First Briefing, June 2025
New surplus flexibilities for Defined Benefit Schemes

The Government has responded to its 2024 consultation *Options for Defined Benefit schemes*. Its response sets out proposals to make it easier for Defined Benefit (DB) schemes to distribute surplus, subject to *stringent* safeguards to protect members' pensions.

In this briefing, we discuss the proposals, the legislative timetable and interim guidance provided by The Pensions Regulator (TPR).

The 2024 consultation

The *Options for Defined Benefit schemes* consultation was started in February 2024 under the previous Government. It was launched against a backdrop of improved DB funding levels, but with a legislative environment that made it difficult for trustees to use surplus for the benefit of either members, sponsors, or both, except as part of a scheme wind-up.

The consultation proposals considered whether a statutory override to restrictive legislation could enable surplus sharing while schemes continued to run, subject to appropriate protections for members.

Employers might use surplus to invest in their business, boost wages or pay higher Defined Contribution (DC) contributions.

Trustees could increase member benefits – perhaps providing discretionary increases to address recent high inflation or the lack of any increases on benefits earned before 1997.

Feedback from the pensions industry was positive, but did include the following points:

- Robust safeguards would be needed to protect member benefits.
- Specific TPR guidance would help trustees (and their advisers) make appropriate decisions as to whether to release surplus and how to distribute it between members.
- A further potential barrier is the requirement in section 37 of the Pensions Act 1995, that trustees need to be satisfied that surplus extraction is in the interests of members. It's unclear whether this is an additional test beyond trustees' existing duties to scheme beneficiaries.
- It would help the tax regime if any surpluses were distributed through one-off lump sum payments to existing pensioners (rather than through annual pension increases).
- While the option to pay a super levy for 100% Pension Protection Fund (PPF) coverage might be helpful to some schemes and sponsors, it would likely be expensive and could create a moral grey area by encouraging inappropriate risk-taking.

What the Government now proposes

The key proposals in relation to surplus are as follows:

Legislation and regulatory changes

- A statutory power to allow trustees to modify scheme rules to allow surplus sharing (and a repeal of the Pensions Act 2004 requirement that schemes had to have passed a resolution before 6 April 2016 to provide for surplus sharing)
- An update to Section 37 of Pensions Act 1995 will clarify that trustees must act *in accordance with their overarching duty to beneficiaries, which will remain unchanged.*
- The Government will not mandate in legislation how surplus might be used.
- TPR will provide guidance to trustees on surplus extraction.

Funding aspects

- To extract surplus, schemes will need to be at least 100% funded on their low-dependency target. This is a more lenient test than the current test, the insurance buy-out basis.

- Actuarial certification that this funding test is met will be required.

Taxation

- Surplus returned to employers will be taxed at the current rate of 25%.
- The Government is *continuing to consider the tax regime for surplus extraction.*

No PPF super levy option

- The option for schemes or sponsors to pay for 100% PPF coverage was rejected.

When will the surplus flexibilities apply?

While a couple of aspects of the proposals are included in the Pension Schemes Bill published on 5 June 2025, more detailed *surplus flexibilities regulations* will be consulted on in 2026 and laid in 2027.

TPR guidance will then follow, with surplus flexibilities expected to come into force by the end of 2027.

What does TPR expect in the meantime?

A few days after the consultation response was published, TPR issued some guidance: *New models and options in Defined Benefit pension schemes*.

In the section on scheme run-on, TPR suggests that *trustees and employers may want to start thinking about how they could generate additional surplus and release it under the new proposals*.

TPR's suggestions

Trustees and sponsors should work collaboratively. Scheme sponsors should not put trustees under undue pressure, for example by looking to replace trustees with individuals more likely to agree to return surplus to the employer.

Trustees might develop a policy on surplus extraction, including details of how members and sponsors are likely to benefit. Such a policy might cover whether surplus is to be released as a single lump sum, or as a series of lump sums over time and subject to review (the latter a counterpart to the more familiar recovery plan setting out deficit reduction contributions over a specified period).

> Trustees may want to set out in an agreement with the employer how they expect surplus to be distributed.

Such an agreement might include:

- How they anticipate the surplus payment would be spent
- When and under what circumstances surplus could be distributed
- What the governance and sign-off processes around surplus distribution would look like.

Trustees should establish a risk tolerance specific to their scheme and sponsor, i.e. a funding level above which surplus can be paid out. This might be a further margin above 100% low-dependency funding.

Significant scheme surplus over a long period of time, but with no plans for distribution, may indicate poor governance controls. Surplus extraction policy should be considered as part of setting a long-term objective.

Pending new legislation being introduced, the restrictions of current legislation and scheme rules apply.

Our view

> *The surplus flexibilities have the potential to be a real game changer for both trustees and employers.*
>
> *For employers, the ability to reinvest surplus into their business, enhance DC contributions, or support wage growth could be transformative.*
>
> *For trustees, the chance to improve member outcomes – perhaps through discretionary increases, addressing pre-1997 benefit gaps, or improving the member experience – offers a meaningful way to deliver value.*
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> *But with opportunity comes responsibility. Trustees must tread carefully, ensuring that any surplus extraction is underpinned by robust funding, clear governance and a transparent rationale.*
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> *As we await further detail in the 2026 consultation and subsequent regulations, one thing is clear – the surplus conversation is no longer theoretical.*
>
> *It's time to start planning.*

Further information

For further information, please contact us.