

Consultation Document

The 2013/14 Pension Protection Levy Consultation Document

Foreword

These are challenging times; both for pension schemes and for the economy as a whole. Pension schemes face the impact of falling yields depressing their funding, while at the same time there is a rising risk of sponsor insolvency. The Pension Protection Fund, as the safety net for Defined Benefit schemes, is not immune to these developments.

Last year, following a major consultation with the industry, we put in place a regime, the New Levy Framework, designed to deliver enhanced predictability and stability for individual schemes. A key component of that was that the total we aim to charge, our Levy Estimate, would rise or fall along with the risk of individual schemes.

Given the substantial rise in risk that we have seen in the last year, and the recognition that parental guarantees offer less protection than they appeared to, it should come as little surprise that levies are on the rise. We are already seeing the impact of this in the current year; as a consequence of these two factors, we now expect the total of bills we invoice for 2012/13 will be around 15 per cent higher than our Levy Estimate predicted.

Our levy framework provides for an automatic restriction on changes in total levy, as the Levy Estimate cannot increase (or decrease) by more than 25 per cent year on year. We have however set a Levy Estimate below that level, at £630 million for 2013/14, which will have the effect of freezing the total we levy at the level we are now expecting to collect this year – so that schemes will typically see levies at similar levels in 2013/14 as they will for this year. However we cannot continue to hold levies down in future years – and assuming a continuation of current conditions we expect to see a further increase in levy in 2014/15 and thereafter.

Whilst any increase in levies is bound to be unwelcome, I would hope that stakeholders will appreciate that there really is no realistic alternative. If our protection regime in the UK is to be credible, then it needs to be funded. The alternative, an inadequately resourced Fund, would fail to offer the security that pension scheme members deserve, and would simply strengthen the hand of those who argue for more radical measures to deal with risk such as the imposition of insurance style solvency requirements for pension schemes.



Alan Rubenstein
Chief Executive

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1. Introduction and Executive Summary

1.1 The 2013/14 Pension Protection Levy Consultation

Overview

- 1.1.1 This consultation document sets out the basis on which the Board intends to charge the Pension Protection Levy for the 2013/14 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 We put in place 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 Amongst these, two of particular significance were that:
- We would aim to hold the parameters for the levy constant, for 2012/13 and the following two years, with the result that the total the Board expected to collect, the Levy Estimate, would rise or fall depending on changes in overall risk;
 - data submitted up to the start of the levy year² would be used in calculations. This means bills are based on more up-to-date information, but requires an extended range of assumptions to be made to predict the amount that a given set of parameters will, in practice, collect.
- 1.1.4 The determination of our Levy Rules and publication of the Levy Estimate for the year remains an annual process (as required by the Pensions Act), so we have given consideration to whether each of the levy parameters remains appropriate and calculated what we think the Levy Estimate for 2013/14 should be. In reviewing the parameters we have had regard to the objective of the New Levy Framework to offer improved stability and predictability over the years to 2014/15, with the result that changes have only been made where there is a compelling reason to consider that the parameter is no longer appropriate.

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

² The principal data deadline was 5pm 30th March 2012, with later deadlines for deficit-reduction contributions (DRCs) and Block Transfers

Increasing Risk

- 1.1.5 The New Levy Framework means that the overall amount we charge rises if risk increases (and falls if risk decreases), subject to a maximum year-on-year change of 25 per cent in the published Levy Estimate. In our measurement of risk, smoothing (especially of asset and liability values) lessens the impact of changing risk, reduces the likelihood of needing to recalibrate parameters of our formula and reduces the scale of any adjustment if one is still needed.
- 1.1.6 The last year has seen risk in the PPF universe rising significantly. This has affected both the amount we expect to collect in 2012/13 and the setting of the Levy Estimate for 2013/14.

Impact on 2012/13 Levy

- 1.1.7 Last year's Levy Estimate was £550 million. However we now expect to collect around 15 per cent more than that, though the exact sum is still uncertain.
- 1.1.8 The most significant factors causing a change in the levy to be billed are the non-recertification of certain contingent assets (the aggregate effect being to reduce the overall impact of those contingent assets that had been put in place in 2011/12 by 15 per cent in 2012/13) and a halving of the impact of new contingent assets compared to that expected. In addition, lower than anticipated certified deficit reductions and the reduction in yields had an impact on funding.
- 1.1.9 There remain uncertainties about the amount we will collect for 2012/13. These include changes in data following reviews and D&B appeals. For this reason we report on the amount invoiced for the levy year in our annual report (which for 2012/13 will be published in 2013).
- 1.1.10 There is no legal basis for setting an updated Estimate, and £550 million remains the base against which any increase in levy for 2013/14 is judged.

Impact on 2013/14 Levy

- 1.1.11 Overall, risk has increased significantly in the last year. The aggregate deficit of those schemes that are in deficit has more than doubled and our expected claims over a twelve month period (based on the deficit of schemes in deficit multiplied by the risk of insolvency) have risen to around £2 billion before recoveries.
- 1.1.12 In addition to the impact of market movements, it now appears likely that the level of risk reduction provided by contingent assets will be lower

than had been anticipated, as many have been withdrawn and new certifications have been at a lower rate than in previous years for 2012/13.

- 1.1.13 As a result, were we to maintain unchanged levy parameters, our Levy Estimate would increase to £765 million. This remains substantially below the Levy Ceiling (which for 2012/13 was £918 million) but would constitute more than the maximum permitted 25 per cent increase on the 2012/13 Levy Estimate of £550 million. We will therefore adjust the levy parameters for 2013/14 to bring the Levy Estimate within the permitted range.

The Board's intended Levy Estimate

- 1.1.14 The Board considered simply making a mechanical adjustment to the parameters to meet the legal requirement that increases to the year-on-year Levy Estimate are limited to 25 per cent. Instead, we have taken the opportunity to consider afresh the level of the Levy Estimate for 2013/14. Our aim in doing so is to provide a balance between the need to charge an appropriate levy for the increased risk we face and recognition of the challenging environment for pension schemes.
- 1.1.15 Accordingly, we have decided to set a Levy Estimate for 2013/14 of £630 million, a similar level to that we now expect to collect for 2012/13. As a result, schemes whose risk moves in line with the average shift in risk over the year to 31 March 2013 can expect to see a levy bill in 2013/14 at a similar level as their 2012/13 invoice.
- 1.1.16 Based on our assessment of economic prospects and changes in the PPF universe, we believe that a levy at this level remains consistent with progress towards our long-term funding objective, provided the reduction does not constitute a permanent reduction in levy income. For this reason, stakeholders should not expect the PPF to intervene to over-ride the normal operation of the New Levy Framework rules in future years.
- 1.1.17 Our expectation is that there will be a further rise in the levy for 2014/15, assuming that current circumstances continue. We currently anticipate the Levy Estimate will increase (by around 10 per cent) between 2013/14 and 2014/15, assuming that current market conditions persist over the period to 31 March 2014. Other factors might reduce that impact, or reinforce it, but our firm intention is that we would only intervene to control the change in levy were it to exceed a 25 per cent year on year shift, and then only to reduce the change to that limit.
- 1.1.18 For 2015/16, with the end of the first triennium, we will review afresh the level at which all the parameters are set. This review will be carried out by reference to our Funding Strategy. We will publish the next annual

update on that in October 2012, but fundamentally unless risk falls – through improvements to the funding of schemes, risk or reduced insolvency experience – then levies will need to remain at a high level.

