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Back to the Future

The return of defined benefit
pension surpluses

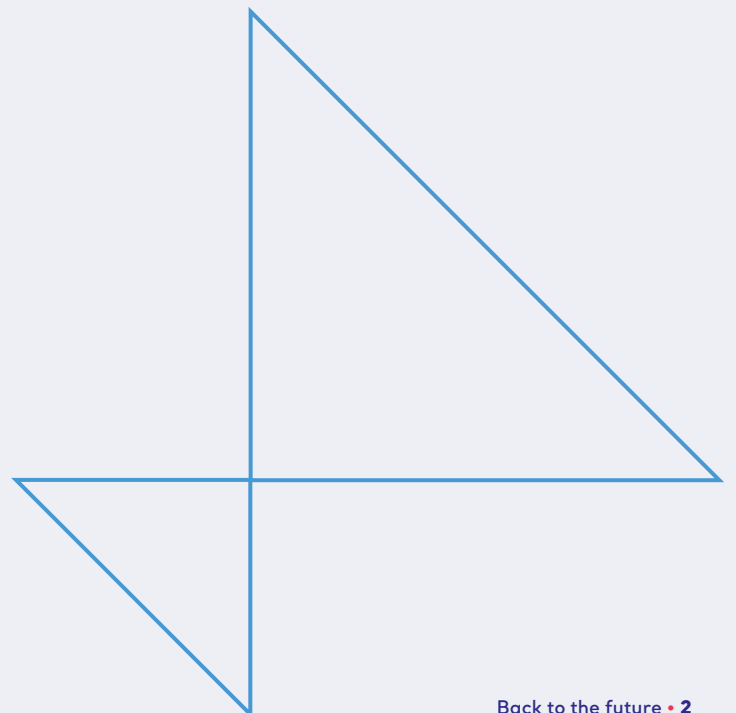
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1. Executive summary





Defined benefit (DB) pension scheme surpluses, once a relic of the past, are re-emerging as a significant financial and strategic consideration for UK corporates. This report explores the historical, regulatory, and transactional dimensions of pension surpluses, offering insights into their valuation, accessibility, and implications for stakeholders.

Key insights

Historic surplus usage

Between 1987 and 2006, DB schemes were subject to a statutory surplus regime requiring them to reduce any surplus exceeding 105% of liabilities to retain full tax approval.

- In the early 1990s, **40%** of large DB schemes (those with more than 12 members) declared an excessive statutory surplus.
- We estimate a further **10%** of the DB scheme universe at that time had a statutory surplus of up to **5%** (overfunded, but not excessively so).
- Approximately **£30 billion** of excess statutory surplus was utilised during this period, equivalent to **£67 billion** in today's money.
- **69%** of the surplus value went to employers, and **31%** to employees.
- Only **4%** (£1.2 billion) of the £30 billion left schemes, in the form of refunds to employers.
- The remaining **96%** was retained by schemes and used for contribution holidays or to enhance members' benefits.
- The vast majority (**95%**) of employers' share of excess surplus was spent on contribution holidays, with only **5%** on refunds.
- The vast majority (**89%**) of employees' share of excess surplus was used to provide additional pension benefits, with only **11%** spent on contribution holidays.

Regulatory evolution

A series of scandals and funding crises led to tighter controls, culminating in the current regime where surplus refunds are only permitted if schemes are fully funded on a buyout basis and trustees are satisfied member benefits are secure.

Current landscape

As of September 2024:

- Nearly 2,000 DB schemes have a buyout funding level of **105% or more**.
- These schemes collectively hold **£100 billion** in buyout surplus.
- Despite this, **only £800 million** in today's money has been refunded to employers since 2006, less than 1% of the total surplus now held, underscoring the difficulty, or lack of desire, to access surplus from ongoing schemes under current rules.

Government reform

The Pension Schemes Bill 2025 proposes:

- Lowering the threshold for surplus extraction to a "low dependency" funding basis.
- Granting trustees new powers to amend scheme rules to permit refunds.

Implementation is expected by 2027.

Projected tax implications

- Refunds of surplus are currently immaterial, with the highest tax paid by employers in any year since 2005/06 being **£60 million**, occurring in 2023/24.
- If half of the current **£100 billion** of buyout surpluses were eventually paid out in employer refunds, on current tax rates this would generate **£12.5 billion** in cumulative taxes.
- The current levels of tax charge could rise rapidly if there is a material shift in schemes' surplus mindsets following the Bill and could rise rapidly to exceed over **£1 billion** a year.
- Assuming the other half of buyout surpluses were used to improve members' benefits, this would eventually give rise to additional income tax charges, predominantly at the basic rate (20%).

Trustee considerations

Trustees remain cautious, prioritising member protection and fiduciary duties. Many schemes lack clear mechanisms to share surplus value with members, especially where discretionary benefits are limited.

The history of DB scheme funding has been marked by sharp swings – from surplus to deficit and back again. Trustees have seen firsthand how external shocks, regulatory changes, and demographic shifts can rapidly erode funding positions. This experience underpins their cautious approach to surplus extraction. Even with reforms underway, trustees should be expected to retain buffers above buyout and prioritise member security.

Wind-up vs ongoing surplus release

Most refunds of surpluses to employers to date, whether under statutory surplus or the current funding regime, have occurred in wind-up scenarios. In those cases, member benefits are fully secured, and surplus can be returned without future risk.

The proposed reforms aim to enable surplus release while schemes are ongoing, but this represents a step change. Trustees will need to weigh the risks of releasing surplus mid-flight, especially where funding is volatile or covenant strength is uncertain.

Member benefit challenges

Providing surplus value to members is not always straightforward. Schemes may have already granted discretionary increases or enhancements in prior surplus periods or more generally, be closed to benefit accrual, limiting or at least making options today more complicated.

Legal constraints also currently prevent simple one-off payments.

Trustees may need to explore complex benefit augmentation strategies or DC support mechanisms for members to receive an appropriate share.

Legal and governance complexity

Surplus release is governed by a patchwork of scheme rules, trustee powers, and fiduciary duties. The proposed statutory power to amend scheme rules will help, but trustees must still act within the proper purpose of the scheme and consider all relevant factors. Whether, when, and how to exercise a power to use surplus is not an easy one. Legal advice and robust governance will be essential to navigate the new framework.

Strategic implications

Surpluses are increasingly relevant in M&A and corporate finance, but their value is contingent. Buyers and sellers must consider the realisable value using multi-basis actuarial modelling, scenario analysis, and risk-adjusted frameworks.

For corporates, surpluses offer potential value. While employers cannot unilaterally determine the course of action taken by their scheme, making representations in relation to the new powers granted under the Bill, and their role in meeting the balance of cost in the development of the scheme's current funding position, would be a logical step for many.

Funding reversal: the employer payback era

While the statutory surplus regime saw employers benefit from contribution holidays and modest refunds, the post-2006 era has been defined by employer support. Since the introduction of scheme-specific funding, employers have paid over £200 billion in deficit reduction contributions. The funding reversal highlights that any surplus now emerging may be the result of sustained employer investment, not necessarily windfall gains.

Regime comparison: compulsion vs discretion

Under the statutory surplus regime, schemes were compelled to remove excess surplus to retain tax approval. Today, surplus release is discretionary, subject to trustee agreement and scheme rules. This shift from mandatory to voluntary action fundamentally changed the dynamics of surplus management and trustee decision-making.

Wind-up realisations vs ongoing release

Surplus refunds continue to occur in wind-up scenarios, where member benefits are fully secured. In these cases, trustees may return 100% of the remaining surplus to the employer, particularly where the employer has driven the funding position. Examples such as WHSmith illustrate this. In contrast, surplus release from ongoing schemes is expected to be more cautious.

Threshold tensions: buyout vs low dependency

While the Pension Schemes Bill 2025 proposes surplus release at the low dependency funding level, trustees are expected to continue using buyout as the practical benchmark. Given buyout funding better secures member benefits, and considering the volatility of surplus positions, most schemes are unlikely to release surplus at the lower threshold. This means the volume of surplus available for ongoing release may be more limited than headline figures suggest.

Equitable distribution expectations

During the statutory surplus regime, approximately one-third of surplus value went to members, and two-thirds to employers – broadly reflecting long-term contribution patterns. Trustees may again seek to ensure members receive a fair share of any surplus released, however, today's context is very different. Employers have borne the brunt of funding volatility for two decades, and their role in creating surplus is much more pronounced.

Final thoughts

The return of DB pension surpluses presents both opportunity and complexity. Unlocking surplus value requires careful navigation of legal, regulatory, and stakeholder frameworks.

For corporates, surpluses can enhance financial resilience and support strategic goals, but only if approached with precision, transparency, and stakeholder alignment. Done well, surplus release can support strategic goals and financial resilience. Done poorly, it risks undermining trust and scheme sustainability.



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2. Introduction





Pension surpluses, once rare and often inaccessible, are returning as a potentially material factor. With many defined benefit (DB) schemes now overfunded on a variety of bases¹, corporates are faced with the challenge of determining how much of that surplus is realisable, how it should be valued, and how trustees and regulators might respond.

This report provides a UK-focused overview of:

- The history and past treatment of DB surpluses.
- The latest reforms for surplus release.
- The expected impact on surplus strategies and future release of value.
- Valuation principles in a transactional context.
- Implications for stakeholders.

Data sources

There is currently no complete data source that is publicly available providing figures for employer refunds from defined benefit pension schemes. To compile the dataset used in this report, we have used a variety of sources including:

- For the analysis of statutory surplus, including employer refunds, over the period 1987 to 2005, we have had recourse to Inland Revenue statistical publications held by the British Library.
- For employer refunds from 2006 to date, we submitted Freedom of Information (FOI) requests to HMRC, who provided figures for the authorised surplus payments tax charges by tax year. They also provide guidance on sourcing further information from the National Archives.

We supplemented this information with a range of data sources compiled from the Pension Regulator, including their funding analysis and research supporting annual funding statements, the Pension Protection Fund and their annual Purple Book publication, as well as from gov.uk and the Office for National Statistics. Further data sources are disclosed throughout the report.

¹ Figures from the Pensions Regulator at 30 September 2024 showed 82% of schemes had a Technical Provisions (funding) surplus, 75% had a surplus on a low dependency basis, and 49% had a buyout surplus.



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3. The evolution of DB scheme surpluses



Before we consider the historic data on DB surpluses, it is worth setting out some brief background on the changes in the pension landscape over time.



The statutory surplus test and tax on refunds

Going back to the 1980s, DB surpluses were like today, relatively commonplace, whilst the funding landscape was generally more forgiving, with high discount rates and conservative benefit structures. By the mid-1980s, the Inland Revenue had become increasingly concerned that the high rates of corporation tax were leading to employers overfunding their schemes for tax efficiency and that as a result, DB surpluses were potentially building up to excessive levels.

Prior to 1986, employers could in theory use their DB schemes to avoid paying tax. Contributions benefitted from full tax relief, as did investment returns, with no tax payable on any refund of surplus. Whilst it was not necessarily easy to obtain a refund in this manner, at the very least it created a legitimate loophole. There were no statutory restrictions specifically preventing employers from reclaiming surplus funds if scheme rules allowed it, and the legal and regulatory environment was underdeveloped compared to today. Some employers even liquidated their schemes to access monies, in turn depriving the government of (immediate) tax revenue.²

To address this 'loophole' and disincentivise such repayments, the Inland Revenue established in the Finance Act 1986 a 40% tax charge on any refund of surplus to employers. Alongside this an 'excessive surplus' rule was also introduced, requiring DB schemes to reduce their surpluses to no more than 5% of the scheme's liabilities,³ calculated on a prescribed actuarial basis, referred to as the statutory surplus basis, to maintain their tax-exempt status.

To retain their tax approval, the employer and trustees of DB schemes were expected to use excess surplus over 105% funding to:

- Increase member benefits, e.g. by providing discretionary increases.
- Reduce employer and/or employee contributions i.e. by having a contribution holiday.
- Refund part of the surplus (subject to approval, and the 40% tax charge).

² The reader is referred to A Pension Scheme Wind-Up: Legitimate Act or Smash-and-Grab? By S.M. Southall and J.D. Punter, from 1987, for further reading on this topic.

³ i.e. to reduce their funding level to be no more than 105% on the statutory surplus basis.



