

Pension
Protection
Fund

The Response to the August 2007 Pension Protection Levy Consultation

November 2007

Foreword

The Board of the Pension Protection Fund is committed to developing the Pension Protection Levy in a manner that is fair, proportionate and simple. Since the inception of the Pension Protection Fund in 2005, six consultation documents and one consultation update have been released, and we have consulted formally for a total of 40 weeks. This continued engagement with our many stakeholders has been invaluable in shaping the development of the levy in its initial phase of inception and consolidation.

We are pleased to have reached a point in our evolution, with the assistance of our stakeholders, where we have developed and consolidated policy principles driving the levy, and are in a position to refine the levy and look to the future. This consultation, therefore, encapsulates our commitment to stabilise the overall levy while increasing, as far as possible, stability and certainty for individual levy payers. In addition, it looks to the future and continues a dialogue on the creation of a fairer levy based on long-term risk.

The first part of this document focuses on our promise to deliver stability and certainty to our stakeholders. The need for stability of the levy estimate over time, and greater certainty as to individual scheme bills, have been of key concern to stakeholders, and this theme unites the policy decisions that have been taken by the Board. The August 2007 consultation document expressed the Board's broad intention to maintain a stable overall levy estimate over the next three years, subject to a significant change in risk exposure. The Board is pleased to confirm this policy decision, together with a number of other modifications to the levy which respond directly to stakeholders' requests, work towards greater stability for individual schemes by refining our distribution mechanisms, and provide a platform for longer term change.

The Board's longer term goal is to optimise the fit between the way the total levy estimate is distributed between all eligible schemes and the theoretical levy produced by our Long Term Risk Model. Early thinking in terms of the Board's proposals for achieving this aim were published in the August 2007 consultation document, and the second part of this document summarises your responses on this, which have been thorough and considered. The Board would like to thank all stakeholders for their input in this important area, and look forward to working with you in the months ahead to further develop our long term proposals for the risk based levy.

Finally, you will find the Board's draft determination for the 2008/09 levy year appended to this document. This element of the publication is open for consultation, and we look forward to receiving your responses.

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Background

1.1 Introduction

1.1.1 The Board of the Pension Protection Fund (PPF) was set up under the provisions of the Pensions Act 2004 and began operating on 6 April 2005. It is a Public Corporation, governed by an independent board, and its functions are set out in the Pensions Act 2004. They can be summarised as:

- managing the assets of the two funds the Board controls: the Pension Protection Fund and the Fraud Compensation Fund
- paying compensation from the Pension Protection Fund to members of underfunded defined benefit and hybrid pension schemes when sponsoring employers become insolvent with insufficient assets in the pension scheme
- paying compensation from the Fraud Compensation Fund to occupational pension schemes in the event of dishonesty
- raising pension protection levies on defined benefit and hybrid schemes, and raising fraud compensation levies on all occupational pension schemes when appropriate.

1.1.2 To date over 7,700 members of 13 schemes have transferred to the PPF. These individuals are either receiving compensation payments because they have retired or will do so at a future date. Compensation payments are funded by the aggregate assets inherited from schemes for which the PPF has assumed responsibility (often enhanced by recoveries of assets from the insolvent employer), supplemented by investment income, and by the annual pension protection levy raised from eligible pension schemes.

1.1.3 In July 2005, the Board consulted on the introduction of the pension protection levy, providing a consultation update in October 2005. The Board published its final proposals in December 2005 setting out how the levy would be calculated taking into account the feedback received in the consultation. In the 2006/07 levy year, the Board charged the first pension protection levy, which was composed of two parts: a scheme based levy and a levy based on the risk posed by an eligible scheme to the PPF. The risk-based levy is calculated using an estimate of the insolvency risk of the sponsoring employer taking into account the scheme structure, and the underfunding risk of the scheme taking into account any deficit-reduction contributions and contingent assets submitted to the Board.

1.1.4 The Board consulted on its proposals for calculating the 2007/08 pension protection levy in September 2006 and published its final proposals in December 2006 on the minor changes that were made to that approach for 2007/08. In December 2006 the Board consulted on the inclusion of investment strategy as an additional risk factor in the calculation of the risk-based levy and published a response in May 2007.

1.1.5 The Board set out its strategy for the development of the levy in line with its principles of fairness, proportionality and simplicity. The 2006/07 and 2007/08 levy years represented a period of initiation, and it was always the intent of the Board to build incrementally upon the strong foundations created in these two years.

- 1.1.6 As the Pension Protection Fund became an established part of the pensions landscape in the UK, the data held on the defined benefit universe improved, and as a result the Board has been able to begin to consider more sophisticated risk management measures, which improve both scheme member security and fairness for levy payers.
- 1.1.7 The next two levy years, 2008/09 and 2009/10, aim to continue to build a fair, simple and proportionate levy that is a better reflection of the distribution of risks posed by schemes than has previously been possible with the data available. The Board's confirmed policy for 2008/09 and 2009/10 contained in the first part of this document is directed at consolidating the current position, and strengthening the fairness in the system, while ensuring a simple and proportionate levy that delivers as far as possible against stakeholders' identified priorities of increased certainty and stability.
- 1.1.8 While stabilising the levy position in both aggregate and to some degree individual terms, the Board has begun to look forward, and in the August 2007 consultation presented some of its early thinking around the possible direction of travel for 2010/11 and beyond. In particular, it explored how to strengthen further the fairness of the levy by aligning the levy to the long-term risk posed by the defined benefit universe of eligible schemes. The second part of this document captures some of the early thinking of stakeholders on these initial proposals.
- 1.1.9 The Board has always been aware of, and committed to accessing, the vast knowledge of pensions industry professionals in determining its way forward, and we are excited to present this early thinking. We intend to continue to consult on these issues, with the speed of implementation and the final design of policy itself being determined in continued consultation with stakeholders.

