



Growth Plan Bulletin

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The Pension Protection Fund - Friend or Foe?

The Pension Protection Fund (PPF), which has now entered its second year, continues to attract a high level of interest. Set up under the requirements of the Pensions Act 2004 the PPF was established to pay compensation to members of eligible defined benefit pension schemes when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.

The PPF levy for 2005/2006 was based upon scheme membership: £15 for active and pensioner members and £5 for deferred members. This is now all set to change: in future years the Pensions Act 2004 requires that at least 80% of the PPF levy must be risk based.

In effect, the PPF operates like an insurance policy. The premium (the risk based levy) will be based upon the likelihood of a claim being made and the impact of any such claim.

In practice, this will mean that both employer insolvency risk (the likelihood) and scheme underfunding (the impact) will in future play a major part in determining how much organisations will pay.

The PPF proposes to measure the employer insolvency risk by using a market solution: credit specialists Dun & Bradstreet have been appointed to fulfil this role for the first two years.

Not surprisingly, as levies are set to soar, the pensions community has reacted strongly to the proposals put forward by the PPF.

In particular;

- The Confederation of British Industry (CBI) is demanding that the Government either put in place a guarantee or credit for the fund, or reduce the amount it pays to scheme wind-up victims if the risk based levy increases above the initial £300m estimate.
- There is outrage that a further 60 companies including Turner & Newall, Allders and MG Rover, who did not initially qualify, would now be allowed to enter into the fund (to be subsidised by other pension schemes).
- There is speculation that the Pensions Regulator could force into administration 'household names' that may not be able to meet their multi-million pound levy arising from their scheme deficits.
- The Charitable sector has also been prominent in stressing that instructing a credit rating organisation to score credit worthiness and convert this into an implied insolvency probability may work well in the corporate sector, but is unlikely to work well in theirs, with charities being the losers.

Some charities have also called for the same exemption as that which local authorities receive.

The two consultation periods are now over, and the PPF has finalised its arrangements. Whilst the PPF has made some concessions and a few amendments to its initial proposals there has been little to recognise the uniqueness of multi-employer pension schemes such as the Growth Plan.

The Pensions Trust has argued both in the media and directly with the PPF that the levy calculations for multi-employer schemes are fundamentally flawed. We have also put forward our own proposals for a more accurate alternative.



The approach favoured by the PPF takes no account of the number of employers in the scheme, and gives very little benefit to multi-employer schemes over single-employer schemes. As the Growth Plan is a “last man standing” scheme, this means that all but one of the existing participating employers would have to leave, before the last remaining employer could turn to the PPF for assistance.

This is analogous to you agreeing to pay building insurance on your home on the understanding that the insurance company would only pay out to you if your house were the last one in the street to be demolished by a tornado!

In effect, the PPF will only recognise a claim if all 2,700 employers become insolvent at the same time. The levy does not reflect such an unlikely outcome and we believe this to be clearly unfair.

A traditional actuarial calculation would normally rely on Probability Theory. This concept is missed by the PPF, which fails to recognise the diversification benefit (in terms of risk of insolvency) that a multi-employer scheme offers. This is one of the key reasons for setting up multi-employer pension schemes.

The PPF has now responded as follows:

“In calculating the insolvency risk of multi-employer schemes the Board of the Pension Protection Fund certainly considers their approach to be a proxy to a more detailed calculation. However, they do consider the approach as set out in the Pension Protection Levy October Update paper to be the most appropriate means of complying with necessary legislation.”

Now, whilst this may be the case, (The Pensions Trust will be seeking its own legal opinion) it does not alter the fact that the difference between the two methods in risk based levy calculation may lead to a difference of £millions in risk based levies for the Trust each year. Excessive levies, totally disproportionate to the risk they are supposed to cover will directly restrict the good works that our employer members are able to carry out. It is for this reason that the Trust will continue with its campaign for a more equitable levy calculation.

What can employers do to help?

As the PPF refuses to recognise the improbability of all 2,700 Growth Plan employers becoming insolvent at the same time (an event which must happen before the PPF will pay out), and instead bases its levy on the weighted average probability of insolvency of all employers, then each employer’s probability of insolvency is important.

The PPF risk based levy for 2006/07 will be based upon Dun & Bradstreet failure scores as at 31 March 2006. The Trust is now urging employers to check that your Dun & Bradstreet failure score as at 31 March 2006 is based on the correct information and that you take what measures you can to improve your position for future years. Dun & Bradstreet can be contacted on their helpline number: 0870 850 6209.

When you call, Dun & Bradstreet will advise you of your organisation’s score out of 100 and will advise you of any steps that you can take to improve your organisation’s score.

Your help can considerably reduce the burden of the PPF risk based levy upon the Growth Plan.