Case study: Hanson and Imperial Group plc

Industrial conglomerate Hanson Trust was known in the 1980s and early 1990s, for acquiring companies and then accessing surpluses in their DB pension schemes as part of their broader acquisition strategy. Hanson would typically look to wind-up the acquired schemes and refund the surplus to the employer, often leaving members with only commuted values or reduced pensions.

One such approach that became significant from a case law perspective for employer duties was Hanson's 1986 acquisition of Imperial Group plc. At the time, Imperial Group's pension scheme held a substantial surplus, estimated at £130 million. Shortly before the acquisition, the scheme was amended to include a new rule guaranteeing annual pension increases of the lesser of 5% or RPI. This was considered a "poison pill" move designed to deter hostile bids by increasing pension liabilities. Nonetheless, the takeover happened.

After the takeover, Hanson refused to approve increases above 5%, despite higher inflation, and proposed a new scheme offering the lesser of 15% or RPI pension increases, but where surplus would revert to the company. The trustees challenged this, arguing a breach of Hanson's duty of good faith in compelling members to give up their rights in the existing scheme (ultimately as a mechanism for Hanson to capture the surplus).

The court agreed with the trustees. Whilst the employer could legitimately act in its own interest, it couldn't use its consent powers for a collateral purpose like capturing surplus as this breached the implied duty of good faith.

The case became a key precedent in UK pensions law, shaping how discretionary powers and surplus management are governed.

The Hanson approach highlighted the risks to members when surpluses were treated as company assets; however, the Maxwell scandal took this even further, into financial fraud.

Maxwell and the road to regulatory reform

In the early 1990s, media tycoon Robert Maxwell, whose business empire included Mirror Group Newspapers, was heavily indebted. To prop up his failing empire and maintain share prices, he plundered over £400 million from the Mirror Group Newspapers Pension Scheme, exploiting the lack of trustee independence and regulatory oversight. Maxwell died in November 1991, after which auditors uncovered the massive pension fund theft, which after a concerted campaign by affected pensioners, ultimately led to a £100 million bailout from the government and a £276 million out-of-court settlement from banks, advisors, and what was left of Maxwell's companies. Nonetheless, many pensioners still suffered substantial losses, receiving as little as half their original benefit promises.

Following this scandal, the Pensions Act 1995 brought about a significant regulatory overhaul for pension scheme funding, investment, and governance. It introduced:

- The Minimum Funding Requirement (MFR). This was a legal standard to ensure pension schemes maintained a certain level of funding, with rules in place for addressing deficits.
- Greater trustee independence and duties, including the creation of member-nominated trustees.
- The establishment of the Occupational Pensions Regulation Authority, a dedicated regulator, later replaced by The Pensions Regulator.

It also intended to make refunds of surplus more tightly controlled by introducing:

- Section 37, which required that in addition to meeting any requirements of the scheme rules and other statutory conditions, for a return of surplus in an ongoing scheme, trustees must be satisfied that it is in members' interests to make the refund. This required active consideration of what was and was not in members' interests.
- A requirement that a scheme had to be overfunded on the MFR basis to be able to pay a refund of surplus.⁴

In practice, the MFR turned out to be too simplistic and rigid a funding measure. The MFR was based on prescribed actuarial assumptions and whilst it was intended to be market-related, a scheme could meet or exceed the MFR while being significantly underfunded on a buyout basis i.e. the cost to secure all pension benefits in full with an insurer. Schemes that met the MFR and were assumed to be 'safe' often transpired not to be.

In July 2002, Allied Steel and Wire (ASW), a steel manufacturer, collapsed into administration. Despite the DB scheme having been compliant with the MFR, it did not have enough assets to secure full member benefits on wind-up, and members only received a portion of their expected benefits. This was particularly stark for some because of the statutory priority order in place at the time, which favoured pensions already in payment.⁵ As a result, active and deferred members were often left with a fraction of their accrued benefits. Some long-serving ASW workers lost up to 70% of their pensions.

The collapse of ASW highlighted the gap between MFR funding and buyout cost and that there was no regulatory mechanism for imposing stronger funding standards where needed. The tragic situation of the members of the ASW scheme came to symbolise the failure of the safeguards introduced in the Pensions Act 1995. The public trust issues it caused led to the Pensions Act 2004 which resulted in:

- The abolition of the MFR.
- The introduction of a risk-based, scheme-specific funding regime, overseen by The Pensions Regulator (TPR).
- The creation of the Financial Assistance Scheme (FAS) and the Pension Protection Fund (PPF) to provide compensation in situations where employers went bust and their schemes were underfunded.
- A substantial raising of the bar on the ability to and requirements for accessing surplus funds, to better protect members' benefits. Specifically, for an ongoing scheme:⁶
 - Employers could only access surplus monies where a scheme was fully funded on a buyout basis.

⁴ Note that the statutory surplus regime continued to operate until April 2006, requiring excess surpluses to be eliminated within the given timeframes to retain full tax-exempt status.

⁵ For a scheme winding-up where the assets are insufficient to meet all the liabilities, the priority order is the order in which the scheme's assets are distributed.

- An actuary must certify the scheme has met the buyout funding test before any surplus can be refunded.
- The scheme rules must permit such payments.
- The trustees must be satisfied refunding the surplus is in the best interest of members.

At the same time, the requirements for schemes in wind-up were also revisited, as the legal debt payable by employers was also framed off the MFR,⁷ which did not ensure members benefits would be secured in full where a scheme wound-up. These were ultimately improved to require scheme liabilities be assessed on a buyout basis, whether the employer was solvent or insolvent, from February 2005.

The Finance Act 2004, effective from April 2006, repealed the statutory surplus test such that from that point on, there was therefore no longer a requirement to remove surpluses deemed excessive. After this date, DB schemes could only pay refunds to their employers on an ongoing basis where:

- Scheme rules allow it.⁸
- The scheme must be fully funded on a buyout basis, as certified by the scheme actuary, and be so after any surplus payment is made.
- The trustees must be satisfied it is in the members' interest to make the payment, as well as meeting their overarching fiduciary duties.
- Members must be notified of the proposed payment.
- A tax charge of 35% applies to any such payment (reduced to 25% from April 2024).

In a wind-up situation, members benefits had to be secured in full with an insurer, practically implementing a buyout.⁹ In either case therefore, from a funding perspective, schemes must be at least fully funded on a buyout basis (having reflected the value of any prospective potential surplus payout).

This is a very high funding bar, representing the most conservative measure of a scheme's liabilities, even before the other steps that must be followed are considered.

As we shall see in more detail in the next chapter, the funding level of DB schemes in the early 2000s were relatively poor, with the median scheme having a funding level of just over 50% on a buyout basis, and most schemes (some 95%) having a funding level of 75% or below on this basis.¹⁰

Since the 1980s then, there has been a clear paradigm shift in the treatment of defined benefit (DB) pension schemes and their surpluses. In the late 1980s, government reforms were introduced to compel the use of excessive surpluses, following concerns about overfunding as a potential route to avoid tax. A series of tests of the support framework for schemes, as well as some high-profile scandals, resulted in legislative changes toughening employers' legal responsibilities. As part of this, a stricter regime for funding oversight was introduced, with the arrival of the Pensions Regulator in April 2005.

This is the regime still in force today, where a refund of surplus is currently only possible in limited circumstances, and only after trustees are satisfied that member benefits are fully secured on a buyout basis.

Things have a habit of going full circle, however, and in Chapter 4 we look at the government's proposals in the Pensions Schemes Bill 2025 to weaken the current regime and enable surpluses to be taken as employer refunds, whilst schemes are still ongoing, on a weaker measure than buyout.

⁶ As compared to a scheme in wind-up, where the rules are tighter still, requiring scheme liabilities to have been fully discharged before a refund to the employer can be made, alongside (the) other requirements.

⁷ Prior to April 1997 the debt was based on a scheme-specific calculation of transfer values. From April 1997 to March 2003, the debt was based on MFR, except for solvent employers where from March 2002 to June 2003 the debt for pensioners was increased to buyout (the remainder was retained at MFR). From June 2003 the debt became buyout for solvent employers, and for insolvent employers from February 2005.

⁸ There must be an express power to make surplus payments to the employer, and the trustees must have passed a resolution by 5 April 2016 to retain the power to refund surplus as an ongoing scheme.

⁹ A refund can then only be made if the scheme rules explicitly allow it, once the trustees have acted in accordance with their duties and followed the appropriate statutory processes, including correct notices and appropriate member communications. Again, tax is payable at 35% (reduced to 25% from April 2024).

¹⁰ See *Occupational defined benefit scheme funding analysis 2025 annex*.



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4. A tale of two eras: surplus usage then and now





In this chapter we analyse the available data on past DB pension scheme surpluses and their uses.

Introduction

We begin by considering the period when there was a statutory requirement for schemes to remove excessive surplus to retain their full tax approval, 1987 to 2006. During this period, there is a richer level of data on how surplus monies were used, as schemes were required to submit detailed plans on their chosen methods of reduction to remove such overfunding. From 2006, when this regime stopped, we are generally limited to considering refunds of surplus to the employer, as there is no known data source for other uses of surplus.¹¹

The Statutory Surplus Regime: 1987 to 2006

Prior to the Finance Act 1986, whilst DB schemes were able to build up funds worth significantly more than their liabilities, an employer's ability to access those monies as a refund was very limited for a continuing scheme.¹² Employers wishing to do so generally had to wind-up their scheme thus, assuming the employer was content to continue providing new benefits, it was generally

much easier for them to take a contribution holiday to access the value, than try and take the monies out.

There were, however, no rules requiring excessive surplus to be contained, or tax to be paid on any refunds that were made back to the employer. Consequently, no figures exist for the extent to which surpluses arose prior to the introduction of the Finance Act 1986 coming into force, or the level of refunds to employers where schemes were generally wound-up to access such monies. More widely, there are no figures for use of surplus generally, prior to this point.

Once the Finance Act 1986 came into force in 1987 though, DB pension schemes seeking to retain their full tax approval were required to submit to the Inland Revenue, every three years, or three and a half for large¹³ schemes, information to show whether the scheme's assets exceeded the liabilities on the relevant statutory surplus basis by more than 5% and if so, by how much. Any surplus over the 5% level had to be reduced, otherwise, tax became chargeable on investment income and gains arising from funds above this level.¹⁴

¹¹ For example, in situations where a refund of surplus was made to an employer after 2006, either on wind-up or an ongoing basis, members benefits may also have been augmented (or not). Details for the value of such augmentations are not available on an aggregate basis, whereas employer refunds are, as a result of data on the tax charge payable on authorised refund of surplus payments.

¹² See A Pension Scheme Wind-Up: Legitimate Act or Smash-and-Grab by S.M. Southall and J.D. Punter, December 1985, page 42, paragraph 11.6.

¹³ Large schemes were classified as those with 12 members or more.

¹⁴ See [Pensions_OCT03_1.PDF](#) paragraph 13.

The removal of any excessive statutory surplus could be achieved by:

- Reducing contributions for employees, employers, or both.¹⁵
- By enhancing existing benefits or introducing new ones.
- By paying the surplus to the employer.¹⁶
- By any mix of the above.

The proposals had to be implemented within six months of acceptance by the Inland Revenue.

Archive figures from the Inland Revenue set out cumulative totals for the amount of excess statutory surplus proposed to be eliminated by each of these methods over the period from 1987/88 through 2003/04.¹⁷ The amounts shown were based on the actuaries' estimated reduction for each category aggregated across all schemes:

Pension fund surpluses for large, self-administered schemes by method of reduction: cumulative figures 1987/88 to 2003/04 ¹⁸	
Method of reduction of excess surplus	Amount of reduction (£bn) ¹⁹
Employer contribution holiday	13.5
Employee contribution holiday	0.3
Employer contribution reduction	4.8
Employee contribution reduction	0.9
Increase in benefits	9.1
New benefits	0.2
Refund to employer ²⁰	1.2
Total	29.9

As shown, over the period reduction of excessive statutory surpluses was required, approximately £30 billion was consumed, equivalent to £67 billion in today's money.²¹ Whilst significant, it's noteworthy that only £1.2 billion (just 4%)

was paid out of schemes through refunds to employers. The vast majority (96%) of the excess statutory surplus remained within schemes, providing for increased or new benefits for members, or to allow member and employer contributions to be temporarily reduced or stopped. By and large, therefore, the impact was to reduce funding by slowing or stopping contributions or increasing benefits.

