Pension Protection Fund

Consultation Document

The 2012/13 Pension Protection Levy Consultation Document

September 2011

Foreword

I am delighted to introduce our consultation on the 2012/13 levy Determination, which will mark the first year under the new levy framework. If you have been following the progress of the new levy framework, you will know that this has been in development for some time. In that period, we've spoken to and heard from hundreds of stakeholders, in order to finalise the design that was confirmed in May 2011 and which is being implemented next year. We intend to fix the rules for three years in order to provide the stability and predictability that levy payers have told us are important to them.

The themes of stability and predictability are ever more relevant in the current environment. It has been a busy and challenging time for employers and pension schemes alike, with little respite over the summer months. The Board of the PPF has likewise been kept on its toes by the fast-changing economic conditions; but it is exactly this kind of circumstance that, as the "lifeboat" for defined benefit schemes, we have been built to withstand. And I think that it is a sign of our maturity that we remain sufficiently confident to embark on a system of fixed rules and "bottom-up" levies which will make it easier for pension schemes to plan, despite the current uncertainty in the global economy.

I am pleased to announce that the levy estimate for 2012/13 is £550 million. This offers a modest reduction from 2011/12 and is the lowest pension protection levy estimate to date. The Board believes that this strikes the right balance between minimising the cost to levy payers and making steady progress towards the PPF's long-term funding target. We will of course be monitoring the levy estimate under the fixed parameters closely; at this stage, we believe that we will raise approximately £550 million in 2013/14 and 2014/15 as well.

The draft Determination for 2012/13 contains the detailed legal rules to give effect to the key features of the new framework, such as insolvency risk bands and the incorporation of investment risk in the underfunding calculation for the first time. I encourage you to read the consultation document and the draft Determination and to consider the implications of the changes that we are introducing for your schemes. As ever, I look forward to your responses.

Alan Rubenstein

Chief Executive

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1. Introduction and Executive Summary

1.1 The 2012/13 Pension Protection Levy Consultation Document

Overview

1.1.1 This consultation document sets out the basis on which the Board intends to charge the Pension Protection Levy for the 2012/13 levy year. This includes the levy estimate (the overall amount the Board aims to collect), the levy scaling factor, the scheme-based levy multiplier, and associated rules.

1.1.2 There are far-reaching changes to the design of the pension protection levy from 2012/13, as announced in *A New Framework: Policy Statement*.[1]

1.1.3 In order to deliver stability and predictability, which the Board recognises as priorities for levy payers, the Board intends to keep the rules of the levy calculation fixed for three years. As required by legislation, the Board will continue to publish its Determination and calculate a levy estimate on an annual basis.

1.1.4 The Board is seeking to raise £550 million in the 2012/13 levy year. Based on its assessment of economic prospects and changes in the PPF universe, the Board anticipates that this will support steady progress towards our long-term funding objective.

1.1.5 There will be significant changes to the measurement of underfunding and insolvency risk, which are discussed briefly[2] in chapters 4 and 5 respectively. A new risk factor, investment risk, will be incorporated into the calculation of underfunding, so this is also covered in chapter 4.

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[1] The Policy Statement and other related documents are available on the PPF website: http://www.pensionprotectionfund.org.uk

[2] Further detail can be found in the policy statement, referred to above.

The Board’s Determination under section 175(5) of the Pensions Act 2004

1.1.6 The draft Determination under section 175(5) of the Pensions Act 2004 is published alongside this consultation document. This expresses the Board’s policy in legal form.

1.1.7 In addition to far-reaching changes required as part of the new levy framework, we are proposing to make several changes to the rules for contingent assets; these are discussed in chapter 6.

1.1.8 We would like to draw the attention of trustees and advisers to the new requirement at paragraph 31(b) of the Contingent Asset Appendix. For Type A contingent assets, schemes will be required to certify on Exchange that guarantors could be expected to meet their full commitment under the contingent asset if called upon to do so as at the date of the certificate. We may reject a contingent asset if it appears to us that it does not reduce the risk of compensation being payable to the extent that is consistent with the levy reduction secured.

Consultation timetable

1.1.9 The deadline for comments on the consultation document and draft Determination is 5pm on 2 November 2011. By the end of 2011 the Board will publish a summary of responses and any changes to the proposals following the consultation, along with the final Determination that will take effect from 1 April 2012.

1.1.10 This will provide as much time as possible for schemes to ensure that their scheme return is up-to-date and to finalise any risk reduction measures they may wish to take.

1.2 Summary of the 2012/13 Levy

A fixed framework

1.2.1 The introduction of the new levy framework means that the levy parameters should be fixed for three years, instead of just one. The intention is that there will only be changes in a scheme’s risk-based levy if its risk, as assessed by the risk-based levy formula, changes. The Board anticipates that fixing the parameters will therefore enable schemes to plan with greater certainty.

1.2.2 In order to set levy parameters that should stand the test of time, the Board needs to make a number of assumptions about changes in the PPF universe and the economy as a whole over the next three years. The

Board has considered the likelihood of a range of possible outcomes, and the PPF's funding position in these scenarios.

1.2.3 We will be publishing our Annual Report and Accounts later this year, which will present our funding position as at 31 March 2011. Concurrent with this, we plan to provide an update on our Funding Strategy which will consider the impact of the new framework over the long term.

Levy estimate

1.2.4 The levy estimate reflects the Board's view of the funding that the PPF will need in order to ensure that it is able to meet its statutory obligations to provide compensation to members. As the nature of our liabilities is long-term and uncertain, we need to consider how these liabilities will develop over time.

1.2.5 It is essential that our funding is strong enough to provide assurance to current members, as well as members that may join us in the future. On the other hand, we are mindful of the interests of levy payers too.

1.2.6 The Board is seeking to raise £550 million for the 2012/13 levy year. This is the lowest levy estimate since the introduction of the risk-based levy and reflects the Board's careful assessment of the PPF's funding needs. It has been set to reflect the Board's desire for reasonably steady progress towards its long-term funding target.

1.2.7 It is the Board's balanced view that a modest reduction in levy estimate is appropriate. In forming this view within the overall framework of its long-term funding strategy, the Board took account of a range of factors. These factors included on the one hand the sound financial position of the Fund and the positive financial effect on cash flows of the adoption of the Consumer Prices Index for the indexation and revaluation of PPF compensation in future. On the other hand the Board also considered the uncertain economic outlook following the global financial crisis and the potentially adverse future effects that this might have on both pension scheme funding and pension scheme sponsors.

1.2.8 Our current assessment is that the scaling factor we are proposing will raise £550 million a year over the next three years. We will monitor scheme behaviour and risk characteristics closely in order to calculate levy estimates for the second and third years of the fixed period.

1.2.9 Chapter 2 discusses the factors and assumptions underlying the levy estimate.

Levy parameters

1.2.10 Based on the levy estimates as described above, the risk-based levy scaling factor that will apply from 2012/13 will be 0.89. This will be multiplied by a scheme's insolvency risk and underfunding risk to calculate the risk-based levy.

1.2.11 The Board confirmed in the Policy Statement that the proportion of total levies to be raised by the scheme-based levy would be set to cover the implicit cost associated with the risk-based levy cap. This provides transparency to levy payers and makes clear the degree of cross-subsidy in the levy.

