HOW TO REDUCE YOUR PENSION PROTECTION LEVY
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The UK economy has been showing a firmer rooted recovery over the past few months, but businesses still face challenges in ensuring that they are positioned to take advantage of the improved economic outlook. Controlling the running costs of the business is always a key part of this.

One such cost for those with defined benefit pension schemes is the annual levy they have to pay to the Pension Protection Fund (PPF), which helps to provide security in retirement for millions of UK defined benefit scheme members.

In 2012/13, we saw the introduction of new levy rules. These were set for three years and changed the way the levy is calculated to make bills more predictable and more reflective of the risk individual schemes pose to the PPF. Practically, that means you will see that your next bill uses exactly the same formula as last year’s.

This multi-year approach encourages businesses to take risk reduction measures which will have a direct impact on the amount of levy charged by giving more confidence about future levies.

This booklet sets out the types of measures you might want to consider to reduce your risk, as well as the practical steps you can take to reduce your individual levy bill for 2014/15.

It also highlights the deadlines the PPF sets to make sure the steps you take are taken into account when the PPF calculates your 2014/15 bill.

The PPF will be revising its approach for the years from 2015/16, including through the move to a new insolvency risk services partner, Experian. More detail on that will follow, including through the PPF consulting on their proposals later in 2014. But for now, this booklet focuses on the next year.

This booklet is only an overview and is not legal advice. Further information can be found on the PPF’s website. This will include updates on the move to Experian for 2015/16.

We hope you find this guidance useful.
What is the Pension Protection Fund?

Established by the Pensions Act 2004, the PPF opened its doors for business in April 2005 and is run by an independent board. The PPF pays compensation to members of eligible defined benefit pension schemes – such as final salary schemes – whose employer has gone bust and left insufficient assets in its scheme to pay members at least PPF levels of compensation.

Which pension schemes are eligible for the PPF?

Defined benefit pension schemes are generally protected by the PPF unless they had been or were being wound up before 6 April 2005. This is referred to as being an “eligible scheme”.

Not all occupational or work-based schemes will be eligible schemes.

How is the PPF funded?

The PPF collects a compulsory pension protection levy from all eligible schemes – it is not funded by the Government.

The fund also takes on the assets of transferring schemes and recovers money and other assets from insolvent employers. It also derives income from returns on its own investments.

The PPF consults annually on the levy and encourages participation from levy payers. There will be an additional consultation in 2014 as the current triennium ends at the levy year 2014/15.

When would a scheme be taken over by the PPF?

When the sponsoring employer of an eligible scheme suffers a qualifying insolvency event, the pension scheme will usually enter what is called the PPF assessment period, during which the PPF assesses whether the scheme will transfer to the PPF.
A scheme will only transfer to the PPF if it does not have enough assets or money to buy at least PPF levels of compensation from an insurance company. A scheme will not transfer to the PPF if:

• the scheme is rescued, that is a new employer takes on responsibility for the scheme, or
• the scheme has enough assets or money to buy benefits with an insurance company, which are at PPF levels of compensation or above.

How does the PPF take responsibility for schemes?

The PPF monitors trustees throughout the PPF assessment period to ensure they take their scheme through the process effectively and enable it to transfer successfully to the PPF.

In certain circumstances, it can direct trustees in areas such as investment of scheme assets, incurring expenditure and legal proceedings.

It monitors the progress of insolvency proceedings and liaises with the insolvency practitioner.

If the PPF takes responsibility for a scheme, it then pays compensation to scheme members.

How much compensation does the PPF pay?

Members who have reached their scheme’s normal pension age will generally receive 100 per cent of the pension in payment at the point when the pension scheme enters assessment.

The PPF also pays 100 per cent compensation to those who have retired on legitimate ill-health grounds, regardless of age.

