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DB Surplus Release: risks, rewards, & responsibilities

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Foreword

The proposed new flexibilities for ongoing Defined Benefit (DB) pension schemes to release surplus assets offer a promising opportunity to improve outcomes for all stakeholders in the right circumstances. Members could receive pension uplifts; employers may recover past contributions; and the UK exchequer can boost tax revenues and investment in the wider economy.

Efforts to quantify the financial benefits of the new rules have varied significantly. The government initially suggested an aggregate *"low dependency"* surplus of £160 billion across the UK DB universe[1], although the Department for Work and Pensions later provided a much more conservative estimate of £11 billion[2] for the amount of surplus that could be released over the next 10 years.

Ultimately, the success of these flexibilities will depend on the expertise and ambition of those managing and advising DB schemes, supported by proportionate regulatory scrutiny. This may require a change in both skillset and mindset across the industry.

However, as SPP has often cautioned, these proposals are not without risks and will not be suitable for every scheme. In some cases, the employer covenant will be too weak; some schemes may be too small for running on to be cost effective; and employers might prefer to exit their scheme to remove risk and management burdens. There is also the possibility that Trustees, after years of uncertainty around how to fund deficits, will be too wary to release surplus.

Major policy changes also bring the risk of unintended consequences, and these proposals are no exception. Where members receive pension outcomes that differ from their expectations, based on Trustee decisions, those decisions will likely face heightened scrutiny.

This paper examines the risks, the rewards and the responsibilities that come with DB surplus release. What follows should prompt debate and lead to better informed actions, providing key decision makers, advisers and other stakeholders with a comprehensive view of the various issues that should be considered when contemplating surplus release.

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1 "20 million workers set to benefit from new Pension Schemes Bill", DWP, June 2025
https://www.gov.uk/government/news/20-million-workers-set-to-benefit-from-new-pension-schemes-bill

2 Pension Schemes Bill impact assessment: summary of impacts, DWP, June 2025:
https://publications.parliament.uk/pa/bills/cbill/59-01/0255/impact_assessment.pdf

How much is surplus?

Current legislation only permits surplus to be released on an ongoing basis when a scheme is fully funded on a buy-out basis, subject to any requirements of scheme rules. However, in practice it is very rare for surplus to be released for schemes that are not winding up. This is largely due to the current requirement for Trustees to be satisfied that releasing surplus is *"in the interests"* of members.

In upcoming regulations, the government is expected to consult on lowering this minimum threshold to full funding on a scheme's low-dependency funding basis - a funding position where a scheme is not expected to need further financial support from its employer but also does not take credit for what support could be available. They are also expected to remove the requirement that surplus release be *"in the interests"* of members and instead require Trustees to act in line with their more general fiduciary duty.

There is a range of what low dependency funding bases will look like under the new funding regime, and if this measure is used as the minimum threshold for surplus release we would expect all parties to want greater scrutiny of the construction of these bases (including, f or example, size of any expense reserves).

Trustees and employers going through their first valuation under the new funding regime may wish to think carefully about how any low dependency basis is defined in the valuation, particularly if there is potential for surplus release in the future.

Trustees and employers will need to agree on a suitable threshold for surplus to be released based on their scheme's individual circumstances. In many cases, Trustees are likely to want to include margins above their scheme's low dependency measure, as a buffer against risks such as investment and longevity and to avoid over-reliance on the covenant. When considering the level at which surplus assets are released, Trustees could also take account of any contingent assets or support available beyond the assets they hold in their scheme. Trustees are also likely to want confidence in their data and benefits before any surplus is released – meaning there may be work to do here (similar to the work that would typically be undertaken in advance of a buy-in or buy-out transaction).

A scheme's funding position on a buy-out basis is also likely to be a useful reference point. Until scheme benefits have been fully insured, any surplus (even against an estimated buy-out measure) may need to be called upon in the future. We expect Trustees will want to understand the implications of any surplus release on their ability to insure members' benefits should the need arise. Indeed, after allowing for margins to manage the risks outlined above, thresholds set by Trustees in some cases may well end up being close to (or above) an estimated buy-out level.

However, there are drawbacks to using buy-out as the primary measure for surplus release. Estimates of the position on this basis are still subjective - based on the prevailing views of insurer pricing - and will only be truly known when a scheme gets a transactable quote from an insurer. DB Superfunds may also offer an alternative safety net at a lower cost than insurance and could become an additional or alternative point of reference as these solutions become more widely used.