1.2 Responses to This Consultation

- 1.2.1 The Board of the Pension Protection Fund would like to thank all those who have taken the time to respond in writing to its recent consultation on the 2008/09 and 2009/10 pension protection levy, as well as those who provided informal responses at numerous seminars and conferences.
- 1.2.2 The consultation ran for a period of 8 weeks from 8 August 2007 to 3 October 2007. 50 formal consultation responses were received from employers, pension schemes, professional bodies and pension scheme advisers. Notably, several responses were received from representative groups, resulting in a sample of respondents that represented over 1300 schemes and over 250,000 employers.
- 1.2.3 Anecdotal feedback from our stakeholders was received in the course of everyday business and also at the six regional seminars held throughout the U.K. The full range of proposals outlined in the August consultation document was presented at these seminars, which were attended by over 500 delegates.
- 1.2.4 The Board has considered both formal and informal feedback. In considering the responses to the consultation, the Board has taken into account all views across the spectrum of respondents. The Board believes that this approach has led to a truly

representative and fair approach to determining policy for distributing the levy across schemes in the context of a stable levy estimate.

- 1.2.5 We are pleased to be able to incorporate a number of improvements to the more detailed aspects of the final proposals in the light of these responses.

2 Executive Summary

2.1 Introduction

- 2.1.1 This document sets out what are now, in light of previous consultation, the Board's firm proposals for the structure of the 2008/09 and 2009/10 pension protection levy, so that schemes can estimate their 2008/09 levy, and consider whether to take actions that are likely to reduce it. The Board will consider any comments on the proposals in this document which are received by 11 January 2008. However, the Board does not at this stage expect to make fundamental changes to the proposals.
- 2.1.2 A draft of the Board's determination under section 175(5) of the Pensions Act 2004 has also been published today, and can be found at Annex B of this document. As with the Board's final proposals, comments on the draft determination would be welcome. The determination summarises the levy formulae, the risk factors for the risk based element of the levy, the time at which the risk factors will be assessed, and the time when the levy becomes payable.

2.2 Summary of Proposals

The Board's Levy Estimate

- 2.2.1 Stakeholders have confirmed the importance of stability in the overall levy estimate to allow them to plan effectively. The Board has therefore decided to set the levy estimate for the financial year 2008/09 at £675m, and has also confirmed the levy estimate for the 2009/10 and 2010/11 levy years, absent a significant change in long-term risk, at £675m, indexed to UK earnings at the same date risk factors are measured in each of those years.

Measurement Date of Risk Factors

- 2.2.2 Both consultation responses and feedback from the PPF levy roadshows demonstrated support for the aim of giving schemes greater notice of their levy. However, concern was expressed at the proposal set out in the August consultation document to credit risk reduction activity after a 12 month time delay rather than in the levy year concerned.
- 2.2.3 The Board has therefore confirmed the proposal to move to measuring risk 12 months in advance, but will take account of risk reduction measures put in place by schemes up to the start of the levy year concerned.

Underfunding Risk

2.2.4 Citing fairness, there was broad support for the Board's proposal to adjust the levy funding boundaries to address the change in distribution of the levy that has occurred – and which has increased the cross-subsidy of the stronger funded by the weaker. For 2008/09 the funding boundaries will commence at 120%, with a 1% rate, with the level of assumed underfunding then reducing by 0.25% for each 5% step in funding up to 140% when no risk based levy will be payable.

| Underfunding category | Funding level (F)% | Underfunding (U) as a % of liabilities |
|-----------------------|--------------------|--|
| A | $F \leq 120$ | $121 - F$ |
| B | $120 < F \leq 125$ | 1 |
| C | $125 < F \leq 130$ | 0.75 |
| D | $130 < F \leq 135$ | 0.50 |
| E | $135 < F \leq 140$ | 0.25 |
| F | $F > 140$ | 0.00 |

The Levy Structure

2.2.5 The formula for the scheme based levy (SBL), which will be 20% of the total pension protection levy, will be:

$$\text{SBL} = L \times h$$

Where:

L = The scheme's pension protection fund liabilities, and

h = The scheme based multiplier, which is estimated to be 0.0152% for 2008/09^[1]

2.2.6 The formula for calculating the risk based levy (RBL), which will be 80% of the total pension protection levy, will be:

$$\text{RBL} = U \times P \times 0.8 \times c$$

Where:

U = Underfunding risk

P = Pension Protection Fund assumed probability of insolvency

0.8 = Percentage risk based for levy year 2008/09

c = risk based levy scaling factor, which is estimated to be 1.6 for 2008/09^[2]

Statutory deadline for the submission of the first section 179 valuation

2.2.7 The majority of respondents agreed that a disincentive should be applied to schemes that fail to submit a section 179 valuation by the statutory deadline.

^[1] This is the indicative scheme based multiplier and is likely to differ when the final determination is published

^[2] This is the indicative levy scaling factor and is likely to differ when the final determination is published

2.2.8 The Board has therefore decided that a disincentive will be applied as follows:

- the estimated section 179 assets and liabilities as at 31/10/06 used in the 2007/08 levy invoice calculation that was obtained by converting a minimum funding requirement (MFR) valuation will be treated as if it had been submitted to the Board in the usual way
- this will be rolled forward to the calculation date (31 October 2007 for 2008/09 and 31 March 2008 for 2009/10) in accordance with our standard roll forward formulae, but
- we will reduce the value of a scheme's assets by 5 per cent for each year between the effective date of the MFR and the calculation date, pro-rated for part years.

Insolvency Risk

2.2.9 The Board has confirmed that for the 2008/09 and 2009/10 levy years the insolvency probability for each participating employer will be measured by taking the insolvency probability associated with the standard D&B 1 to 100 failure scores as at 31 March 2008, and has instructed D&B to disregard the "severe parent at risk" override. The overrides for accounts filed in foreign currencies and negative net worth are no longer part of the methodology, and the rules concerning County Court Judgements have now been amended broadly as per the approach taken by the PPF in 2007/08.

2.2.10 In support of the Board's principle of simplicity, the majority of respondents were in favour of the use of a single insolvency risk provider for the new contract to be awarded for the 2010/11 levy year. Also, reflecting feedback from stakeholders, the Board will amend the insolvency risk provider selection criteria to reflect the importance of transparency of methodology and customer service.

2.2.11 In line with the Board's direction of travel in terms of the development of the levy, the selection criteria will also request tenders to provide an indication of their capability to measure long term risk on an employer specific basis.

Electronic Data Submission

2.2.12 In accordance with the unanimous responses received, the Board will work with the Pensions Regulator to ensure that data is collected in the most consistent and appropriate manner.