Those members who have not yet retired will receive 90 per cent of the entitlement they have built up. Members who have retired but have not reached the normal pension age of their scheme will receive up to 90 per cent compensation. In some cases a cap on the level of compensation will apply.
THE PENSION PROTECTION LEVY

What is the levy?
The PPF levy is an annual charge on eligible pension schemes. Nearly 6,500 schemes currently pay the levy. It is divided into two parts:

• The scheme-based levy – this is currently around 10 per cent of the total levy to be collected and is based on the size of an eligible scheme (measured by its liabilities).
• The risk-based levy - this represents the majority of the total levy to be collected and is based on the likelihood of an eligible scheme entering the PPF and the funding position of the scheme. It ensures that lower risk schemes pay a lower levy.

Income generated from the levy helps to fund compensation payments.
The overall amount of levy that needs to be collected is based on the PPF’s Funding Strategy. As part of this, modelling tools are used to work out how much risk the PPF may face over the next twenty years. This enables the PPF to build long-term sustainability, ensure that people get the compensation they are entitled to and endeavour to set a stable pension protection levy year-on-year.

What is used to calculate the levy?
The following is intended to provide a brief summary. More detailed information can be found on the PPF website: (www.pensionprotectionfund.org.uk/levy/Pages/PensionProtectionLevy.aspx).

1. Scheme return data
Trustees and managers of pension schemes have a legal obligation to supply the Pensions Regulator (the Regulator) with information about their scheme. This is done through Exchange, an online system managed by the Regulator.

This scheme return data is used by the PPF to calculate levies. The Regulator uses the information to ensure its register of pension schemes is up-to-date.

2. Insolvency risk of the sponsoring employer
Dun & Bradstreet (D&B) measures insolvency risk and provides the PPF with an insolvency risk score for every sponsoring employer of an eligible scheme. This figure is based on the average failure score over the preceding year (to the end of March) which is measured monthly. This is then placed into one of ten bands, each of which has an associated insolvency risk.
Following a competitive tendering exercise the PPF announced that from levy year 2015/16 insolvency risk information will be provided by Experian. The PPF will set out its plans for future levy years, including how Experian’s scoring methodology will work and how schemes can engage with Experian. However, all queries relating to failure scores for 2014/15 levy bills should continue to be directed to D&B.

3. Levy scaling factor
The insolvency and underfunding risks are multiplied by a scaling factor. This adjusts the outcome of the levy formula to ensure it adds up to the amount the PPF Board set out to raise.

What is the scheme-based levy formula?
Scheme-based multiplier x liabilities

What is the risk-based levy formula?
Underfunding x insolvency risk x levy scaling factor
The risk-based levy takes two types of risk into account:
• Insolvency risk – the relative risk of the scheme’s sponsoring employer going bust; and
• Underfunding risk – the potential funding gap (measured against the ability to pay benefits at the same level as the PPF pays compensation). The asset and liability data that schemes report is adjusted. For example, to reduce the impact of short term volatility in the financial markets, values are smoothed over a five year period. The investment risk associated with the scheme’s assets and liabilities is taken into account by applying stresses to the smoothed values.

The amount of risk-based levy a scheme is required to pay is subject to an overall cap which is a percentage of liabilities. The cap is designed to protect the weakest schemes and their sponsoring employers from disproportionately high levy bills.

Risk reduction measures
Schemes can reduce the amount of levy they pay by putting in place contingent assets, such as parent or bank guarantees, or security over property. The PPF also considers deficit reduction contributions – special contributions to bolster the scheme – as reducing the risk of the scheme, which also reduces the amount of the levy bill.
10 WAYS TO REDUCE YOUR PENSION PROTECTION LEVY

1. Make sure the PPF and the Regulator hold the correct data on your scheme

Before submitting your scheme return data via Exchange, the Regulator’s scheme maintenance system, check it carefully to ensure that all data used in your levy calculation, such as the asset allocation and scheme structure, is up-to-date and accurate. The accuracy of the information you submit can have a significant effect on the calculation of your levy bill.

A significant number of schemes are reporting information on assets held that appears to be out of date. In many cases, given trends in asset allocation, this will result in overstating their risk.

Once you have submitted your data, you can log on to Exchange and update the information until the data deadline on the last working day of March.

**Do not forget:** the PPF will not generally accept corrections to the data it receives from the Regulator after the March deadline.