> *"Trustees and employers going through their first valuation under the new funding regime may wish to think carefully about how any low dependency basis is defined in the valuation..."*

The benefits and risks for scheme members

It appears likely that pension scheme members will be expected to share in the benefits of any surplus release, alongside sponsoring employers. This is indicated by the government response to the Options for DB schemes consultation, which states:

"It is imperative that Trustees continue to make surplus extraction decisions in the context of other, wider considerations, including the strength of the employer covenant and the potential for members to benefit from surplus extraction"[3] and *"The potential for members to benefit from any surplus shared with the sponsoring employer must remain a key consideration for Trustees and is vital to the success of this policy. The government will work with TPR to develop guidance regarding surplus extraction. This guidance will reference a suite of options open to Trustees to bring benefits to members from surplus sharing."*[4]

It is therefore likely that negotiated benefit improvements will be part of Trustee and employer discussions on surplus release. However, there will be several issues that Trustees will need to consider when deciding how members should benefit:

- **Beginning surplus release:** if surplus is allowed to build up for a number of years before being released, this may mean older members (e.g. those who die before the surplus is paid) miss out. Conversely, if surplus it paid too quickly, or targeted at particular generations of members (e.g. those with pre-1997 benefits), then this may result in current pensioners benefitting at the expense of non-pensioner members. These issues are covered more comprehensively in the SPP's forthcoming paper on pre-1997 indexation .
- **Treating different groups of members fairly:** for example, providing pre-1997 increases to members where these are not provided under the rules will benefit some members more than others. Similarly, providing DC benefits for current employees in the scheme (or indeed in a separate scheme if surplus is released to the employer for this purpose) may be an option but will not benefit former employees who are deferred members or pensioners. Members do not have to all be treated the same but Trustees will need to consider all categories and ensure that they are treated fairly.
- **How often surplus is distributed to members:** frequent surplus distributions (e.g. annually) ensure members see the benefits of run-on regularly, but there is potential for very small uplifts / distributions, which may not be meaningful to members and disproportionate to administer. Releasing surplus less frequently may result in more meaningful distributions but could mean some members miss out.

  One-off lump sums would prove a useful and likely very popular option but are not (currently) permitted under the pensions tax regime. We suggest that the Government explores permitting this option.
- **Interaction with triennial actuarial valuation process:** Agreeing a level of surplus release (which may be as a lump sum or a series of payments) every three years as part of the triennial valuation may make sense and allow for a more accurate assessment of the scheme's funding position and cash flow requirements. This would also mean less volatility compared with doing so on an annual basis, after all, any material surplus is more likely to grow over three years than one.
- **Approach to communicating any enhancements:** members will need to be notified in relation to surplus release but it will be important to ensure that any enhancements are clearly communicated with members and that no promises are given or implied regarding future distribution.

The ability to release surplus may encourage some schemes to *"run on"* rather than insure as soon as affordable. In some cases, this could arguably be to members' advantage, preserving access to valuable retirement and benefit options — including scheme-specific flexibilities or financial advice services — that might be unavailable or more limited if the scheme moves to buy-out.

Risks

While surplus release presents opportunities to enhance member benefits, it also carries risks that Trustees must manage carefully including:

- ***"Regret risk"*:** Trustees who decide to run-on leave members exposed to covenant, funding and investment risks and could jeopardise the security of member benefits where these risks cannot be supported.
- **Perceived unfairness:** benefit improvements for certain groups could cause other members to object.
- **Expectation management:** once members have received an uplift, there may be an expectation of future improvements even when the funding position does not allow them. Surplus levels are likely to vary each year due to market performance or changes in actuarial assumptions, creating uncertainty over the sustainability or level of enhancements.

3 Government response: Options for Defined Benefit schemes, May 2025
https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes/outcome/government-response-options-for-defined-benefit-schemes

4 Ibid

- **Tax implications:** benefit uplifts could have significant tax implications for some members, particularly in relation to the annual allowance for active and deferred members. Should a lifetime allowance ever be re-introduced, with associated protections, Trustees and employers would also need to exercise care to avoid unintended tax consequences when providing benefit enhancements to affected members.

The benefits and risks for employers

Employers will want to consider benefits and risks of running on to generate and release surplus against settling a scheme through a bulk annuity or superfund transaction.