In addition to the £1.2 billion paid out as refunds to employers to reduce excessive statutory surpluses below the 5% threshold, employer refunds were also made where schemes were wound up.²² In total, including the refunds for reducing excessive statutory surpluses, some £3 billion of refunds were paid out to employers over the period from 1987/88 to 2005/06, equivalent to £7 billion in today's money.²³

Although the figures for the level of excess statutory surplus that were utilised were sizeable, it is important to note these schemes were only a relatively small segment of the DB universe by asset value. To provide context, the table below shows the number of large²⁴ schemes reporting figures on the statutory basis in each of the first three full years for which the regime was in force. The numbers of schemes are split between whether they had a statutory surplus of 5% or more, or not, or were in the process of being wound up:

Year	Surplus of or over 5%	Surplus under 5% or deficit	Wound-up	Total schemes
1988/89	466	1,015	24	1,505
1989/90	650	886	27	1,563
1990/91	767	973	49	1,789
Total	1,883	2,874	100	4,857

This snapshot indicates that at the start of the 1990s of the order of 40% of these schemes had an excessive statutory surplus requiring removal to retain full tax-exempt status.

¹⁵ In this case i.e. where contribution holidays or reductions were employed, the statutory surplus had to be removed within 5 years.

¹⁶ In which case, it was taxed at 40% up to 6 April 2000, and 35% thereafter.

¹⁷ Whilst the regime requiring statutory surpluses to be reduced to retain full tax approval remained in place until April 2006, archive figures on the uses of excess surplus are only seemingly available up to 2003/04. In practice removal of excessive statutory surplus after the turn of the millennium was minimal. Note that some of the planned reductions set out in the table were in any case timed to fall after 2003/04.

¹⁸ https://webarchive.nationalarchives.gov.uk/www.hmrc.gov.uk/stats/pensions/7_8_sep05.pdf

¹⁹ Individual figures do not sum due to rounding.

²⁰ The figure for refunds to employers excludes the amounts paid over by schemes winding up in each year.

²¹ Based on the increase in the CPI indexing the implied annual figures for surplus usage over the period.

²² Wind-up is the formal process of closing a pension scheme and bringing the trust to an end.

²³ Gross refunds based on the Authorised Surplus Payments Charge of 40% during this period.

²⁴ For statutory surplus reporting purposes large schemes were those with more than 12 members and had to provide valuations every three and a half years (small schemes had to provide valuations every three years).

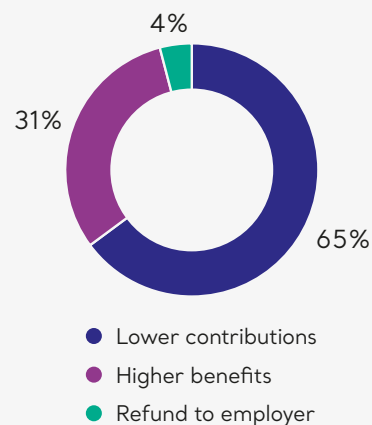
In addition to these schemes, there would also have been a substantial number of the 60% of schemes that whilst not excessively funded (that is, over 105% funded on the statutory surplus basis), still had a significant surplus on a different measure, such as the funding basis used to determine cash contributions. The statutory surplus basis was, after all, intended to identify truly excessive surplus as a potential mechanism for avoiding tax, not surpluses in general.

Of the 60%, we would expect a sizeable proportion would have had a funding surplus. This reflects both that funding measures would generally have been expected to be materially weaker than the statutory surplus basis, as well as that there were schemes that were overfunded on the statutory basis but not excessively so. Some of these schemes would also have been expected to have implemented contribution holidays, the granting of additional benefits and, potentially, employer refunds, to manage their healthy funding positions. The difference, of course, was that these well-funded schemes weren't compelled to reduce their surpluses, with any such actions voluntary and/or to avoid future compulsion.

Whilst the Inland Revenue data on the schemes declaring excessive statutory surpluses only provides an insight into part of the surplus landscape, therefore – in terms of the behaviours of trustees and employers on their choices for the uses of overfunding in a situation where they are compelled to remove surplus – nonetheless, it gives us some rich detail. This is illustrated in the charts opposite, which show how excess statutory surplus arising over the period was used.

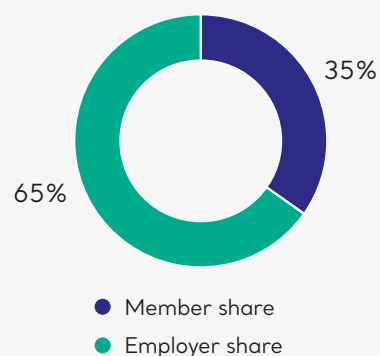
The first chart shows the breakdown by broad method of reduction. It shows that the majority (some 65% of the total) was used to reduce employer and/or employee contributions, with most of the remainder being used to increase member benefits (31%). Only a small percentage (4%) was actually paid out of schemes through refunds to employers:

Breakdown of uses of excess statutory surplus



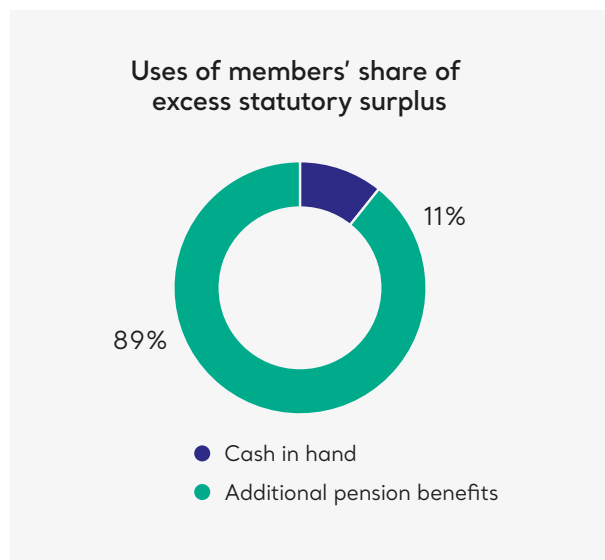
In aggregate terms, two-thirds of the utilised surplus value went to employers, with one-third to members. This is surprisingly close to estimates of the split of long-term contributions to DB schemes, with Pensions UK calculating employers accounted for 63% and members 37%²⁵:

Share of excess statutory surplus

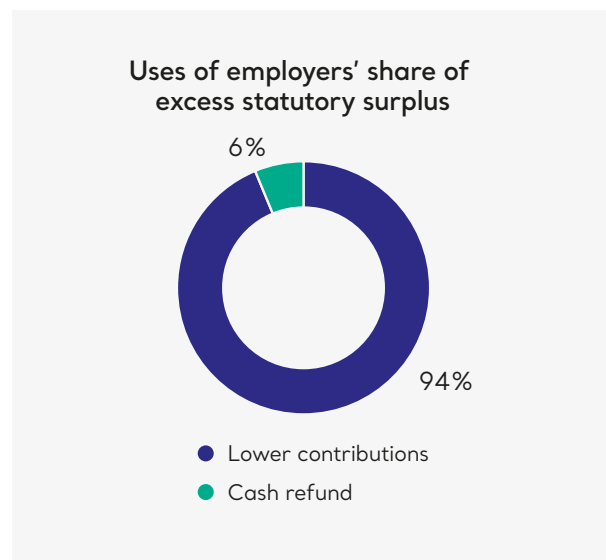


²⁵ See the TUC discussion document, *Prospects for Pensions*, July 2002. Pensions UK was known as the National Association of Pension Funds (NAPF) at this time.

In terms of how their respective shares were used, for members, the vast majority (89%) of the excess statutory surplus value was used to provide them additional pension benefits, with the remainder reducing their contributions for a period:



For employers, the position was even more stark – only 6% was refunded, the remainder used to reduce their contributions for a period:



The charts provide an interesting reference point both for considering how surpluses arising today might be used, and what split could be considered reasonable between members and employers, a topic we return to later.

Improving member benefits

Prior to 1997, aside from on Guaranteed Minimum Pensions, there was no statutory requirement to increase pensions in payment and, prior to 1986, no statutory requirement to revalue the benefits of early leavers. During the 1990s this landscape developed significantly with the introduction of requirements to provide an inflationary link to pensions in payment for benefit accrual after April 1997. Although schemes weren't required to do so, the provision of discretionary pension increases to existing retirees on pre 1997 pensions, often linked to inflation, became more common. This was one way in which schemes with excessive statutory surpluses, as well as those without, improved member benefits.

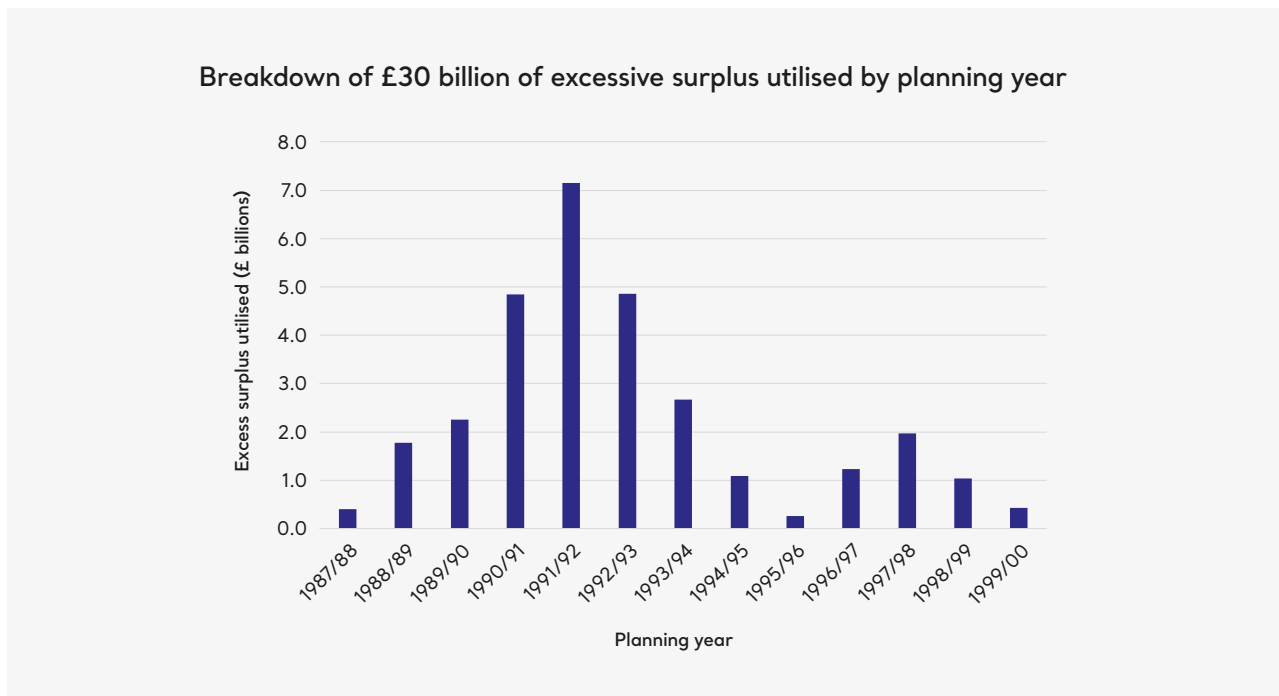
Another was early retirement. During the 1990s, some employers, particularly in manufacturing, utilities, and the public sector, were downsizing or restructuring, as the decline of manufacturing and shift to the service economy gathered pace

alongside the widespread adoption of computers and automation more generally. Surplus assets could be used to fund generous incentives to reduce the cash costs that would otherwise be associated with redundancies, such as:

- Waving early retirement reductions, e.g. allowing retirement at 50-60 rather than a normal retirement age of 65.
- Adding pension enhancements like extra years of service, or uplifted pension amounts.



We can also consider the split of the £30 billion total excess statutory surplus that was utilised through time. The chart below shows how much excess surplus was proposed to be dealt with each year, from 1987 to 2000.²⁶ As shown, the majority of excess surplus arose in the early 1990s (65% between 1990/91 and 1993/94 inclusive), with smaller amounts thereafter:



Looking at the period from the turn of the millennium to the new funding regime coming into effect, 2000/01 to 2005/06, the Inland Revenue figures show that there was no noticeable use of excess surplus. There were in turn, negligible refunds of excessive statutory surplus back to employers during this period. Figures for the tax paid on employer refunds showed a material uptick, however, with a spike in 2001/02 declining year-on-year thereafter:



²⁶ Whilst plans for excessive surplus use continued to be submitted until 2005, the total surplus that was utilised remained unchanged after 2000 at £30 billion.