1.2.12 According to its assessment of economic conditions and forecasts for the next three years, the Board considers that affordability remains of sufficient concern to merit a cap on risk-based levies to provide protection to 9 per cent of schemes. This proportion is broadly similar to those in the recent past. This means that the maximum risk-based levy will be 0.75 per cent of smoothed liabilities.

1.2.13 To cover the cost of capping risk-based levies, the scheme-based levy multiplier will be 0.000085. In order to support stability of total levies, the scheme-based levy will be assessed relative to smoothed liabilities.

1.2.14 The Board estimates that the scheme-based levy raised will comprise 11 per cent of the total levies. This will almost halve the proportion of scheme-based levy compared to the past; this achieves the scale of reduction we previously indicated might be feasible under the new levy framework.

1.2.15 A system of fixed parameters means that we will have less control over levy estimates in the future. There may be circumstances in which we would need to revise the parameters. These relate mainly to legislative conditions governing the levy estimate, as well as the likelihood of material adverse impact on our funding should the levy estimate fall significantly and unexpectedly.

1.2.16 The levy parameters will need to be revised if either of the 2013/14 or 2014/15 levy estimates:

- exceed the levy ceiling;
- comprise a risk-based proportion of less than 80 per cent of the total; or,
- vary from the previous year's estimate by more than 25 per cent.

1.2.17 In extreme circumstances, we may also reconsider the levy parameters if our funding is adversely challenged to a material degree.

1.3 Key Changes to the Levy Framework

1.3.1 A summary of the main changes that will take effect for the 2012/13 pension protection levy is provided below. Further details are available in the related chapters of this document and in the draft Determination, as well as in the policy documents on the PPF website.[3]

1.3.2 An important feature that will be introduced to reduce volatility of funding year-on-year is to use average values of financial indices and rates over five years when transforming assets and liabilities. This will produce smoother funding levels, so that the calculation of underfunding risk will be less likely to fluctuate. Details on this precise calculation are available in the Transformation Appendix of the draft Determination.

1.3.3 This will also be the first year in which the risk-based levy will reflect the investment risk posed by a scheme. The calculation of underfunding risk will consider the size of a scheme's deficit based on the application of stresses to its assets and liabilities. The assessment of investment risk of liabilities will be carried out by the PPF for all schemes. For most schemes, the value of stressed assets will be based on the asset split that is reported on the Pensions Regulator's data collection system, Exchange.

1.3.4 Schemes with protected liabilities of £1.5 billion or more will be required to carry out a more detailed exercise so that we have a more precise measurement of the level of investment risk associated with their investment strategies. Other schemes may choose to report this additional information. Details of this bespoke calculation, and responses to the consultation on the draft guidance that was held earlier this year, are available in chapter 4.

1.3.5 We would like to remind trustees that accurate and timely completion of the scheme return is a legal responsibility. This requirement extends to the asset split data which we will use to measure investment risk under the standard approach, as well as the investment risk results reported under the bespoke approach. Schemes should note that the accuracy of this information could have a substantial impact on the degree of underfunding as assessed in the new framework.

1.3.6 Insolvency risk will be measured by placing sponsoring employers into one of ten Levy Bands, based on their average monthly Failure Score as measured by Dun and Bradstreet (D&B) over the preceding year. Chapter

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[3] Background information is available from *A New Framework: Consultation Document* at: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/levy_consultation_oct10.pdf . The Board's confirmed policy is available from *A New Framework: Policy Statement* (link as in footnote 1).

5 contains further information on the new method of measuring insolvency risk.

1.4 Data Deadlines and Measurement Dates

1.4.1 Schemes are reminded that timely and accurate completion of the scheme return is a legal obligation under the Pensions Act 2004. The Board strongly encourages all schemes to take steps to ensure that the information provided is correct and up to date.

1.4.2 Key dates and deadlines for the 2012/13 levy year will shift as part of the new levy framework, and are set out below.

- Information from the scheme return submitted by 5pm on 30 March 2012 will be used in the calculation of levies. The Pensions Regulator's Exchange system will continue to be the sole point of data submission for the purposes of the PPF levy. This will be available from November 2011.

- Insolvency risk will be measured using the average annual Failure Score of each sponsoring employer measured on the last working day of each month, from 28 April 2011 to 30 March 2012.

- The deadline for certification and/or re-certification of contingent assets will be 5pm on 30 March 2012.

- Deficit reduction contributions that have been made up to and including 31 March 2012 must be certified by 5pm on 10 April 2012.

- Full block transfers that have taken place up to and including 31 March 2012 must be certified by 5pm on 29 June 2012.

- We will use market data over five years to smooth funding levels. For levy year 2012/13, we will use market data for each working day in the 5-year period up to 30 March 2012.

- The date to which we will transform section 179 valuations is 31 March 2012. These transformed values will be subject to the smoothing and stressing described above.

2. The Levy Estimate and Parameters under the New Framework

2.1 Introduction

2.1.1 The objective of the new framework to deliver fixed rules for three years has profound implications for setting the levy estimate and levy parameters. This chapter discusses these implications and how they are likely to affect the levy estimates over the first fixed period of the new framework. The Board's consideration of overall economic and PPF universe-specific factors and risks is outlined below.

2.1.2 We will be publishing our Annual Report and Accounts later this year, which will present our funding position as at 31 March 2011. We plan to also provide an update on our Funding Strategy at that time.

2.1.3 This chapter also contains a summary of the levy formulae that will be used to calculate levy invoices from 2012/13. A fuller discussion, including the policy background behind the changes, is available in the publications *A New Framework: Consultation* and *A New Framework: Policy Statement* on the PPF website.

2.1.4 The levy parameters (the risk-based levy scaling factor, the scheme-based levy multiplier and the risk-based levy cap) that we intend to apply from 2012/13 to 2014/15 are described below. The assumptions underlying these are also outlined.

2.2 Levy Estimate

2.2.1 The Board is required by legislation to estimate the amount of levy it will collect for a given year on an annual basis. As discussed below, we will continue to estimate annually the total amount of pension protection levy that we expect to raise based on the fixed levy parameters.

2.2.2 For the 2012/13 levy year, starting from 1 April 2012, the Board is seeking to raise £550 million. The Board believes that setting the levy at this level achieves an appropriate balance between assuring our ability to provide security to current and future members, and the interests of levy payers. The levy estimate is consistent with steady progress towards our long-term funding objective.

2.2.3 This is the lowest levy estimate since the introduction of the pension protection levy. In making its decision within the overall framework of its long-term funding strategy, the Board took account of a range of factors. These factors included on the one hand the sound financial position of the Fund and the positive financial effect on cash flows of the adoption of the Consumer Prices Index for the revaluation and indexation of PPF compensation in future. On the other hand the Board also considered the uncertain economic outlook following the global financial crisis and the potentially adverse future effects that this might have on both pension scheme funding and pension scheme sponsors.

2.2.4 Under the framework of the PPF Funding Strategy published in August 2010, the Board has an objective of keeping a probability of reaching self-sufficiency in 2030 above 80 per cent. The levy estimate of £550 million is in line with this objective. An update on the Funding Strategy will be published with our Annual Report and Accounts in October. This will consider the impact of the new framework over the long term.

