Defined Benefit Schemes - The Government's response to the consultation "Options for Defined Benefit (DB) Schemes"

Background to the consultation

Many DB pension schemes are currently enjoying high levels of funding, with approximately three in four schemes in surplus. The Government acknowledged that, while the DB landscape is currently very well-funded, funding can be volatile and could change in the future. The new funding arrangements and revised DB Funding Code, which came into force in November 2024, underpin this.

Many schemes have been looking to manage the risk of future volatility and secure improvements in funding levels. Additionally, there's been an increase in buy-ins with insurance providers; reducing the risks schemes are facing.

In this context, there's potential for trustees to share scheme surplus with sponsoring employers and scheme members. There are, however, currently legislative barriers in place that can make this difficult.

Aim of the consultation

The aim of the consultation was therefore to introduce reforms that jointly benefit sponsoring employers, scheme members and the wider economy and introduce measures to:

- make the sharing of DB scheme surpluses with employers and scheme members easier, whilst maintaining member security, and
- establish a Public Sector Consolidator managed by the Pension Protection Fund (PPF) for schemes that are unattractive to commercial consolidators.

The Government has now published its response to the consultation.

What are the key highlights of the Government's response?

Facilitating the release of pension scheme surpluses

The Government recognises that one of the main barriers to releasing surplus is that many scheme rules prohibit trustees from extracting surplus and returning it to the sponsoring employer. The Government will introduce a statutory resolution power for trustees to modify their scheme rules. This will allow schemes to choose to release surplus funds, subject to scheme funding levels.

Funding thresholds

The Government is considering changing the threshold at which trustees are able to share surplus with the sponsoring employer. Changing it from the current 'buy-out' threshold, to a threshold set at full funding on the 'low dependency' funding basis.

Releasing surplus will remain subject to trustee discretion and actuarial certification.

Further details regarding funding thresholds will be set out in draft regulations that will be subject to further consultation.

Section 251 of The Pensions Act 2004 repealed

The Government will repeal the requirement for DB scheme trustees to have passed a resolution before April 2011 to have the power to make a surplus payment from the scheme to the sponsoring employer (and to have issued a notice to members before April 2016).

Surplus repayment taxation

The Government reduced the rate of taxation applicable to surplus repayments to sponsoring employers from 35% to 25% from 6 April 2024. Its aim was to incentivise the release of surplus funds. The Government will continue to keep the taxation of surpluses under review, but considers this level remains 'balanced and fair'.

Safeguards for members

The Government will amend Section 37 of the Pensions Act 1995 to clarify that trustees must act in accordance with their overarching duties to scheme beneficiaries and must be satisfied that surplus extraction is 'in the interests' of the members.

Working with the Pensions Regulator (TPR)

The Government will work with TPR to develop guidance in respect of DB surplus extraction to ensure trustees feel comfortable with releasing surplus.

100% PPF underpin

One of the proposals in the consultation was to allow trustees of DB schemes to opt to pay a higher 'super levy' to the PPF. In return, they would receive 100% coverage of scheme liabilities in the event a scheme were to enter the PPF. The Government did not think the proposal was appropriate due to the high cost and moral hazard concerns. It also did not believed it to be necessary to encourage the release of surplus. As such, this proposal has been rejected.

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Public sector consolidator

Despite significant funding improvements across the DB landscape, the Government has also acknowledged there remains hundreds of schemes which remain significantly underfunded (75% or less of buyout). They have also stated that there is evidence that some smaller, well-funded schemes have faced challenges in buying out benefits with the commercial market. Although commercial buyout providers will offer a solution for many DB schemes, this may not work for every scheme. However, this is not our experience, as we not only have a 100% completion rate with over 10 buy-in transactions a year for smaller schemes but we typically save our clients at least 10% of the bulk annuity premium.

The Government are, however, continuing to explore what role a government consolidator, administered by the Pension Protection Fund, could play.

Next steps

Issued on 5 June 2025, the Pension Schemes Bill will take forward the DB Surplus flexibility reforms.

The Government will undertake further work to better understand the costs and benefits of a government consolidator. This work will take into account the views and perspectives received from the consultation and gather further evidence and insights to understand the implications on DB schemes, employers, and the insurance market.

If you’d like to discuss any of these issues further, please get it touch with your usual contact at Cartwright.

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