2.2.13 The deadline for submission of scheme data, via the Pension Regulator's online scheme maintenance system ('Exchange'), in respect of both the 2008/09 and 2009/10 levy years has been set at midnight 31 March 2008. It is the responsibility of trustees to ensure that data submitted to the Board is accurate. For 2008/09, the PPF **will not allow any corrections** to scheme return data as held by the Pensions Regulator on its scheme maintenance system, 'Exchange', on 31 March 2008.

2.2.14 For the 2008/09 levy year there will be no change in terms of the process by which schemes should submit additional voluntary information to the PPF. The deadlines for submitting this information to the Board is as follows:

- Actuarial Certificate of Deficit-reduction Contributions - midnight at the end of 7 April 2008
- Contingent Asset Certificates – New Arrangements - midnight at the end of 31 March 2008
- Block Transfer Certificates - midnight at the end of 7 April 2008

Schemes with existing, approved, contingent asset arrangements in place will be contacted individually by the Board and asked whether they wish to recertify these assets for the 2008/09 levy year.

Levy Waiver

2.2.15 There was broad support for the proposal to waive levies for schemes in assessment, but that any waived levy should be recouped if a scheme in assessment is subsequently rescued. The Board believes that it is in the best interests of schemes to implement a solution that minimises administrative burden. To this end, rather than calculating and then waiving the levy for schemes in assessment, the Board will charge a nil rate of pension protection levy for these schemes from 2008/09. In order to qualify for this nil rate a failure notice under s122(2)(a) of the Pensions Act 2004 must be filed on or before **31 March 2008** and subsequently become binding. If no such notice is received, the scheme will be charged the full levy. In addition, if the scheme or section has not filed its first s179 valuation by the same date, the levy will be calculated applying a disincentive as described in section 2.9 of this document. If a scheme considers that it may be rescued, it will need to ensure a s179 valuation is submitted by 31 March 2008.

Treatment of Annuity Contracts

2.2.16 It is clear from the responses received that this is a complex area. The Board therefore considers that there is considerably more analysis required to be performed before it is able to make a clear policy statement on this issue. The Board will not be seeking at this stage a change to legislation to render fully insured schemes ineligible, but will bring forward proposals as part of a future levy consultation exercise.

Evolution of the Pension Protection Levy

2.2.17 Overall, of those that expressed an opinion, a majority supported the Board's principle of a move to longer term measurement of risk. The Board therefore intends to undertake further work to evaluate the options for aligning the levy more closely with long-term risk, and will work closely with the industry to bring forward more detailed proposals in summer 2008.

3 The Final Pension Protection Levy Proposals for 2008/09 and 2009/10

3.1 Determination under section 175(5) of Pensions Act 2004

- 3.1.1 The Board's draft Determination under section 175(5) of the Pensions Act 2004 in respect of the 2008/09 levy year is published as Annex B. The Determination sets out the 2008/09 levy formulae, the risk factors for the risk based levy, the date and time at which the risk factors will be assessed and the date and time upon which the levy becomes payable.
- 3.1.2 The Board's final Determination will be published in early 2008 and will be a definitive statement of the rules for levy calculation for the 2008/09 levy year. Under section 181(3) (b) of the Pensions Act 2004, the Board must apply the Determination to the relevant facts pertaining to a particular scheme when calculating the amount of pension protection levy payable. Once the Determination is made, the Board does not have any discretion to depart from the Determination in calculating the pension protection levies for any particular scheme.
- 3.1.3 The draft Determination forms part of this consultation. The Board will consider any comments on the document which are received by 11 January. However, the Board does not at this stage expect to make fundamental changes to the proposals.

3.2 Levy Estimate

- 3.2.1 The levy estimate is set using the policy framework described in the 2007/08 Pension Protection Levy Estimate Consultation Document, informed by the results of the PPF's Long-Term Risk Model (LTRM), but is ultimately a matter of judgment for the members of the Board taking into consideration both qualitative and quantitative factors.
- 3.2.2 Some levy payers have expressed an interest in the model used to help set the levy estimate. Therefore, in August 2007 the PPF published "Modelling uncertainty: an introduction to the PPF Long-Term Risk Model". This is an information paper providing background to the modelling approach taken by the PPF to estimate the claims it might experience over the medium term, and the impact on its balance sheet.
- 3.2.3 This should give our stakeholders a better understanding of our long-term approach to measuring risk and aid understanding of the impact and relative contribution of different factors (controllable and non-controllable) on the levy estimate. Most significantly, it allows external professional scrutiny of the assumptions underlying the model, to promote confidence that the long-term risk is appropriately assessed.
- 3.2.4 Stakeholders have confirmed the importance of stability in the overall levy estimate and their individual bills, as well as the importance of knowing the amount of their individual bills in advance of the start of the levy year. In setting the levy estimate, the Board balances affordability and prudence: balancing costs to the levy payer against security that the Fund is able to meet future liabilities and to maintain confidence in its

ability to do so. Alongside considerations of affordability and prudence there is also a need to weigh the benefits of stability in the estimate – which has merits in building confidence in the PPF and in allowing schemes to plan effectively.

- 3.2.5 The pension protection levy estimate for the financial year 2008/09 is £675m, comprised of a total risk based element of £540m and a total scheme based element of £135m.
- 3.2.6 For the 2009/10 and 2010/11 levy years, absent a significant change in long-term risk, the levy estimate will be set at £675m, indexed to UK earnings annually at the same date risk factors are measured each year.

3.3 Measurement Date of Risk Factors

Summary of the Proposal

- 3.3.1 This proposal was developed in response to levy payers' expressed wish to have greater advance notice of their levy bills and to enable the Board to collect a total levy as close as possible to its estimate in the interests of stability.
- 3.3.2 There is currently an inherent mismatch between the data used to set the levy estimate, set prior to the start of the levy year based on indicative insolvency (P) and underfunding (U) information, and the data used in the levy invoice calculation for individual schemes, based on data including additional information collected via scheme returns and the Board's voluntary certificates.
- 3.3.3 To eliminate this mismatch, the Board proposed that all risk factors should be measured and all data supplied to the Board 12 months in advance of the start of the levy year, so that the levy estimate and individual bills could be calculated using the same data set.
- 3.3.4 Adopting this approach would bring forward the date at which schemes can calculate their individual bills and also allow more time to scrutinise the data held prior to calculating the levy estimate, enabling us to commence invoicing earlier in the levy year.