In total, between 2000/01 and 2005/06 there was approximately £650 million in gross refunds to employers. Given excess statutory surplus use was negligible for this period, and on the expectation that trustees were generally not likely to agree refunds to the employer on an ongoing basis given the high bar required to be met, we anticipate these refunds were associated with wind-ups of DB schemes. Whether this relative uptick is reflective of a glut of very well-funded DB schemes winding up, or the lower employer debts that were legally in force during this period;²⁷ is unknown. It is nonetheless of brief note that the decline to (effectively) zero occurred at the point when the measure for paying out surplus and settling debts moved to the most conservative measure, buyout.

Finally, it is worth remembering that, during this period, employers were compelled to remove excess statutory surplus if they wished to retain the full tax-exempt status of their DB schemes. While some employers did exploit what was arguably an underdeveloped funding landscape and legislative framework, the data on surplus refunds does not suggest a widespread effort – nor a net outcome – of employers liquidating DB schemes for their own gain.

By the end of the statutory surplus regime in April 2006 – an operational period of twenty years – the value of the gross refunds paid to employers totalled just £4 billion.²⁸ This compares to DB scheme assets of some £771 billion at the time – refunds represented just 0.5%. More broadly, the total surplus value used for the benefit of both employees and employers under the statutory surplus regime came to around £40 billion, or roughly 5% of the DB universe's assets at the time.

In April 2006, the median funding level on a Technical Provisions basis stood at 81%, and just 52% on a buyout basis. While contribution holidays and benefit enhancements were taken by more schemes than those declaring excessive statutory surpluses, these figures suggest the regime's overall impact on scheme funding was relatively modest. In contrast, wider economic and demographic factors had a far more material effect – evidenced by the total buyout deficit of some £450 billion in March 2006, many multiples higher than the surplus utilised in the twenty years prior.

The value employers extracted during and as a consequence of the statutory surplus regime, which compelled such action to retain tax-exempt status, does not appear to have caused or materially contributed to the then funding position of schemes. Indeed, following the regime's end in 2006, employers collectively paid in more than £200 billion in contributions over many years to reduce deficits alone, with further payments made to support ongoing accrual and one-off special contributions. This subsequent funding effort far outweighs the value of surplus refunds, underscoring that the regime's legacy was not ultimately one of employer enrichment at the expense of scheme sustainability.

The new funding regime: 2006 onwards

As previously set out, from 2006²⁹ a new funding regime for DB schemes was introduced, replacing the outdated and outmoded Minimum Funding Requirement (MFR). It necessitated scheme-specific funding, with trustees required to adopt prudent assumptions, holding sufficient and appropriate assets to meet their Technical Provisions (TPs). This regime laid the groundwork for more tailored and risk-aware funding strategies, and has since evolved further, most notably, with the introduction of the new DB Funding Code in 2024 (the 'Code').³⁰

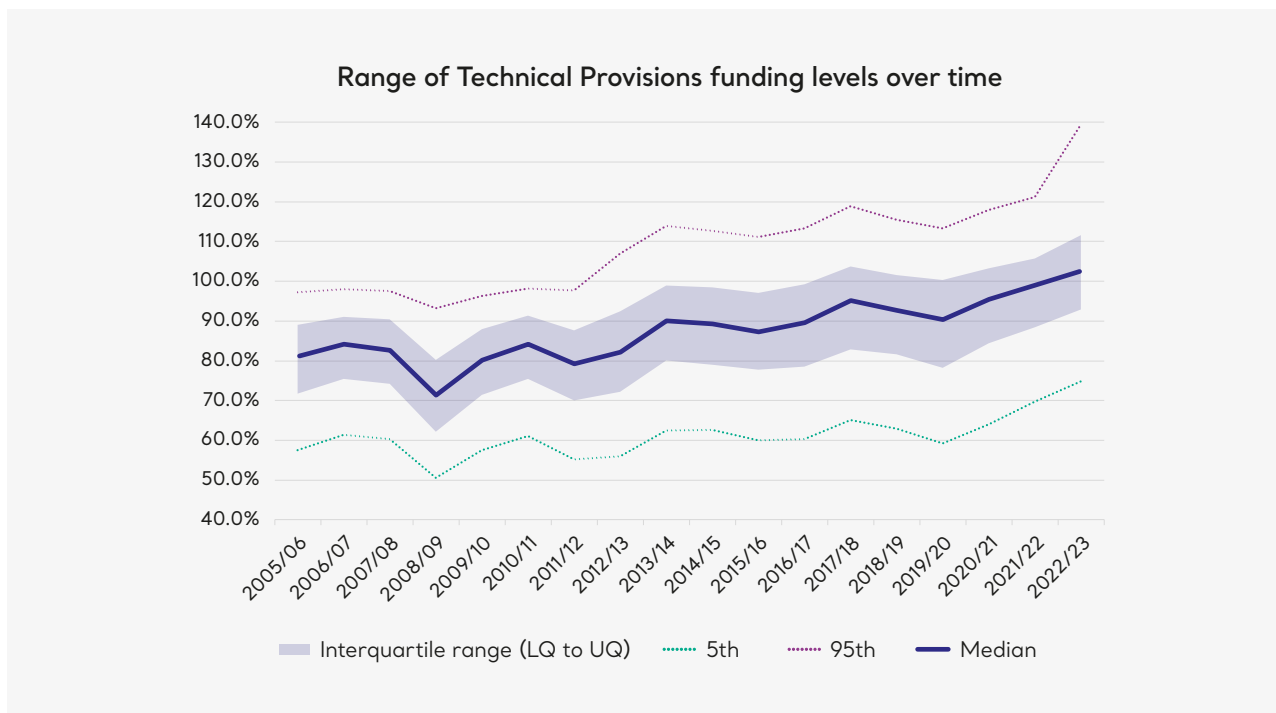
²⁷ As previously set out from April 1997 to March 2003, the debt was based on MFR, except for solvent employers where from March 2002 to June 2003 the debt for pensioners was increased to buyout (the remainder was retained at MFR). From June 2003 the debt became buyout for solvent employers, and for insolvent employers, buyout from February 2005.

²⁸ Including refunds on wind-up.

²⁹ The new funding regime began on 22 September 2005.

³⁰ The Code aims to strengthen long-term planning, improve risk management, and ensure member benefits are secure. It represents the most significant change to DB scheme funding in nearly 20 years.

The TP's measure is used to determine the cash contributions, if any, an employer is required to pay to reach full funding, if they are in deficit. In the chart below, we show how the range of funding levels on a TP's basis has varied over time across the DB universe.³¹ It plots the 5th and 95th percentiles, as well as the median funding level, and interquartile range (weighted figures):

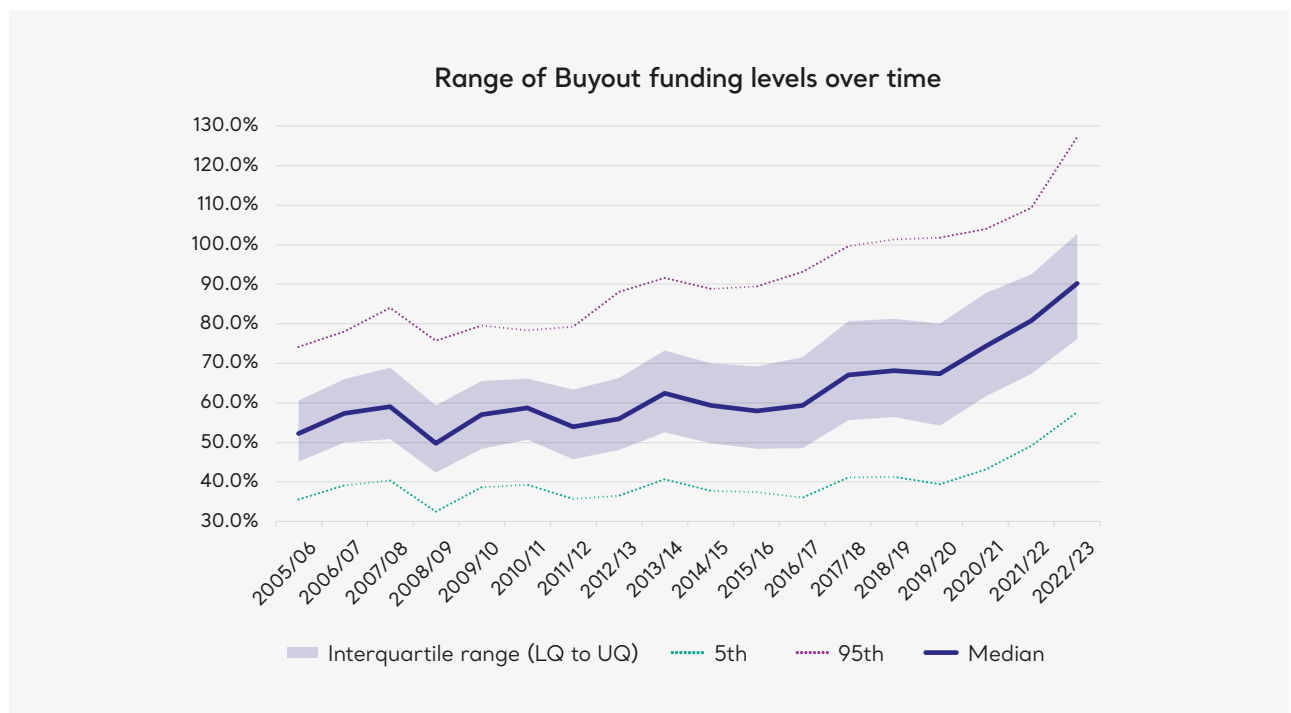


The chart shows that in the initial years of the new funding regime, 2005/06 to 2011/12, most schemes were in a funding deficit (the 95th percentile being below 100% for all these years). From around 2012 onwards, however, an increasing proportion of the DB universe began to reach full funding on a TP's basis and by 2022, a decade later, around half of DB schemes had reached this point. In practice the improvement has been greater than that shown in the chart, as schemes' TP's have strengthened over time, notably, relative to buyout assumptions. Since 2022/23, TP's funding has continued to improve significantly.

Whilst the chart shows the TP's funding position has now developed to a position whereby most schemes are in surplus on this measure and therefore, do not need to pay any further contributions, any refunds of surplus to the employer during the period from 2006 to date require consideration of the funding position on a buyout basis. This, the most conservative funding measure, has also seen marked improvement over time³²:

³¹ Based on the most up-to-date detailed figures available to 2022/23. The latest summary figures indicate funding has continued to improve, with the Pensions Regulator's figures at 31 December 2024 showing an average funding level of 123%, a significant jump relative to the 106% for 2022/23.

³² As with the TP's basis, buyout funding levels have continued to improve, with figures at 31 December 2024 showing an average funding level of 102% on a buyout basis, compared to 89% for 2022/23.



The chart also shows, however, that schemes were substantially underfunded on this measure for most of the period and it's only more recently that full funding and then overfunding (surpluses) has become a more predominate feature of the buyout landscape.

Given the funding status of the DB universe on a buyout basis, and full funding required for schemes to even be able to begin to consider a refund to the employer, with those winding-up having to first buyout, too, the level of employer refunds dropped substantially after 2006, relative to those paid out in the early 1990s. In the first decade from 2006, gross refunds only exceed £50 million once, in 2009/10 (£86 million), with a low of £5 million in 2015/16.