The potential upsides and risks of running on may not be symmetrical for the employer. Using a (prudent) low-dependency basis should mean that positive outcomes would be expected more often than negative outcomes, however there may be an expectation for surplus to be shared with members, and the expenses of operating the scheme on an ongoing basis will be payable regardless. Additionally, tax will be payable on any surplus released, while employers are expected to bear the entirety of any downside risk.

Employers can benefit from surplus release in many ways, some of which are already possible:

- **Using surplus within the scheme:** funding ongoing DB accrual or future DC contributions in a separate section or using the surplus to meet ongoing scheme running costs.
- **Transferring surplus from one scheme to another:** funding other DB schemes that are in deficit through intra-group scheme mergers, or meeting employer contributions to other DC schemes (including those payable to DC master-trusts) where permissible under the current legal regime.
- **As a source of free cashflow to support commercial activities:** such as capital expenditure or other investment, funding debt repayments or distributions to shareholders.

  If an employer can demonstrate a stable, regular flow of surplus, this could be communicated to credit rating agencies / equity analysts who may allow for this positively in their assessment of the employer's credit rating / business valuation.

  This is likely to depend on factors such as their cashflow needs and potential accounting impacts. For example, they may prefer to retain any surplus within the scheme, letting it build until needed or until the preferred time for accounting recognition. Some employers (particularly those who are part of US corporate groups) may also be attracted to running on their scheme as a means of avoiding the negative accounting treatment of settling their pension scheme with a third party.

  Government could make surplus release more attractive for employers by reducing the tax on refunds. However, it is debatable whether this would be fair given that original contributions to the scheme would likely have received tax relief.
- **Employer-related investment:** Although employer-related investment is usually avoided, schemes can invest up to 5% of their assets in their employer through various means. Relaxing these rules to provide more flexibility in respect of surplus assets would provide employer access to surplus funds without scheme's losing recourse to them if their funding level deteriorated in the future.

Risks

The main risk for employers will be:

- **Contribution risk** of having to make future contributions to a scheme following a decline in the funding position (e.g. due to poor investment performance or increases in longevity).
- **Reputational risks** from any decisions on how surplus is used. On the one hand, there is a risk of negative reaction from members if they do not feel they are getting a fair share of any surplus, especially where there is a strong trade union presence. Against this, employers will need to consider the expectations of their investors and other stakeholders who may have accepted a lower share of free cash flows over the last decade to accommodate pension funding requirements and may now be expecting to recoup some of that loss.
- **Accounting risk:** some employers (such as public companies) will also need to carefully consider the accounting implications of using surplus to grant benefit improvements to members on a DB basis, which would typically be accounted for as a costs in the employer's profit and loss account. Running on will also retain balance sheet volatility particularly where schemes are over or under hedged on the accounting liability basis.

Ensuring security

Following the release of surplus the resilience of the scheme and the security of members will be determined by the funding buffer and covenant protections, overlaid with a strong governance framework (discussed in a later section).

Funding and investment buffer

One key protection for members will be in the level of reserves within the scheme which will, in the first instance, be required to absorb any adverse financial experience.

Under the new funding regime, a low dependency investment allocation should be 'highly resilient'. The Pensions Regulator (TPR) uses an example of a one-year stress with a one-in-six likelihood needing to be expected to be returned to full funding within six years, with no further contributions from the employer.

Where a buffer is smaller, there will be a bigger risk that financial support may again be required from the employer. Trustees will need to be very confident that the covenant can provide this support or seek additional covenant protections.

Many Trustees and employers will want to go further to limit the risk of the employer needing to make additional contributions. To do this, they may apply more stringent tests when considering the release of surplus than for the ongoing funding and investment strategy under the DB funding code.

Many stakeholders will be wary of overreliance on stochastic models which are vulnerable to regime changes and can underrepresent tail events. They may instead choose to explore the impact of hypothetical stress scenarios particularly if the employer would be adversely impacted by those scenarios.

Covenant protections

Where the release of surplus leaves the scheme funded below buy-out (or, arguably, below superfund pricing) there will be increased reliance on the covenant. In some cases, the strengths of the employer will mean this is not a concern, such as:

- Legal recourse to an entity of financial substance
- A covenant that is material relative to the size of the scheme
- A track record of profitable trading
- Operating in a stable industry
- Limited financial obligations
- A long-term and supportive owner

In some situations, additional action may be required to protect against the residual risk in the surplus release strategy in a scenario where the covenant fails. Typical options include letters of credit, surety bonds, escrow accounts, or charges over assets. Group guarantees could be appropriate, but Trustees will need to carefully consider whether the prospects of the group are sufficiently independent from those of the employer should the latter fail.