The Consultation Responses

- 3.3.5 Both consultation responses and feedback from the roadshows demonstrated support for the aim of giving schemes greater notice of the amount of their levy.

"We are in favour of fixing the measurement date for the levy in advance. Certainty of levy payments over an extended period is desirable and a longer period of stability will help manage the planning. Changes in scaling factor at the last minute create unhelpful uncertainty".

- 3.3.6 However there were significant concerns expressed about the inability under this proposal to take into account risk reduction activity undertaken after 31 March 2008, with a view expressed by many that crediting such activity after a 12 month time delay would reduce the incentive involved, and therefore reduce uptake of risk reducing activities.

“... a reduction in the risk based levy has until now acted as an effective incentive for employers to improve the security of their scheme... The (presumably) unintended consequence of this will be that fewer employers will take steps to improve the security of their scheme, meaning that members’ benefits generally will be less secure.”

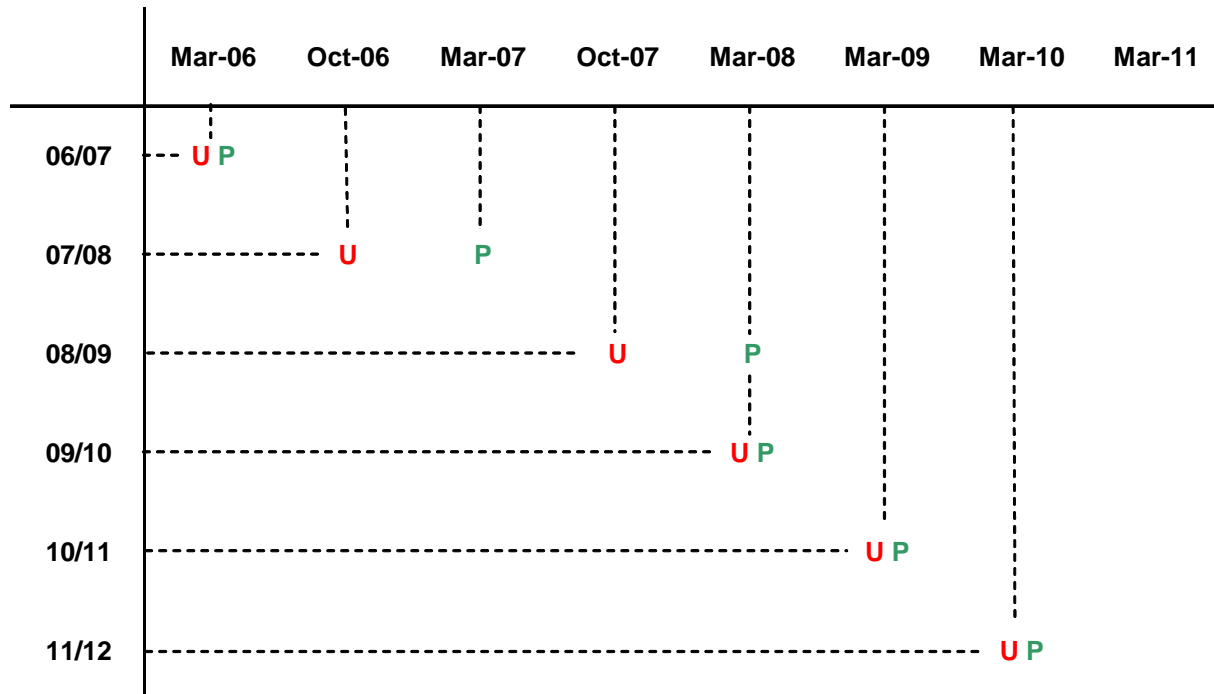
- 3.3.7 It is the intention of the Board to charge a fair levy which accurately reflects the risk posed by a particular scheme. It is not the intention to apply a policy that is perceived by stakeholders to breach this principle. We accept that the proposal to align the dates at which risk is measured would in result in some risk reducing activity not being taken into account for a full 12 month period. We have been persuaded that it may have a material impact on some schemes, particularly those sponsored by small to medium employers. In addition, we are deeply committed to incentivising risk reduction and would not wish to proceed with actions which our stakeholders indicate would reduce such incentives.
- 3.3.8 Although the vast majority of concerns expressed related to the effect on risk reducing activity, some responses also mentioned that bringing forward the measurement dates would mean that data on which levy calculations were made would be substantially out of date.
- 3.3.9 The Board carefully considered all possible combinations of measurement dates, including retaining the formula used in 08/09, or moving all measurement dates to 31 October (thereby giving only a six month time lag in crediting risk reducing activity). It concluded that the advantages of bringing forward the main measurement dates, both as expressed in responses to the Consultation and taking into account practical considerations, outweighed the importance of using the latest possible data in all instances.

The Board’s Confirmed Policy

3.3.10 The Board’s confirmed policy is that:

- 31 October 2007 be the measurement date for U and 31 March 2008 the measurement date for P for the 2008/09 levy
- 31 March 2008 be the measurement date for U and P for the 2009/10 Levy, as proposed in the Consultation, but that
- Contingent Assets and Deficit-reduction Contributions are accepted to be taken into account for the 2009/10 Levy with deadlines of 31/03/09 and 07/04/09 respectively.

3.3.11 We believe this approach, illustrated diagrammatically below, incorporates the key benefits of the proposal to move to measuring risk 12 months in advance, while exemplifying the Board’s core principle of fairness.



3.4 Underfunding risk

Summary of the Proposal

- 3.4.1 From 2008/09, the Board proposed to assess the distributional effects of the funding boundaries at which underfunding becomes a fixed percentage of liabilities at the time at which the levy estimate is set for any given year.
- 3.4.2 We therefore asked stakeholders to consider whether the funding limits and risk based levy cap should remain floating, i.e. not determined, until the draft 2008/09 levy determination is published. For subsequent years, they would be fixed when the levy estimate and scaling factors are known.

