new regulations (which came into force for valuations with an effective date on or after 22 September 2024) is that schemes are required to set out a plan for how they intend to provide benefits, including targeting a 'low dependency' position over time. As a principle, a long-term run-on strategy could fit perfectly well within this framework. However, there is a key question as to how Government will define surplus relative to a low dependency basis, as well as other practical points to comply with the new Funding and Investment Strategy regulations without inadvertently closing off doors to future strategy paths.

Find out more

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