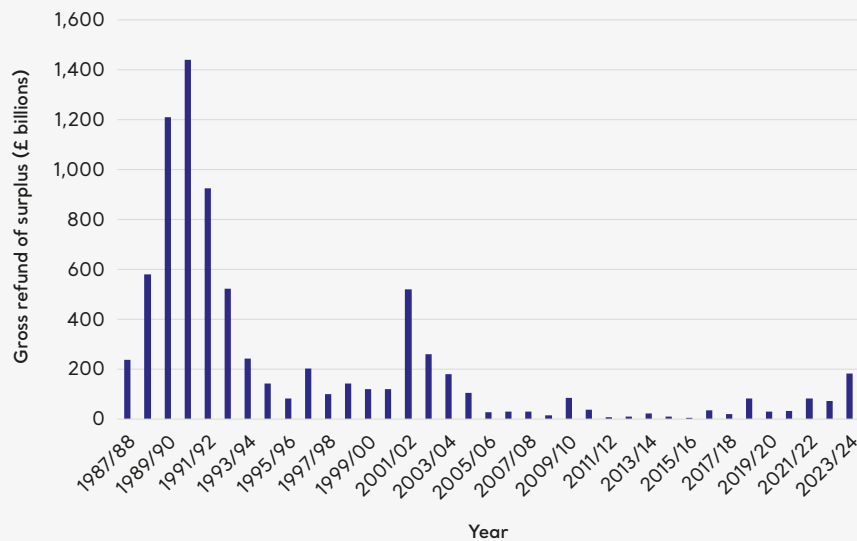
The schemes receiving refunds after 2006 to date are expected to be those winding-up in surplus, given the high bar for refunds of surplus whilst schemes were ongoing, that most schemes were in deficit on a buyout measure, and that unlike with the statutory surplus regime, there is no requirement to eliminate surpluses on any measure after April 2006. There are therefore a raft of reasons why we should expect surplus use to be substantially smaller subsequently.

The recent dramatic improvements in funding, however, mean that sizeable employer refunds are again becoming a feature of the DB landscape. This is illustrated further in the chart below, which shows the level of employer refunds over the whole period from 1986/87 to 2024/25. All figures are expressed in today's money³³ for ease of year-on-year comparison (figures are gross refunds i.e. before tax, and in £ millions):

³³ Taken as July 2025.



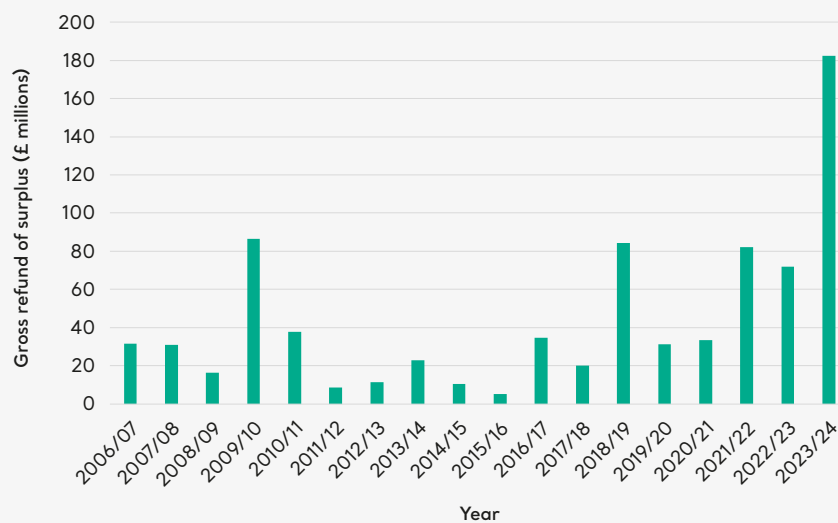
Gross refund of surplus by year (July 2025 values)



As indicated, the chart shows refunds under the statutory surplus regime dwarf those arising subsequently, with 90% of the value of all refunds to date occurring before April 2006. In total, some £6.9 billion of refunds to employers occurred over the period from 1987 to 2005 inclusive, with a further £800 million paid out thereafter (all figures in July 2025 values and gross of tax).

To provide more detail on the position since 2006, the chart below focuses on refunds of surplus after April 2006. Again, all figures gross of tax and in July 2025 values:

Gross refund of surplus by year (July 2025 values)



As shown, in most years the aggregate refunds have been under £50 million, but with an uptick in recent years, 2023/24 being a record year for refunds in this period.



On the expectation that the return of sizeable refunds of surplus is reflective of the significant improvement in DB schemes' funding positions in recent years, assuming those are maintained, this trend can be expected to continue. Relative to the DB universe, however, the level of refunds remains immaterial: 2023/24's gross employer refund figure of £180 million compares to the almost £100 billion of buyout surpluses collectively held in DB schemes at this point (0.2%).



This apparent disparity – significant surpluses seemingly stuck in schemes – is something the government is acutely aware of and actively seeking to address, which is the focus of the next chapter.



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5. A new era for surplus release: the latest reforms



The UK government has recognised the shift in the funding landscape and begun taking steps with the overarching aim of unlocking funds for economic growth, whilst seeking to balance the interests and needs of the various stakeholders i.e. trustees, members, and employers.



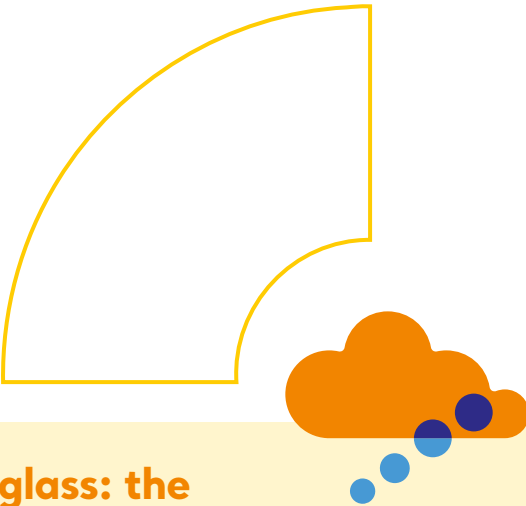
As a first step, in April 2024 the government reduced the tax on surplus refunds from 35% to 25%, making it more attractive for employers to access surpluses in DB schemes. Of course, to do so employers still need the consent of their scheme's trustees, and the right to receive a refund in the first place, which may not exist.

The government therefore launched a consultation in early 2024 seeking views on how to unlock the estimated £160 billion in surplus funds held by DB schemes.³⁴ This focused on whether to make surplus extraction easier, considering factors such as the levels at which surplus can be refunded, covenant strength, and the potential benefits of a 100% underpin from the Pension Protection Fund (PPF).

Trustees' responses to the consultation expressed a range of perspectives regarding proposed reforms. Whilst some supported the potential benefits, many remained cautious, emphasising the need for robust safeguards to be put in place to protect members' interests.

Respondents generally emphasised the need to only extract surplus when it is safe to do so from a member perspective, highlighting concerns over the potential volatility of surpluses over time. A survey of trustees by the Pensions and Lifetime Savings Association (now Pensions UK) reported that half of respondents were concerned about the potential for unreasonable demands from employers regarding surplus release, with 73% believing surplus extraction should always be at the trustees' discretion.³⁵

³⁴ See <https://www.gov.uk/government/news/record-pension-scheme-funding-means-up-to-160-billion-ready-to-boost-growth>
³⁵ <https://www.ipe.com/news/uk-db-funds-rethink-endgame-amid-surplus-extraction-plans/10129542.article>



Through the looking glass: the pinball path of pension schemes

The history of DB scheme funding and the range of outcomes members have received depending on their scheme's and supporting employer's specific circumstances suggests trustees are right to be cautious.

At times, navigating DB scheme funding has often felt like being flung around inside a pinball machine – the ball ricocheting through the unpredictability, external events, and constant recalibration parties have had to make over time with each legal ruling, economic shock, or demographic shift.

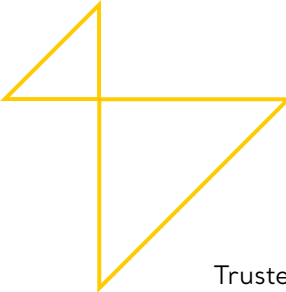
Each collision has left its mark – reshaping funding strategies, recalibrating assumptions, and redefining what security means for members. This has continued throughout the period, the ball never having stopped moving.

Lest we forget the dot-com crash, the global financial crisis in 2008, the massive decline in real yields from the turn of the millennium onwards, the substantial increase in liabilities from longevity improvements, or the impact of the COVID-19 pandemic, recent examples include:

- **GMP equalisation (2018 onwards)** – Complex, retrospective, recalculation of benefits.
- **LDI crisis (2022)** – Rapid rises in gilt yields triggered collateral calls, forced asset sales, and mismatched assets and liabilities.
- **Rise in real yields and good investment performance (2023-2024)** – Resulting in substantial improvements in scheme funding generally.
- **De-risking expansion (2000 onwards)** – The growth of the buy-in and buyout market, and material improvements in pricing, alongside the introduction of superfunds.
- **Funding code reform (2024)** – Potentially more flexibility for well-funded schemes, but those less well-funded are likely to face a more structured and demanding regulatory environment.



Whilst there are reasons to be positive about the developments through time – schemes are arguably in a much better position today – history shows us that deficits and surpluses can disappear and reappear.



Trustees' fiduciary duty to act in the best interests of scheme members remained a central concern. The consultation responses indicated that trustees were unlikely to consider extracting surplus before wind-up due to the risk of creating a funding gap. The complexity of deciding whether it is prudent to extract surplus added to their caution, with emphasis placed on the need for clear regulatory guidance and safeguards to ensure member benefits are protected.

In June this year, the government published the (draft) Pension Schemes Bill 2025 (the 'Bill'), which included their proposed framework for surplus extraction from DB schemes. The key changes include that:

- Trustees will have a new statutory power to modify scheme rules to allow surplus payments to employers, even if the current rules do not permit it. Of course, it remains their choice as to whether they wish to use this power and amend the rules in this way.
- The funding threshold for surplus extraction is being lowered, with the government "minded to amend the threshold at which trustees are entitled to share surplus with the sponsoring employer from the current buyout threshold to a threshold set at full funding on the low dependency funding basis".
- Surplus extraction will still require trustee consent, and independent actuarial certification that the scheme is adequately funded will be required.
- The existing requirement for trustees to be satisfied that surplus release is "in the interests of members" will be removed. Trustees will, however, still have to act in accordance with their fiduciary duties.
- Under the amended provisions, "trustees will remain responsible for negotiating with sponsoring employers regarding possible benefits to members from surplus extraction".

Although the Bill signals the expected direction of travel, there remain areas that could change, such as the threshold at which surplus can be extracted. The approach of the Pensions Regulator and the guidance they provide on surplus extraction is expected to be key, too, given their moral hazard powers. The existing moral hazard regime is based around buyout funding so if the threshold for surplus distribution is set differently, such as based on low dependency, how these two work together will be important to understand.

Alongside the Bill, the government also published a roadmap to give clarity to when the reforms are expected to come into force. Their proposed timetable is as follows:

- **Early to mid-2026** – Bill receives Royal Assent.
- **Mid to late 2026** – Surplus flexibilities regulations consultation.
- **Late 2026 / early 2027** – Surplus flexibilities guidance.
- **Mid to late 2027** – Surplus flexibilities regulations laid.
- **Surplus regulations and guidance** – to come into force by the end of 2027.

Assuming this remains on schedule, the changes won't come in for at least another two years, which will be of frustration to some.

Assessing the potential impact

In their 2025 Annual Funding Statement, the Pensions Regulator highlighted it is good practice for trustees to have in place a policy for the release of surplus in the context of their specific scheme and may wish to start thinking about how they would approach any requests from the employer to release surplus.³⁶

They also highlighted that as of 31 December 2024 around:

- **85%** of schemes were in surplus on a TPs basis.
- **76%** of schemes were in surplus on a TPR derived low dependency basis.
- **54%** of schemes were in surplus on a buyout basis.

This is similar to the figures underlying the government's statement that schemes in surplus on a low dependency basis held a collective £160 billion of surplus, representing 75% of all schemes.³⁷ Considering these figures in more detail, we observe that the schemes with a low dependency surplus collectively hold assets of some £1 billion, equating to 80% of the total DB universe. On a buyout basis, these schemes have a funding level of approximately 88% or above.

Some of these schemes have a buyout deficit, therefore. Refunding surplus to the employers of these schemes would increase those deficits further, placing greater reliance on the future covenant strength. Similarly, those with only a small buyout surplus would be pushed into deficit by refunding surpluses. This aspect is explored further in the following box.