2.3 Levy Estimates with fixed parameters

2.3.1 In order to assess what levy estimates are probable in the second and third years of the fixed period, we need to consider economic prospects and likely changes in the risk characteristics of our universe over the medium term.

2.3.2 Based on our current assessment of likely economic trends and our best estimates as to changes in scheme risk over the triennium, i.e. the three years under the new framework, we expect to raise total levies of £550 million in 2013/14 and 2014/15. These are the amounts that we anticipate will be generated by keeping the levy scaling factor, the scheme-based multiplier and risk-based levy cap constant.

2.3.3 These results reflect the combined effect of a number of competing factors. These are outlined below:

- We expect that schemes will continue to put in place new contingent assets and to certify deficit-reduction contributions on roughly the same scale as in recent years. These will cause the estimate to move downwards over time.

- As a result of the smoothing mechanism transmitting some of the impact of market volatility between 2007 and 2008 into the triennium, funding levels are expected to decline slightly in 2013/14. This pushes the levy estimate upwards.

- We expect that schemes will continue to undertake gradual investment de-risking. This will affect underfunding risk as the new investment risk measurement would result in lower aggregate risk. This would cause total levies to fall.

- While the new system of Levy Bands means that movements in D&B Failure Scores will have less direct effect on levies, it is likely that there will be sufficient changes to result in some movement between bands in both directions. We think these changes will balance out, resulting in a neutral effect on levies.

2.3.4 Our assumptions do not, however, incorporate the impact of potential changes to D&B methodology. We are aware that such a change is being considered by D&B and that it will likely be implemented within the triennium. Chapter 5 discusses this in more detail.

2.3.5 Another factor for which we have made no provision is the effect of any changes to section 179 valuation assumptions. By law, these assumptions must be set by reference to pricing in the bulk annuity market. We did not consider that an appropriate adjustment to the levy scaling factor could be made for such developments.

2.4 Levy Parameters

The risk-based levy formula

2.4.1 The formula for the risk-based levy under the new framework is shown in box 1. Each element is discussed separately in this consultation document, as follows:

- we discuss the levy scaling factor and other parameters in this chapter;
- chapter 4 discusses the measurement of underfunding risk including a new risk factor, investment; and
- chapter 5 discusses our approach to insolvency risk.

Risk-based levy = U x IR x LSF

U = Underfunding (Higher of Smoothed or Stressed Deficits)

IR = Insolvency Rate

LSF = Levy Scaling Factor = 0.89

Levy scaling factor

2.4.2 Based on the levy estimate of £550 million for 2012/13, and our preliminary levy estimates for 2013/14 and 2014/15 as described above, the levy scaling factor that we propose for the first triennium under the new levy framework is 0.89.

2.4.3 We expect that, in the first year, the risk-based proportion will be 89 per cent. This will vary in the following years in line with changes in aggregate risk. Based on our modelling of the future levy under the new formula, it is unlikely that this proportion will breach the statutory minimum of 80 per cent and thereby require the levy parameters to be revised as described in 1.2.16.

Risk-based levy cap

2.4.4 As in previous years, we will apply a cap to the amount of risk-based levy that a scheme pays based on the size of a scheme's liabilities. To ensure that the proportion of schemes that are capped is relatively constant, this will generally be based on section 179 liabilities smoothed over five years. Using smoothed liabilities should also have the effect of reducing year-on-year volatility in levies for capped schemes.

2.4.5 The objective of the risk-based levy cap is to ensure that levies are affordable. Without this, schemes that are high-risk would likely face levies on a scale that would exacerbate any financial difficulties faced by the scheme and its sponsoring employer(s).

2.4.6 Since 2010/11, the Board has set the cap in order to protect the weakest 10 per cent of schemes. This meant that, in 2011/12, we set the threshold at which the cap would apply at 0.75 per cent of liabilities.

2.4.7 The Board believes it is appropriate to maintain a cap on the risk-based levy to protect approximately the same number of schemes as for 2011/12. It therefore proposes a risk-based cap of 0.75 per cent of smoothed liabilities, which would protect 9 per cent of schemes.

The scheme-based levy

2.4.8 The formula for the scheme-based levy is shown below. This will generally be calculated with reference to section 179 liabilities smoothed over five years. Using smoothed liabilities has the benefit of reducing the potential for fluctuations in individual and aggregate scheme-based levies.

Scheme-based levy = UL x SLM

UL = Smoothed liabilities

SLM = Scheme-based levy multiplier = 0.000085

2.4.9 The scheme-based levy multiplier the Board proposes to set is 0.000085 for the triennium. At this level, the scheme-based levy is estimated to constitute 11 per cent of total levy, which is approximately half the current proportion.

2.4.10 As part of the new framework, the scheme-based levy has been set to cover the "cost" of the cross-subsidy introduced by the cap on the risk-based levy. By identifying this cost as a distinct element of the pension protection levy, we are increasing transparency for levy payers.

Conditions for revising the levy parameters

2.4.11 Our intention to fix the levy parameters that apply over three years is key to achieving the stability and predictability that underpin the new levy framework. Based on our modelling and assumptions as described above, we should be in a position to deliver this over the triennium.

2.4.12 Under normal circumstances we would not plan to vary any of the levy parameters unless one of the following scenarios arise. As confirmed in the Policy Statement, we would need to adjust the levy parameters if the levy estimate would otherwise:

- breach the legislative ceiling;
- result in a risk-based proportion of less than 80 per cent; or
- vary from the previous year's estimate by more than 25 per cent.

2.4.13 We would also have to consider a revision of the parameters should exceptionally adverse scheme risk and economic conditions challenge our funding position to an unacceptable degree. We reserve the right to vary the parameters should such extreme circumstances materialise.

3. Draft 2012/13 Determination

3.1 Introduction

3.1.1 The draft Determination and associated appendices for the 2012/13 levy year are being published for consultation. This section provides an overview of the Determination and appendices. These govern how we will calculate levies; we are unable to depart from the Determination once it has been finalised.

3.1.2 A number of amendments have been made throughout the Determination to incorporate the changes to the levy formula under the new framework. As part of this, new definitions and terminology have been included, and the structure of the Determination has in some places changed from the previous levy year.

3.1.3 This chapter describes the structure of the draft Determination. The Board's view on corrections to data under the new levy framework is also discussed below, as are changes to the approach for partial transfers, as described in the Policy Statement earlier this year.

3.2 Overview of the Determination and Appendices

3.2.1 Under section 175(5) of the Pensions Act 2004, the Board is required to determine each year the levy factors and rates by which pension protection levies will be assessed. The Board will continue to review the details of the rules to ensure that the new levy framework is being implemented as expected. The Determination governs the calculation of levies and takes precedence over any other communication (such as guidance documents) from the PPF.

3.2.2 Our intention, under the new framework, is to keep the levy scaling factor, scheme-based levy multiplier and risk-based levy cap fixed for three years. They will be subject to revision only if legislative conditions are breached or if our funding position is severely challenged to the extent that immediate remedial action is required, as discussed in chapter 2.

3.2.3 The Determination gives effect to the wide-ranging changes confirmed in *A New Framework: Policy Statement*. The main features, and their associated rules, are as follows:

- Part A sets out the definitions that apply for the purposes of the levy calculation and the measurement times and deadlines for scheme information to be used for 2012/13 levies.

