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60-second summary

Unshackling DB surpluses

The Government has confirmed plans to liberalise '*how well-funded, occupational defined benefit pension funds that are performing well will be able to invest their surplus funds.*' The Government will provide policy details in the spring, as part of its response to the February 2024 consultation on *Options for Defined Benefits*.

Recap—past proposals

This Government, like its predecessor, is considering removing barriers to the accumulation and extraction of surplus. The idea is to allow surplus to be more easily repurposed for the benefit of employers or members (or both), in the belief that it will give trustees and sponsors confidence to run their schemes on and invest more in productive assets.

The previous (Conservative) Government was minded, as described in a consultation exercise that ran from 23 February to 19 April 2024, to liberalise surplus extraction whilst maintaining member protection. It suggested that freed-up surplus might be available for a wide variety of uses, such as benefit augmentations, reinvestment in the sponsoring business, and employer contributions to money purchase schemes.

The changes mooted in February 2024 came under four headings:

Statutory override

To surmount barriers in legislation and scheme rules, the Government could empower trustees to amend their rules if they currently contain no power to make surplus payments. Alternatively, it might simply permit surplus distributions, without the need for rule amendments.

Taxation

The Government proposed to and subsequently did reduce the authorised surplus payments charge, from 35% to 25%, with effect from 6 April 2024. It also spoke of changing the tax rules to facilitate one-off surplus payments to members.

Safeguards for member benefits

The consultation document discussed lowering the minimum funding condition that must be met before surplus payments can be made to employers. Currently buy-out-based, the document mentioned the possibility that it might rest upon the 'low-dependency funding basis' (LDFB), as established by the recent funding and investment strategy reforms, plus a fixed or variable margin. The addition of covenant-related factors was also raised, but the difficulties of such an approach meant that it was '*not* [the] *preferred option.*' It was thought that the necessary legal changes might be backed up with new Pensions Regulator guidance, either as an addendum to the funding Code of Practice or in a standalone document.

Alternative safeguard: 100% PPF underpin

The Government sought views on the desirability of providing increased Pension Protection Fund (PPF) coverage, for schemes whose trustees and sponsors choose to pay a higher levy. The idea was that it might give them the confidence to make more growth-seeking investments. The PPF estimated that the price for such increased cover would be very high: perhaps more than 0.6% of a scheme's buy-out liabilities each year (more if take-up was low).

Back to the future—the latest announcement

It seems that we will have to wait until the spring to find out precisely what the Labour Government has in mind. For now, the message is that—

'*Where trustees agree to share a portion of scheme surplus with a sponsoring employer, the employer may choose to invest these funds in their core business... and/or provide additional benefits to members of the pension scheme.*'

However, there are some pointers to be found in the press release. It appears that there will, as proposed a year ago, be a statutory override allowing scheme rule changes, subject to trustee and employer agreement and fiduciary-duty considerations. More speculatively, there is some indication that the measure of surplus that the Government is working with is a low-dependency funding basis: the £160bn surplus estimate quoted in the press release matches the Pensions Regulator's appraisal of the LDFB surplus in the private-sector DB system at the end of September 2024. The Regulator published the estimate to coincide with the Government's announcement, saying that the Department for Work and Pensions had requested updated statistics '*to inform private pension policy.*'

The Regulator also issued a statement confirming that it's receptive to the proposed changes, at least in principle:

'*Where schemes are fully funded and there are protections in place for members, we support efforts to help trustees and employers consider how to safely release surplus if it can improve member benefits or unlock investment in the wider economy.*'

Easier surplus sharing was at top of our wish list for 2025, so naturally we welcome the emergence of this development so early in the year. With the right guidance and safeguards, this would help to open up the prospect of more DB schemes running-on for longer, in ways that can benefit members, sponsors and—with the right investment opportunities in place—the wider UK economy. Careful implementation will, however, be essential.

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