Measures matter: the immediate impact of refunding surplus

Let us consider an example scheme which has a surplus on a low dependency basis but is on deficit on a buyout basis, as follows (before any surplus use):

Scheme before	Low dependency	Buyout
Assets	200	200
Liabilities	180	220
Surplus / (Deficit)	20	(20)
Funding level	111%	91%

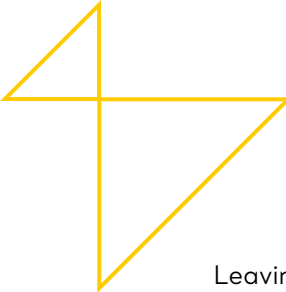
Now suppose the trustees and employer agree to remove the surplus on a low dependency in full, using half of the monies (£10 million) to improve members' benefits (through additional pension increases in payment) with the other half (£10 million) being refunded to the employer (noting £10 million of low dependency liabilities equates to £12 million on buyout):

Scheme after	Low dependency	Buyout
Assets	190	190
Liabilities	190	232
Surplus / (Deficit)	-	(32)
Funding level	100%	82%

As expected, the low dependency funding level decreases to 100%, with no buffer remaining. More importantly, however, the shortfall on a buyout basis increases from £20 million to £32 million, the funding level declining to 82%.

³⁶ See [Annual Funding Statement 2025](#). Note this was released prior to the draft Pensions Bill.

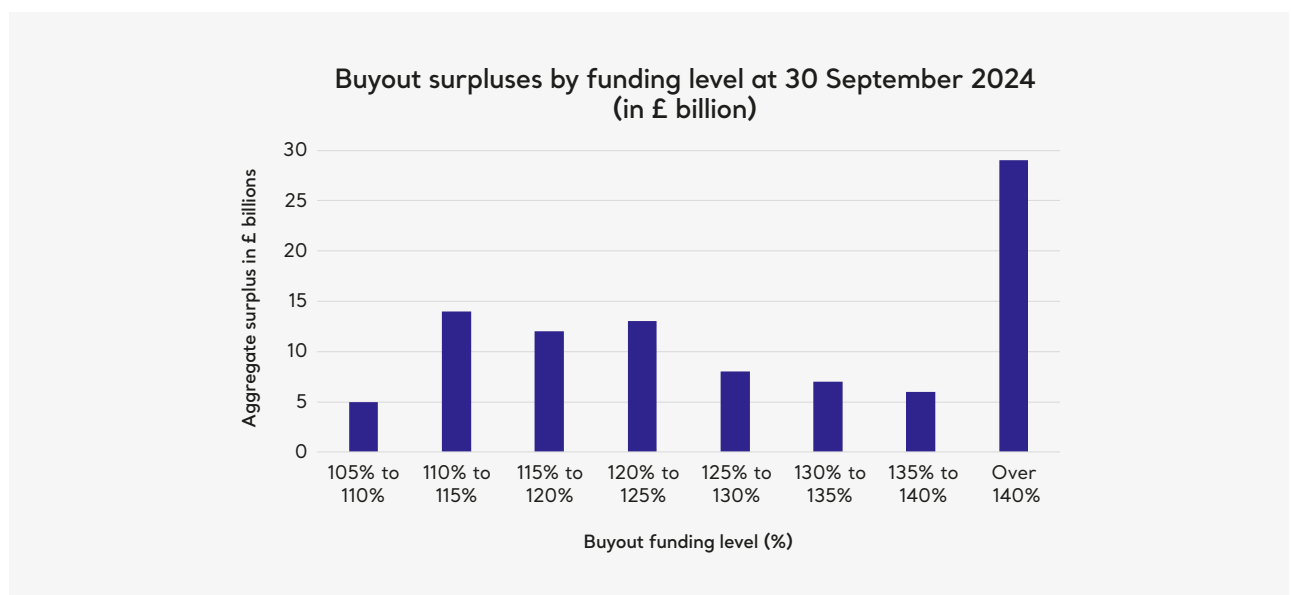
³⁷ See [Estimated DB scheme universe funding splits and assets under management](#) | The Pensions Regulator.



Leaving aside the various actuarial, legal, and other considerations that would be required, the example illustrates that trustees are very unlikely to take such a course of action unless the risks it potentially creates – particularly, the risk of not recovering the buyout shortfall on an insolvency of the employer – was mitigated.

In general terms, it seems unrealistic to imagine trustees and schemes will be paying out surpluses to this new, lower threshold of low dependency and will retain buyout as the appropriate measure for the most part. Indeed, reflecting the inherent volatility of surpluses, it is expected that trustees will principally look to retain a buffer over full funding on buyout, the level dependent on the specific risks for their scheme. We might anticipate that 105%³⁸ of buyout might be a potential starting point for those schemes and trustees willing to consider ongoing surplus distribution under the new regime proposed in the Bill.

Based on Pensions Regulator figures, as of 30 September 2024 approaching 2,000 schemes had a funding level of at least 105% on a buyout basis, collectively holding surpluses of nearly £100 billion. This is illustrated further in the chart below, which shows the figures broken down by funding level bands:



Even on this higher threshold of buyout rather than low dependency, there remain significant sums available for distribution under the government's proposals. Over £50 billion of the combined buyout surpluses are in some 800 schemes with a funding level of at least 125%. This demonstrates a very large number of schemes genuinely appear to be significantly overfunded on any reasonable measure.

It is not known, however, how such large funding buffers came to be built up, or the extent to which they are in schemes where surplus payments to the employer are not permitted.



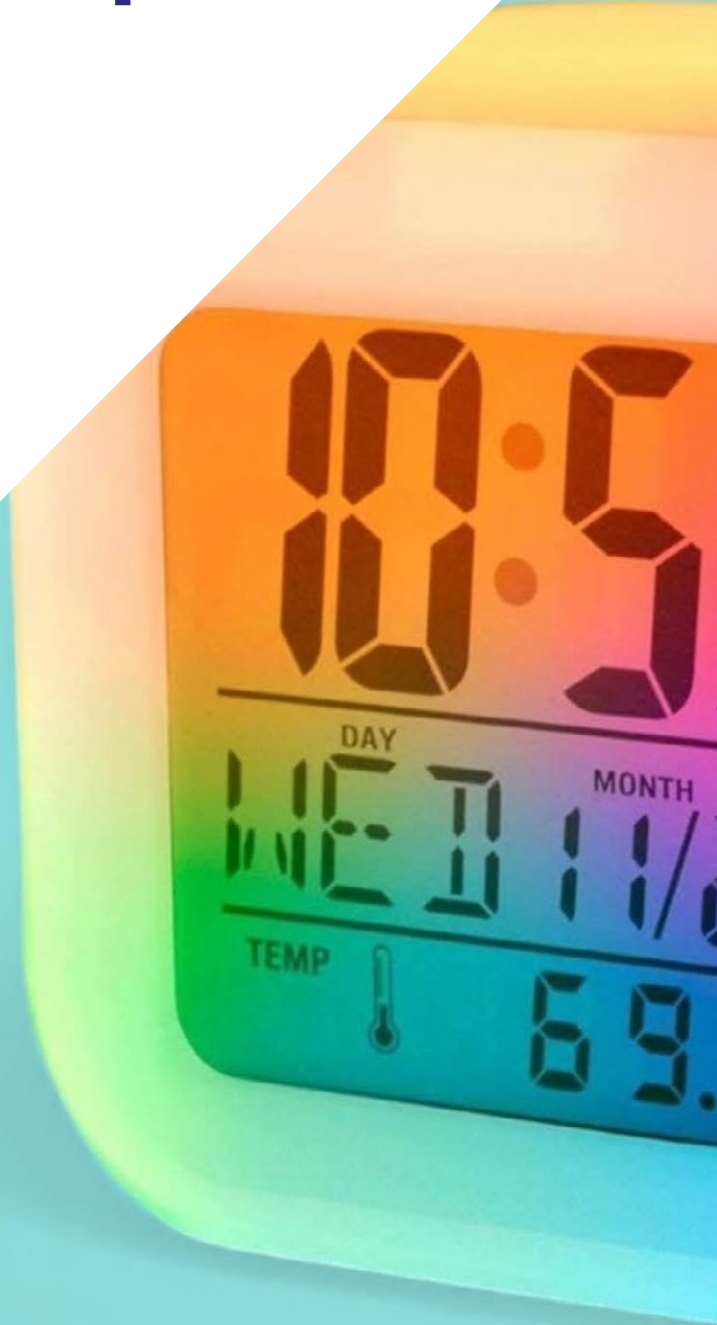
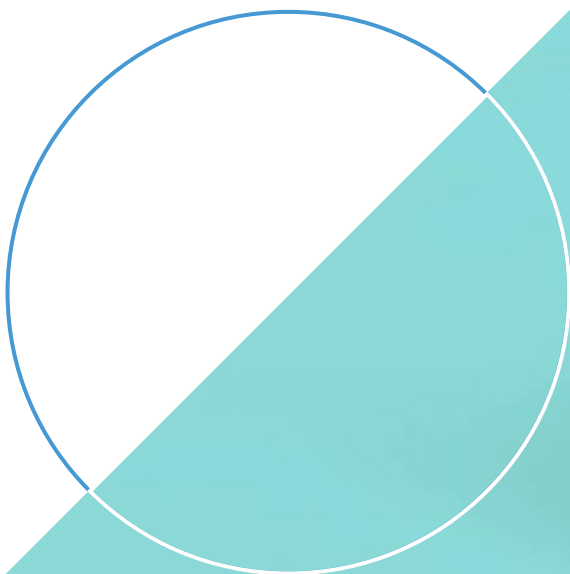
Removing certain legislative barriers and introducing a new framework with guidance on its operation provides some grease to the wheels, but paying out surplus whilst schemes are ongoing will still be a step change.

³⁸ The level of buffer will vary from scheme-to-scheme depending on specific circumstances including but not limited to funding and investment risks, employer covenant strength and its stability, scheme maturity, and the long-term destination or endgame (which may include run on).



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6. From possibility to practice: the path ahead for surplus release



With legislative reform opening the door to surplus extraction at lower funding thresholds, attention now turns to how trustees might respond in practice.



Introduction

The shift from theoretical permission to real-world decision-making brings new complexities; balancing duties, member outcomes, employer interests, and long-term scheme sustainability. As we have seen though, surplus release is not a new concept.

In this chapter we explore the emerging landscape, having recourse to the past experience of realising surplus and uses for it, whilst recognising that the context has changed. We consider the factors likely to shape trustee behaviour, and the practical considerations that will be expected to define the next phase of surplus strategies.

Potential uses

We know that trustees must act in the best interests of members, and that they remain responsible for negotiating with employers regarding possible benefits for members from using surplus.

In contrast however to the late 1980s and 1990s, when trustees had to address excessive surpluses and most schemes remained open to new members and future accrual, today, most

schemes are closed to both. Likewise, while schemes may have previously granted additional benefits — such as introducing or enhancing the level of pension increases on certain benefits — they cannot do so a second time. The options for providing surplus value to scheme members are, therefore, not necessarily obvious, as varied, or easy to implement. They are also taking place in an environment where outside of public sector schemes, granting new DB benefits has become something of an anathema.

In consequence, DB schemes have been innovating to find uses for their surplus. One such approach has been to support contributions to DC schemes, for current employees. This has a natural appeal, as it avoids a full release of surplus back to the employer and the limitations and complexities associated with that.

This mechanism will not be available for all, however. It depends on scheme set ups, as well as the relative levels of DB surplus to DC accrual. As importantly, it's an approach that only benefits the employer, meeting the cost of DC contributions they would otherwise have to pay, from surplus DB monies.³⁹ Unless members receive an appropriate share, releasing surplus to the employer in this way may not be in their best interests.

³⁹ Unless enhancements to DB members benefits are also agreed alongside, as was the case with Aberdeen.

Case study: Aberdeen Group plc (Aberdeen)

In early 2025, Aberdeen reached a significant agreement concerning its legacy DB scheme, the Standard Life Staff Pension Scheme (SLSPS). Under it, the trustees and the company agreed to unlock part of the DB scheme's substantial surplus to fund defined contribution benefits for current employees. More specifically:

- The SLSPS, closed to new accruals nearly two decades ago, had accumulated a surplus of approximately £800 million. Under the new arrangement, £35 million annually will be released from the DB scheme to support DC contributions for active employees.
- DB members will receive enhancements to their pension entitlements, including guaranteed inflation increases that were previously discretionary. Guardrails were put in place to ensure the continued financial strength of the DB scheme.
- Aberdeen went to the Court of Session to confirm the legal position and that after entering into a buy-in agreement and enhancing member benefits, it could return any remaining surplus to the employer.