- Part B governs the use of alternative information in exceptional circumstances.

- Part C establishes the levy formulae for the risk-based levy and the scheme-based levy, including the levy scaling factor and scheme-based levy multiplier.

- Part D describes how underfunding risk will be calculated, and the additional investment stress information that will be required of schemes with liabilities of £1.5 billion or more. Formulae for converting and rolling forward (and backward) assets and liabilities to transform the measure of underfunding to an appropriate smoothed and/or stressed figure at 31 March 2012 are available in the Transformation Appendix. The Investment Risk Appendix details the requirements that apply to the bespoke calculation of investment risk.

- Part E sets out the detailed rules that will apply to the measurement of insolvency risk. This includes the use of an annual average Failure Score, as provided by D&B, to band employers into one of ten Levy Bands. Rules E3.2 to E3.3 relate to the treatment of multi-employer schemes, with changes to the calculation of the levy reduction for non-associated last man standing schemes. The Insolvency Risk Appendix contains the Levy Rates that will apply to the Levy Bands into which employers will be allocated.

- Part F details the special rules that apply where a full transfer occurs. The Transfers Appendix sets out the details of the information required in respect of full transfers.

- Part G contains the requirements for recognition of risk reduction measures such as deficit–reduction contributions and contingent assets in the risk-based levy. The Deficit-Reduction Contributions Appendix and Contingent Asset Appendix set out the details of the respective calculations and the certifications required.

3.2.4 We will publish the contingent asset, transfers and levy practice guidance documents with the final Determination in December, although a draft of the contingent asset guidance will be available in the weeks following the publication of this consultation. The Guidance for the Bespoke Calculation of Investment Risk is being published alongside this consultation.

3.3 Corrections to Scheme Return Data

3.3.1 Trustees are reminded that it is an obligation under the Pensions Act 2004 to provide complete and correct information according to the timelines specified by the Pensions Regulator.

3.3.2 Rule B2 provides discretions to the Board to use data other than that which is submitted before the specified deadline in the scheme return. These discretions remain the same as those available currently; there is no obligation on the Board to use alternative information merely because a scheme has been disadvantaged due to a failure to supply correct information at the proper time.

3.3.3 Where information that has been used in the calculation of levies appears to be incorrect in a material respect, we may review and revise the levy. Each case is assessed on its own merits. To assist levy payers, we will publish a Levy Practice Guidance to provide examples of how the Board may choose to exercise its discretions in particular circumstances. This will be available with the final Determination later this year.

3.3.4 There will be new formulae for calculation of 2012/13 levies and, to a limited extent, new data fields. These may be unfamiliar to schemes, although the scheme return will remain broadly similar to that of previous years. We are taking a variety of steps to ensure that schemes are aware of the increased significance of certain aspects of the scheme return (e.g. asset allocation information), and to provide readily accessible guidance on how to complete these data fields. We hope that these steps support trustees in meeting their obligation to provide accurate information in the scheme return.

3.3.5 We will continue to consider factors such as the reason for the error, its impact, how quickly it was identified, and steps taken by a scheme to correct the error once identified, when assessing whether to allow a correction.

3.4 Partial Block Transfers

3.4.1 From 2012/13, we will remove the process by which partial transfers may be reported. This is due to the shift of the measurement date to immediately before the start of the levy year. The operational complexity of delaying the start of calculating levies in order to take account of partial transfers, if the end of June deadline were to be maintained, would challenge our objective of being in a position to invoice the vast majority of schemes in autumn 2012.

3.4.2 Where schemes are involved in partial transfers, and do not anticipate submitting an updated section 179 valuation for the relevant year, we will use the pre-transfer valuations of the affected schemes to calculate levies. We expect that the apportionment of levies should be a matter for the transferring and receiving schemes to consider and resolve between themselves in deciding whether post-transfer section 179 valuations should be undertaken.

4. Underfunding and Investment Risk

4.1 Introduction

4.1.1 From 2012/13, the calculation of underfunding risk will incorporate two key changes: smoothing and investment risk. This section outlines how we have reflected these features in the levy rules.

4.1.2 In May, we published the draft guidance for the bespoke calculation of investment risk for consultation. A total of 20 submissions were received; a summary of these is included below, as well as our response to themes emerging from the consultation. This guidance has been revised and is being published as part of the consultation on the Determination, along with an Investment Risk Appendix setting out the Board's requirements.

4.2 Underfunding in the New Framework

4.2.1 An important change that reduces volatility in the measurement of underfunding risk is the introduction of smoothing through the use of averaged values in the roll forward process, rather than, as currently, values as at a single date (31 March). We will roll forward assets and liabilities using the daily average of the relevant indices and yields measured over the five-year period to 30 March 2012.

4.2.2 This process will produce smoothed values of assets and liabilities; it is the latter that will be used to calculate the scheme-based levy and to assess whether a scheme's risk-based levy will be capped. These values will also be used to calculate a smoothed deficit which may be used in the measurement of underfunding risk (see paragraph 4.2.6 below). This process of smoothing (and rolling forward) is detailed in the Transformation Appendix of the draft Determination.

4.2.3 For the first time, the asset split information that schemes report in Exchange will be used to calculate an investment risk factor. All schemes, including those submitting bespoke results, are advised to ensure that this information is as up-to-date and accurate as possible. This is consistent with trustees' broader responsibilities to provide complete and timely information to the Regulator. The help file on Exchange has been updated to provide guidance on classifying investments – we encourage schemes to review their reported asset split closely in the light of this.

4.2.4 We would like to draw attention to the treatment of assets reported as "other" and "insurance funds" for the purposes of investment risk stressing. In the absence of information on "other" assets, we will treat them as equivalent to equities. We will also apply the equity stress to assets reported as insurance funds. We expect that schemes should be able to identify the separate components of insurance funds and that this category should only be used in rare circumstances where a scheme is unable to obtain detailed information. The Transformation Appendix contains details of how each asset class will be stressed under the standard approach.

4.2.5 For all schemes, the PPF will use the profile of liabilities reported in the scheme return to apply risk factor stresses. For index-linked benefits, we will apply the inflation and interest rate stresses in calculating a stressed liability value. For non-index linked benefits, we will apply only the interest rate stress. The formulae for these calculations are available in section 4 of the draft Transformation Appendix.

4.2.6 Investment risk will be used in the calculation of underfunding risk that feeds into the risk-based levy. We will use the value of stressed assets compared to stressed liabilities to derive the stressed deficit. We will take the greater of the stressed deficit and the smoothed deficit as the measure of underfunding risk in the risk-based levy calculation.

4.2.7 We noted in the Policy Statement that, based on the methodology developed by our advisers Redington, we would update the asset and risk factor stresses to incorporate five years of data up to March 2011. These are published below, and are reflected in the Transformation Appendix and the Investment Risk Appendix and guidance for the bespoke calculation.

4.2.8 In the tables we published in May, we made adjustments to the inflation and interest rate risk factor stresses so that the combined effect of the stresses would be limited to 100 basis points. This constraint was introduced to ensure that the combined effect of inflation and nominal interest rate stresses would not lead to a negative inflation-linked gilt yield once smoothing and stresses have been applied. This reflected feedback we had received on the October proposal. We have updated this analysis by looking at the five-year average of the real yield of the 15-year inflation-linked gilt and have made corresponding adjustments to the stresses.