Trustees will also need to consider whether security protection is needed from day one (in which case it may be questionable whether surplus should be released at all), or whether it is sufficient to enter into a contingent arrangement. This might be an enforceable commitment by the employer to provide security if the covenant were to objectively weaken or if funding were to fall below a predetermined level. This would need to be the subject of a clear monitoring arrangement as part of the agreed terms of the surplus release (which will have some parallels to a banking document).

Investment implications

Investment strategy will be an important consideration where schemes are running on. Trustees normally have the power to set investment strategy having consulted with the employer, but in the context of medium to long term run-on, the investment strategy should be agreed jointly as part of a holistic framework.

The key decisions that will need to be made, together with some considerations for Trustees and employers when making these decisions, are set out below.

What is the right target investment return?

Targeting a higher investment return would be expected to generate more surplus which can be used to benefit the employer and members over time. If some of the surplus is retained within the scheme, it could also help to protect against subsequent downside risks requiring further financial support from the covenant and could support a gradually increase in the target investment return as the scheme's surplus increases.

However, where a large buffer has not been retained, the associated risks will need to be supportable by employer covenant. As part of this, thought will need to be given on whether to focus on managing short-term volatility (which may lead to a lower target return), or whether to allow downsides to self-correct over time.

What is the hedging strategy?

Given the likely desire to maintain strong funding positions, in theory the level of hedging is likely to be high (against financial risks such as interest rates and inflation). However, thought will be needed over:

> Which funding measure should be considered for hedging – for instance, is it low dependency, buy-out or another measure - and whether it should include any funding buffer

> Whether hedging should focus on the funding ratio or the total value of surplus

> Whether leverage will be used and, if so, how much. As part of this, thought will be needed on the availability and quality of collateral and the impact on what other assets are available to generate return

The preferred approach will depend upon the objectives, including intended use of surplus. This is an area where trustee and employer objectives can differ. For example, employers may wish to hedge the surplus that can be refunded whereas Trustees may prefer to hedge the funding ratio e.g. to protect the affordability of discretionary pension increases.

Should schemes attempt to match insurer pricing?

If insurance is a potential contingency plan (e.g. in the event of weakening of employer covenant) it may be relevant to consider the interaction with insurance pricing. One option to reduce the risk of a shortfall compared to insurer pricing could be to attempt to invest in a similar way.

However, investing like an insurer would still represent a constraint compared to the flexibilities available to pension schemes and may limit the ability to generate surplus. The insurers also invest differently and in a dynamic way, so precise matching is not possible and may not be worth attempting.

Liquidity and cashflow matching

Where schemes can commit to longer-term run on (for instance, where the covenant is stronger) schemes will be better placed to benefit from illiquid assets and the additional return premium they offer.

By contrast, where surplus release forms a larger share of scheme assets, a more liquid approach may be required. In addition, illiquid assets can also have less certain valuations – as a clear understanding of the scheme's funding position will be key before releasing surplus, a less liquid strategy will lend itself to less regular release of surplus.

Cashflow generating assets will potentially be beneficial for mature schemes paying out a material proportion of assets each year. Using income generating assets to meet cashflow requirements can also help to minimise dealing costs.

Productive finance

Whilst greater investment in productive finance is a stated government objective, it is not clear which asset classes would meet this definition – despite the SPP making recommendations in this area last year[5].

Furthermore, legal input will also be needed on whether their fiduciary duty is flexible enough for Trustees to allow for the potentially positive effect that productive investment could have for their members (for example, through building a more prosperous UK) when making their investment decisions.

Longevity hedging

Longevity risk can represent a more material proportion of overall risk for well-funded schemes and is typically considered to be uncorrelated to investment risks. Longevity swaps may be considered for some schemes that are being run on over the long-term – typically this will be most relevant for larger schemes where it is unlikely that there will be a buy-in transaction, which would require the swap to be unwound or novated, for many years. Collateral would be required to support a swap which could impact flexibility for the wider investment strategy.

Company accounting

The impact on corporate accounting is likely to be a key consideration behind the investment strategy, although the impact may vary between applicable accounting standards. For instance, under US GAAP a higher target return can increase profitability which US parented employers may see as positive. By contrast, under IFRS / UK GAAP asset movements are typically recognised in Other Comprehensive Income which means this point will have less impact.

Furthermore, the impact of different hedging strategies on the volatility of accounting surpluses will be important for corporates to understand (recognising that schemes will typically be over-hedged relative to accounting liability measures).