Levy parameters

- 1.1.19 Based on the assumptions that we have made, and set out in Section 2 below, a reduction of the levy scaling factor from 0.89 to 0.73 is needed to raise a levy of £630 million.
- 1.1.20 This reduction in the scaling factor will mean that fewer schemes will have their levy capped. Under the New Levy Framework the scheme based levy (SBL) is set at the level which covers the cost of capping risk-based levies. Accordingly the SBL will be reduced to £55 million and the scheme-based levy multiplier will be 0.000056, a reduction from 0.000085 in 2012/13.
- 1.1.21 We have concluded that all other levy parameters remain appropriate and will not be changed.
- 1.1.22 The switch to making use of data as at the start of the levy year means that the role of the assumptions that we have made in developing the levy estimate has never been more important. Accordingly these assumptions are prominently discussed in this consultation document.

The Board's Determination under section 175(5) of the Pensions Act 2004: the Levy Rules

- 1.1.23 The draft Determination under section 175(5) of the Pensions Act 2004 is published alongside this consultation document. These Levy Rules express the Board's policy in legal form.
- 1.1.24 Policy changes in the Levy Rules are limited, in order to provide stability. We have relaxed the requirements in relation to guarantors and custodians for Type B and Type C contingent assets – to recognise that current market conditions have resulted in the downgrading of bank credit ratings of many financial institutions.
- 1.1.25 We have also indicated areas in which we plan to develop the Guidance that we publish alongside the Levy Rules in December, and are inviting stakeholders to flag areas in which they would appreciate more guidance. One area of focus is likely to be the requirement introduced in 2012/13 in relation to strength of guarantors for Type A contingent assets – where we now have the benefit of a year's experience.

Contingent assets

- 1.1.26 Section five sets out the background on contingent assets and our plans for 2013/14 and beyond. The intention is to operate the contingent asset regime for 2013/14 in much the same way as for 2012/13, though we intend to update the Guidance we issue to reflect experience over the last year, and we are likely to operate with somewhat less “benefit of the doubt” than in 2012/13. As best we can tell this will affect only limited numbers of schemes.

1.2 Future change in insolvency risk methodology

- 1.2.1 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.
- 1.2.2 In the 2012/13 levy consultation process we indicated that it was likely that D&B would introduce an updated methodology in the first three year period of fixed levy rules, and, recognising the potential for this to cause instability of scores, we said that we would work closely with D&B with the aim of ensuring that development and implementation of any new methodology was as seamless as possible. We also made reference to the possibility of a change in insolvency risk provider, as our contract with D&B was due to expire during the triennium.
- 1.2.3 Since then, we have extended our contract with D&B to run for the three years of the levy triennium, and have begun a competitive re-tendering exercise with a view to the appointment of a provider for the subsequent period. In the meantime, we have arranged with D&B that if there is a substantial change in their methodology before March 2014 (the end of the measurement period for levy year 2014/15 which concludes the triennium) we will be able to continue to receive scores produced on the existing basis. Maintaining a consistent methodology should minimise uncertainty during the triennium. Our early tender for a future provider is designed to allow additional time for the chosen provider to develop their systems if this is required.

1.3 Data Deadlines and Measurement Dates

- 1.3.1 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.

- 1.3.2 We have received a number of requests to relax one of the data deadlines, for submitting deficit reduction contribution certificates. Traditionally this has been set five working days into the new levy year, to allow time for schemes to obtain certification for payments up to midnight on 31 March. We have reviewed our processes, and are now able to relax the deadline to the last working day of April, without delaying invoicing for 2013/14.
- 1.3.3 We expect this change to be generally welcomed, but if there are any concerns then stakeholders should raise them before the change is confirmed.
- 1.3.4 Key dates and deadlines for the 2013/14 levy year are set out below.
- Information from the scheme return submitted by 5pm on 28 March 2013 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 by December 2012.
 - 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 30 April 2012 to 28 March 2013.
 - The deadline for certification and/or re-certification of contingent assets will be 5pm on 28 March 2013.
 - Deficit reduction contributions that have been made up to and including 31 March 2013 must be certified by 5pm on 30 April 2013.
 - Full block transfers that have taken place up to and including 31 March 2013 must be certified by 5pm on 28 June 2013.
 - We will use market data over five years to smooth funding levels. For levy year 2013/14, we will use market data for each week day in the five-year period up to 31 March 2013.
 - The date to which we will transform section 179 valuations is 31 March 2013. These transformed values will be subject to smoothing and stressing as set out in the Transformation Appendix to the Determination.

1.4 Consultation timetable

- 1.4.1 The deadline for comments on the consultation document and draft Determination is 5pm on 2 November 2012. Ideally, we would have preferred a longer period but this timetable should allow the Board to publish a summary of responses and any changes to the proposals following the consultation, by the end of 2012, along with the final Determination.
- 1.4.2 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.