The potential for difficulties to arise in trying to provide surplus value to members remains an unresolved issue. Many respondents to the original consultation on the Bill advocated for a change to the tax rules to address this. They wanted to see trustees be given the option to offer members a simple, one-off benefit, such as a cash payment. Currently, such payments are not classified as 'authorised payments' and cannot be made without fines and the real risk of being deregistered for tax approval. There were also calls to allow tax exemptions or reductions where surplus is transferred to a defined contribution (DC) arrangement — particularly in cases where the DC scheme is separate from the defined benefit (DB) trust.

Neither aspect was captured in the Bill, however. While there remains scope for such regulation to be introduced during its implementation, trustees may instead need to consider the more complex existing options – such as benefit augmentation or enhancements. In any case, trustees would need to carefully assess whether to increase benefits, and if so, which benefits to target, alongside a range of other considerations. This would include how to allocate benefit improvements between different categories of member, another potentially thorny aspect.

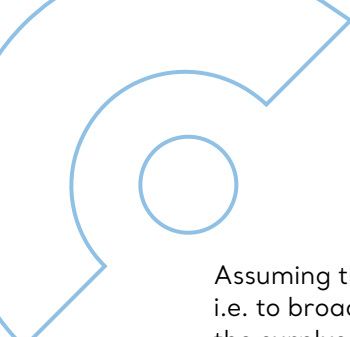
Dividing the spoils: who gets what?

Assuming then, trustees agreed in principle to a distribution of surplus, what split of value between the employer and members could be expected?

The following commentary is intended as a general overview of some of the issues that may arise here. This is a complex area which is highly dependent on the specifics of each scheme. Parties would need to seek independent legal advice tailored to their circumstances before taking any action or making decisions in this area. We are not lawyers, and what follows is not legal advice.

There will, undoubtedly, be competing views on and uses for surplus, which need to be navigated, all whilst the trustees act within the powers set out in a scheme's trust deed and rules.

If the scheme rules do not permit a refund of surplus on an ongoing basis, or there are constraints in their existing powers, trustees must first consider whether they should exercise the statutory power introduced in the Bill to amend scheme rules in this respect.



Assuming that becomes part of the discussion i.e. to broaden the question to consider how the surplus might be utilised if trustees were to exercise this power,⁴⁰ we can explore a hypothetical scenario to help inform that thinking.

Case law plays a key role, as do the specific provisions and powers of each scheme, which can vary in different ways such as:

- Whether there is a power to return surplus to the employer and on an ongoing basis or in wind-up.
- Whether the power is held unilaterally or jointly by the trustees or employer, and/or if other parties such as the members have a role.
- Whether or not there are conditions on surplus use, such as requiring benefits to be augmented to a certain extent before any monies are refunded to the employer.
- Whether there are discretions on the use of surplus.
- How the surplus rule is written and interacts with other provisions in the rules and wider legislative requirements.

Generally, the logical starting point would be the duty on trustees to use their powers only for the purposes they were given. A large part of the proper purpose of a scheme will be the payment of benefits that are due under it. Consequently, where surplus funds exist, other considerations are likely to arise, since the benefits members expected to receive are covered.

The source of surplus is expected to be an important one, having arisen in several legal claims:

- In *Thrells v Peter Lomas*, the judge used actuarial evidence estimating how much of the surplus was a result of unnecessary employer contributions, investment outperformance, and so on. The sources of surplus may generate reasonable expectations on the part of different stakeholders for how it should be shared between employer(s) and members.
- In *Edge v Pensions Ombudsman*, the Court of Appeal considered how surplus should

reasonably be distributed where there was a discretionary power on its use. The trustees had reduced the surplus by cutting the employer and employee contribution rates and increasing benefits for actives. Pensioners received no additional benefits and complained to the Pensions Ombudsman, which led to the Court of Appeal.

The judgement held that trustees should take account of all relevant considerations only, ignoring any irrelevant considerations. If trustees followed this their decision could only be challenged if it were “perverse”. This is a high bar as it implies a decision no reasonable body of trustees could have reached. It also established trustees are protected from potential criticism of seeming to prefer one beneficiary group over another.

- In *Entrust Pension v Prospect Hospice*, the Court of Appeal summarised trustees’ duties when considering whether and how to distribute surplus as:
 - To act in good faith.
 - To give genuine and responsible consideration to the exercise of a power.
 - To exercise their power for the purpose for which it has been given.
 - To give proper consideration to the relevant matters, by making appropriate enquiries to inform themselves, and exclude from their consideration those which were irrelevant.

Members may, nonetheless, have a reasonable expectation to receive value from any surplus. For example, what has been said to them about discretionary benefits, and if members have been told they would be awarded if the scheme was in surplus, could create an expectancy. Whilst members may not be able to insist on it, unless the scheme rules required it, members have a right to have the matter properly considered. There is no general rule however, that members of a contributory scheme have an interest in the surplus.⁴¹

Similarly, trustees may look at members’ needs. With the high levels of inflation that have been experienced in recent years, for members whose pension increases are linked to inflation but subject to caps or do not benefit from any increases, trustees may want to consider this.

⁴⁰ Note that trustees cannot pre-commit to using a power in a certain way and can only assess a given situation at the relevant point in time.

⁴¹ See <https://www.pinsentmasons.com/out-law/analysis/pension-buy-outs-deciding-how-to-use-surplus-on-winding-up>

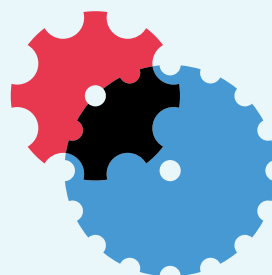
Case study: Pre 1997 DB benefits

There is no legal requirement for private sector DB schemes to provide inflationary increases on benefits accrued before April 1997. Increases depend on scheme rules and can be at the discretion of the employer even where potentially applicable. Some schemes provide increases, but some do not. Providing such increases was one of the uses of surpluses during the 1990s.

Many pensioners have in consequence seen the real value of their pre-1997 pensions eroded, some losing 30-50% or more over time because of persistent inflation.

Campaign groups such as the Pre 1997 Alliance have been lobbying the government for change, with proposed amendments to the Bill to mandate their indexation (these changes were not successful).

For some, increases remain discretionary, and most affected pensioners still receive no inflation protection on these benefits. Members remain hopeful the changes to surplus release will result in their being granted the indexation they want.



Considering again the split of surplus monies that was made during the statutory surplus regime, it showed that members received approximately one third of the value of surplus monies, with employers receiving two-thirds of the value. That happened to align very closely with the long-term split of contributions between employees and employers at the time, as evidenced by Pensions UK. It was a broadly equitable outcome therefore, when considered in the context of overall contribution patterns. However, whereas in the 1980s and 1990s many schemes were by then well-established, Deficit Reduction Contributions (DRCs) had not yet become the prominent feature of the funding landscape that they would later become.

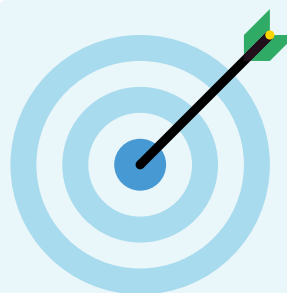
Today, looking back at where surpluses arose from, the picture is very different. Since the advent of the new funding regime in 2005, employers have collectively paid well over £200 billion of DRCs to their DB schemes. These payments reflect the employer backstop of meeting the balance of cost of DB schemes, absorbing funding volatility through time. Against that backdrop, it is reasonable to ask whether the historic surplus split we observe remains appropriate. Might today's surplus release tilt more toward the employer, given the scale of their retrospective funding burden?

Case study: WHSmith's wind-up windfall – a case of employer payback?

In 2022, WHSmith received a £85 million refund of surplus following the buyout and wind-up of their defined benefit pension scheme, the full remaining surplus after securing member benefits. This came after the company had paid in nearly £300 million in deficit reduction contributions over the period since 2005, including a whopping £130 million in that year alone.

While the outcome is clear (WHSmith received all the surplus), the process behind it is less so. We don't know how the trustees reached their decision to allot the entire surplus to the employer, nor what considerations were weighed in that process.

What we do know is that due process was followed by the trustee, and that the employer had borne the significant funding burden over many years, making substantial contributions that dwarfed the eventual surplus refund.



The employer is, importantly, a relevant party too. It is reasonable and proper for the trustees to take account of their interests if they consider it appropriate to do so. This could include whether the employer has overfunded the scheme, and by how much, and how the scheme has affected the employer's financial position generally.

If the employer has the power to deal with a surplus, it's a fiduciary power to be exercised as if it were a trustee. Employers can consider their own interests, and it is not a breach for it to prefer its own financial interests, though it must act rationally.

Thus, whilst the historic data on addressing excessive statutory surpluses showed us that members typically saw a third of the value of surpluses released, the position and considerations for current surpluses are likely to be markedly different and in turn, the split of any value.

From an employer perspective, if they have provided significant support to their DB scheme over time, including but not necessarily limited to paying substantial and/or sustained deficit reduction contributions (DRCs), we anticipate

it may be worthwhile to make representations to the trustees in this respect. Doing so would ensure the trustees are aware of the employer's role in the funding of the scheme, ensuring their position is considered, whilst highlighting the origins of the surplus. This is particularly relevant where trustees are considering how any surplus might be distributed while the scheme remains ongoing, and it may be appropriate for the employer to initiate a dialogue at this stage to ensure their perspective is considered as part of the decision-making process. This could be made alongside wider discussion to consider or formulate a scheme's strategy on surplus extraction, a matter the Pensions Regulator has said would be good governance to establish.

Ongoing versus winding-up

The Bill proposals concern release of surplus on an ongoing basis, an approach not generally adopted by schemes to date, other than when compelled to under the pre-2006 statutory surplus regime. Outside of that and the proposed changes, where schemes have released surplus, generally, this has been at the end of their existences, on wind-up.⁴²

⁴² Wind-up is the formal process of closing a pension scheme and bringing the trust to an end.

Case study: Bristol Water and the Pensions Ombudsman (2023)

This recent case, where the Bristol Water Section of the Water Companies Pension Scheme returned a surplus of approximately £12 million to the sponsoring employer on the scheme's wind-up, highlights the different perspectives of stakeholders i.e. trustees, members, the employer. Specifically:

- The scheme rules allowed the trustees, in consultation with the employer, to augment member benefits if it was "just and equitable" to do so, and any remaining assets could be returned to the employer.
- The trustees considered factors such as securing full member benefits, past benefit augmentations, and the employer's significant contributions to de-risking the scheme. They concluded that returning all the surplus to the employer was consistent with the scheme's purpose and not unreasonable.
- A member subsequently complained to the Pensions Ombudsman (PO), arguing it was "morally indefensible" to refund the entire surplus to the employer, that it had failed in its duties to members, and that it wasn't in the members' best interests.
- The PO rejected the complaint on the grounds that the trustees had followed the correct process, emphasising that although the trustees had a discretion to augment benefits in consultation with the employer, it wasn't compelled to do so.
- The PO's determination noted that all of the downside risk had lain with Bristol Water whilst the scheme was ongoing and they had paid significant additional contributions over time to mitigate those risks.



As in an ongoing scheme, the position of how to address surplus on winding-up should begin with consideration of the rules of the scheme and what they require. There are a wide range of potential outcomes, reflecting the variety of schemes and circumstances, and the broad range of acceptable outcomes with that.

In a wind-up, however, the position is quite different to that of an ongoing scheme: members' benefits, enhanced or otherwise, have been secured in full, and any (remaining) surplus can and should be dealt with. It is not subject to the risk of future reassessment, or past reflection on a subsequently regretted decision – such as trustees agreeing to augment members' benefits or refund surplus to the employer, only for markets to fall sharply thereafter and the sponsoring employer to enter insolvency, leaving the scheme unable to secure full benefits at buyout, and members facing reductions.

Given that, schemes will generally be expected to retain a surplus buffer even where they look to use the new powers to be granted under the Bill, and will likely also continue to use buyout rather than low-dependency as the relevant measure for paying out surplus on an ongoing basis. It is questionable therefore, whether much will change in practice.