5 Solving the UK Investment Puzzle, September 2024: https://the-spp.co.uk/wp-content/uploads/SPP-Paper-Solving-the-UK-investment-puzzle-September-2024-1.pdf

Interaction with funding basis

For schemes looking to run-on and invest over the longer term, consideration should be given to the appropriate funding basis for such a strategy.

One option would be to consider a dynamic discount rate approach. For some schemes this might have advantages in terms of improved consistency between asset and liability measures leading to reduced overall volatility of scheme funding position, and arguably better risk measurement focussed on the actual investment strategy rather than an artificial actuarial measure. Against this, there is additional complexity and it may not be right for all types of investment strategy.

The funding basis used will also clearly impact the hedging strategy, as well as potentially any funding buffer required and/or wider surplus strategy.

Governance

The emerging rules around surplus sharing for DB schemes create opportunities for employers and, potentially, members. However, they also raise challenging governance issues, in particular for Trustees who under the current draft legislation (Pension Schemes Bill) are responsible for making key decisions about changes to scheme rules, and whether and how much surplus should be released. This section explores the potential governance considerations.

Robust decision-making frameworks

A robust decision-making framework will be critical when considering surplus release. In its Annual Funding Statement 2025 and recent guidance on DB options, TPR has encouraged all schemes to develop a policy on surplus release. Such a policy should set out the principles under which Trustees and employers will approach surplus sharing, detailing what factors will be considered and how decisions will be documented. In many cases this would form part of a more comprehensive decision-making framework and/or legal agreement, which is likely to include:

- How often decisions on surplus release will be taken;
- The agreed funding level(s), who will calculate this and how they will do it at each review point;
- Clarify when and how surplus can be used including the share of value between employer and members, and how any release would be structured; and
- How the parties will respond if funding levels deteriorate below an agreed minimum or if there is a material detrimental event affecting the employer covenant.

Designing such a framework should help mitigate the associated risks of surplus release and give clarity to all stakeholders.

In doing so, Trustees must be clear on which factors are relevant, and which are not. Trustees have fiduciary duties primarily to act in the interests of scheme members, but case law recognises that employers' interests may also be relevant in certain circumstances. Surplus release is one context where Trustees may need to consider the interests of both employers and members both carefully and explicitly.

Decisions on surplus release should be supported by contingency planning and stress testing, both of which should be documented as part of the Trustees audit trail. The analysis they perform to explore the risks set out earlier would help ensure that surplus releases are sustainable and defensible even if circumstances change.

Conflicts of Interest

Surplus release heightens the risk of conflicts of interest, either perceived or actual. These may arise in several forms:

- Employer influence over Trustees: employers have the ability, in many cases, to replace trustee boards and/or appoint a *"sole trustee"*. TPR has highlighted in its endgame guidance that it *"would expect scheme sponsors not to put Trustees under any undue pressure, including, for example, aiming to replace trustee board members with the sole aim of the new trustee board being able to agree a [surplus] release."* More generally, employers can exert pressure on trustee boards and Trustees will need to manage this.
- Trustee incentives: Trustees and professional Trustees (PTs) may face subtle incentives; for instance, a scheme that runs on for longer as a result of putting in place a surplus release policy would extend the PT's engagement. In some cases, Trustees may also be members of the scheme they manage and thus are able to benefit from any member share of a surplus release.
- Adviser conflicts: scheme actuaries, lawyers, and investment advisers may also face conflicts - explicit or implicit. These could include similar conflicts around longevity of their advisory mandates, or the positions they take on key judgements, such as advising on the strength of a low-dependency funding basis or the legal interpretation of Trustees' fiduciary duties.

Identification and proper management of these potential conflicts underline the importance of rigorous governance.

Wider governance implications

There are also several wider implications linked to governance. Trustee boards should also consider whether:

- Surplus release could increase their risk exposure and, by extension, could impact in wider areas such as professional indemnity insurance. Trustee boards may need to engage with their insurers accordingly.
- They have any additional training needs and/or additional personnel needed to ensure robust decision making.
- Their advisers have the requisite experience and expertise.
- Data and benefits are sufficiently accurate to mitigate against the risk of material additional liabilities being discovered after surplus is released.
- They are protected against reputational and associated risks, such as the potential for raised member expectations if other schemes start paying discretionary increases.