2. The Levy Estimate and Parameters for 2013/14

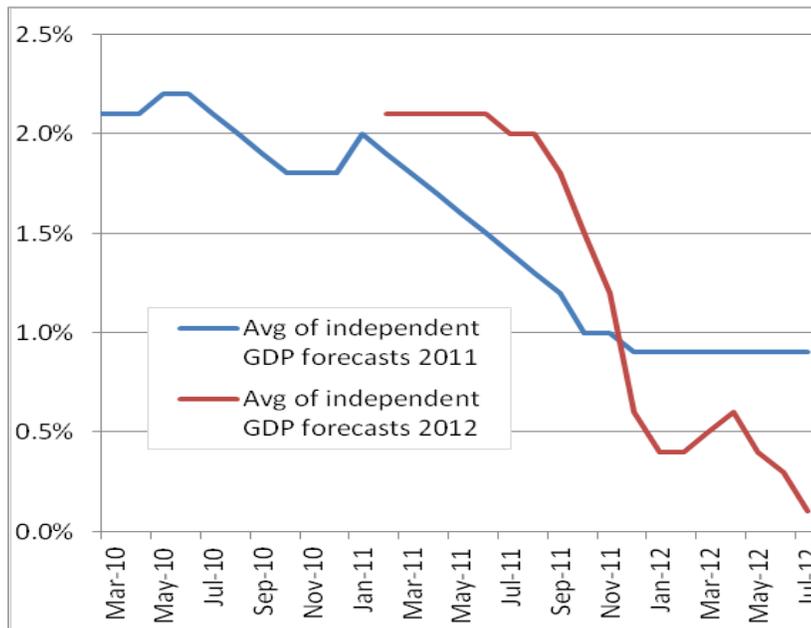
2.1 Introduction

- 2.1.1 The objective of the New Levy Framework (NLF) to deliver more stable rules for three years means we aim to avoid unnecessary changes to the levy parameters. The NLF provides for the levy scaling factor and other associated parameters to remain fixed, other than in specific limited circumstances, up to and including levy year 2014/15. In particular, our policy intention was that the levy parameters implemented for the 2012/13 levy year would only be revised for 2013/14 if otherwise, the levy estimate for 2013/14:
- Would exceed the levy ceiling; or
 - Would vary by more than 25 per cent from the 2012/13 published estimate of £550 million; or
 - Would result in more than 20 per cent of the total levy being raised by the scheme-based levy.
- 2.1.2 We remain committed to the principles behind the NLF, including keeping parameters as constant as possible throughout the three year period and that schemes' risk based levy calculations should move with changes in the level of risk they pose to the PPF year to year.
- 2.1.3 While our proposals to amend the levy scaling factor and the scheme based multiplier in 2013/14 acknowledge the difficulties currently facing schemes, we anticipate that our proposals for 2014/15 will allow the consequences of changed level of risk to flow through to levy calculations, subject only to the limits referred to above.
- 2.1.4 The maximum permissible Levy Estimate for 2013/14 is £687.5 million, £57.5 million higher than the estimate decided upon. While this lower estimate still allows us to retain an acceptable level of confidence in the probability of success under our published Funding Strategy it would not be sustainable to see similarly restricted estimates in future years, particularly considering the cumulative impact this would have.
- 2.1.5 For the reasons set out later in this document the past year has seen significant increases in scheme liabilities, coupled with lower asset returns and an expectation of historically low yields until at least March 2013.
- 2.1.6 Our starting point in setting the Levy Estimate for 2013/14 is to consider, based on the new data available to us and appropriate assumptions about data we will actually receive for the levy year, what levy quantum would

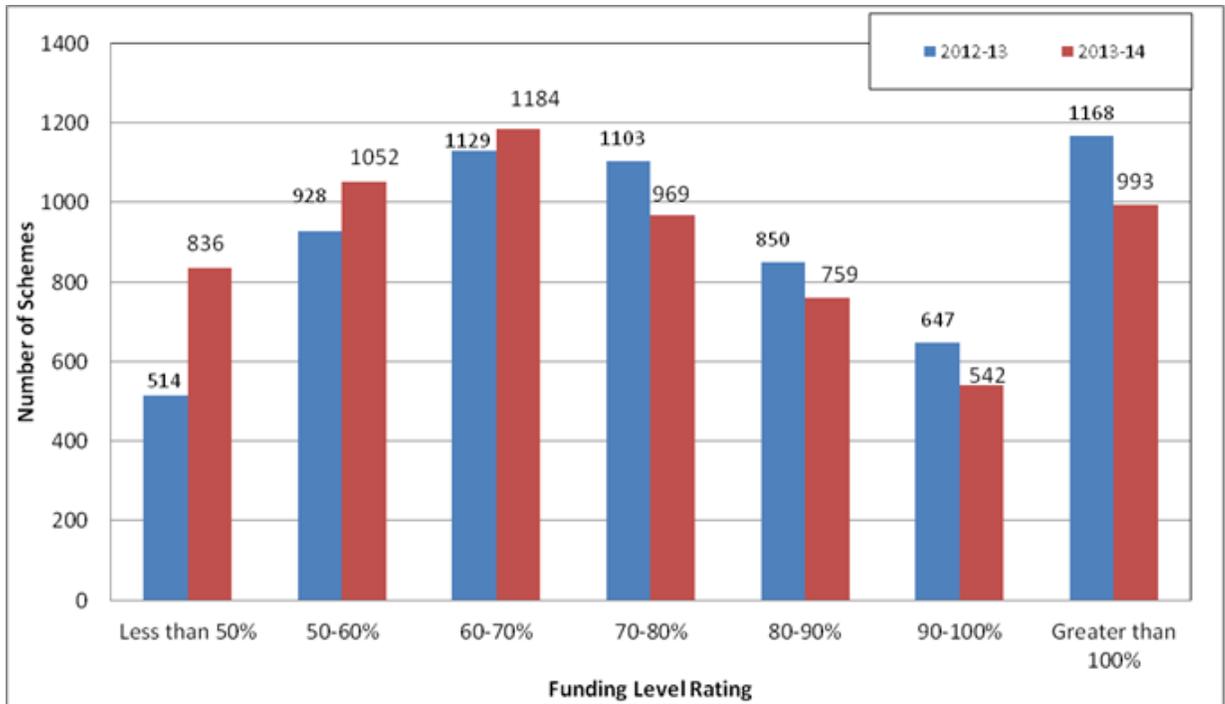
result from unchanged levy parameters. If this results in a levy quantum outside the required range for the Levy Estimate, then the parameters must be adjusted to achieve an appropriate Levy Estimate.

2.2. Levy Estimate

- 2.2.1 We have given careful consideration to the most appropriate level at which to set the Levy Estimate, given the deterioration in the risk outlook since last year, the higher than expected level of the levy in 2012/13 (itself largely a sign of worse-than-expected risk), and the impact on levy payers.
- 2.2.2 At a macro level, the economic outlook has deteriorated. A year ago there was cautious optimism about the year ahead - with economists forecasting UK economic growth of just over two per cent for 2012. However, the economy returned to recession, with forecasters now expecting zero growth or possibly a drop in GDP for 2012 as a whole. Growth has also disappointed in the US and Euro area, and has recently slowed in the large emerging economies such as China and Brazil.

