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DB surpluses and run-on: what they really mean for corporate sponsors

Defined Benefit (DB) pension schemes have long been seen as the bedrock of retirement income for millions, but with significant and unknown cost to the businesses that sponsor them. More recently, attention has helpfully shifted from managing deficits to dealing with surpluses, endgames and run-on. The conversation around surplus is evolving fast, raising questions not just about actuarial funding, but also about member and employer benefits, and the broader economy.

UNDERSTANDING DB PLAN SURPLUSES

At its core, a DB plan surplus arises when the assets of a pension scheme exceed its liabilities, on a particular actuarial basis. In other words, there is more money in the trust than is currently expected to be needed to pay all promised benefits. However, there is judgement on the level of prudence included in the basis, and this can be subject to a number of factors including regulatory requirements, views on demographic risks, long-term strategy and the risk appetite of key stakeholders.

This shift into surplus territory has been accelerated by a blend of rising interest rates, stronger-than-expected investment performance, and a slow down in future longevity improvements. The 2023 Mansion House reforms, where the Chancellor encouraged schemes to consider how pension fund assets can be used to support productive finance, and the direction of travel from the Labour Government in the past year, has brought this issue into sharper focus, signalling a policy shift toward unlocking pension capital for economic growth.

Surplus isn't therefore just a technical accounting number at an individual scheme level. It has real-world implications and is a key focus of those adopting a run-on strategy. In professional pensions policy circles, there's increasing debate around what is fair surplus distribution and what should be the right run-on framework to allow stakeholders to benefit from this. Should the surplus fund better member benefits? Should it go back to the sponsors who've weathered the darker days? Should it support business and broader economic growth? Should it remain untouched as a buffer, or be used to fund the cost of insurance?

In the context of emerging surpluses and the government's agenda to use pensions to support economic growth, we provide more detail below and over the page on what a run-on strategy really means, and what's changed in the past few years.

WHAT IS RUN-ON AND WHY IS IT RESURFACING?

With material surplus generation now a real possibility, a once-rare concept is regaining attention: *run-on of a DB scheme*.

Over the past 20 years, most DB schemes aimed to de-risk and ultimately buy out benefits with an insurer. But run-on challenges that narrative. It refers to schemes continuing to manage assets and pay pensions with the sponsor remaining responsible for supporting the scheme.

There are different flavours of run-on. For example, whether a pension scheme wishes to run-on over the longer term to generate material surpluses or to just be in a low-risk self-sufficiency state. Others may plan to run-on over a short to medium timeframe, or may wish to have flexibility in their investment strategy to pivot to buy-out at a short notice if circumstances change.

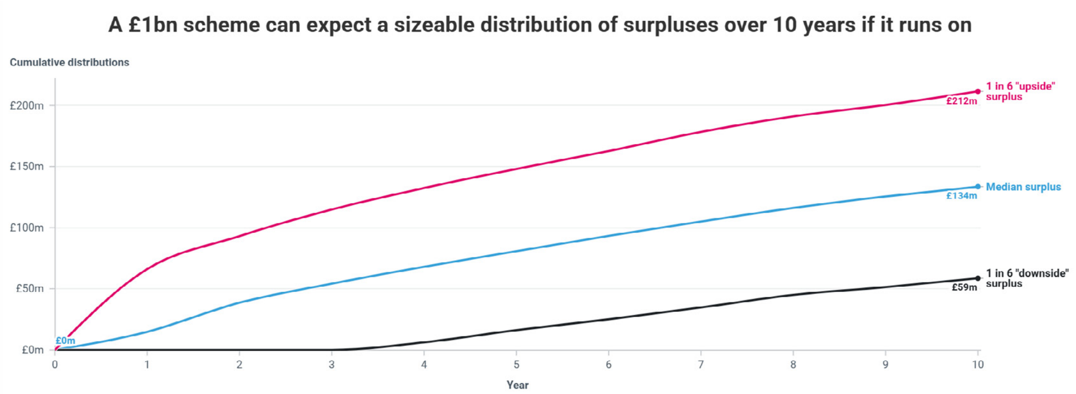
We've listed below some of the key benefits and risks of a run-on strategy.

POSSIBLE BENEFITS	POTENTIAL RISKS
Retain control over future investment and hedging strategy.	Maintain long-term exposure to financial, demographic, legal, regulatory and operational risks.
Emerging surplus can be used to provide economic value for the Sponsor.	To the extent there is a severe downside event, the Company could be on the hook for further/higher contributions.
Surplus can be used to improve outcomes for DB and / or DC members.	Regret risk of missing an opportunity to remove the scheme from your balance (for instance, insurer pricing could worsen in the future).
Retain link to members and control of member experience, including member options and retirement support.	Less economically feasible for smaller schemes.
Subject to rules, pension scheme asset remains on Company balance sheet for longer and hence accounting impacts of settling are deferred or avoided.	Tax issues.

The specific benefits and risks above are subject to trustee agreement, and any nuances in the scheme's rules.