If your scheme has had the members of another scheme transferred to it, you should submit a block transfer certificate. A representative of the transferring scheme should do the same. Otherwise, the PPF will charge a levy based on both schemes’ data, this is likely to overstate the liabilities of the transferring scheme.

2. Check that D&B holds the right data on the sponsoring employer

You can telephone D&B to check your failure score and get information about how it can be monitored over time (see the ‘Useful Contacts’ page for details).

If you have not submitted your audited accounts to Companies House, then you can submit them directly to D&B.

3. Understand your insolvency risk and discuss your failure score with D&B if you think it is wrong

The way the sponsoring employer’s failure score is calculated is based on an average of monthly scores over the year to March. Failure scores take account of a number of things.

They include: financial statements, payment of supplier invoices, audited...
accounts, secured charges and demographic information such as the business sector operated in, regional location or company directors.

In addition, a subsidiary’s score may be affected by the score of its parent company, if that parent is at severe risk of failure; and businesses with branches in three or more different UK regions can benefit from being classified as nationwide.

We recommend that you contact D&B now to ensure they hold the correct information on your group structure and branch locations so that your score can be calculated accurately, if you think the information may be wrong.

More accurately reflecting the position of the employer in one or more of these areas could reduce the probability of insolvency which the PPF would use when working out your levy.

Some of these are weighted more heavily than others. For example, financials and payments to suppliers are weighted heavily for commercial businesses by D&B. So by ensuring company accounts are filed on time and outstanding invoices are paid, you could see an improved score. Ensuring out of date charges have been removed from Companies House records could also be beneficial.

4. Understand your scheme’s investment risk and how most appropriately to report it

Investment in growth assets can contribute to improving the funding of your scheme over time. However it will also increase the risk of a pension scheme to the PPF, and this is therefore reflected in the levy charged. It is worth understanding the trade-offs involved.

To calculate investment risk, the PPF generally uses the details that you provide to Exchange on how your investment assets are split. Assets reported as ‘insurance’ or ‘other’ will be treated as potentially high-risk and so it makes sense to break them down as much as possible. This means that individual asset classes held within pooled funds can be reported to enable the PPF to make a more accurate calculation of investment risk. If you are not sure how to do this then talk to your investment advisor or fund manager.

If you use derivatives, it may be worth carrying out your own investment risk assessment in line with the PPF guidance.
5. **Certify any deficit reduction contributions**

A deficit reduction contribution is a payment you make to your scheme between s179 valuations to reduce the scheme’s deficit.

These contributions need to be certified to the PPF by 30 April, in order for them to affect your levy.

6. **Use a group company guarantee**

You can improve the strength of the covenant (contract) between employer and pension scheme by using the financial strength of another company in your group.

This is called a type A contingent asset and it affects the insolvency risk part of the levy calculation.

In this situation, the company guarantees all, or a specified part of the employers’ liabilities to the scheme. Where this gives an appropriate reduction in risk, the guarantor’s insolvency probability is then used in the scheme’s levy calculation, taking into account the level of liability guaranteed. It is important to be able to demonstrate that the arrangements reduce risk, and do not result in a disproportionate levy benefit, otherwise the guarantee may not be recognised.

The PPF website includes examples of what they view as stronger and weaker guarantee arrangements.

7. **Pledge company assets to the scheme**

A sponsoring employer, or group company, can pledge assets which will go to the pension scheme if a sponsoring employer goes bust. This affects the underfunding risk part of the levy calculation.

There are three categories of type B contingent asset:

- B(i) – security over a bank account;
- B(ii) – security over land (in the United Kingdom); and
- B(iii) – security over a portfolio of securities.

These must all be independently valued.
8. Get a guarantee from a third party

Pension scheme security can be improved with a guarantee from a suitable financial institution outside the scheme or its sponsoring employer group.

Such a letter of credit or bank guarantee is referred to as a type C contingent asset and affects the underfunding risk part of the levy calculation.

There are two categories of type C contingent asset:

- C(i) – ‘evergreen’ assets – assets that are renewed or replaced once they expire;
- C(ii) – guarantees against planned future special contributions to the scheme.