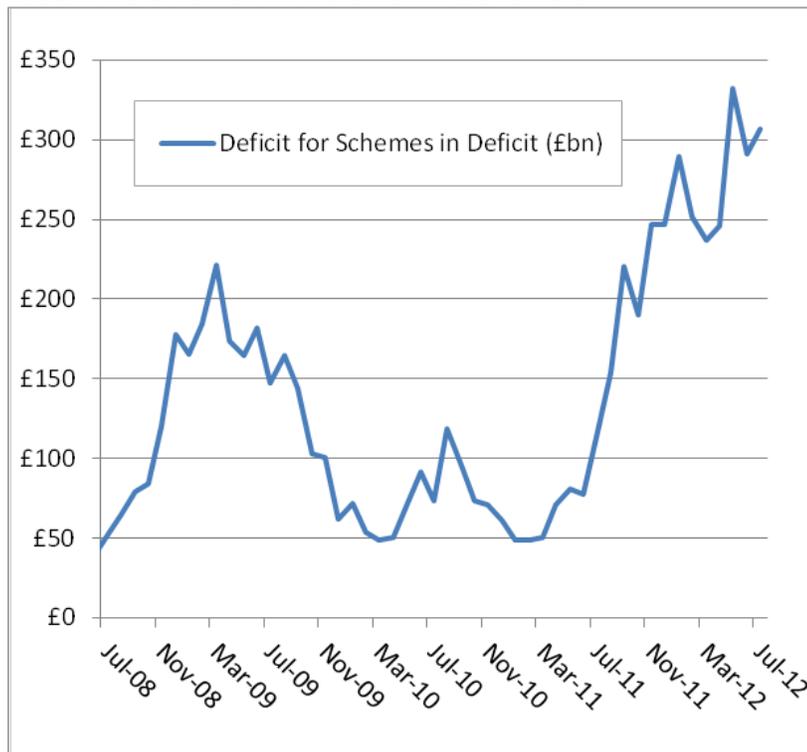


- 2.2.3 Focusing more narrowly on the risk to the PPF, there has been a marked deterioration in scheme funding on a s179 basis for our universe of schemes.



2.2.4 The funding ratio (assets divided by liabilities) has fallen to 79 per cent in July 2012 down from 93 per cent a year earlier. The aggregate deficit of schemes in deficit has leapt from £130 billion to £306 billion over the same period.

Chart of Deficit of schemes in deficit



- 2.2.5 Insolvency risk has also risen over the same period. The 1-year ahead insolvency probability for the company sponsors of our 500 biggest risks has moved up from around 0.6 per cent to 0.7 per cent over the year to August 2012. Combining this increased insolvency risk and the increase in deficits of schemes in deficit increases our expected annual claim amount before recoveries to around £2 billion.
- 2.2.6 Following our indication that we would look more closely at the value placed on contingent assets, we have also seen, the withdrawal of a large number of such assets. This suggests that the protection offered by group company guarantees is substantially lower than had been assumed in our previous modelling and it appears likely that many of those contingent assets were, in practice, of limited value.
- 2.2.7 A combination of factors including the lower than expected number of contingent assets means that our current expectation of collections for 2012/13 is that they will be around 15 per cent higher than the Levy Estimate.
- 2.2.8 For the 2013/14 levy year, starting from 1 April 2013, the Board is seeking to raise £630 million, an amount comparable to the levy we now anticipate we will collect in 2012/13. This levy is £57.5 million below the level that would have applied if the estimate were set at the maximum 25 per cent level of increase above the 2012/13 Levy Estimate. The Board believes that setting the levy at this level strikes an appropriate balance between assuring our ability to provide security to current and future members, and protecting the interests of levy payers.
- 2.2.9 The Levy Estimate is consistent with steady progress towards our long-term funding objective. Under the framework of the PPF Funding Strategy published in August 2010, the Board has an objective to maintain a probability of at least 83 per cent of reaching self-sufficiency in 2030. The Levy Estimate of £630 million is in line with this objective.
- 2.2.10 We will be publishing our Annual Report and Accounts later this year, which will present our funding position as at 31 March 2012. We plan to provide an update on our Funding Strategy at that time.

2.3. Our assumptions for the 2013/14 levy

- 2.3.1 Assumptions are needed because we produce the estimate in advance of collecting all the data. In particular, in order to ensure that the most up-to-date data is used for 2013/14 invoices we will only collect the data used for invoicing from March next year. As a result, none of the actual data that will be used for calculating levies for 2013/14 is available at the time of setting the levy parameters or determining the Levy Estimate for 2013/14.

- 2.3.2 In setting our assumptions we have looked at experience of trends in previous years, market data where available and also sought input from a number of firms of actuaries, to take account of their views of scheme behaviour in the run up to 2013/14. It is always difficult to judge individual assumptions but taken together the Board considers that these assumptions provide a balanced view of the factors that may affect the total levy.

Changes in the defined benefit universe

- 2.3.3 Each year a proportion of schemes will cease to be eligible for the PPF levy. This may be because they have bought out their liabilities, or otherwise transferred them out of the levyable universe, or it may be because the scheme has entered an assessment period.
- 2.3.4 We have removed those schemes which have entered assessment and adjusted for the transfer of Royal Mail liabilities to Government. In addition, we have removed some schemes whose particular circumstances mean that they are highly likely to enter assessment in the immediate future³, and assumed that further schemes entering assessment will have the same percentage impact on the levy collected for 2013/14 as was the case overall for 2012/13.

Changes in funding

- 2.3.5 Each year the funding risk of schemes will change as a result of market movements, new accrual and payments to reduce deficits. The assumptions for market movements are particularly critical as these include the gilt yields used to discount liabilities, as well as the indices used to value assets.
- 2.3.6 To reduce volatility in invoice amounts arising from market movements, the calculation of the underfunding risk smooths market conditions over a period of five years. As a result assumptions are required regarding market yields and indices over the period from the date on which the levy estimate is calculated up to 31 March 2013.
- 2.3.7 The levy estimate is particularly sensitive to this assumption as yields are currently at a historically low level. Most commentators expect the current economic conditions will persist, so we have assumed that recent levels will continue to March 2013.
- 2.3.8 A characteristic of the current period is that market values have been extremely volatile over the short term. Using the last available value of yields and indices could therefore lead to very different results depending

³ Whilst these schemes are identified, we do not consider it appropriate to name them.

- on the date used. In order to reduce this volatility we have projected future yields and indices over the outstanding period to 31 March 2013 based on the average values over the three months preceding the calculation date.
- 2.3.9 In relation to new accrual, our assumption is that this is balanced by regular payments into schemes. This is unchanged from previous years.
- 2.3.10 In relation to payments certified to reduce deficits, we have assumed that payments made by schemes continue at the rate they have been made in the past two years. We have considered schemes that certified payments, and the date of their last s179, in order to forecast what their certification will be by the end of April 2013 on current trends. This assumption is based on the three year cycle of actuarial valuations which typically determines the contribution levels to be set for the next three years.
- 2.3.11 The introduction of investment risk in the assessment of scheme funding for 2012/13 means that for 2013/14 we need to consider assumptions about:
- Shifts in asset mix between reporting in 2012/13 and the data that will be collected on Exchange in 2013/14;
 - The impact of bespoke stress tests, which the largest schemes must carry out, and which a proportion of other schemes can choose to do, where this would better reflect risk reduction measures.
- 2.3.12 There is little reason to expect a substantial shift in investment strategies amongst the majority of schemes so we have assumed that the asset mix of schemes as reported by March 2013 will be the same as the mix for 2012/13.
- 2.3.13 Submission of bespoke stress information was a new requirement for 2012/13, and had the effect of reducing levies by around £18 million.
- 2.3.14 The feedback from consultants suggested that some more schemes will submit voluntary bespoke stress calculations this year, as industry knowledge of the regime increases and as there is a trend for schemes to increase their use of hedging investment strategies over time. However, it was also noted that schemes may be inclined to delay implementing new hedging strategies until yields pick up, which as discussed above may not happen for some time.
- 2.3.15 On balance new submissions seem likely to be limited in number and no allowance has been made for any increase in the number of voluntary bespoke calculations for 2013/14. We have further assumed that the impact on the underfunding risk will be proportionately the same as for 2012/13.

