DB surplus options – something for everyone?

March 2025

Sackers

On 28 January 2025, HM Treasury announced plans to lift restrictions on how well-funded, occupational DB schemes that are "performing well" will be able to invest their surplus funds. A response to the DWP's February 2024 consultation on DB options is due this spring.

Are there surpluses in DB schemes?

TPR's data[1] shows that, as at 30 September 2024, the overall aggregate funding of DB schemes saw:

82%
in surplus on their technical provisions basis

75%
on a low dependency basis, and

49%
on a buy-out basis.

Going for growth?

Plenty of room, the Government may think, for surplus to come out of schemes either into members' pockets, or into UK investments to help stimulate growth in UK plc.

TPR's research was carried out to inform DWP policy, so how will this ultimately fit with its new DB approach?

What options are on the table?

In 2024, the DWP consulted on proposals to make it easier to make payments from scheme surplus to sponsors and scheme members. Intended to "*balance enhanced options for trustees with prioritising the security of member benefits*", the following options were on the surplus table.

1 A statutory override

This was proposed to ensure that all schemes could choose to share surplus either in the form of a power to amend scheme rules to allow for payments, or a statutory power to make surplus payments.

In theory, this would do away with the rules drafting lottery. But, an override may only provide trustees with an answer to "**can** you pay surplus to the employer", not the second question, "**should** you do so"?

As many trustees and sponsors already know, the payment out needs to be considered against the balance of powers in the rules, the covenant and the funding. There is already a well-established body of case law surrounding distribution of surplus and the exercise of trustee duties. Whilst the factors to consider may vary depending on whether the scheme is ongoing or in wind up, this is likely to continue to be relevant even with the Government saying the psychological barriers to surplus repayments need to change.

It will be interesting to see how any legislative change is framed (and whether TPR will issue guidance alongside it), as we currently have to consider section 251 of the PA04 resolutions, prohibitions in scheme rules and the PA95 procedures for surplus repayment to the sponsor.

2 Allowing one-off payments

These would currently be "unauthorised" (and therefore subject to penalty charges) under the pensions tax rules. As scheme rules might not cater for such payments, the possibility of a statutory power to facilitate them was also explored.

This option could be popular with members and employers who do not see such payments being "baked-in" to long term liabilities and funding obligations.

3 Eligibility criteria for surplus extraction

Eligibility criteria for surplus extraction would be based on factors such as funding levels and covenant strength so as to safeguard member benefits.

The funding level for return of surplus is currently buy-out, but TPR's research includes low dependency figures which suggests the Government may be considering a lower threshold. This could form the basis of a discussion between trustees and sponsors as to the parameters of a potential surplus extraction.

4 Super levy

The Government also wanted to understand whether giving employers the option of paying a higher "**super levy**" in return for 100% compensation in the event of the employer's insolvency would enable increased surplus extraction.

Many commentators felt this proposal was unworkable. We doubt it will be pursued.

1 Estimated DB scheme universe funding splits and assets under management | The Pensions Regulator (27 January 2025)

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Pre-Spring Statement 2025

The Government's announcement was seemingly prompted by a meeting with some of the country's leading CEOs to discuss proposals to "remove blockages that are inhibiting its growth agenda" and to "improve lives of working people across the UK". While details are limited, the announcement notes that:

- legislative "*changes could enable all DB schemes to change their rules to permit surplus extraction where there is trustee-employer agreement*", enabling trustees to strike a deal with employers on sharing surplus with scheme members, but
- when "*considering surplus extraction, trustees must fund the scheme and invest its assets in a way that leads to members receiving their full benefits*".

TPR's statement, published the same day, confirms its support for the proposals, "*where schemes are fully funded and there are protections in place for members*".

What those protections will be and how the test for repayments will be structured will be key. We may see new rules on the "**can**" surplus question and therefore may need to be agile on the "**should**" angle.

Funding frameworks and surplus – innovation on the road ahead?

Sponsors and trustees may be keen to map out a funding and surplus plan, not on a once and done basis, but giving both sides comfort on the direction of travel, be it security of benefits (with covenant support) or an easier repayment to the employer (with the new lower tax of 25% from 6 April 2024).

The tax on any surplus refund may mean that more innovative solutions come to the table that are more tax efficient. Escrow accounts and reservoir trusts are typically used to avoid a surplus arising, but what if surplus could be more readily accessed?

Running on and using surplus for DC in the same trust is an obvious solution, but will the Government think unlocking for growth means offering more legal ways to use surplus – ie between trusts or arrangements of the same employer or by one-off payments to members?

What next? Will we see legislative change on surplus?

Details of the Government's surplus policy will be included in the DWP's response to its DB options consultation, which is expected to be published in the DWP Spring. Could this mean measures will be included in the Pension Schemes Bill 2025?

As around "*75% of schemes are currently in surplus, worth £160 billion*", this will be a key development for DB schemes and their advisers to monitor closely, so listen carefully to what the Chancellor may be foreshadowing in the Spring Statement.

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