4.3 Standard Approach for Asset Stressing: Overview

4.3.1 The standard approach is the methodology that the PPF will apply to the asset information reported in Exchange. For schemes with liabilities of less than £1.5 billion that choose not to submit bespoke results, we will apply asset stresses to the value of assets after roll forward and smoothing. Details on the calculations are available in the Transformation Appendix. This stressed asset value will then be used to feed into the calculation of a stressed deficit.

4.3.2 As noted above, we have updated the asset stresses with an additional two years' data. These are shown in table 1 below.

Table 1

Asset class	Stress
UK Equity	-22%
Overseas Equity	-16%
Unlisted/Private Equity	-22%
Property	-6%
Hedge Funds	-7%
Commodities	-16%
Corporate bonds	0%
Nominal gilts	+10%
Inflation-linked bonds	+16%
Insurance Funds	-22%
Annuities	+16 %
Other	-22%

4.4 Bespoke Approach for Asset Stressing: Overview

4.4.1 The bespoke approach will be mandatory for schemes with protected liabilities of £1.5 billion or more; this requirement is described in Rule D3 of the Determination. Only formal section 179 valuations will be tested against this threshold; in particular Post-Transfer Valuations submitted following a block transfer are not subject to the test.

4.4.2 Schemes submitting bespoke results will have to provide two additional pieces of information on Exchange: the value of unstressed and stressed assets as at their most recent audited accounts date. We will use these to calculate a bespoke investment risk factor, which will be applied to smoothed section 179 assets. As with the standard approach, we will then use the stressed assets to calculate a stressed deficit. A new appendix, the Investment Risk Appendix, contains the requirements for the bespoke calculation. The Guidance for the Calculation of Bespoke Investment Risk complements this appendix and is being published again following the earlier consultation.

4.4.3 We have developed the bespoke approach in order that a more accurate, though in some cases more complex, measurement of investment risk is available for the largest schemes that pose the greatest underfunding risk to us should a claim be made. This is achieved by allowing for a more refined table of asset stresses and a risk factor assessment, whereby any derivative exposure is measured.

4.4.4 For schemes that have the option of submitting bespoke results, we generally expect that only schemes with risk-reducing derivative positions will find that this option is attractive. For example, LDI strategies that use swaps are likely to find that this de-risking is better recognised in the bespoke approach. We advise trustees to consider any costs associated with bespoke analysis compared to the potential for a lower levy.

4.4.5 Schemes that are considering whether to submit bespoke results for 2012/13 should note our expectation that, once a scheme has chosen to submit bespoke results, it should continue to do so for future years. We will be considering rules to support this policy next year based on analysis of our experience in 2012/13.

4.4.6 It is an offence under section 80 of Pensions Act 2004 to knowingly or recklessly provide information that is false or misleading in a material particular. As with other data fields, we will monitor the plausibility of bespoke results that are reported, including a comparison of the stress factor under the bespoke approach relative to that implied under the standard approach. We may request further information on the calculations underlying the bespoke results and may disregard those results which are not verifiable.

4.4.7 In the interests of minimising costs to schemes, we do not require formal certification of the bespoke results. We will, however, keep this policy under review should we consider that there is evidence of inaccurate and misleading results being reported. We will also be monitoring voluntary submissions across years to ensure that any reduction in levy appropriately reflects any reduction in risk.

4.5 Consultation on Guidance for Bespoke Calculation

Summary of consultation responses

4.5.1 The Board would like to thank all respondents to the consultation on the Guidance for the Bespoke Calculation of Investment Risk. Overall, most respondents were broadly content with the clarity and content of the guidance.

4.5.2 A number of comments related to the recognition of asset classes such as hedge funds and multi-asset funds. Several respondents noted that a single category of “hedge fund” seemed too broad given the range of strategies that could be covered by this term. There were also a few respondents who questioned our proposal that multi-asset funds generally be reported according to their underlying component breakdowns, as they felt that this would not reflect sufficiently the diversification benefits of such funds.

4.5.3 Another issue raised was that the stresses for overseas asset classes were derived assuming that the level of currency hedging adopted, if any, was fixed. A few respondents suggested that there should be greater distinction between fully hedged and unhedged investments.

4.5.4 The treatment of annuities also attracted comment, with several respondents suggesting that the proposal to apply a positive asset stress of 12 per cent to all annuities could lead to anomalous results, particularly compared to the degree and number of stresses for fixed income assets.

4.5.5 Other responses discussed the asset class definitions provided in the Exchange help file and the formulae contained in the guidance. Most points related to areas of ambiguity or inconsistency in certain descriptions, for which clarification was requested. Some comments supported the flexibility of the approach, while others felt that certain categories should be more specifically defined to reduce the scope for discretion.

4.5.6 A few responses requested more details on how schemes should reconcile the process and timelines for the bespoke calculation and those for reporting of annual accounts.

4.5.7 There were also several comments raising the role of longevity risk, and whether this would be considered as a specific risk factor in future versions of the bespoke approach.

The Board's response

4.5.8 We have updated the guidance to clarify areas of potential ambiguity and to remove any inconsistencies. Where further discussion of particular issues was requested, such as timelines for calculation and reporting, we have made additions as appropriate. Consistent with requirements for reporting of schemes' asset allocation, we expect the bespoke analysis to be carried out on an annual basis. This should be undertaken using the most recent audited accounts, as available at the time that the scheme return is submitted.

4.5.9 We considered alternative approaches that would allow for drawing greater distinctions within the category of hedge funds. One method that could accommodate a fuller spectrum of risk for different strategies was to allow individual managers and advisers to calculate stresses specific to their own fund or product using the published set of risk factors. Such an approach could take the form of assessing an asset stress of an investment relative to its historical record of volatility, for example.

4.5.10 Such an option would challenge our objective of an approach that would be consistent and relatively simple to apply across the diverse range of products that are available. The calculations involved would increase advisory costs for schemes, which would likely wish to assess the levy impact of an alternative option if this were available.

4.5.11 Another suggestion was to have the subclasses of “fund of hedge funds” and “single strategy hedge fund”, on the assumption that holdings of the latter would be higher risk and be subject to a higher asset stress. While this appeared to offer an attractive option, we did not consider that many schemes would invest in a single strategy hedge fund in isolation from other strategies. This would suggest that assets held as such would benefit from the diversification benefits inherent in a fund of funds, and so, in aggregate, a higher asset stress would be inappropriate.

4.5.12 We consider the treatment of hedge funds and multi-asset funds allows for an appropriate degree of recognition of the range of risk profiles associated with these investments, given the objectives of the bespoke approach and the data on scheme investments that is currently available. These categories encompass a wide range of assets and strategies, including active currency; it would be challenging to identify all of these as distinct asset classes. We will, however, continue to monitor whether any additional categories can and should be provided for over time.

4.5.13 In order to assess the impact of our currency hedging assumption in the overseas equity stress, we calculated volatilities across different hedge ratios over rolling five-year periods. We did not find sufficient evidence to support greater recognition of different hedge ratios. The volatilities for completely hedged compared to unhedged were broadly similar. Furthermore, there was no consistent pattern of higher or lower risk for unhedged compared to hedged instruments across time periods.