3.4.3 The five categories of scheme funding in the 2006/07 and 2007/08 risk based levy calculation were as follows:

| Underfunding category | Funding level (F)% | Underfunding (U) as a % of liabilities | % of schemes in 2007/08 | % of liabilities in 2007/08 |
|-----------------------|--------------------|--|-------------------------|-----------------------------|
| A | $F \leq 104$ | $105 - F$ | 79.7% | 64.7% |
| B | $104 < F \leq 111$ | 0.75 | 5.9% | 11.2% |
| C | $111 < F \leq 118$ | 0.50 | 4.2% | 9.1% |
| D | $118 < F \leq 125$ | 0.25 | 2.7% | 2.9% |
| E | $F > 125$ | 0.00 | 7.6% | 12.1% |

3.4.4 2007/08 saw a rise in the number of schemes falling into categories B-E. As funding positions improve because of short term market fluctuations or deficit-reduction measures, the number of schemes in category A may decrease significantly. A shift of this type leads to a redistribution of the total levy amount towards schemes remaining in category A, resulting in what are arguably disproportionate increases in individual amounts payable by them.

3.4.5 To avoid a disproportionate rise in levy bills for some schemes in category A, and to keep the upper funding limit in line with the benchmark cost of buying out full scheme benefits, would require an increase in the funding levels represented by categories B to E (and for some schemes in category A). This would also better reflect the long-term risk represented by schemes in categories B-E.

Consultation Responses

3.4.6 72 per cent of respondents supported this proposal. The principle of fairness was cited in a number of responses, with respondents keen to avoid an unfair redistribution of the levy towards schemes in category A:

3.4.7 *“We think that the goal of arriving at a fairer distribution of the total levy should be arrived at sooner rather than later and hence we support the idea (of allowing the distribution parameters to remain floating until publication of the levy estimate)”.*

3.4.8 Responses noted that the aim of setting the funding limits at the time the scaling factor is calculated is beneficial to planning for levy bills. However, there was some concern over the fact that some contingent assets are linked to a particular funding level, as we noted in the consultation document, and so sufficient warning was called for when revising the funding limits.

The Board’s Confirmed Policy

3.4.9 The Board confirms its intention to adjust the levy parameters to address the change in distribution of the levy that has occurred – and which has increased the cross-subsidy of the stronger funded by the weaker schemes.

3.4.10 This change will also mean that schemes would be able to work out their bills for the 2009/10 levy year well in advance of the start of the levy year, contrasting with the current approach that means schemes do not know their bills until after the start of the levy year.

3.4.11 Data on changes in scheme funding in the period to 31 October 2007 confirms that the trend to an increased burden on schemes in category A has continued. The table below shows the extent of the shift, if no change were made to the levy parameters:

| Underfunding category | Funding level (F)% | % of schemes in 07/08 | % of liabilities in 07/08 | Estimated % of schemes in 08/09 | Estimated % of liabilities in 08/09 |
|-----------------------|--------------------|-----------------------|---------------------------|---------------------------------|-------------------------------------|
| A | F <= 104 | 79.7% | 64.7% | 65.4% | 41.9% |
| B | 104 < F <=111 | 5.9% | 11.2% | 8.6% | 10.7% |
| C | 111 < F <=118 | 4.2% | 9.1% | 8.1% | 20.5% |
| D | 118 < F <= 125 | 2.7% | 2.9% | 4.7% | 8.8% |
| E | F > 125 | 7.6% | 12.1% | 13.2% | 18.1% |

3.4.12 Rather than simply reverse the change of the last 12 months, the Board believes it is justified to make a larger adjustment to the levy parameters. This will:

- more accurately align the start of the levy taper, at 120%, with the actual volatility in funding positions experienced in recent periods¹;
- represent the first stage in a transition to a levy that reflects more fairly the long-term risks that schemes impose on the PPF. The long-term risk model now allows us to estimate the contribution of (a sample) of individual schemes to our actual long-term risk. Schemes with funding levels above 125% still contribute to our risk. And there is evidence, as set out in the August 2007 levy consultation document, that well funded schemes risks are being cross-subsidised by less well funded schemes.

3.4.13 The Board will also take advantage of the opportunity to change the parameters by making some additional adjustments. Firstly it is proposed to add a sixth funding group – so that there will be an initial step in the taper set at 1 % of liabilities. Secondly, the cap will be adjusted down, so that the levy will not exceed 1% of scheme liabilities – as based on recent analysis the Board has concluded that keeping the cap at 1.25% would result in capped schemes paying more than justified by the risk they pose the PPF. Each of these changes will make a contribution to improving the fairness of the levy.

¹ The 105% starting point was selected in 2005 to “reflect downside risk over a one year period...due to non-matched assets and liabilities” (Consultation Document July 2005). In practice the 7800 index shows volatility has in recent periods been above +/-20% in a one year period.

3.4.14 Under the Board's revised parameters for the levy taper, there would be six categories of scheme funding for the 2008/09 risk based levy:

| Underfunding category | Funding level (F)% | Underfunding (U) as a % of liabilities | Estimated no. of schemes in 08/09 | Estimated % of schemes in 08/09 | Estimated % of liabilities in 08/09 |
|-----------------------|--------------------|--|-----------------------------------|---------------------------------|-------------------------------------|
| A | $F \leq 120$ | $121 - F$ | 6,346 | 83.5% | 74.8% |
| B | $120 < F \leq 125$ | 1 | 247 | 3.3% | 7.1% |
| C | $125 < F \leq 130$ | 0.75 | 193 | 2.5% | 3.2% |
| D | $130 < F \leq 135$ | 0.50 | 168 | 2.2% | 6.6% |
| E | $135 < F \leq 140$ | 0.25 | 140 | 1.8% | 1.4% |
| F | $F > 140$ | 0.00 | 506 | 6.7% | 6.9% |

3.4.15 In reaching its decision to amend the distribution parameters the Board considered carefully the effect on those schemes which have put in place contingent assets targeted at a particular level of funding. In relation to Type A contingent assets it will retain the existing threshold of 105% for the guarantor's insolvency probability to be used in full in the levy calculation. Type B and Type C contingent assets will continue to be given credit in the levy calculation based on their value at the relevant time. In this way very few, if any, schemes will see any need to amend the contingent asset documentation they have entered into; schemes may however wish to review the amount of protection represented by their Type B and C assets. However, parties are of course under no obligation to amend contingent asset agreements once they are in place, and the levy formula will continue to give appropriate credit for the cover provided by existing contingent assets. Please see Annex C and the amended Contingent Asset guidance for more details.

