



July 2025

DB SURPLUS - HOW SHOULD TRUSTEES DECIDE WHAT TO DO? KEY CASE LAW PRINCIPLES

SHOULD TRUSTEES ALWAYS STRIKE A DEAL FOR MEMBERS? NOT NECESSARILY...

Often, it is the trustees who have a discretion under a scheme's rules to distribute a surplus to an employer. And this will certainly be the case for any trustees taking advantage of the new DB surplus provisions in the *Pension Schemes Bill*, which will (when enacted) allow trustees to amend their rules to grant themselves a discretion to distribute surplus to employers.

Much of the initial commentary on the draft Bill has suggested trustees should look to 'strike a deal' in return for a release of surplus to a scheme employer, for example, by augmenting scheme benefits. However, case law makes clear that it is not necessarily the trustees' duty to do that.

In this briefing we explore how trustees should go about making a decision on the return of surplus and some of the factors trustees will want to take into account when making that decision.

HOW SHOULD TRUSTEES APPROACH A DECISION ABOUT RETURNING SURPLUS TO AN EMPLOYER?

An important principle was established in the Court of Appeal case of *Edge v the Pensions Ombudsman* (a case on the distribution of surplus) that said, in exercising a discretionary power, trustees should exercise the power for the purpose for which it is given, taking account of all relevant considerations only, and ignoring any irrelevant considerations.

Provided trustees follow this approach, it cannot be challenged as long as the decision was not perverse (i.e. it is not a decision that no reasonable body of trustees could have reached). In the context of decisions relating to surplus, this also protects trustees from criticism where they reach a decision that seems to prefer one beneficiary group over another, whether that of the employer(s), current employees or deferred/pensioner members.

It is therefore vital, in the context of surplus decisions, to identify relevant considerations and not give weight to the irrelevant considerations. The trustees should also be taking legal, actuarial and investment advice to support them in their decision-making to reach a robust decision.



WHAT ARE THE RELEVANT CONSIDERATIONS?

There will of course be scheme-specific considerations including the balance of powers under the scheme's rules, whether the power is being exercised in an ongoing scheme or on wind-up and any specific conditions that apply under the relevant surplus rule, the scheme's benefits history and the covenant support available to the scheme.

There are though some core considerations which trustees will always want to take into account in a decision about surplus distribution, which include:

- + The proper purpose of the scheme,
- + The origin of the surplus,
- + Any legitimate expectation of members that a surplus would be used to augment benefits, and
- + The interests of the scheme employer(s).

And what about the duty to act "*in the best interests of the beneficiaries*"? This is in fact an abbreviation of the "proper purpose principle" as explained in the case of *Merchant Navy Ratings Pension Fund (MNRPF) v Stena Line*:

"the 'best interests of the beneficiaries' should not be viewed as a paramount stand-alone duty... it should not be treated as if it were separate from the proper purpose principle... It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests."

The proper purpose principle is therefore the starting point. Often the proper purpose will be the payment of pensions and others benefits due under the scheme, and the best interests of the beneficiaries should be considered in that context. Where the funds available exceed the value required to provide those benefits, then other considerations come into play.

First, the origin of the surplus, whether it arises from excess contributions, revised mortality expectations, investment performance or a combination of these or more factors. In *Edge*, the court looked at how trustees should balance a discretion to augment benefits and a return a surplus to an employer:

"The obligation to consider, properly, the question whether to increase benefits (and, if so, which benefits) will usually require the trustees to consider (amongst other matters) the circumstances in which the surplus has arisen. In deciding what is fair and equitable in all the circumstances, the trustees may be expected to give weight to the claims of those whose contributions are, or will be, the effective source of the surplus..."

Notably, this does not bind the trustees to a particular course of action. It is though a relevant consideration.

Members may also have a legitimate expectation of sharing in a surplus in which case that should also be considered by trustees. For example, where members have previously been told that discretionary increases would be awarded if the scheme was in surplus. However, in *Edge*, the court did emphasise that (unless the scheme's rules require it) **"beneficiaries could not insist upon an augmentation, but did have a right to have the matter properly considered"**.

Finally, in relation to the employers' interests, the MNRPF case makes clear that **"...as long as the primary purpose ...under the Rules is furthered and the employer covenant is sufficiently strong to fulfil that purpose, it is reasonable and proper should the Trustee consider it appropriate to do so, to take into account the Employers' interests."** In other words, both members and the employer(s) are beneficiaries of the scheme whose interests' (including their financial interests) can be considered by the trustees in a decision to distribute surplus.



WHAT ABOUT GOVERNMENT'S POLICY AND REGULATORY GUIDANCE?

The Government has a clear interest in surplus DB funds being released back to scheme employers, to support growth in the wider economy. Similarly, the Pensions Regulator's recent guidance on endgame planning will no doubt prompt a re-balancing of the discussions between trustees and employers around run on and buy-out, and distributions of surplus. This does not however displace the trustees' core duties when exercising discretionary powers; the guidance should be considered as part of the wider decision-making process outlined above.

There are also statutory requirements that must be complied with, particularly in relation to communicating the trustees' decision to members.

IMPLEMENTING AND RECORDING DECISIONS

Decisions as to surplus are complex and highly significant in the life of the scheme. Trustees must therefore ensure their decision-making process is robust and well documented in case they ever have to disclose their considerations to beneficiaries, the Ombudsman or the Court.

Please contact your usual Stephenson Harwood contact or any of our Pensions Advisory team if you would like further advice on these matters.

CONTACT US

STEPHEN RICHARDS

*Partner, Head of Pensions
Advisory*

+ 44 20 7809 2350
stephen.richards
@stephensonharwood.com

ESTELLA BOGIRA

Partner

+ 44 20 7809 2298
estella.bogira
@stephensonharwood.com

PHILIP GOODCHILD

Partner

+ 44 20 7809 2166
philip.goodchild
@stephensonharwood.com

GILLIAN JOHNSON

Of Counsel

+ 44 20 7809 2730
gillian.johnson
@stephensonharwood.com