The regulatory approach

TPR's initial position on surplus release

TPR's recent guidance on New models and options in defined benefit pension schemes[6] states that once the legislation on surplus release is enacted TPR *"will consult and publish guidance on further considerations and factors that Trustees may want to take into account when releasing surplus"*[7]. In the meantime, TPR has set out initial considerations and encourages Trustees to take advice.

For now, TPR expects Trustees to:

- Work collaboratively with the scheme employer and for scheme employers not to put Trustees under any undue pressure or replace the board solely to enable surplus release to be agreed;
- Develop a policy on surplus release including detail of how members and the employer are likely to benefit;
- Establish their risk tolerance for surplus release in the individual circumstances of the scheme. TPR notes that *"this may be at a margin above the low dependency basis funding level, if regulations permit;"* and
- Set out their approach to surplus release for the scheme as part of the long-term objective under the new DB funding code requirements.

In terms of TPR's general position on surplus release, it notes that *"in situations in which the scheme is likely to remain fully funded on a low dependency basis and there is no realistic risk of sponsor insolvency, it is unlikely that TPR would have reservations about the release, subject to [Trustees] having considered any other relevant matter related to the circumstances of the scheme and the sponsoring employer"*.[8]

TPR notification requirements

Under current legislation, any payment of surplus to an employer must be notified to TPR under Regulation 11 of the Occupational Pension Schemes (Payments to Employers) Regulations 2006, with notification required within one week of payment. Unless these regulations are amended to reflect the possibility of regular surplus sharing from an ongoing scheme, each payment to an employer will need to be notified to TPR.

One possible development is that surplus release reporting could move towards a model similar to flexible apportionment arrangements (FAAs), where Trustees notify TPR of an FAA and then receive a standard set of questions for TPR to consider. In this context, TPR may wish to understand the rationale for the release, the covenant advice obtained, the funding position post-release, and any concurrent benefits provided to members.

Member considerations and regulatory boundaries

In TPR's New models and options in defined benefit pension schemes, discretionary benefits are mentioned several times. TPR included the potential to provide such benefits as a key *"pro"* of running on a scheme and also suggested a surplus release policy should include details of how members and the employer are likely to benefit (but it stopped short of saying that surplus release should include something for members).

A key question for many is whether TPR will actively encourage, or even require, that any surplus release includes some form of benefit for members. However, this would represent a significant expansion of TPR's role to mandate such sharing. It is likely that TPR's regulatory approach will be more measured in line with the initial position it has taken, emphasising that Trustees should consider benefits for members, but stop short of regulatory compulsion.

6 New models and options in defined benefit pensions schemes, June 2025: https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/new-models-and-options-in-defined-benefit-pensions-schemes

7 Ibid

8 Ibid

Enforcement and regulatory powers

TPR already has wide-ranging powers to intervene in the running of occupational pension schemes and to act if the security of members' benefits is detrimentally affected by actions of relevant parties. These powers are not specific to surplus release but could be engaged if surplus is released from an ongoing scheme and there is subsequently an employer insolvency, and the security of member benefits is compromised.

Whether TPR will deploy these powers actively in this context and/or encourage early engagement by Trustees and employers (or potentially an application for clearance) remains to be seen, but Trustees should assume that robust governance and a clear audit trail of decisions made will be essential to withstand any regulatory scrutiny.

TPR will know it is their role to police this new legislative framework and the risk of regulatory embarrassment if any members were to lose out on guaranteed benefits could potentially influence their approach.

When surplus release may not be appropriate

Even once the legislation on surplus release has been enacted, it will not be appropriate for all schemes.

For example:

> Where there is a weak or deteriorating employer covenant, lack of additional security and there are concerns regarding the employer's ability to support the scheme going forward. In this situation, it would usually be prudent for Trustees to decide to move to buy-out (or consolidation) when this is affordable.

> The scheme's funding position is volatile such that a market downturn or longevity shift could quickly *"remove"* any surplus on a low-dependency basis.

> Where there is insufficient allowance for risk and contingency – this will of course vary for individual schemes and their own circumstances.

> Where there are other material uncertainties e.g. around data or benefits, or legislative uncertainty.

> Where the surplus release compromises longer-term objectives such as the scheme's planned journey to buy-out and it is not in the interests of scheme members in the circumstances to deviate from this journey.

> Where Trustees are being placed under undue pressure from the employer to agree to surplus release and/or any conflicts have not been appropriately managed.

> Where the scheme is small, such that the ongoing operating expenses mean that the economic benefits of run-on and surplus sharing too challenging to achieve.