Changes in insolvency risk

- 2.3.16 We also need to make assumptions in relation to the failure scores that underlie our measurement of insolvency risk, since these are collected for the year to 28 March 2013, and may change after that date if there is an appeal in relation to the score.
- 2.3.17 Last year we assumed that the average failure score over the period from April 2011 to March 2012 would be the same as that which applied at 31 March 2011. Overall, the actual average D&B failure scores were higher than expected, meaning that levy rates proved to be lower than the proxy used in setting the published estimate. This factor in isolation has resulted in an estimated under-collection of the 2012/13 levy by £23 million.
- 2.3.18 We considered whether to make an assumption about changes for 2013/14. The continuing weak state of the economy might be expected to lead to a rise in insolvencies, though recent experience suggests that rates remain low whilst interest rates are low, and in any case the failure score is a relative measure and so there is no reason to expect a worsening in the position of PPF universe employers relative to other businesses.
- 2.3.19 We did consider whether to make an assumption that scores would improve, in line with previous experience. There is little to base a judgement on, as we have only one transitional year's experience of the impact of the New Levy Framework changes. These changes – including the reduced sensitivity of the formula to insolvency risk, averaging of failure scores and banding - should reduce the incentive to seek to improve scores, as the Framework settles down. Accordingly we have decided not to have an assumption of further improvement in failure scores, but we recognise this is a relatively conservative assumption.
- 2.3.20 In relation to changes in failure score due to appeals, our assumption is based on actual experience in the previous levy year. The table below summarises the actual experience since 2010/11.

Reduction in levy collections due to D&B appeals

Year	Experience (£m)
2010/11	47
2011/12	34

- 2.3.21 The analysis suggests the impact of successful D&B appeals is of a consistent magnitude to the previous year. The assumption used for the 2013/14 estimate is equal to actual experience in 2011/12 (the last year for which experience exists).

2.3.22 We have assumed that changes to data will have a very limited impact – and have allowed approximately £10 million in 2013/14, a much lower assumption than has been used in previous years.

Contingent assets

2.3.23 We make separate assumptions in relation to the recertification of existing contingent assets and the impact of new contingent assets. However the impact of these is best judged together.

2.3.24 In the years up to and including levy year 2011/12 we saw a steady rise in the number of Type A contingent assets certified, with the result that (other considerations remaining unchanged) the levy scaling factor would have needed to rise by around seven per cent per year to maintain a constant levy quantum. For 2012/13, however there has been a substantial drop in recertification and also in new certifications.

2.3.25 This change in behaviour is likely to have been in response to a change in our certification process, with the introduction of requirements to test the ability of the guarantor to meet the amount guaranteed. When the 2012/13 assumptions were finalised we were aware that there was an issue with guarantees of limited value, but had no basis for estimating its scale. We expected that the main effect would be to deter an increase in the existing rate of certification in new contingent assets and that it would not have a significant effect on existing contingent assets.

2.3.26 In the Board's view this emphasises that the reduction in the number of contingent assets indicates that risk is higher than it had previously judged. In this context, it is reasonable that the levy that will be billed is higher than the Levy Estimate initially set.

2.3.27 The Board's expectation is that for 2013/14 the great majority of schemes that have felt able to make the certification for 2012/13 will continue to be able to do so for 2013/14. As is set out in the chapter on contingent assets, our plans for 2013/14 are likely to see our testing of contingent assets applied somewhat more rigorously, but analysis we have carried out suggests limited impact.

2.3.28 In response to our questionnaire, the actuarial consultancies broadly agreed with this sentiment but suggested that a small proportion may be withdrawn, for example where a guarantor's financial strength has weakened over the year. Most did not quantify the impact and those that did suggested numbers whose impact is likely to be relatively small and difficult to model accurately. We have therefore assumed that all contingent assets in place for 2012/13 will remain in force for 2013/14.

2.3.29 Our analysis shows that rejections of and amendments to contingent assets have had little impact on the Levy Estimate. We have therefore assumed that these factors will have no impact for 2013/14.

New contingent assets

2.3.30 For 2012/13 we estimate that the impact of new contingent assets will be to reduce levy collections by £19 million; this equates to a reduction in levy of around 2.5 per cent – or approximately a third of the annual impact in previous years.

2.3.31 Historically there has been a view from some stakeholders that over the longer term we might expect a decline in the level of contingent assets from current levels as schemes become better funded. However, actual funding has declined over the year, so the incentive to set up contingent assets remains high for the time being.

2.3.32 Respondents to our questionnaire suggested that Type A contingent assets have become less attractive under the New Levy Framework, due to the new certification requirements and reduced differentials between employer and guarantor levy rates. The responses indicated that this could lead to fewer such arrangements put in place going forward, possibly offset by an increase in the number of new Type B and C contingent assets. Also, they suggested that as time goes by, it becomes more likely that those schemes that are inclined and able to implement contingent assets will already have done so and that any new contingent assets are likely to relate to smaller schemes, with correspondingly reduced levels of coverage - though this has not been the case in the years to 2011/12.

2.3.33 Militating against such an assumption is the likelihood that in 2012/13 some schemes were cautious about putting in place contingent assets given uncertainty about how the new system will operate. With the great majority of new contingent asset submissions for 2012/13 having been accepted, we suspect this will have been a temporary effect and that there may be a bounce back.

2.3.34 On balance therefore, assuming the same impact as in 2012/13 could be seen as a relatively limited allowance. By way of balance, at the margin, the assumptions in relation to existing contingent assets may tend to overstate them, though we have no evidence on which to assess how much or which contingent assets might be withdrawn. It therefore seems appropriate that our assumption in relation to new contingent assets is set to be relatively conservative and, as the percentage impact on levy collections is already small, we have assumed that the percentage impact of new contingent assets put in place will be the same as for 2012/13.

