

# Pensions Bulletin

## Fact Sheet 2

Summer 2011 Issue 11

### Pension Protection Fund (PPF)

#### 1 The PPF levy

- 1.1 The 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.
- 1.2 The PPF aims to collect £600 million in levies in the 2011-12 levy year. This estimate aims to cover expected claims and help reduce the PPF's own deficit. This compares to £720 million in 2010-11, £700 million in 2009-10 and £675 million in 2008-09.
- 1.3 A summary of the factors used to calculate levies is shown below.

Factor	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Scheme based levy multiplier	0.014%	0.016%	0.0165%	0.0162%	0.0145%	0.0135%
Risk based levy scaling factor	0.53	2.47	3.77	2.22	1.64	2.07
Risk based levy cap (as % of liabilities)	0.5%	1.25%	1.0%	1.0%	0.5%	0.75%

- 1.4 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.
- 1.5 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.
- 1.6 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
- 1.7 The underfunding risk is essentially the shortfall of the scheme's assets when measured against its liabilities. The probability of insolvency is dependent on the 'failure score' attributed to participating employers in the scheme (as determined by Dun & Bradstreet (D&B), 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.
- 1.8 The risk based levy cannot be more than a scheme's PPF liabilities multiplied by the risk based levy cap.

#### 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).



- 2.2 However, invoices for 2007-08 did arrive earlier and we received the majority of the invoices for 2008-09, 2009-10 and 2010-11 well before the end of the relevant year.
- 2.3 Over the years, the schemes at The Pensions Trust have paid PPF levies amounting to a combined total of the following:

Year	2006-07	2007-08	2008-09	2009-10	2010-11
Total PPF levies paid	£0.96m	£1.93m	£1.33m	£1.25m	£1.77m

- 2.4 The invoices for the 2010-11 levy originally totalled £2.25m. However, as a result of challenging the D&B numbers used on a number of invoices, we have been able to reduce the total to £1.77m, a saving of £477,375. We hope to make further savings as a result of ongoing appeals for the Growth Plan and the Social Housing Pension Scheme (SHPS).
- 2.5 We have estimated that the combined levies for 2011-12 will be in the region of £2.5m.

### 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 D&B accessed only those accounts filed with Companies House.
- 3.2 The Trust wrote to the PPF and to D&B pointing out that the Charity 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). Indeed, for the 2011-12 levy, D&B obtained accounts from the Charity Commission, although we are still encouraging our employers to submit accounts directly to D&B.
- 3.3 Regarding action in advance of the 2012-13 levy, we considered the key changes proposed by the PPF consultation in October 2010, which were confirmed in an announcement made by the PPF in May 2011 (see section 4 below).
- 3.4 We requested failure scores from D&B in February and wrote to all employers to encourage submission of accounts to D&B. The letter also detailed the proposed changes. Follow up contact continues to take place with 'High Impact' employers to ensure accounts submission and emphasise the importance of monitoring failure scores.

### 4 The new levy framework

- 4.1 In May 2011, the PPF published its Policy Statement, which contains details of the levy framework that will apply for the three years from 2012-13.
- 4.2 Under the new rules for the 2012-13 levy, the PPF will:
- use an average five-year measure for underfunding risk (*this will ensure that sharp movements in financial markets will have less of an effect on a scheme's year-on-year levy*);
  - calculate an employer's insolvency risk as an average over the year, with the employer's 'failure score' measured each month (*previously this was measured once a year*); and
  - place employers in one of ten risk categories (*previously 100 risk categories were used*).
- 4.3 In addition, investment risk will be taken into account in the risk-based element of the levy for the first time. This will be done by applying 'stress tests' to a scheme's asset and liability values.

- 4.4 The PPF has stated that well funded schemes and those with lower risk investment strategies will see lower levies under the new framework. However, poorly funded schemes with a strong employer covenant and those with higher risk investment strategies will experience higher levies.
- 4.5 For non-associated multi-employer schemes (such as those at the Trust – for example, the Growth Plan and SHPS), the PPF will use a new method of calculating overall insolvency risk, using an approach based on the 'Herfindahl Index'. It is anticipated that this change will benefit such schemes and that lower PPF levies will result.

## **5 PPF membership update**

- 5.1 The latest PPF membership figures were issued in April 2011. 283 schemes have now been accepted for PPF compensation. These schemes cover 74,651 members, of whom over 23,000 are receiving compensation payments each month.
- 5.2 The average yearly compensation payment is around £4,000 per person. The oldest recipient of compensation is 106, and the youngest is four years old.
- 5.3 335 schemes covering 187,223 members are in the assessment period being assessed for entry to the PPF. As at 31 March 2011 the PPF had paid out almost £257 million in compensation.

**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.*