4.5.14 We have considered how we could recognise annuity assets to reduce the potential for unfavourable treatment relative to liabilities. In order to ensure that the risk reduction provided by annuities is reflected in the asset stress without the need for more complex calculations, we have increased the positive stress by assuming that annuities held are heavily weighted towards inflation-linked benefits.

4.5.15 As we noted in the October consultation on the new levy framework, it was unclear how longevity risk could be reflected in the context of investment risk measurement. In their original report, Redington tested whether this could be identified as a separate risk factor and concluded that it would not be appropriate to do so.[4] We will monitor this position in future.

[4] The Redington report is available at: http://www.pensionprotectionfund.org.uk/levy/Documents/redington_investment_risk.pdf

5. Insolvency Risk

5.1 Introduction

5.1.1 This chapter sets out important changes to the way that insolvency risk will be measured in the new formula. A key feature is the use of monthly D&B Failure Scores to place employers into one of ten Levy Bands. The rules for how this will be implemented, as well as how we will measure insolvency risk where no monthly Failure Score is available, are described below. The application of scheme structure factors is also addressed.

5.1.2 We note a likely change to D&B methodology during the first three years of fixed levy rules, and D&B's commitment to managing its development and implementation carefully with us. The Board aims to deliver the stability and predictability schemes and employers are looking for.

5.1.3 Levy payers will, as now, be able to appeal their Failure Scores with D&B. This is described briefly below.

5.2 Insolvency Risk in the New Framework

5.2.1 As confirmed in the Policy Statement, a new system of insolvency risk measurement will take effect from 2012/13. Part E of the draft Determination details the rules as they relate to measuring the risk of employer insolvency.

5.2.2 The vast majority of employers will be placed into one of ten Levy Bands, each of which has an associated Levy Rate. The Insolvency Risk Appendix of the draft Determination sets out how an employer's average D&B Failure Score over 12 months[5] will be mapped to a Levy Band. Where a scheme acquires a new employer during the measurement period, we will use the average Failure Score of that new employer over the same 12 months (if available), notwithstanding that the new employer was not associated with the scheme for all of the 12 month measurement period.

5.2.3 We aim to measure insolvency risk of guarantors in the same way as for employers but are making some changes to how guarantor insolvency risk is measured in some multi-employer schemes. Chapter 6 discusses how contingent assets will be affected by the new framework.

5.2.4 The Insolvency Rate is the rate which is applied to the scheme. For single-employer schemes, this will generally be the relevant Levy Rate. The

[5] As measured on the last working day of each month.

Insolvency Rate for multi-employer schemes will be the average of all employers' Levy Rates, weighted by members, and subject to final multiplication by a scheme structure factor where appropriate.

5.2.5 Foreign employers will continue to have their non-UK Failure Score converted to a UK Failure Score, and then be placed into the appropriate Levy Band after averaging.[6] In some circumstances, D&B may assign a Risk Indicator rather than a Failure Score. Where an employer is assigned a Risk Indicator, this will be mapped to the UK Failure Score with the closest insolvency probability as measured by D&B. If available on a monthly basis, we will use these UK Failure Scores to calculate an average Failure Score, which will then be placed into a Levy Band. Otherwise we will use the Risk Indicator as at the end of March 2012 to map to a UK Failure Score.

5.2.6 Where Failure Scores or Risk Indicators are not available, we will apply a scheme average, an industry average or a blended average. These will be calculated broadly as now, except that we will use Levy Rates instead of insolvency probabilities to construct the relevant averages (Rule E2.5-E2.7 of the draft Determination). Where an average measure is appropriate, it will be applied directly to the relevant employer without being placed into a Levy Band.

5.2.7 For last man standing associated schemes, as set out in rule E3.3(1), a scheme structure factor of 0.9 will be applied to the weighted average of Levy Rates to calculate the scheme's Insolvency Rate.

5.2.8 Rule E3.3(3) contains the formula for a new scheme structure factor for last man standing non-associated schemes. The factor has been developed to reflect the relative size of all employers within the scheme, rather than solely the relative size of the largest employer as is the case currently. We encourage the minority of schemes that are affected by this change to review this new calculation.

5.3 Updating Employer Information

5.3.1 Employers and schemes are reminded that monthly Failure Scores from the end of April 2011 to the end of March 2012 will be used in calculating each employer's annual average Failure Score. It is this average that will be used to allocate employers into PPF Levy Bands as at 30 March 2012, as set out in the Insolvency Risk Appendix. D&B will provide the monthly Failure Scores that will be used for the purposes of averaging (i.e. those

[6] The conversion tables that will be used are available in the Insolvency Risk Appendix.

as at the last working day of each month) to schemes, employers and their advisers free of charge on request.[7]

5.3.2 Schemes may wish to ensure that D&B holds information on their employers that is as accurate and up-to-date as possible. All information that is provided by the end of a month will be used to update the Failure Score that applies for the following month. For example, financial accounts lodged with Companies House on 26 October 2011 will be reflected in the score that is assigned as at 30 November 2011.

5.4 Possible Changes in D&B Methodology

5.4.1 D&B regularly monitors the predictive power of the methodology by which it assesses employer strength. This means that it makes adjustments to its methodology to incorporate new information and analysis. While minor adjustments are made on a routine basis, D&B also undertakes more fundamental reviews of its methodology and the factors that are reflected in its Failure Scores from time to time.

5.4.2 It is likely that D&B will introduce an updated methodology in the first three year period of fixed levy rules, but we have not yet been able to assess its impact on sponsoring employers of eligible schemes as it is still being developed by D&B. We will work closely with D&B with the aim of ensuring that development and implementation of any new methodology is managed carefully, assuming D&B is still the insolvency risk provider, to ensure that the Board's goals of stability and predictability can still be achieved.

5.5 D&B Appeals

5.5.1 The system of D&B appeals as it applies to monthly Failure Scores will remain broadly similar. All schemes or employers may appeal the Failure Scores underlying the annual average Failure Score following the issuance of the levy invoice or following calculation of the average Failure Score after the end of May 2012. We would note that, in many circumstances, the combined effect of banding and the use of 12 monthly scores will be to reduce the potential levy impact of appeals relating to individual Failure Scores.

5.5.2 As with the 2011/12 levy, D&B will use a streamlined three-stage appeals process. Rather than two stages handled by each of the customer services and scoring teams, these teams will review each appeal once. This will

[7] Contact details are available on the PPF website under "Insolvency Risk".

allow appeals to be escalated more rapidly to senior levels within D&B. As now, schemes will have 28 days from the conclusion of unsuccessful appeals to initiate the next stage. Details of this new process are available on the PPF website.

6. Risk Reduction: Contingent Assets, Deficit-Reduction Contributions

6.1 Introduction

6.1.1 This chapter discusses the risk reduction measures that schemes may take that will be recognised in the risk-based levy. The treatment of deficit-reduction contributions and contingent assets in the context of the new levy framework is described. Changes mainly relate to adjustments for the new smoothing and/or stressing processes.