2.4. The effect of maintaining fixed parameters

- 2.4.1 Our analysis indicates that if the levy parameters are unchanged, then based on the assumptions set out in the previous section the Levy Estimate for 2013/14 would be approximately £765 million. By comparison, the Levy Estimate for 2012/13 was £550 million.
- 2.4.2 This 39 per cent increase is greater than the 'trigger' of 25 per cent we set out. The levy parameters will therefore need to be reset for 2013/14, and the Board has considered what the most appropriate set of parameters and Levy Estimate would be.

2.5. The levy parameters

- 2.5.1 Based on the assumptions that we have made, a levy scaling factor of 0.73 is needed to raise a levy of £630 million. This is a reduction of 18 per cent on the levy scaling factor of 0.89 operated in 2012/13.
- 2.5.2 Risk-based levies are capped for those schemes for which the levy would otherwise cost over 0.75% of smoothed liabilities. This reduction in the scaling factor will mean that fewer schemes are capped and reduce the required cross-subsidy in the levy to £55 million, a little under nine per cent of the levy (from 11 per cent in 2012/13).
- 2.5.3 Under the New Levy Framework the cost of capping is recovered through the scheme-based levy, rather than by inflating risk-based levies. Given that we have re-opened the levy scaling factor we have concluded that it is appropriate to recalibrate the scheme-based levy multiplier also, to reflect the reduced cost of capping.
- 2.5.4 To cover the cost of capping risk-based levies, the scheme-based levy multiplier will be 0.000056, a reduction from 0.000085 in 2012/13.
- 2.5.5 We have concluded that all other levy parameters remain appropriate and so there will be no other changes.

2.6. Conditions for revising the levy parameters in 2014/15

- 2.6.1 Our intention was to minimise changes to the levy parameters that apply over the three years to 2014/15 to help offer stability and predictability in levies. Having adjusted the parameters for 2013/14, we will now treat the revised parameters as the starting point for 2014/15.
- 2.6.2 In other words we would propose to only adjust the levy parameters if the levy estimate for 2014/15 would otherwise:

- breach the legislative ceiling;
- result in a risk-based proportion of less than 80 per cent; or
- vary from the 2013/14 estimate of £630 million by more than 25 per cent.

2.6.3 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.

3. Draft 2013/14 Levy Rules

3.1 Introduction

- 3.1.1 The draft Levy Rules and associated appendices for the 2013/14 levy year are being published for consultation. This section provides an overview of the Levy Rules and appendices. These govern how we will calculate levies; we are unable to depart from the Levy Rules once they have been finalised in the Board's Determination.
- 3.1.2 We have sought to keep amendments to the Levy Rules relatively limited, in view of the desirability of maintaining a stable framework throughout the triennium. The main amendments made are set out at 3.4.
- 3.1.3 This chapter describes the structure of the draft Levy Rules. The Board's view on corrections to data under the New Levy Framework is also discussed below.

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 Levy Rules to ensure that the New Levy Framework is being implemented as expected. The Levy Rules govern the calculation of levies and take precedence over any other communication (such as guidance documents) from the PPF.
- 3.2.2 Our intention, under the New Levy 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.
- 3.2.3 The Levy Rules are set out 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 2013/14 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 and the MFR Conversion 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. 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 Levy Rules in December.

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 Guide to provide examples of how the Board may choose to exercise its discretions in particular circumstances. This will be available with the final Levy Rules later this year.
- 3.3.4 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 Detailed changes to the Levy Rules for 2013/14

- 3.4.1 We have made limited changes to the Levy Rules.

Requirements for financial institutions offering guarantees

- 3.4.2 For 2012/13, Paragraph 4(2)(a) of the Contingent Asset Appendix requires that a Type C contingent asset (letters of credit or bank guarantees) must be issued by an "Acceptable Financial Institution" i.e. which "has either a current Moody's credit rating of Aa3 or better, or a current Standard and Poor's credit rating of AA- or better, or a current Fitch credit rating of AA- or better". A similar requirement applies to custodians of Type B contingent assets.
- 3.4.3 Several stakeholders have questioned whether, in view of the current economic situation, the Board would consider relaxing this requirement given that a number of institutions have seen, or are likely to see, a decline in their credit rating.
- 3.4.4 The Board considers that to recognise contingent assets that have guarantors below AA- would involve increasing the risk that the guarantor was not able to meet their commitment, to the cost of other levy payers. At the same time, it recognises that the impact of the recent economic conditions has been to create widespread reductions in rating and the Board wishes to preserve the possibility of schemes obtaining bank guarantees. Balancing these two factors, the Board considers that a limited relaxation is appropriate.
- 3.4.5 The Board believes it is reasonable to continue to expect an investment grade rating and that it makes sense to insist on A- rather than BBB/B+

(the lowest investment grade rating) as it would be undesirable to recognise an arrangement where a Bank might easily then drop out of investment grade status.

- 3.4.6 The Board considered whether to apply a range of reductions to the value of contingent assets to reflect the strength or weakness of the institution giving the guarantee, because the acceptance of guarantees from less strong institutions would increase our risk to an extent. On balance the Board has concluded that the additional risk is limited enough that it would not be desirable to do so, as a range of reductions would significantly increase the complexity of levy calculation.

Do you agree it is appropriate to relax the requirement for guarantors and custodians to A- ?

If so, do you agree that there should be no reduction applied to reflect the higher risk?

Other changes

- 3.4.7 We have also made a change to how the contingent asset appendix describes the calculation process for Type A contingent assets. This is to simplify the drafting, so that all Type A contingent assets are now covered by the same rules rather than having a separate rule for each maximum liability type. Whilst the Appendix is different in appearance, this makes no difference to how levies are calculated, it simply mirrors the formula we already use for all Type A contingent assets from 2012/13 onwards.

- 3.4.8 One other area where we plan to update the Contingent Asset Appendix of the Levy Rules and / or the Guidance is in respect of the valuation of Type B (ii) contingent assets. We are not proposing to substantively alter the basis on which we expect valuations to be carried out, the principle of which is that where land or buildings are leased to a related company the valuation should not assume the company remains a going concern. However, we would like to improve the link between our Appendix, the Guidance and the Royal Institute of Chartered Surveyors "red book".

We would be grateful for comments on the drafting at section 32(c) of the appendix.

4. Impact analysis

4.1 Introduction

- 4.1.1 As set out in section 2 we are proposing to set a Levy Estimate of £630 million for 2013/14, which is lower than the maximum levy that we could have charged.
- 4.1.2 This chapter considers the impact of that reduction on schemes' levies by comparison with the previous levy year.