3.4.16 The fairness of the levy can be measured by comparing the levy calculated using the levy formula for each scheme with the proportion of the total levy that would be paid if the scheme paid its share of the PPF's long-term risk, as measured by the PPF's Long-Term Risk Model (we refer to this as the theoretical levy)². The theoretical levy for 2008/09 has been estimated³ and the tables and graphs below show the comparison with actual levies for 2006/07 and 2007/08 and the projections for 2008/09 on the Board's chosen parameters.

² i.e. A scheme that represented £10million of a £1000 million total risk as calculated by the model would pay 1/100th of the total levy – which if set at £675million would be £6.75 million.

³ One element of the long-term work set out below will be to use the LTRM to generate exact theoretical levies for all schemes, for this present task an estimate has been generated. An approximation of this kind will tend to underestimate the degree of cross subsidy

TABLE 1 - Proportion of Total Levy Paid, By Scheme Size By Levy Year

| Membership Size, October 07 | 2006-07 | 2007-08 | 2008-09 | 2008-09 Estimated Theoretical Levy |
|-----------------------------|---------------|---------------|---------------|------------------------------------|
| 5 to 99 | 3.4% | 3.5% | 2.8% | 1.4% |
| 100 to 999 | 22.2% | 28.7% | 24.5% | 16.8% |
| 1,000 to 4,999 | 22.0% | 25.9% | 22.6% | 17.9% |
| 5,000 to 9,999 | 10.5% | 11.7% | 10.6% | 11.2% |
| 10,000+ | 41.9% | 30.2% | 39.4% | 52.7% |
| TOTAL | 100.0% | 100.0% | 100.0% | 100.0% |

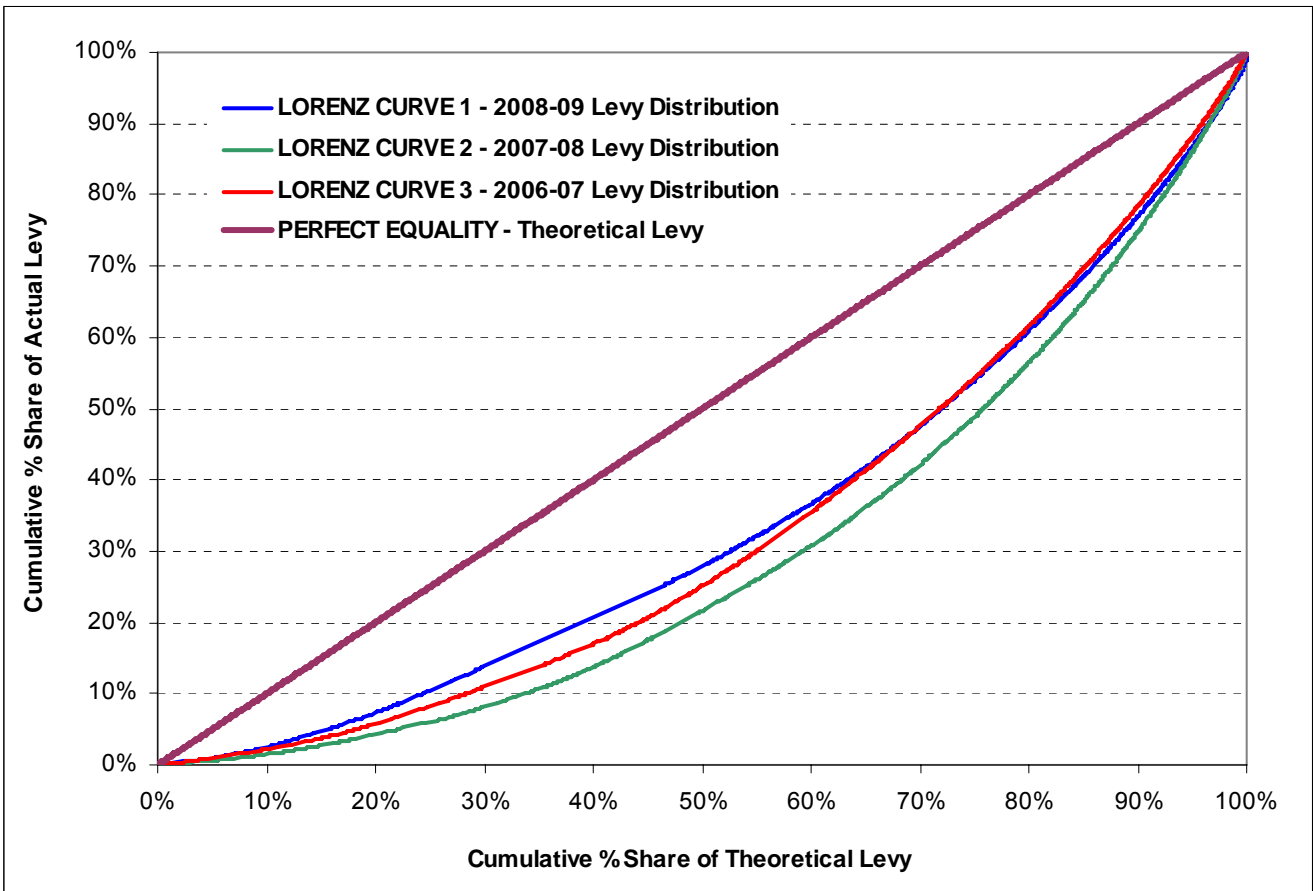
3.4.17 Table 1 shows that the change in parameters will bring the levy charged closer to a fair levy in terms of charging large and small schemes the same relative to the risk they pose.