WHAT DOES IT MEAN FOR AN INDIVIDUAL SCHEME?

We've projected here, under 5,000 simulations, how much surplus could be distributed for a £1bn scheme, that is fully funded on a buy-out basis and uses an investment strategy that targets returns of gilts + 1.5% pa. We've assumed surpluses are distributed each year, above the buy-out level only. Many believe the government are considering setting the minimum surplus distribution threshold to the low dependency basis. Of course, surplus distribution at a lower level than buy-out would increase the potential surplus on offer provided member interests were safeguarded.



Source: Hymans Robertson Flourish chart - see link on ***page 03*** *to full chart.*

The numbers are stark and can be transformational for a pension scheme, corporate and individual member. We estimate that at the median level in today's terms, £134m could be distributed over 10 years, with projections at the downside 1 in 6 level over this timeframe meaning still c£59m is distributed, and at the upside 1 in 6 level, c£212m is distributed. If the distributions weren't made regularly, and the surplus was built up over time, these figures would be significantly greater.

However, this illustration doesn't capture the more severe downside events or the “black swan” event and is an area that needs to be considered carefully. Our view is that having contingencies under run-on and a robust framework helps ensure that any material downside events are managed appropriately. There is also increasing market innovation to help schemes deal with the risk of deficit under the run-on strategy, particularly in the alternative risk transfer market. We'll be covering these themes in a future article.

TWO YEARS SINCE MANSION HOUSE – WHAT'S CHANGED?

Industry voices remain divided. Many trustees see surplus on certain bases as a strategic buffer with protection against future volatility, or still see buy-out as the endgame. Sponsors that have been burned by DB pensions in the past are still working towards getting them off their balance sheet as soon as possible.

Others are exploring surplus-sharing frameworks that balance stakeholder interests, with the potential to improve member outcomes, return some of the £350bn of deficit contributions that sponsors have paid into schemes since 2006, or to better support the economy.

Below we look at a few key metrics to see how the world has changed in the past three years.

	MARCH 2022[1]	SEPTEMBER 2024[2]
Size of assets	£1.7 trillion	£1.2 trillion
Surplus for schemes in surplus (buy-out)	£16 billion	£100 billion
Legislation / rules flexibility	Restricted with rules lottery on ability to share surpluses externally	Statutory override being considered as well as a review of the minimum threshold for sharing surpluses
Those considering run-on (based on a Hymans' survey)[3]	Survey information not available at this date *	43%

**This question was not asked, but we expect the majority were working towards the goal of buying out with an insurer.*

TO HIGHLIGHT A FEW NOTABLE POINTS:

- Despite the rise in interest rates, and the UK DB Universe having shrunk, the funding position of many schemes has improved significantly. Industry data shows a rising number of DB schemes in surplus, with analysis showing that further hundreds of billions could be generated in the coming years.
- Legislatively, there's movement too reflecting the government objectives to unlock pensions assets to drive economic growth. The Pensions Regulator (TPR) has introduced a new DB funding code and will be releasing guidance for those looking to run-on, whilst the government is exploring reforms that would allow more flexible surplus extraction and potentially at lower than buy-out levels (namely at the new low dependency objective basis, where it was estimated there was a £160 billion surplus at September 2024). Of course, this is with the right safeguards and framework being in place.
- A significant proportion of schemes are considering running on, and we expected this to have increased in the past two years. With 300 schemes making up nearly £1 trillion of assets in the UK, it also doesn't take many by number to make a real difference.
- Our recent policy paper explored some of these issues and we project that with the right framework, potentially £400 billion of DB assets over the next decade could be available for surplus distribution or to invest in growth assets, better supporting the economy.

*We have shown a graphical summary of how the DB universe has changed in the past 20 years, and the potential futures **here**.*

[1] Source: 2022 PPF purple book
[2] Source: TPR September 2024 analysis
[3] Research published by Hymans and conducted by Censuswide in July 2024, where 250 companies responded

LOOKING AHEAD

As the industry navigates an evolving landscape, one thing is clear: DB schemes are entering a new era. Surpluses are no longer just technical accounting figures, they're emerging as strategic assets with meaningful potential for sponsors, members, and the broader economy. It's also clear that pensions remains to be under the spotlight from the government.

For sponsors considering their endgame strategy, or reassessing one already in place, now is the time to reflect on recent market developments and anticipate potential legislative changes. For those pursuing or exploring a run-on approach, establishing a robust governance and risk framework is essential to protect outcomes for all stakeholders.

In our next article, we'll explore the key risk considerations of the run-on strategy and why effective risk management is critical.

In June 2025, we'll also be hosting a webinar focused on how to future-proof your DB pension run-on strategy. You can register or access the recording **here**.

Finally, do refer to our **'Excellence in Endgames' hub**, which is designed to support you in navigating complexity, identifying the right endgame path for your scheme, and delivering strategies that keep member outcomes at their core.

If you would like to discuss anything further, or have any questions, please reach out to one of our authors below or get in touch **here**.

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