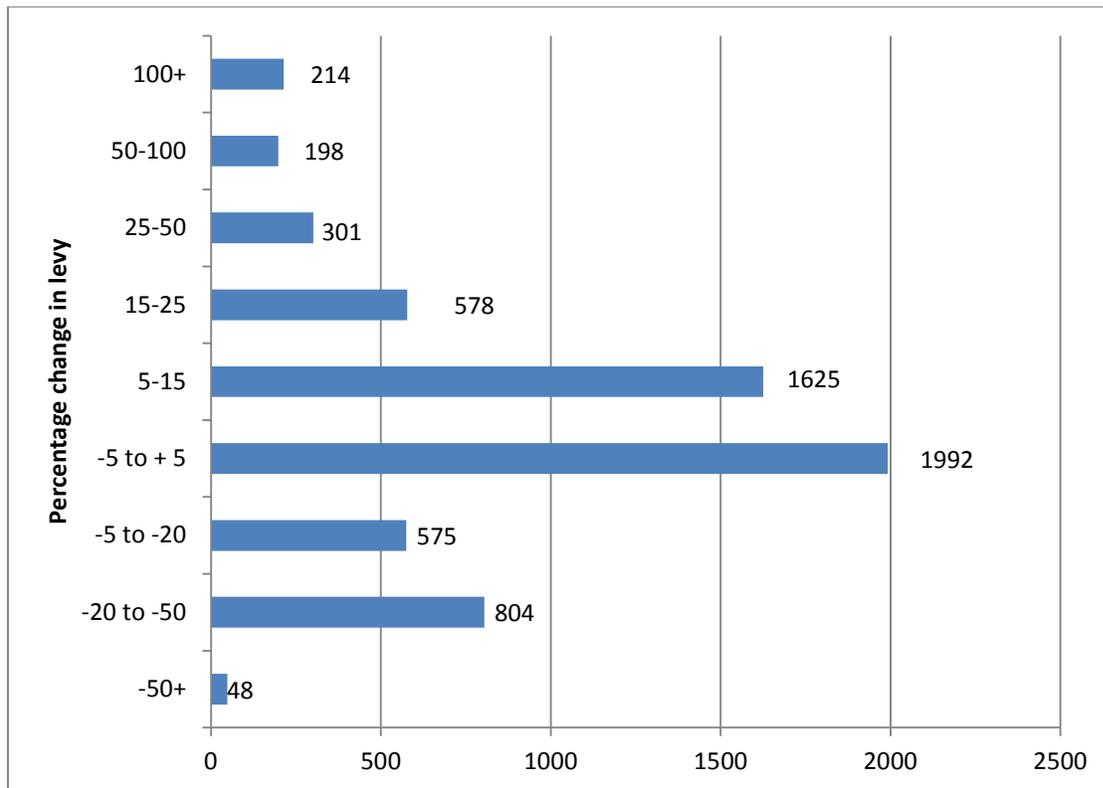
4.2 Comparison of 2013/14 with expected bills for 2012/13

- 4.2.1 Most schemes will have already received a 2012/13 levy invoice, or will receive one in the next few weeks. We have therefore focused our assessment on how anticipated levies based on our levy estimate for 2013/14 will compare with those levies.
- 4.2.2 Comparing the projected levy payments for 2012/13 and 2013/14 shows that:
- 31 per cent of schemes see little change in their levy (changes of 5 per cent or less).
 - 26 per cent of schemes see increases in their levy of between 5 and 15 per cent. These increases are mainly attributable to the projected deterioration of funding levels between 31 March 2012 and 31 March 2013, which outweigh the reduction in the levy scaling factor from 0.89 to 0.73.
 - Nine per cent of schemes see increases of between 15 per cent and 25 per cent. Most of these are either poorly funded schemes or schemes with moderate funding levels coupled with a riskier than average investment strategy.
 - 11 per cent of schemes witness levy increases greater than 25 per cent, with the majority of those schemes experiencing a very large relative increase in levy because they are close to being fully funded in 2012/13.
 - Nine per cent of schemes see decreases in their levy of between 5 and 20 per cent. These decreases mainly relate to schemes with lower investment risk which are relatively immune to general deteriorations in funding levels

and which can therefore gain the full benefit of the reduction in the levy scaling factor.

- 13 per cent of schemes witness levy decreases greater than 20 per cent, with the majority of these schemes paying (and assumed to continue to pay) significant deficit reduction contributions which act to reduce their underfunding risk in 2013/14.
- The percentage of total levy paid by the top 10 levy payers remains unchanged at 14 per cent.
- The percentage of schemes paying no risk-based levy is projected to fall from 19 per cent to 16 per cent.

Comparison of 2013/14 predicted invoices (based on Levy Estimate data) to 2012/13 invoices



5. Risk Reduction: Contingent Assets

5.1 Introduction

- 5.1.1 Last year we flagged a concern raised with us by stakeholders about the robustness of some Type A contingent assets. An initial analysis had suggested that a number of guarantees might be of less value than we had expected. As a result of this we made changes to the Determination and to the certification of contingent assets. At the heart of these changes was the expectation that if a guarantee is to be recognised in the levy as substituting for the risk of the employer for a given portion of the scheme's underfunding⁴ then the guarantor should actually be able to meet that obligation.
- 5.1.2 We required schemes certifying Type A contingent assets to certify that: "The trustees have no reason to believe that each certified guarantor, as at the date of the certificate, could not meet its full commitment under the contingent asset as certified." We also provided within the Contingent Asset Guidance points for trustees to consider in forming a view prior to giving the required certification. The Guidance was designed to ensure that trustees were able to confidently take a proportionate approach to consideration of the issue. This included recognising that trustees might generally be able to use available information rather than commissioning fresh analyses.
- 5.1.3 Alongside this, we indicated that we would also assess guarantor strength ourselves using publicly available information and then challenge those schemes where the reduction in levy that would result from recognition of the contingent asset was not consistent when compared with the reduction in risk. We also made clear that, because the requirement on trustees was a simplified one (we were not requiring trustees to carry out their own analysis of the funding position of the scheme for levy

⁴ The amount of underfunding covered by the contingent asset (and for which it is therefore the guarantor's risk of insolvency that is reflected in the levy) is limited by the cap on the maximum liability notified on Exchange by the scheme, but may be lower if not all the contingent asset would be likely to be called due to the strength of the scheme's funding. So if a guarantee is capped at £20 million, but on the basis used in the levy the scheme is only £10m underfunded, then we deem the contingent asset to be worth £10million.

purposes), there could be cases where the trustees reasonably certified a contingent asset that was subsequently rejected as not meeting our requirements as to guarantor strength.