More information on contingent assets can be found on page 12.

9. Consider an out-of-cycle s179 valuation

If your scheme circumstances have changed significantly since you submitted your last s179 valuation (for example because of the transfer of members), you should consider whether to submit a new one. This will enable the PPF to produce the most accurate estimate of your liabilities.

This information should be submitted on Exchange.

10. Get involved in the development of the levy

The PPF wants to ensure that the levy accurately reflects the risk it faces, and that the money it charges is fairly raised across eligible schemes. The current levy formula was developed after long consultation with many stakeholders, including a Steering Group which the CBI was represented on.

The intention is that the main levy rules are set on a triennial basis, but there are annual consultations on the exact rules for each year. The PPF also consults on other factors which indirectly influence the levy, such as the assumptions it uses in s179 valuations.

The PPF regularly speaks at and attends industry events allowing an opportunity to provide feedback on its policies and practices.

If you would like to find out what is happening at the PPF, register your interest at www.pensionprotectionfund.org.uk and sign up for PPF news alerts.
MORE INFORMATION ON CONTINGENT ASSETS

Contingent assets are taken into account when the PPF calculates the risk-based element of the levy.

The PPF wants to be able to:

• view positively the actions taken by the scheme or employer to improve the scheme funding, or the strength of employer covenant, and

• incorporate contingent assets in a way that reflects the principles of fairness, simplicity and proportionality.

Most importantly, contingent assets must represent a real reduction in risk. While a contingent asset must represent a long-term commitment to a scheme for it to affect your levy calculation, you can replace it or, subject to the levy rules, make changes to the level of cover it provides.

Contingent assets can be very effective in increasing scheme security and reducing the levy but you must ensure you have fulfilled all of the requirements for the PPF to accept them. In particular, attention should be paid to the following:

• Certificates
• Standard form agreements
• Amendment and replacement conditions, and
• Legal opinion.

For type A contingent assets, the PPF may also request sight of the evidence used to judge guarantor strength before accepting it and may carry out its own testing – with an assessment of whether the guarantor could pay the full sum that could be due, assuming the sponsoring employer(s) have failed. Where the PPF judges the guarantor could not meet the sum in full, it will generally give no credit at all for the guarantee.

Detailed guidance on contingent assets can be found on the PPF website.
WHAT IF I HAVE DONE ALL THIS AND I THINK MY LEVY IS STILL TOO HIGH?

1. Appeal your failure score if you think it is wrong

D&B has a three-stage process for appealing failure scores. If you want to appeal you will need to do so within 28 days of the date of your invoice or the previous appeal stage.

If you think your failure score is wrong, because it has not taken into account available information or information that you provided to D&B, you should talk to D&B customer services to put it right.

2. Review your invoice with the PPF

If you think the PPF has made a mistake on your invoice (other than the failure score), you should call the PPF Stakeholder Support Team within 28 days of the date of your invoice to review it informally.

If the problem can be resolved at this stage, you will be issued a credit note and a new invoice. Most invoice problems are resolved in this way.

If the problem cannot be resolved informally, there is a formal review process which has some legal requirements, such as the timescale within which you must make any appeal, which is within 28 days of the date of the invoice or the conclusion of a query.

Also, some schemes may qualify to have all, or part, of their levy waived for one levy year. If seeking a waiver, you must do so within 28 days and before paying the invoice.

Information on reviews and waivers is available on the PPF website.

Please note:

(1) The PPF charges interest on late payment of invoices, and this can include cases where a review application has been made. If you therefore choose to pay a bill you are challenging, the PPF will not regard this as affecting the validity of a review and any sum overpaid will be credit noted promptly following conclusion of the review.

