

Pensions Bulletin

Fact Sheet 5

Spring 2008 Issue 1

Pension Protection Fund

- 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 expected to incur a significant shortfall (around £275m) in levies for the year to 5 April 2007, compared to its original estimate of £575m. Taking no chances for the 2007/08 year, it has used levy factors which may increase the levies for some schemes a staggering five-fold. The aim is to collect £675m in levies, partly to make good the shortfall for 2006/07.
- I.3 A summary of the factors used to calculate levies is shown below. Note: The figures for the 2008/09 levy year are subject to confirmation by the PPF at the end of May 2008.

	2006/07	2007/08	2008/09
Scheme based levy multiplier	0.014%	0.016%	0.0152%
Risk based levy scaling factor	0.53	2.47	1.60
Risk based levy cap (as % of liabilities)	0.5%	1.25%	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:

$$\text{"Underfunding risk"} \times \text{"Probability of insolvency"} \times \text{Risk based levy scaling factor} \times 0.8$$

- 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 (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.
- 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 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, although invoices for 2007/08 have arrived earlier this time around. For the 2006/07 levy calculations we found that many of our employers were allocated low failure scores, or industry average scores: they are simply not on D&B's radar since they are not required to lodge their accounts with Companies House.

- I.10 The Trust wrote to the PPF and to 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). We are hopeful that some of our suggestions will be taken on board and will lead to fairer treatment of – and lower levies for – our employers.
- I.11 The Trust was further encouraged by some of the information contained in a recent PPF consultation document on the future development of the levy. D&B has developed a new “scorecard” for not-for-profit organisations which recognises the lower risk of insolvency in this sector compared with commercial organisations.
- I.12 The probabilities of insolvency allocated to the highest failure scores have been reduced, and the net result should see those of our employers with failure scores in the high 90's paying lower levies.
- I.13 The PPF estimates that it needs to collect £675 million in levies in 2008/09 – a figure unchanged from 2007/08. This levy estimate will remain stable for the next three financial years, subject to indexation against earnings and provided there is no significant change in the level of risk faced by the PPF.
- I.14 It 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.
- I.15 From 2008/09 the levy cap is reduced from 1.25 per cent of liabilities to one per cent of liabilities - this continues to protect the weakest five per cent of schemes from disproportionately high levy bills.
- I.16 The consultation document contained a proposal that data collected as at 30 March 2008 would be used for levy calculations for 2008/09 and 2009/10. In response to concerns expressed by the pensions industry, contingent assets and deficit reduction contributions made after 31 March 2008 will be taken into account in the calculation of the levy for 2009/10 provided they are notified to the PPF by the published dates.
- I.17 In April 2008 the PPF confirmed, following consultation, changes to the assumptions used for PPF scheme valuations.
- I.18 In the light of developments and expansion of the buy-out market, the PPF considered changes to these assumptions, in order to bring valuations into line with market prices.
- I.19 The 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.
- I.20 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 have 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.

- 1.21 The new assumptions apply from 31 March 2008. This means there will be no impact on PPF levies for 2008/09. The first year in which these new assumptions will have an impact will be 2009/10.
- 1.22 As at 31 March 2008, 41 schemes had been accepted by the PPF for compensation. These schemes cover 12,131 members, of whom 3,525 are receiving compensation payments totalling £1.4 million a month direct from the PPF. A further 225 schemes representing 118,000 members 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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