6.1.2 There are two main proposed changes to the rules for contingent assets, detailed below. These relate to the definition of "associate", as required of chargors, guarantors, and purchasers, and the recognition of Type A contingent assets in multi-employer schemes.

6.1.3 This chapter also notifies trustees and advisers of the importance of establishing that any Type A guarantor has sufficient financial strength to be able to stand behind the liabilities being guaranteed. As part of the move to the new framework, we are proposing to further strengthen our rules in this area, including by the introduction of a new certification on Exchange.

6.2 Contingent Assets in the New Framework

6.2.1 Schemes may continue to reduce their risk by certifying contingent assets. The current process and deadlines will remain in place, so hard copies of documentation must be received by the PPF by 5pm on 30 March 2012.

6.2.2 We consider that the following adjustments to the value of Type A, Type B (ii) and B(iii) contingent assets are appropriate to ensure that the measurement of underfunding and insolvency risk remains consistent between assets that are held by a scheme and contingent assets, and between employers and guarantors. The Contingent Asset Appendix of the draft Determination contains further details of the formulae that will be used.

6.2.3 Type A: Type A guarantees will continue to reflect the commitment made by the guarantor by substituting the risk of insolvency of the guarantor for that of the employer, where the guarantee is for 105 per cent of liabilities. The insolvency risk of guarantors will be assessed using average Failure Scores measured on a monthly basis over a year if available, then assigned to a Levy Band with an associated Levy Rate. If fewer than 12 months' data are available, we will use the single Failure

Score as at the end of March 2012. New guarantors will be subject to the same process, i.e. if the contingent asset is properly certified by 5pm on 30 March 2012, we will look at the insolvency risk of the guarantor over the previous year.

6.2.4 Type B(ii) security over property: The certified value of charges over property will be subject to the asset stress on property (which is minus 6 per cent). As we consider that property valuations include an element of averaging, no separate smoothing will be applied.

6.2.5 Type B(iii) security over securities: The certified value of charges over securities will be subject to both smoothing and stressing as "other" assets.

Policy changes to contingent assets

6.2.6 As announced in *A New Framework: Policy Statement*, we do not propose any wholesale changes to the types of contingent assets we will recognise, nor the main requirements for recognition. We will continue to monitor and review the regime in the context of industry and stakeholder developments to ensure it continues to be fit for purpose.

6.2.7 A limited number of changes to the current requirements are proposed for 2012/13, as described below.

Definition of associate

6.2.8 We propose to amend the definition of "associate" for the purposes of being a guarantor, charger or purchaser; this new definition is at paragraph 4 (4) of the Contingent Asset Appendix. The objective of this change is to broaden the range of eligible chargors, purchasers, and guarantors. Currently, we require that a guarantor or charger or purchaser is "associated" to one of the scheme employers in a strict legal sense, i.e. by reference to section 435 of the Insolvency Act. We are aware that this rule has prevented some entities with a legitimate interest in offering a guarantee for the benefit of the scheme from doing so. This could be the case, for example, for organisations that do not fall within the strict legal definition but nevertheless have a close connection to a scheme employer.

6.2.9 This amendment expands the definition of "associate", so that an entity which satisfies the Board of a sufficiently strong connection to an employer, independent of the existence of the contingent asset, would be recognised as an associated party. We expect that this should enable a number of additional schemes to enter into contingent asset arrangements. We do, however, require a genuine connection between the guarantor or charger or purchaser and the employer. We will require an appropriate certification to be given on Exchange and evidence of this connection to be presented to us as part of an affected scheme's contingent asset submission, in advance of the deadline of 5pm on 30 March 2012. It is intended that the Contingent Asset Guidance, which will be published for 2012/13 alongside the final levy Determination, will contain further details as to what evidence would suffice. A draft of the guidance will be available in the coming weeks.

Type A contingent assets in multi-employer schemes

6.2.10 We also propose that, where a Type A contingent asset is provided for a multi-employer scheme, the Levy Rate of the guarantor will only be substituted for those employers which have a higher Levy Rate. If any employers have a lower Levy Rate (i.e. pose less insolvency risk) than the guarantor, they will be able to carry this through to the calculation of the scheme's Insolvency Rate. This change is reflected at paragraph 17 of the Contingent Asset Appendix.

6.2.11 This amendment has been made to reflect levy payer concerns that our rules could deter the use of Type A contingent assets by multi-employer schemes, particularly where there may be a wide range of employer strengths represented and the guarantor is not the strongest company in the group.

6.2.12 Where a multi-employer scheme has a Type A contingent asset in place and is either a centralised or last man standing scheme, the relevant scheme structure factor will apply only to the Levy Rate(s) of any employer that is used in the calculation of the Insolvency Rate. Any Levy Rate or Non-Employer Score that is derived from the guarantor will not be multiplied by the scheme structure factor.

Strength of Type A contingent assets

6.2.13 We would like to emphasise that it is a requirement that contingent assets reduce the risk of compensation being payable to an extent that is proportionate to the levy reduction secured. We propose to strengthen our rules in this area, for the benefit of all levy payers. The 2012/13 Determination requires that the reduction in levy, if any, should be consistent with any reduction in risk of compensation being payable.

6.2.14 Based on our analysis of current Type A agreements, there is evidence to suggest that the financial strength of some guarantors may not be sufficient to meet the obligations that have been undertaken. We have undertaken an exercise to assess the potential amount that could be claimed under some contingent asset arrangements and compared this with publicly available information on the financial strength of the guarantor. The results of this exercise have raised concerns that, for a minority of schemes, the contingent asset would not realise the value anticipated. In such circumstances, it is difficult to conclude other than that the risk reduction provided by the contingent asset is of limited or no value.

6.2.15 As part of the new levy framework the PPF will be requiring schemes to certify on Exchange that guarantors could be expected to meet their full commitment under the contingent asset if called upon to do so as at the date of the certificate. The PPF will also be taking active steps to obtain comfort as to the financial strength of entities that are entering into guarantee arrangements for the 2012/13 levy year to consider whether any reduction in a scheme's levy that may result from recognition of a contingent asset for levy purposes is consistent when compared with the reduction in risk.

6.2.16 This will apply both to newly certified contingent assets, and to existing recertified contingent assets. It is proposed that a new certification requirement will be included on Exchange, details of which are set out at paragraph 31(b) of the Contingent Asset Appendix. Where there is reason to question the value of the arrangement to a scheme, we may request further independently verifiable information to assist us in deciding whether to accept that contingent asset. Where satisfactory evidence is not forthcoming within the required timescales, the contingent asset will be ignored for the purposes of the levy calculation.

6.3 Deficit-Reduction Contributions in the New Framework

6.3.1 Certified deficit-reduction contributions (DRC) made to a scheme will continue to be recognised in the calculation of underfunding risk. As now, schemes will receive immediate and full credit for DRCs that have been made up to 31 March 2012 and appropriately certified on the Exchange system by 5pm on 10 April 2012.

6.3.2 We do not propose any changes to the DRC certification requirements, which are widely understood and accepted across the industry. In order to maintain the current requirements, and to avoid introducing disproportional complexity, DRCs will not be subject to smoothing or stressing.