That said, at least currently, only a very small percentage of schemes are currently in wind-up. The Purple Book 2024 sets out there are some 155 schemes currently in the process of winding up, with aggregate assets of only £11 billion.⁴³ This represents just 3% of all schemes and less than 1% of the assets of the DB universe – compared to the over £500 billion held across almost 2,000 schemes that have a buyout funding level of 105% or more, who collective hold surpluses of almost £100 billion.

⁴³ See <https://www.ppf.co.uk/-/media/PPF-Website/Public/Purple-Book-Data-2024/PPF-The-Purple-Book-2024.pdf>



Of course, some of the schemes with buyout-level surpluses will already be in the process of completing a buyout and winding up, following an earlier buy-in. In those cases, surplus extraction will typically occur as part of the wind-up process.

Outside of wind-ups, it is probable that employers will, over time, seek to use the new surplus framework to try and drive through ongoing use and release of surpluses, noting that:

- The Impact Assessment for the Bill set out it that based on industry engagement and consultation, most DB schemes do not permit extraction of surplus prior to wind-up of the scheme, with respondents estimating between 15% to 25% allowed this. This would imply significant potential for surplus to become 'trapped'.
- Whilst the buy-in/out volume each year

is significant and increasing, the assets in DB schemes in buyout surplus comfortably exceeds the volume transacted to date.

A sizeable part of the DB schemes with a buyout surplus are therefore expected to be in schemes that have yet to transact in the insurance market.

- It is likely that a sizeable part of the DB universe's £100 billion of buyout surpluses is therefore trapped, rather than simply sat in schemes working through wind-up.
 - Substantial sums are currently sat in schemes with very high funding levels – more than £50 billion in schemes at least 125% funded on buyout. At these levels, and with the relatively low-risk investment strategies expected to be in place, running on to generate further surplus is unlikely to be economically advantageous to the employer from a cost of capital perspective.



While employers cannot unilaterally determine the course of action taken by their scheme, making representations in relation to the new powers granted under the Bill would be a logical step for many.



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7. Unlocking value: Surplus valuation and deal dynamics

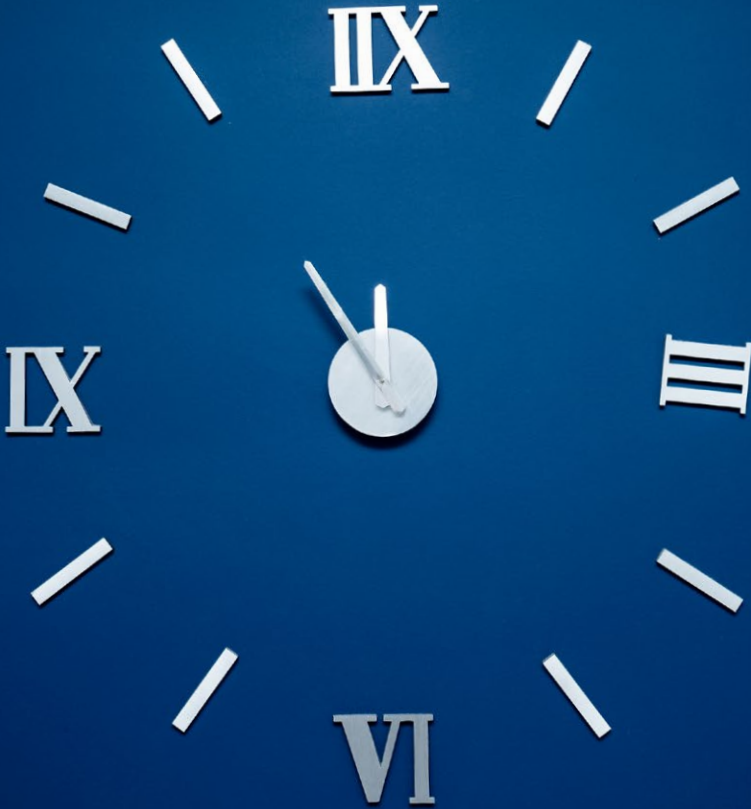


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VI



As surplus release moves from theoretical possibility to practical reality, attention naturally turns to how surplus should be valued – not just in actuarial terms, but in strategic and transactional contexts.

For corporate sponsors, trustees, and M&A practitioners alike, the re-emergence of surpluses in UK defined benefit pension schemes presents both opportunities and complexities.

This chapter explores how surplus should be assessed using a risk-adjusted framework, and how its presence can influence corporate transactions, particularly in deal pricing and enterprise value negotiations.

Surplus valuation framework: a risk-adjusted approach

While a pension scheme's financial position can be modelled on multiple bases to estimate headline surplus, these figures often fail to capture key constraints:

- **Access likelihood** – Even where a surplus is recorded, extracting it is legally constrained. Trustee involvement remains a critical factor, having regard to the rules of the scheme. They may request or require member benefit enhancements as a condition of surplus access and seek governance protections to ensure the scheme's position is protected.

In M&A scenarios, negotiation with trustees adds uncertainty to timelines and outcomes. Regulatory reform scenarios, such as the

government potentially easing surplus access also need to be factored in.

- **Tax impacts** – Depending on how any surplus value is to be utilised, tax is a further constraint, with a 25% tax charge currently payable on any refunds to the employer. Depending on the recognition of any surplus, deferred tax liabilities may also be relevant.
- **Timing discount** – Allowance must be made for the time before any surplus might be extractable, allowing for an appropriate cost of capital to discount any payments.
- **Pricing volatility** – Surpluses can appear or disappear with changing market conditions, introducing volatility to the value of any surplus assessed today.
- **Alternative uses** – The value of the surplus will depend on the use to which it is put. For example, offsetting future contributions would be of benefit to the sponsor, whereas enhancing members' benefits wouldn't be.

A robust valuation approach must capture these aspects, applying a likelihood-weighted or scenario-based methodology. Parties must assess not just the gross surplus, but its net realisable value, discounted for timing and access risks.

Impact for corporate transactions

The reappearance of surpluses in UK defined benefit pension schemes presents both opportunities and complexities for corporate finance and M&A practitioners. Where once DB pensions were viewed primarily as risk-laden liabilities, many schemes now present potential sources of value – albeit value that is often contingent, conditional, and politically sensitive.

This shift has several strategic implications for how schemes are valued, and financial decisions are made.

Impact on enterprise value and deal pricing

Surpluses can materially affect a company's enterprise value (EV) depending on the size of the scheme, but unlike cash, they are rarely treated as fully accessible assets. Buyers and sellers must agree on how to reflect any surplus:

- **Sellers** may argue that surpluses are a source of value, justifying a higher price.
- **Buyers** are more likely to apply a discount to the surplus, reflecting legal uncertainty, tax drag, and trustee negotiations.

In practice, many acquirers heavily discount surpluses or exclude them entirely from enterprise value. Others may structure deals to ring-fence the pension scheme, isolating surplus-related risks and opportunities.

Surpluses may now feature in strategic conversations, but their value is far from straightforward. Legal, tax, and governance constraints mean they must be assessed with care, especially in transactional settings. A risk-adjusted lens helps ensure surplus is treated not as guaranteed value, but as a contingent asset.

Strategic takeaways

As surpluses become more prevalent in the UK pensions landscape, they are no longer just a footnote but a strategic issue. However, realising that value is far from straightforward.

Handled correctly, a surplus can reduce deal risk, enhance value, and support long-term financial resilience. Mishandled, it can delay transactions, alienate trustees, or trigger unexpected costs.

The winners in this environment will be those who bring technical precision, stakeholder empathy, and creative deal structuring to the table.

Acquirers should integrate pension surplus assessment into transaction timelines, from due diligence and valuation through to post-deal integration and capital planning, noting:

- **Surpluses are real, but not always accessible.** While many DB schemes now show material funding surpluses, the ability for sponsoring employers to access them remains constrained by a combination of scheme rules, trustee discretion, and regulatory safeguards. Legal and tax considerations mean that the net economic value of a surplus may be very different to its accounting value.
- **Rather than being priced directly into transactions, surpluses often serve as a point of negotiation** – whether to justify a higher valuation, reduce consideration, or offset future contributions. Deals that anticipate trustee engagement and access constraints tend to be more efficient and realistic.
- **Trustee cooperation is critical.** Even where the legal right to extract a surplus exists, no surplus value can be unlocked without trustee agreement.
- **Valuation must be scenario-based and risk-adjusted.** A single accounting figure is rarely sufficient. Corporate finance teams should incorporate multi-basis actuarial modelling, tax scenarios, and time-to-access assumptions to derive a risk-adjusted value. Surplus value should be treated as contingent and subject to discounting like any other uncertain asset.

As pension deficits fade and surpluses grow in prominence, the challenge is no longer just about de-risking liabilities – it's about capturing and deploying pension value intelligently and responsibly. For corporates engaged in M&A, this requires financial creativity, legal precision, and strategic dialogue with trustees. If done right, DB surpluses can become not a liability, but a lever for competitive advantage.



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8. Conclusions



The return of DB pension scheme surpluses marks a significant shift in the UK pensions landscape. Once a feature of the past, surpluses are now re-emerging as a strategic consideration for corporates, trustees, and policymakers alike. Yet, as history shows, their presence does not automatically translate into accessible value.

A nuanced legacy

Between 1987 and 2006, the statutory surplus regime compelled schemes to reduce excessive surpluses to retain full tax approval. While this led to the utilisation of approximately £30 billion in surplus (equivalent to £67 billion today), only 4% of that value was refunded to employers. The vast majority remained within schemes, used to enhance member benefits or reduce contributions. This was not a period of widespread employer enrichment; rather, it was one of constrained surplus management under regulatory pressure.

Even when refunds did occur, they were modest relative to the DB universe. By April 2006, total gross refunds stood at just £4 billion, compared to DB assets of £771 billion – a mere 0.5%. More broadly, the total surplus value used for the benefit of both employers and members represented around 5% of DB assets. These figures suggest that surplus usage, while material in isolated cases, did not significantly undermine scheme funding overall.

Funding, not just regulation, shaped the story

The statutory surplus regime ended in 2006, but the real shift came from the funding landscape itself. As deficits deepened in the early 2000s, employers collectively paid over £200 billion in deficit reduction contributions to restore scheme health. This dwarfs the value of surplus refunds and underscores the broader narrative: the post-2006 era was defined more by employer support than surplus extraction. Just £800 million has been paid out in gross refunds to employers since 2006 (July 2025 value).

The present: cautious optimism

Today, half of DB schemes are overfunded on a buyout basis, collectively holding surpluses of around £100 billion. Yet accessing this value remains difficult. Since 2006, only £800 million has been refunded to employers – again, a fraction of the total surplus held. Most refunds have occurred in wind-up scenarios, where member benefits are fully secured and surplus can be returned without future risk.

Trustees remain rightly cautious. The volatility of funding, the complexity of surplus extraction, and the fiduciary duty to protect members all contribute to a conservative stance. The history of DB funding – from surplus to deficit and back again – reinforces this caution.

However, the context today is markedly different from the pre-2000 era. Many schemes have significantly de-risked their investment strategies, reducing exposure to market shocks. Schemes are also more mature, with a higher proportion of pensioner liabilities, making funding levels less sensitive to changing conditions. The regulatory regime has tightened, with clearer guidance and oversight, and trustee boards are generally more professional and better supported. These factors combine to create a more stable and resilient funding environment, even if caution remains a prudent default.

The future: reform and realism

The Pension Schemes Bill 2025 proposes a new framework for surplus release, lowering the funding threshold from buyout to low dependency and granting trustees new powers to amend scheme rules. While this could unlock significant value, it also introduces new risks. As illustrated in the report, extracting surplus on a low dependency basis can materially worsen a scheme's buyout position – a risk trustees are unlikely to accept without strong mitigations.

Even under the new regime, trustees are expected to retain buffers above buyout and seek equitable outcomes for members. The historic split – two-thirds to employers, one-third to members – may serve as a reference point, but today's context is very different. Employers have borne the brunt of funding volatility for two decades, and their role in creating surplus is much more pronounced.

Strategic implications

For corporates, surpluses offer potential value. While employers cannot unilaterally determine the course of action taken by their scheme, making representations in relation to the new powers granted under the Bill, and their role in meeting the balance of cost in the development of the scheme's current funding position, would be a logical step for many.

Final thought

Surpluses are not windfalls. Unlocking their value requires careful navigation of legal frameworks, trustee discretion, and member interests. Done well, surplus release can support strategic goals and financial resilience. Done poorly, it risks undermining trust and scheme sustainability.

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