

Pensions Bulletin

Fact Sheet 3

Spring 2009 Issue 4

Pension Protection Fund

I The PPF levy

- I.1 The Pension Protection Fund (PPF) was set up in 2005 to provide compensation to members of defined benefit pension schemes whose employer becomes insolvent, leaving behind an under funded pension scheme. It is funded by levies from schemes eligible to benefit from it.
- I.2 The PPF aims to collect £700 million in levies in the 2009/10 levy year. This estimate aims to cover expected claims and help reduce the PPF's own deficit. This is an increase from £675 million in 2008/09.
- I.3 A summary of the factors used to calculate levies is shown in the table below:

	2006/07	2007/08	2008/09	2009/10
Scheme based levy multiplier	0.014%	0.016%	0.0165%	0.0162%
Risk based levy scaling factor	0.53	2.47	3.77	2.22
Risk based levy cap (as % of liabilities)	0.5%	1.25%	1.0%	1.0%

- I.4 The PPF levy is split into a scheme based levy and risk based levy. In general, better funded schemes will pay lower risk based levies.
- I.5 The scheme based levy multiplier is used in the calculation of the scheme based levy. The calculation of the scheme based levy is simply a scheme's PPF liabilities multiplied by the scheme based levy multiplier.
- I.6 The risk based levy scaling factor is used in the calculation of the risk based levy. The calculation of the risk based levy is as follows:

"Underfunding risk" x "Probability of insolvency" x Risk based levy scaling factor x 0.8
- I.7 The underfunding risk is essentially the shortfall of the scheme's assets when measured against its liabilities. The probability of insolvency is dependant on the "failure score" attributed to participating employers in the scheme (as determined by Dun & Bradstreet, the credit rating agency used by the PPF). The factor of 0.8 is used to reflect the fact that 80% of the total levy is risk based.
- I.8 The risk based levy cannot be more than a scheme's PPF liabilities multiplied by the risk based levy cap.
- I.9 The PPF has also announced that it has raised the funding level at which schemes pay no risk-based levy from 125 per cent to 140 per cent. This recognises that even very well funded schemes present a long-term risk to the PPF.

2 Invoices received

- 2.1 The Pensions Trust's experience of the first year of risk based levies was not encouraging. Some invoices for larger schemes were not received until June 2007 (i.e. after the end of the year to which the invoices related to). However, invoices for 2007/08 did arrive earlier and we have now received the majority of the invoices for 2008/09.

3 Failure scores

- 3.1 For the 2006/07 levy calculations we found that many of our employers were allocated low failure scores, or industry average scores, mainly because Dun & Bradstreet accessed only those accounts filed with Companies House.
- 3.2 The Trust wrote to the PPF and to Dun & Bradstreet (D&B) pointing out that the Charities Commission and housing regulators, for example, can provide free public access to accounts (one of D&B's criteria is they will make use of publicly available information). This is now starting to bear fruit and has led to lower levies for our employers.
- 3.3 The Trust has been further encouraged by the development (by D&B) of a new "scorecard" for not-for-profit organisations, which recognises the lower risk of insolvency in this sector compared with commercial organisations. The probabilities of insolvency allocated to the highest failure scores have been reduced, and the net result should see those of our clients with higher failure scores paying lower levies.

4 Changes for the 2009/10 levy

- 4.1 In April 2008 the PPF confirmed, following consultation, changes to the assumptions used for PPF scheme valuations. These changes may result in fewer schemes entering the PPF because valuations based on the proposed new assumptions may mean they are able to pay benefits greater than PPF levels of compensation.
- 4.2 The confirmed new assumptions are:
- Mortality – to use the actuarial tables PCMA00 (for males) and PCFA00 (for females), in each case with the medium cohort mortality improvement rates, and with a one per cent floor to the annual improvements. This change is expected to make only a small (1%) increase to a scheme's PPF liabilities.
 - Discount rates – to increase all existing rates by 0.3 per cent. This is at the high end of the spectrum of discount rate assumptions adopted by insurers. This change is expected to decrease PPF liabilities by about 3% for pensioners and 8% for deferred pensioners.
- 4.3 The new assumptions apply from 31 March 2008. This means there will be no impact on PPF levies for 2008/09, but there will be an impact from 2009/10 onwards.