TABLE 2 - Proportion of Total Levy Paid, By Scheme Funding By Levy Year

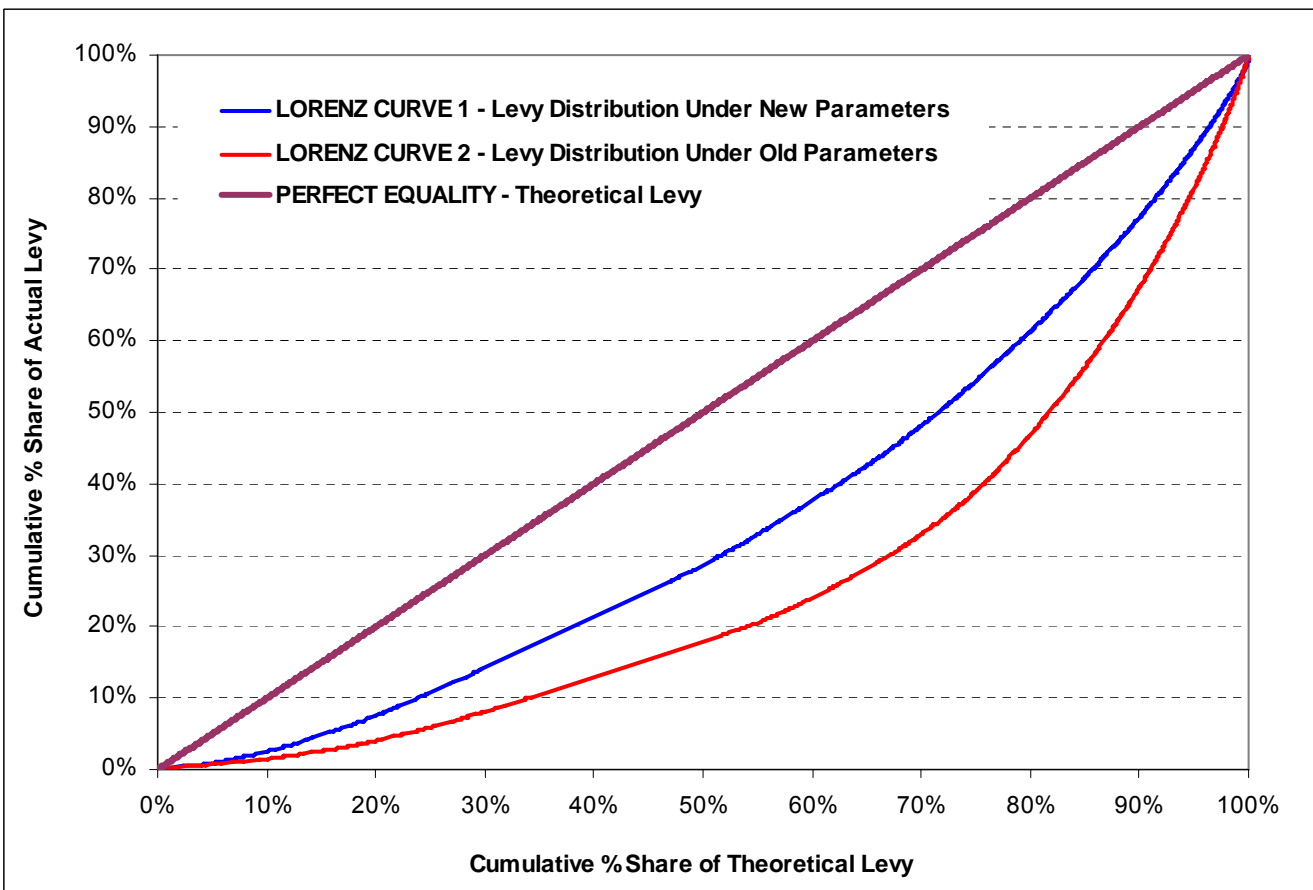
| Funding Level, October 07 | 2006-07 | 2007-08 | 2008-09 | 2008-09 Estimated Theoretical Levy |
|---------------------------|---------------|---------------|---------------|------------------------------------|
| Less than 50% | 0.6% | 2.1% | 1.9% | 1.5% |
| 50% - 80% | 15.8% | 25.1% | 18.7% | 12.0% |
| 80% - 90% | 16.3% | 22.4% | 19.3% | 12.9% |
| 90% - 100% | 24.5% | 24.2% | 31.2% | 32.5% |
| 100% - 110% | 18.4% | 15.5% | 16.1% | 18.0% |
| 110% - 120% | 11.9% | 5.3% | 7.2% | 10.6% |
| 120% - 130% | 5.4% | 2.4% | 2.4% | 6.7% |
| 130% - 140% | 3.9% | 1.6% | 1.7% | 4.1% |
| More than 140% | 3.3% | 1.3% | 1.3% | 1.7% |
| TOTAL | 100.0% | 100.0% | 100.0% | 100.0% |

3.4.18 Table 2 shows the Board's chosen parameters will lead to a levy in which underfunded and well-funded schemes pay a fairer proportion of the levy. In order to better match the theoretical levy the Board would need to amend the distribution formula for the levy to reflect long term probabilities of insolvency and make an allowance for the impact of investment strategy as a risk factor. The response to the August 2007 consultation considering these issues is outlined in chapter 4 as is the Board's approach and timetable for evolving the levy to reflect these issues.

3.4.19 The graph below shows the relative fairness of the levy for the years from 2006/07 to 2008/09 (based on the Board's chosen parameters).



By comparison, had the Board left the levy parameters unchanged, the distribution would have been substantially less fair, as is shown by the following graph comparing the distribution achieved by Board's chosen parameters and that which would have resulted from using the previous parameters for 2008/09:



3.4.20 Based on these graphs we have correlated an index of fairness (or Gini coefficient) which represents the area between each curve and the theoretical distribution. A low Gini coefficient indicates a more equal distribution, while a high Gini coefficient indicates more unequal distribution. The Gini coefficients (or the degree of cross subsidy) estimated are as follows:

- 47% if the existing parameters had been used in 2008/09
- 39% for 2007/08's levy, and 33% for 2006/07's levy
- 31% for the revised 2008/09 levy parameters.

3.4.21 The Board considers that a reduction in Gini coefficient from an estimated 47% to 31% as a result of shifting the levy distribution parameters in 2008/09 represents a proportionate improvement while taking account of the limitations of using a relatively straightforward single mechanism to adjust the levy distribution.

3.5 The Scheme Based Levy Multiplier for the 2008/09 Levy Year

3.5.1 The 2008/09 scheme based multiplier is calculated using the formula:

$$h \sum_{i=1}^T L_i = (1 - R) \times Q$$

$$h = \frac{(1 - R) \times Q}{\sum_{i=1}^T L_i}$$

Where,

T = number of Pension Protection Fund eligible schemes/sections excluding schemes/sections in assessment

$\sum_{i=1}^T L_i$ = sum of s179 liabilities over all eligible schemes

Q = pension protection levy estimate

R = percentage of the pension protection levy that is risk based; hence (1-R) is the percentage that is scheme based

3.5.2 The scheme based multiplier is the solution, h, to the linear equation shown above⁴.

⁴ Note that the formula in 5.6.1 is slightly simplified and does not take account of, among other things, the need to scale up for schemes in respect of which the Board does not have adequate data when it is calculating the scaling factor and multiplier. The detailed formulae are set out in the draft Determination.

