

## Using DB surplus to fund DC

Rising bond yields have pushed many DB schemes into surplus positions. At a similar time, the tax rate applied to any surplus returned to an employer was reduced from 35% to 25% from 6 April 2024, and at present the Department for Work and Pensions (DWP) is consulting on pension scheme surpluses. Employers with DB surpluses should be proactively considering their options. One such option is the use of DB surplus to fund DC.

### Introduction

Following the unprecedented rise in the yields on government bonds over the past two years, a substantial proportion of UK defined benefit (DB) pension schemes now find themselves with a funding surplus.

Having paid deficit contributions for a number of years, many corporates are now be considering how they may be able to access any such funding surplus, and further options to utilise this. One such option is to use DB surplus to fund defined contribution (DC) contributions.

### Why might employers consider using DB surplus to fund DC?

The talk of employers accessing DB surplus will raise questions and considerations amongst differing stakeholders. Whilst an employer may want to access this 'trapped' money, Trustees will have their duty to protect the benefits of members. Often the rules will determine who 'owns' the surplus and how it can be used, and this will also have to be considered.

However, should discussions around using surplus focus on utilising this to fund pensions rather than purely to be refunded to the employer, this can often be perceived as more paternalistic and better received by Trustees and members.

Further, the differences in pension wealth between DB and DC members are stark. To address this intergenerational fairness some employers have considered whether the DB surplus can be used to 'top up' DC contributions and improve outcomes.

### How might an employer do this in practice?

The concept of using a DB surplus to fund DC is not new. Indeed, many schemes with a hybrid DB and DC scheme may already have a DC section that was established on the basis that a DB surplus can be used to cover future DC contributions.

However, more recently with the regulatory push for Own Trust DC schemes to consolidate into Master Trust schemes, this has introduced some added complexity for employers and trustees to consider. We outline some of the ways an employer might be able to use their DB surplus to fund DC within this shifting dynamic:

#### 1 Maintain DB and DC under the same trust

This previously has been the most simple way to enable the transfer of DB surplus to DC. Fewer employers nowadays have such hybrid solutions. But should you have one, this could be a mechanistically simple way to use DB surplus to fund DC, so long as the transfer is permitted within the Scheme rules.

## 2 Keep DC Own trust open for actives and utilise a Master Trust for deferreds

Master Trusts are increasingly being seen as a vehicle that can add value for members - often through the economies of scale that they can achieve and increased member support and access to to-and-through retirement solutions.

If you currently have an own trust arrangement for active and deferred population, you could still maintain this arrangement for actives, whilst setting up a Master Trust arrangement for deferred.

The surplus would be used to fund the contributions for actives, whilst deferreds could be regularly moved to the Master Trust to be able to access the additional value that the provider may be able to offer.

## 3 Re-open an Own Trust Arrangement

Should you not have a DC own trust that is under the same trust arrangement as your DB trust, you could reopen a DC trust for your members (either both active and deferreds or just active).

The own trust arrangement would be opened and surplus could be used to fund the future accrual of active members. You may also be able to request a bulk transfer of past assets to the new arrangement too so that your members are able to keep their accrued and future pots together.

## 4 Move members to a Master Trust and share your surplus with a Master Trust provider

Some Master Trusts have been developing innovative solutions whereby you could still move the surplus to the Master Trust provider (as a 'recognised transfer') and the provider would then use the surplus to pay contributions in a pre agreed way. This would enable you to access both the value that a provider can offer for your members as well as use your surplus within this environment. As with any new solution, taking your own comprehensive advice will be very important.

### In Summary

The possibility of using DB surplus to fund DC may be more pertinent now than before. There are lots of options to consider, and these may vary depending on where you are with the current structure of your DB and DC arrangements. It's clearly important to take into account your own scheme's circumstances, including what's practically possible under the rules given the balance of powers between the employer and trustees. Whilst there are a number of legal complexities surrounding the use of a surplus, both within legislation and specific to scheme rules, previous barriers or hurdles may be less difficult to overcome now than before.

If you're considering how you may be able to use your DB surplus to fund DC, or would like further information or support, please contact one of our corporate team:



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