(2) If you think your scheme will have difficulty in paying your levy bill, you must contact the PPF immediately and they will discuss with you ways they can help.
USEFUL LINKS

Email:
information@ppf.gsi.gov.uk for general queries
levyinvoice@ppf.gsi.gov.uk to query your PPF levy invoice
consultation@ppf.gsi.gov.uk to respond to consultation documents
lena.levy@cbi.org.uk for further information on CBI pensions policy

Website:
Submission of voluntary certificates
www.thepensionsregulator.gov.uk/trustees/exchange.aspx

Contingent assets guidance
www.pensionprotectionfund.org.uk/levy/riskreduction/Pages/ContingentAssets.aspx

Reviews and appeals
www.pensionprotectionfund.org.uk/levy/invoicing/Pages/ReviewsandAppeals.aspx

Waivers
www.pensionprotectionfund.org.uk/levy/whopays/Pages/WhoHastoPay.aspx

Register your interest
www.pensionprotectionfund.org.uk/Pages/EmailAlerts.aspx
USEFUL CONTACTS

Pension Protection Fund
www.pensionprotectionfund.org.uk
Stakeholder Support Team: 0845 600 2541
Text phone: 0845 600 2542
Knollys House, 17 Addiscombe Road, Croydon, Surrey CR0 6SR (until April 2014)
Renaissance, 12 Dingwall Road, Croydon, CR0 2NA (from April 2014)

Dun & Bradstreet (Insolvency Risk Services Provider)
www.dnb.com/uk
PPF-related enquiries: 0870 850 6209
customerhelp@dnb.com
D&B Customer Services, Marlow International Parkway, Marlow, Bucks, SL7 1AJ

The Pensions Regulator
www.thepensionsregulator.gov.uk
Customer support: 0845 600 5666
customersupport@thepensionsregulator.gov.uk
Napier House, Trafalgar Place, Brighton BN1 4DW

Confederation of British Industry
www.cbi.org.uk
Lena Levy, Head of Group
lena.levy@cbi.org.uk
Centre Point, 103 New Oxford Street, London WC1A 1DU (until March 2014)
GLOSSARY OF TERMS

Compensation – payments to scheme members who transfer to the PPF after their sponsoring employer has gone bust.

D&B (Dun & Bradstreet) – the company that measures insolvency risk for the PPF.

Failure Score – a percentile score which is designed to predict the likelihood that a company will go bust within the next twelve months. The score indicates a relative measure of risk, ranging from one to a hundred. One represents businesses that have the highest probability of failure and a hundred the lowest. Failure Scores are taken monthly and averaged, and employers are then placed into one of ten bands.

Insolvency risk – the relative risk of a scheme’s sponsoring employer(s) going bust based on the levy bands into which scheme employer(s) are placed.

Levy invoice – this is a scheme’s individual invoice for the amount of pension protection levy due for the relevant levy year.

Levy year – for example, the 2014/15 levy year will run from 1 April 2014 to 31 March 2015.

Scaling factor – a multiplier which ensures that the PPF can collect the total amount required to meet its long-term funding requirements.

Exchange – the Regulator’s online service which allows for the reporting of scheme information, some of which the PPF uses to calculate a scheme’s levy. This works in the same way as the online scheme return but can be accessed right up until the last working day in March, the deadline when the Regulator sends the information to the PPF.

Section 179 valuation (s179) – this is a valuation of a pension scheme to determine how well funded it would be if it had to buy out benefits at PPF levels of compensation. The name refers to section 179 of the Pensions Act 2004.
The Pensions Regulator – the regulator of work-based pension schemes in the UK, with objectives to: protect members’ benefits; promote good administration; reduce the risk of calls on the Pension Protection Fund, and take account of sustainable employer growth. Its focus is on education and enablement, with risk-based intervention where appropriate. Under the Pensions Act 2004 it has the ability to:

- collect detailed information, including scheme returns, information through the scheme specific funding regime and reports from trustees, employers and whistle-blowers;
- issue notices requiring actions to be taken, freeze a scheme at risk, prohibit trustees who are judged not fit and proper to carry out their duties or appoint an independent trustee; and
- issue a contribution notice where there is a deliberate attempt to avoid liabilities, or a financial support direction, where the employer is a service company or insufficiently resourced.

Underfunding risk – how well funded the scheme is, taking account of investment risk. This uses the most recent s179 valuation as the starting point.