Unlocking DB surplus to create value

Themes from roundtable dinner for senior executives of corporates sponsoring medium to large UK DB schemes

In June 2025, Isio hosted a private dinner with a group of senior executives from employers sponsoring £50 billion of UK defined benefit (DB) schemes. Given the Government's plans to change the legislative and regulatory regime to support more ongoing DB surplus release from late 2027 onwards, we explored whether employers of larger schemes expect to shift their long-term strategies and how they feel about sharing some surplus with members as part of an overall package deal.

Key themes

The main themes of the discussion are summarised below:

1 The impact on business valuations is not yet clear

There are examples of positive news about previously underfunded DB schemes having increased business valuations, particularly where schemes are large relative to the sponsor. However, the approach to surplus on business valuations is not yet clear.

Many corporate boards have stopped seeing DB pensions as a top 5 concern and some are starting to ask the question about surplus upside. Analyst views are powerful and their approaches to DB pensions vary. It could be that demonstrating a track record of safely and gradually releasing surplus will give analysts confidence to allow for expected surplus release in forecasts. It will also be interesting to see whether well-funded DB schemes will start to be seen as a source of value in M&A.

2 Deciding between run on and near-term buy-in is finely balanced and scheme specific

Many schemes are already in a significant surplus on a buy-out basis. Surplus that could be released following a near term buy-in can be viewed as equity and the merits of run on may be assessed by considering the anticipated return on that equity. This analysis can be nuanced e.g. there is range around the expected surplus progression, trustees may require a higher member share of surplus to agree to ongoing surplus release and re-returning the investment strategy may be required to give sufficient expected IRR. Institutional investors may feel more comfortable in running on.

Different considerations apply for schemes that are less well funded where sponsors wish to decide between insuring at the earliest opportunity and running on for the medium term. Stakeholder views can also vary widely between and within organisations. What is common for all medium sized and large schemes is that determining the preferred approach is a crucial decision that requires careful stakeholder management and that should be supported by quantitative and qualitative analysis.

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3 Trustee approaches to surplus vary widely

When deficits were common, trustee objectives to agree cash contributions and security were clear. When surpluses first emerged ceasing DRCs and meeting running costs from assets may have felt like relatively easy decisions for many trustees. Trustees have more difficult decisions to make now that most schemes have been in a sustained surplus and sponsors are seeking to engage on surplus management plans that include ongoing or one-off refunds.

The new surplus release regime is now clearer and tPR guidance suggests that schemes being materially overfunded for a long period of time with no plan to distribute excess funding may indicate poor governance controls. Against this backdrop, a mindset shift is required that some trustees seem to be wrestling with. Even allowing for differences in rules and how surpluses arose, there is a surprisingly wide range of trustee stances on the extent to which it is appropriate to use trustee powers to improve member benefits or to seek sponsor agreement to improve benefits as part of a package deal. A lack of precedent is likely to be contributing to this wide range of views, which may narrow as more market practice develops.

4 Sponsors and trustees should properly understand risks remaining after insurance

Buy-in removes most financial risk and the insurance regime is widely accepted to offer more security than a typical sponsor covenant for the benefits secured under the policy. However, sponsors should be careful to understand remaining risks such as inaccuracies in data and benefits secured under buy-in policies and the extent to which these can be mitigated. Where a scheme has minimal assets other than a buy-in policy any uninsured additional cost will fall on sponsors. DWP's plans to allow retrospective actuarial confirmation that benefit changes were compliant with contracting-out requirements is welcome, but there are many other ways in which benefits secured could be incorrect.

There may be a misconception that a process of buy-in and moving to buy-out and wind-up fully extinguishes all sponsor risks and is the best outcome for members in all circumstances. The shorthand that the pensions industry has developed of buy-out being the "gold standard" has perhaps been unhelpful in creating this misconception.

From a member or trustee perspective, full buy-out removes the trustee control over benefit options for those yet to retire (including both the terms and the support provided in considering them). Full buy-out forgoes the opportunity for future discretionary increases or benefits particularly in times of higher cost of living increases.

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