It will be crucial for Trustees and employers to take advice for their own scheme's circumstances.

From theory to practice: how to evaluate a request for surplus release

When considering surplus release, Trustees will want to consider a range of factors. While these will differ from scheme to scheme, the following will generally be key:

> **Scheme rules:** the forthcoming regime is intended to give Trustees of all schemes the ability to release surplus to employers on an ongoing basis. However, individual scheme rules for requirements including trustee discretions to apply surplus on wind-up and the balance of employer and trustee powers to trigger wind-up, will remain important for Trustees when assessing the reasonableness of employer requests for surplus refunds against any upside for members being offered.

> **Covenant:** Trustees should commission an independent covenant assessment (or update an existing one) to understand (i) the employer's current and projected financial strength, (ii) whether the surplus release itself (and planned use of that surplus) would itself materially weaken the employer's ability to support the scheme in adverse circumstances, and (iii) sector-specific risks, refinancing events or corporate transactions that could detrimentally impact the covenant. Allowance should be made for any contingent assets including external security and how released surplus will be used. Covenant longevity will be important where the intention is to run on over the long-term.

> **Funding:** the current and projected funding position of the scheme, which could include modelling of the range of outcomes for funding progression, surplus released and any discretionary pension increases considering both downsides and upsides. Downside scenario analysis may also be helpful e.g. a significant loss on risk assets, interest rate shocks, inflation changes and longevity improvements, and how these fit in with any agreed framework agreement regarding funding buffers and contingency reserves.

- **Members:** what benefits for members are being proposed and whether agreement to the proposal will be in accordance with the Trustees' overarching fiduciary duties to scheme beneficiaries. Modelling should quantify the range of potential outcomes for members including any discretionary pension increases depending upon the criteria for surplus release and agreed member share. Trustees should also consider the potential loss to members should an employer insolvency coincide with a funding downturn.
- **Investment:** several decisions that will need to be made on investment strategy e.g. relating to target return, hedging, liquidity and the extent to which it is desirable to attempt to aim to match insurance pricing. Some key considerations when making these decisions are covered in the investment section of this paper.
- **Strategy:** whether the requested surplus release aligns with the scheme's long-term strategy and, if the scheme is targeting buy-out, whether the proposal could unduly delay or jeopardise that goal.
- **Governance:** whether conflicts of interest have been appropriately identified and managed and a robust governance process is in place. Where a surplus release policy / framework has been agreed whether the proposal is aligned with that policy / framework agreement.

Wider implications for the DB landscape

The proposed new flexibilities for DB schemes could have material and far-reaching consequences that extend well beyond their immediate policy objectives.

Greater external scrutiny of endgame decisions

There is likely to be more external scrutiny of the long-term strategy adopted by schemes. Because Trustees' choices could mean that members with equivalent accrued benefits receive different pension outcomes, both the decisions themselves and the advice underpinning them will attract heightened attention.

Legal challenge from members who feel they have been disadvantaged, either by missing out on a better financial outcome or by losing valuable options or discretions, is possible. On the other hand, if Trustees decide to release surplus funds to a sponsoring employer and the scheme subsequently fails to pay full benefits, their actions will be subject to intense examination.

While the narrative that insurance improves the security of pensions has taken hold in the industry, the evidence to support this view is limited unless the covenant is clearly weak. More weight is now being attached to the opportunity to seek better outcomes by securely generating and releasing surplus. Trustees will need to consider which approach they believe to be in the best long-term interests of members on a case-by-case basis.

Shareholders, too, may become more engaged with the choices made about the scheme's future, especially when the pension scheme represents a large source of potential value relative to the wider business. Recent research suggests that, for two-thirds of FTSE350 employers, running their scheme on for a period would be the financially optimal strategy, although the potential financial benefits will need to be weighed against the required management time and other consequences[9].

Compensating members for insuring their pensions

Where insurance does not offer a clear security benefit - such as where the employer covenant remains strong - Trustees may face calls to compensate members for losing potential discretions and/or the ability to receive financial upside following insurance. Such demands are likely to be especially pronounced among members with non-indexed pre-1997 benefits, whose pensions have been eroded in real terms, or in situations where material discretionary practices are lost through insurance (as illustrated by the experience of the Boots pensioners[10]).

Additionally, employees with less generous DC arrangements may object to surplus value being used to enhance DB member benefits rather than to improve DC offerings. Where substantial employer contributions were needed to repair deficits and may have suppressed other employee benefits, it is questionable whether it is fair for only DB members to benefit from the changes in market conditions that have led to surpluses arising.