6.3.3 As described in Part G of the Determination and the Deficit-Reduction Contributions Appendix, the amount that is certified will be added to the measure of assets used in the calculation of underfunding risk. We propose, however, to monitor the usage of the DRC certification process to ensure that this treatment remains appropriate.

7. Consultation Arrangements and Key Dates

7.1 Introduction

7.1.1 This chapter provides contact details to respond to this consultation. Key dates for the calculation of 2012/13 levies are also set out below.

7.2 Consultation Arrangements

7.2.1 The consultation on the 2012/13 Determination will run from 21 September 2011 to 5pm on 2 November 2011. Please ensure that your response reaches us by the deadline. Submissions may be made by email or post, using the details below.

Email: consultation@ppf.gsi.gov.uk

Postal address: Catherine Mo
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon, Surrey
CR0 6SR

7.2.2 Please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

7.2.3 Under the Freedom of Information Act 2000 (FoIA), all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication.

7.2.4 If this is not the case, the respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with FoIA obligations and general law on this issue. Further information can be found on the website of the Ministry of Justice at: http://www.justice.gov.uk/guidance/freedom-and-rights/freedom-of-information.

7.2.5 A summary of responses and the Board's final Determination and confirmed policy will be published on the PPF website at http://www.pensionprotectionfund.org.uk in December 2011.

7.3 Key dates

7.3.1 Under the new framework, we will continue to use information from the annual scheme return that is submitted via the Pension Regulator's Exchange system to calculate levies. The deadline for submission is 5pm on 30 March 2012, except as detailed below.

Item	Key dates
Monthly D&B Failure Scores	Between 28 April 2011 – 30 March 2012
Consultation on draft 2012/13 Determination closes	5pm, 2 November 2011
The Exchange system opens for submission of scheme returns	November 2011
Submit scheme returns on Exchange	By 5pm, 30 March 2012
Reference period over which funding is smoothed	5-year period to 30 March 2012
Certification of contingent assets	By 5pm, 30 March 2012
Certification of deficit-reduction contributions	By 5pm, 10 April 2012
Certification of full block transfers	By 5pm, 29 June 2012
Invoicing starts	Autumn 2012

7.4 Comments on the Consultation Arrangements

7.4.1 This consultation is being conducted in line with the Code of Practice on Consultation. This is available on the website of the Department for Business, Innovation and Skills (BIS) at: http://www.bis.gov.uk/policies/betterregulation/consultationguidance/code-of-practice.

7.4.2 The Board would welcome feedback on the consultation process. If you have any comments, please contact:

Paul Reynolds
Director of Corporate Affairs
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
CR0 6SR

Telephone: 020 8633 4968
Email: Paul.reynolds@ppf.gsi.gov.uk

Annex A: Formulae for the risk-based levy scaling factor and the scheme-based levy multiplier for 2012/13

A.1 Risk-based levy scaling factor

A.1.1 The pension protection levy estimate for the 2012/13 levy year is £550 million.

A.1.2 The 2012/13 risk-based levy scaling factor is calculated using the formula:

$$LSF \times \sum_{i=1}^{T} (U_i \times IR_i) = Q$$

Where,

- T = the number of Pension Protection Fund eligible schemes excluding schemes that are in assessment;
- U_i = the underfunding risk factor (including contingent assets and certified deficit reduction contributions) of the ith eligible scheme/section;
- IR_i = the insolvency risk factor for the ith eligible scheme/section;
- Q = the pension protection levy estimate;

A.1.3 The levy scaling factor is the solution, LSF, to the linear equation shown above.[8]

A.1.4 In deriving LSF, the above formula is applied to the known universe of eligible schemes and sponsoring employers as at 31 March 2011, using estimates of underfunding risk and insolvency risk as at 31 March 2012. For this purpose, underfunding risk is estimated using transformed scheme assets and liabilities based on historic market information available at the

8 Note that this formula is slightly simplified and does not take account of, among other things, the need to scale up for schemes in respect of which the PPF does not have adequate data when it is calculating the scaling factor and multiplier, and the technical criteria for the exclusion of a scheme in assessment from the levy.

time of calculation and insolvency risk is estimated using Levy Rates derived from Failure Scores at 31 March 2011.

A.1.5 Individual schemes' risk-based levies will be calculated using actual underfunding risk and insolvency risk as at 31 March 2012. For this purpose, underfunding risk will be determined using transformed assets and liabilities based on market information over the five year period to the last working day in March 2012, and insolvency risk will be calculated using Levy Rates derived from the average of month end Failure Scores over the year ending 31 March 2012 for the known universe of sponsoring employers.

A.1.6 When the formula set out in A.1.2 above is applied in accordance with the principles detailed in A.1.4, the resultant risk-based levy scaling factor is 0.89. Although the calculation of the levy scaling factor is included in the scope of this consultation, we do not expect the final figure to differ.

A.1.7 Individual schemes' risk-based levies will continue to be subject to a cap of 0.75 per cent. This levy cap will be calculated using a scheme's smoothed but unstressed liabilities.

A.2 Scheme-based levy multiplier

A.2.1 For the 2012/13 levy year the scheme-based element of the pension protection levy will be set to equal that element of the levy estimate which would otherwise have been foregone as a result of the application of the levy cap.

A.2.2 References to s179 liabilities in the formula and definitions below relate to those used in the calculation of the levy cap, i.e. the smoothed but unstressed s179 liabilities.

A.2.3 The 2012/13 scheme-based multiplier is calculated using the formula:

$$SLM \times \sum_{i=1}^{T} L_i = Q - \sum_{i=1}^{T} \min(U_i \times IR_i \times LSF, K \times L_i)$$

$$SLM = [Q - \sum_{i=1}^{T} \min(U_i \times IR_i \times LSF, K \times L_i)] / \sum_{i=1}^{T} L_i$$

Where,

- T = the number of Pension Protection Fund eligible schemes excluding schemes in assessment;
- $\sum_{i=1}^{T} L_i$ = the sum of s179 liabilities over all eligible schemes;
- Q = the pension protection levy estimate;
- U_i = the underfunding risk factor (including contingent assets and certified deficit reduction contributions) of the ith eligible scheme;
- IR_i = the insolvency risk factor for the ith eligible scheme;
- LSF = the risk-based levy scaling factor;
- K = the levy cap expressed as a decimal.

A.2.4 The scheme-based multiplier is the solution, SLM, to the non-linear equation shown above.[9]

A.2.5 In deriving SLM, the above formula is applied to the known universe of eligible schemes and sponsoring employers as at 31 March 2011, using estimates of underfunding risk and insolvency risk as at 31 March 2012. For this purpose, underfunding risk is estimated using transformed scheme assets and liabilities based on historic market information available at the time of calculation and insolvency risk is estimated using Levy Rates derived from Failure Scores at 31 March 2011.

A.2.6 Individual schemes' scheme-based levies will be calculated using actual transformed scheme liabilities as at 31 March 2012. For this purpose, transformed scheme liabilities will be determined using market information over the five year period to the last working day in March 2012.

A.2.7 When the formula set out in A.2.3 above is applied in conjunction with the principles detailed in A.2.5, the scheme-based levy multiplier is 0.000085. The multiplier will be confirmed in the final determination and is unlikely to differ from this figure.

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[9] See note 8 above.

www.pensionprotectionfund.org.uk