- 5.1.4 Our analysis for 2012/13 was based on a straightforward comparison of publicly available financial information (principally the net asset value of the entity, and in some cases net profits) with the value that would be attributed to the contingent asset in the levy if the contingent asset were to be recognised. Apart from some cases where the maximum liability under a contingent asset is limited in nominal terms (to a maximum sterling figure), guarantor strength was assessed reflecting the funding position of the scheme on the basis set out in the transformation appendix to the Levy Rules (i.e. on a smoothed and stressed basis), to estimate the “gap” the guarantor’s promise is covering. Where the value of the business appeared insufficient, the scheme was to be provided with an opportunity to make representations as to why the guarantor would in fact be able to meet the guarantee.
- 5.1.5 We noted that having a net assets position in recent accounts that is equal to the guarantee would not necessarily mean that the guarantee would be met in full (e.g. due to the existence of other charges, difficulties in repatriating funds, or the possibility that failures of other group companies would weaken the guarantor or mean that shareholdings in group companies were written down).
- 5.1.6 Accordingly, we noted that it would be reasonable to build in a margin and ask schemes for further evidence at a somewhat higher threshold than a guarantor’s net assets being at the same level as the guarantee’s maximum value. However, we considered that as 2012/13 was the first year in which a formal test of guarantor strength applied and that the basis on which bills are calculated is also new (as a result of introducing the New Levy Framework), we should give the benefit of any doubt to schemes and their guarantors and only challenge guarantees where the net assets are somewhat below the sum guaranteed rather than applying an exact comparison.
- 5.1.7 The impact of the new requirement has been greater than we expected with:
- 157 contingent assets not recertified (though some may have been withdrawn for other reasons, or have been withdrawn in favour of new certificates)
 - A reduction in the number and maximum value of new certificates

- A limited number of certified contingent assets that following PPF testing are being challenged.

5.1.8 We indicated in December 2011 that for 2012/13, as a transitional year, we intended to give schemes and their sponsors the benefit of the doubt, and so would only challenge clear-cut cases. We would expect to extend that approach in 2013/14, seeking further information where there may be doubt, or alternatively looking at a sample of certifications.

5.2 The approach for 2013/14

- 5.2.1 We indicated that we believed the certification should be one trustees are in a position to form an opinion on – and whilst there were questions in advance of the reporting deadline, given the limited feedback in relation to difficulties with recertifying this appears to have been the case. Having reviewed the data for 2012/13, it is clear to us that a large number of schemes have moved quickly to deal with this issue, though a proportion have not.
- 5.2.2 We consider that there is no need to make further changes to the Levy Rules in this area.
- 5.2.3 We plan to revise the guidance for contingent assets to reflect our recent experience – to further clarify what is expected of trustees in certifying a contingent asset.
- 5.2.4 The most significant development is that schemes will generally have received their first levy invoice using the new methodology, and this will in most cases make it easier for trustees to directly assess the value likely to be placed on a contingent asset in future levies. This should reduce the likelihood of trustees forming a judgement about the guarantor on different information than that used by the Board, without placing an additional burden on trustees to undertake an entirely fresh calculation of the stressed/smoothed value of their assets/liabilities.
- 5.2.5 We will also amend the guidance to reinforce the message, pointed to in the 2012/13 consultation (e.g. and set out above at 5.1.5), that in some situations it is appropriate to discount the value of the assets/profits when considering guarantor strength, though we would expect that in most cases where this is relevant, trustees will have taken account of the point. This addition to the guidance is as a result of recent experience of guarantees with little practical value where the value of the guarantor simply reflected shareholdings in group companies. We may also carry out some analysis to test if this is a more widespread issue.

Are there any other amendments or additions to the Guidance that would help clarify the requirements on trustees or strengthen the regime?

5.3 Policy changes to contingent assets in future years

- 5.3.1 As announced in *A New Framework: Policy Statement*, we do not propose any wholesale changes to the types of contingent assets we will recognise in the years to 2014/15. However, we do plan to review policy in this area more thoroughly for the following years. We would expect consideration to commence in the next year.

6. Consultation Arrangements and Key Dates

6.1 Introduction

- 6.1.1 This chapter provides contact details to respond to this consultation. Key dates for the calculation of 2013/14 levies are also set out below.

6.2 Consultation Arrangements

- 6.2.1 The consultation on the 2013/14 Determination will run from 25 September 2012 to 5pm on 2 November 2012. 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: Chris Collins
Chief Policy Adviser
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon, Surrey
CR0 6SR

- 6.2.2 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.
- 6.2.3 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.
- 6.2.4 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>.

- 6.2.5 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 2012.

6.3 Key dates

- 6.3.1 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 28 March 2013, except as detailed below.

Item	Key dates
Monthly D&B Failure Scores	Between 30 April 2012 – 28 March 2013
Consultation on draft 2013/14 Determination closes	5pm, 2 November 2012
The Exchange system opens for submission of scheme returns	December 2012
Submit scheme returns on Exchange	By 5pm, 28 March 2013
Reference period over which funding is smoothed	5-year period to 31 March 2013
Certification of contingent assets	By 5pm, 28 March 2013
Certification of deficit-reduction contributions	By 5pm, 30 April 2013 (subject to consultation)
Certification of full block transfers	By 5pm, 28 June 2013
Invoicing starts	Autumn 2013

6.4 Comments on the Consultation Arrangements

6.4.1 This consultation is being conducted in line with the Cabinet Office's Consultation Principles that can be found on their website at:
<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

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

Richard Williams
Head of Corporate Affairs
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
CR0 6SR

Telephone: 020 8633 5925

Email: Richard.williams@ppf.gsi.gov.uk

Annex A: Formulae used for calculating the levy scaling factor and the scheme-based levy multiplier for 2013/14

A.1 Risk-based levy scaling factor

A.1.1 The pension protection levy estimate for the 2013/14 levy year is £630 million.

A.1.2 The 2013/14 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 i th eligible scheme/section;
- IR_i = the insolvency risk factor for the i th 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.⁵

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 2012, adjusted for subsequent and imminent anticipated exits from the universe, and using estimates of underfunding risk and insolvency risk as at 31 March 2013. For

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.

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 averaged Failure Scores over the year to 31 March 2012.

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 0.73. 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.2 Scheme-based levy multiplier

A.2.1 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. For the 2013/14 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 2013/14 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 i th eligible scheme;
- IR_i = the insolvency risk factor for the i th 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.⁶

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 2012, adjusted for subsequent and imminent anticipated exits from the universe, and using estimates of underfunding risk and insolvency risk as at 31 March 2013. 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 averaged Failure Scores over the year to 31 March 2012.

A.2.6 Individual schemes' scheme-based levies will be calculated using actual transformed scheme liabilities as at 31 March 2013. For this purpose, transformed scheme liabilities will be determined using market information over the five year period to the last working day in March 2013.

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 0.000056. The multiplier will be confirmed in the final determination and is unlikely to differ from this figure.

⁶ See note 8 above.