> *...it is questionable whether it is fair for only DB members to benefit from the changes in market conditions that have led to surpluses arising.*

9 FTSE 350 Pensions, assessing the value of DB scheme run-on, Barnett Waddingham 2025: https://view.barnett-waddingham.co.uk/ftse350-pensions-2025/p/1?utm_source=linkedin&utm_medium=social&utm_campaign=ftse_2025&utm_content=july_2025

10 Booting the issue of discretionary benefits back into the spotlight, Burges Salmon, July 2024: https://www.burges-salmon.com/articles/102jf1e/booting-the-issue-of-discretionary-pension-benefits-back-into-the-spotlight/

Changing perspectives and opportunities for DB pension professionals

The new flexibilities will reshape the perspectives and opportunities for firms and individual professionals working within the DB pensions sector. For example, scheme actuaries and other pension professionals may find their career prospects enhanced. On the other hand, teams focused on selling and broking pensions insurance may experience a decline (or at least a delay) in deal volumes, although in practice significant volumes of insurance transactions are likely to continue, even if a substantial number of schemes decide to run-on. The same may also be true for DB superfunds.

Firms and regulators will need to apply greater scrutiny to endgame strategies, ensuring that decisions are made in the best interests of beneficiaries - both members and employers - and that promotional material from both the run-on and insurance camps is fair and not misleading. More DB schemes operating for longer will increase the time horizon for the regulation of DB schemes, extending beyond the limited number of schemes that are still open, which could have resource implications for TPR and perhaps DWP.

A cultural shift may also be needed in the industry. The prevailing approach of trying to eliminate or transfer all risk will need to be replaced with one that strives for an optimal balance between risk and reward. A renewed focus on wealth creation, rather than just wealth protection, could lead to better outcomes for all stakeholders, but achieving this will require a change in mindset. An infusion of skills and perspectives from the wider financial services industry may prove beneficial to complement the established capabilities of pension professionals.

The question hanging over surplus release: will Trustees feel comfortable releasing assets?

A key issue will be Trustees' focus on the security of member benefits. Even if their pension schemes have more than enough assets to secure member outcomes, cautious Trustees may decide against releasing any assets beyond what is required to conduct a buy-out with an insurer, other than in situations where the employer covenant is sufficiently strong or there is other robust support in place.

Addressing this issue will improve the chances of the government's surplus release policy being successful. While the government recently decided that an opt-in 100% PPF underpin is not feasible (and the SPP had raised the *"moral hazard"* risk associated with this in the past), a range of other options which provide equivalent protection are already commercially available at market rates.

Implications for wider UK pension developments

These changes must be seen in the context of ongoing shifts in UK pension provision, such as the focus on scale and consolidation of DC schemes, the expansion of collective defined contribution (CDC) arrangements, and persistent concerns about retirement adequacy.

As scale is likely to be a prerequisite for schemes to efficiently run on and release surplus to beneficiaries, there is a risk that members will face a lottery depending on whether they belong to a large scheme capable of running on or a smaller one that cannot do so economically. Addressing this disparity may require new solutions for smaller schemes, such as the development of the DB master trust market.

Conclusion

A new legislative regime around surplus release means that Trustees and employers should review what is the right long-term path for their scheme and its beneficiaries. Many schemes may choose not to make use of the new flexibilities and to retain their existing plans, but by reaffirming their strategy they can pursue it in greater confidence and with a lower risk of subsequent challenge.

As a new area of law and government policy, first-movers (in particular) will want to perform and document suitable diligence before agreeing to release any surplus, but it should be expected that these steps will in time become business-as-usual activities.

While the factors that influence their decision-making will vary from scheme to scheme, the core themes will be largely the same as those that Trustees, employers and advisors have had to consider over the last decade to improve scheme funding and reduce risks for members. This should provide confidence to all stakeholders that the risks associated with surplus release can be suitably identified, managed, monitored and often mitigated.

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About The Society of Pension Professionals

Founded in 1958 as the Society of Pension Consultants, today SPP is the representative body for a wide range of providers of pensions advice and services to schemes, trustees and employers. These include actuaries, accountants, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and pension specialists.

Thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds.

The SPP seeks to harness the expertise of its 85 corporate members - who collectively employ over 15,000 pension professionals - to deliver a positive impact for savers, the pensions industry and its stakeholders including policymakers and regulators.

Further information

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