5 Action required to reduce the 2010/11 levy

- 5.1 Participating employers of The Pensions Trust should now look to submit accounts to D&B, the credit rating agency used by the PPF. This must be done **by 5pm on 31 March 2009** and will help to reduce the impact of the 2010/11 levies.
- 5.2 Audited accounts should be sent electronically to D&B using the email address customerhelp@dnb.com. To assist employers with this, an email template is available in the "Employers Area" on the homepage of the Trust's website. Please remember to attach a copy of your organisation's latest accounts and include the following information in the body of the email:

- name of the pension scheme your organisation participates in;
- your organisation's full name and address; and
- any Charity or Industrial & Provident Society registration numbers.

5.3 *Please note that employers who participate solely in the Trust's Unitised Ethical Plan or Flexible Retirement Plan do **not** need to take the action as outlined above; neither do organisations who are Registered Social Landlords or are registered with Companies House.*

6 Future levies

6.1 The PPF has recently undertaken a consultation that proposed some changes that will affect the calculation of future levies. The consultation included proposals to:

- reduce the scheme-based element of the levy;
- add a component to the risk-based element of the levy to reflect a scheme's contribution to the long-term risks that the PPF faces; and
- offer greater year-on-year stability in PPF bills.

6.2 The PPF risk-based levy formula currently only reflects the one year probability of employer insolvency. For the 2011/12 levy, the PPF is proposing that the levy formula should be adjusted to take account of the longer-term risk a scheme poses to the PPF, to reflect unexpected as well as expected risk.

6.3 Research from the PPF shows that stronger companies decline over time whilst poorly rated companies become stronger on average. For instance, a couple of years ago companies such as Lehman Brothers and Woolworths would have had a low insolvency probability, yet both have now been absorbed into the PPF. It should be noted that the share of the total cost is not proportionate to that of the one year cost. The consequence is that today's stronger companies will see an increase in their levy. However, the PPF have used the term "company" and do not make specific reference to the third sector.

6.4 According to the PPF, the impact of this adjustment in the calculation of the risk-based levy will vary between schemes, as follows:

- half of schemes would have had a lower levy if the new formula had been used in 2008/09;
- a quarter would have seen a fall in their levy of up to a quarter; and
- one in ten would have seen their levy halve.

6.5 However, because of redistribution:

- half of schemes would have seen a higher levy;
- one in six would have paid a levy of up to a quarter higher; and
- just over one in ten would have seen a doubling of their levy.

6.6 The PPF's consultation document is available on their website at www.pensionsprotectionfund.org.uk. The Pensions Trust responded to the consultation, which closed on 13 February 2009.

7 Other developments

7.1 Consulting actuary Barnett Waddingham conducted a PPF levy survey in summer 2008. 40 schemes with assets totalling more than £10bn responded and while 61% of respondents support the existence of the PPF as a means of providing security, 94% said the current levy structure does not represent a fair sharing of costs. The findings have been shared with the PPF.

7.2 The PPF has recently engaged a firm of consultants, Oliver Wyman, to help it to develop a new levy formula based on long-term risk. The Pensions Trust will continue to press for more equitable treatment of multi-employer last-man standing schemes.

7.3 Over coming months the Trust will also explore strategies to reduce the PPF levy for its clients' schemes including employer insolvency insurance. A new insurance product currently under development aims to insure a scheme's buy-out liability against the insolvency of all the participating employers. This cover would provide better benefits for members than the PPF would, and the Trust will monitor developments with interest.

8 PPF compensation update

8.1 As at 18 February 2009, 71 schemes had been accepted by the PPF for compensation. These schemes cover 21,478 members. Total compensation payments made so far amount to £51 million, with average yearly payments per person of £4,700. The oldest recipient of compensation is 103, and the youngest is six. A further 280 schemes are currently in assessment.

Further updates regarding the PPF will be included in future issues of the Pensions Bulletin and also via supplementary, more detailed, fact sheets.

While every effort has been made to ensure the accuracy of the information contained in this fact sheet, it should not be treated or relied upon as a statement of law. Readers should contact their regular Account Manager at The Pensions Trust in relation to their own circumstances and / or refer to the original source material as appropriate.

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