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Beyond 100%: How trustees can approach releasing a pension surplus

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

From April 2027, new rules are set to make it easier for pension scheme trustees to extract surplus funds. With the right decision-making framework, they can approach this with confidence.

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After many years of deficits, the UK's **defined benefit (DB)** pension schemes have seen a marked turnaround in their funding levels. Although each scheme's circumstances are different, around three-quarters are now in surplus on a low dependency basis, thanks mainly to the increase in gilt yields since 2022 and – for those still holding material growth allocations – strong risk asset performance.

This transformation will leave trustees better placed to meet their key objective: delivering the retirement benefits their members have been promised. But it also raises another possibility: releasing part of their scheme's surplus under the framework that the government put out to consultation in June.

The proposed rules for releasing surplus DB assets represent a recognition by ministers and regulators that trustees should have greater discretion over how to manage schemes that are in surplus. Up to now, once a scheme is fully funded on a buyout basis, trustees have tended to lock in their members' benefits through an insurance buyout. But that certainty comes at a material cost: buyout typically requires funding above the level needed to run the scheme on, and future investment upside passes to the insurer rather than to members or the sponsor.

Under the regime the government has proposed, the focus is on low dependency, which enables trustees to consider releasing part of their scheme's surplus earlier, perhaps to enhance members' benefits, support an associated DC scheme or to return value to the scheme sponsor.

For many trustees, this may not seem an obvious choice. Having shepherded their scheme to full funding, they will naturally be wary of compromising that progress by releasing part of any surplus. However, provided they set a prudent, probability-based framework to guide their decision-making, there need not be a conflict between meeting their obligations to members and releasing part of their scheme's excess funds.

Any decision will depend on a scheme's specific circumstances: current and forecast funding levels, availability of sponsor support or guarantees, the purpose of any surplus release and how much investment risk trustees are comfortable taking to build a surplus sustainably. The key is to establish a system of triggers that define when a release can be considered, when it can go ahead – and when it should be paused if conditions deteriorate. These triggers must be set at prudent levels and must align with the scheme's pre-defined risk appetite.

BlackRock has modelled scenarios involving three illustrative schemes with different funding levels, surplus objectives and scale of sponsor support. The modelling used a framework of trigger points that reflect the probability of being fully funded over a 10-year period. This exercise showed that with a prudent framework, surplus can be released with only a minimal increase in the risk of underfunding, provided the starting point is sufficiently strong and appropriate safeguards are in place.

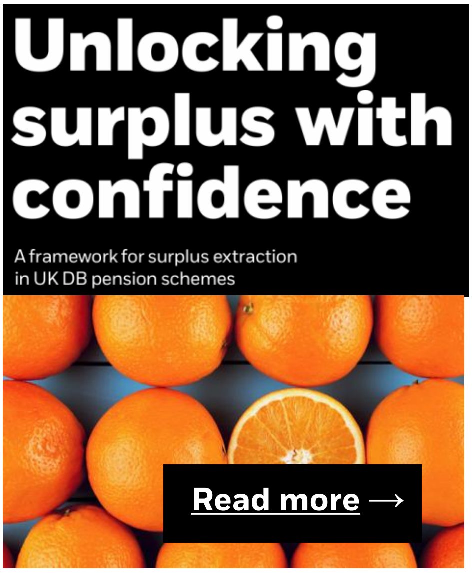
The regulations the government has proposed are relevant for schemes in a wide range of funding situations – both those already in surplus and choosing to run-on, and those maintaining the optionality to buyout. The consultation closes in September and the new rules are expected to come into force in April 2027. Trustees can use this time to work with their sponsors and advisors to put in place framework that reflects their scheme's situation and consider whether their investment strategy supports their desired outcome.

Of course, funding positions are dynamic and respond to shifts in financial markets, so setting a prudent trigger framework will not be sufficient on its own. Trustees also need a means to stress test the assumptions that underlie their trigger framework as conditions change, and to model the impact of those changes on the scheme's long-term projections. But with the right tools and support, trustees can approach the new surplus rules with confidence.

With more schemes moving into surplus each year, the choices available to trustees are set to increase. This broadens the range of options available for Trustees, their members and their sponsors.

Want to know more?

To explore these themes in more detail, read our latest paper, ***Unlocking Surplus with Confidence:*** *A framework for surplus extraction in UK DB pension schemes.*



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