- 3.5.3 For the 2008/09 levy year the percentage of the pension protection levy that will be made up by the scheme based element (1- R) remains unchanged at 20%.
- 3.5.4 The scheme based levy estimate is the Board's estimate of the total amount of scheme based levy that should be collected for the 2008/09 levy year. This has been calculated as £135million.
- 3.5.5 The total liabilities are the same as those used to determine total underfunding risk for the risk based levy scaling factor calculation. When the above formula is applied to estimated s179 liability information available for the known universe of eligible schemes and sponsoring employers as at the 31 October 2007, the indicative scheme based levy multiplier is 0.0152%. The actual multiplier will be determined in accordance with the formula set out in the final Determination and is likely to differ from this indicative figure. Only the finally calculated and published figure will be definitive.

3.6 The Risk Based Levy Scaling Factor for the 2008/09 Levy Year

- 3.6.1 For the 2008/09 levy year, the formulae for calculating the risk based levy scaling factor is set out below. The Board will not publish the final risk based levy scaling factor and the scheme based levy multiplier until 31 May 2008 at the latest. This is a later date than 2007/08 but reflects the fact that the Board expects to receive almost 3500 additional section 179 valuations by 31 March 2008. The Board aims to capture as much scheme specific information as possible and include it in the calculation of the levy scaling factor and scheme based levy multiplier. The Board does not intend to publish any further indicative estimates. The Board has sought to neutralise the impact of controllable factors on the levy scaling factor formula as far as possible.
- 3.6.2 The 2008/09 risk based levy scaling factor will be calculated using the formula:

$$\sum_{i=1}^T \min(U_i \times P_i \times R \times c, K \times L_i) = Q \times R$$

Where,

T = number of Pension Protection Fund eligible schemes/sections excluding schemes/sections that are in assessment

U_i = underfunding risk factor (including contingent assets) of the i th eligible scheme/section

P_i = insolvency risk factor for the i th eligible scheme/section

L_i = estimated s179 liabilities of i th eligible scheme/section

Q = pension protection levy estimate

R = percentage of the pension protection levy that is risk based

K = levy cap expressed as a decimal

- 3.6.3 The levy scaling factor is the solution, c , to the non-linear equation shown above⁵.
- 3.6.4 For the 2008/09 levy year the percentage of the pension protection levy that will be made up by the risk based element (R) remains unchanged at 80% and the levy cap (K) will be 1.00%.
- 3.6.5 The risk based levy quantum (R x Q) is the Board's estimate of the amount of risk based levy that should be collected for the 2008/09 levy year. This has been calculated as £540million.
- 3.6.6 The total risk exposure will be the sum of the product of underfunding risk as at 31 October 2007, insolvency risk as at 31 March 2008 and percentage risk based, subject to the levy cap, for all schemes.
- 3.6.7 Scheme assets and liabilities for the purpose of the underfunding risk calculation will be determined using market information available as at close of business on 31 October 2007. Insolvency risk will be calculated using insolvency probabilities derived from 31 March 2008 Failure Scores for the known universe of sponsoring employers.
- 3.6.8 When this formula is applied to the insolvency and underfunding information available for the known universe of eligible schemes and sponsoring employers as at 31 October 2007, the indicative risk based levy scaling factor is 1.60. The actual scaling factor will be determined in accordance with the formula set out in the final Determination and is likely to differ from this indicative figure. Only the finally calculated and published figure will be definitive.
- 3.6.9 This figure could change before a final levy scaling factor is set due to:
- changes in D&B scores between 31 October 2007 and 31 March 2008
 - the certification of contingent assets in the period between 30th September and 31st March 2008
 - deficit-reduction contributions certified between 30th September and 31 March 2008; and
 - an additional 3500 s179 valuations due by 31 March 2008
- 3.6.10 Taken together, these leave a significant degree of uncertainty about the final scaling factor for 2008/09. The changes outlined in 3.3 should eradicate this uncertainty in future levy years.

⁵ Note that the 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 Board 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. The detailed formulae are set out in the draft Determination.

3.7 Statutory Deadline for the Submission of a First Section 179 Valuation

Summary of the Proposal

- 3.7.1 The Pension Protection Fund (Miscellaneous Amendments) Regulation 2007 (SI 2007/782), which came into force on April 6 2007, requires all eligible schemes registered before that date to submit their first section 179 valuation by the earlier of 31 March 2008 or 15 months after the effective valuation date. Rolled forward/backward section 179 valuation information submitted by the 31 March 2008 deadline will be used for both the 2008/09 and 2009/10 levy years.
- 3.7.2 Schemes which fail to complete a section 179 valuation by 31 March 2008 will be in breach of their statutory obligation. The Pensions Regulator is able to impose statutory sanctions on these schemes and we will work closely with them to monitor the situation and take appropriate action.
- 3.7.3 The Board believes that a sufficiently strong levy disincentive should be applied to schemes which have failed to comply with the statutory requirement, to reflect the fact that it is reasonable to assume that such schemes represent a greater risk to us than the average scheme.

Consultation Responses

- 3.7.4 A majority of respondents agreed that a disincentive should be applied to schemes that fail to submit a section 179 valuation by the statutory deadline.

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- 3.7.5 The Board considers that a disincentive (which represents an approximation for the risk of poor administration) should be applied to the schemes which fail to meet the deadline. The Board is required to insure against risk so far as is possible, and believes this approach also recognises the commitment shown by schemes who have acted appropriately in ensuring a section 179 valuation is submitted by the statutory deadline.
- 3.7.6 This deadline has been publicised in our biannual stakeholder newsletter, during our nationwide seminars supporting this consultation and on our website. In November 2007 we wrote to all schemes for which a section 179 valuation had not yet been received by the Board at that time, reminding them of the 31 March 2008 statutory deadline.
- 3.7.7 While the Pensions Regulator is responsible for ensuring schemes adhere to their statutory requirements, the Board has further concerns; namely that an inability to adhere to this statutory requirement may be indicative of a broader administrative failure within the scheme.

3.7.8 However, any action taken in response to this risk must be specific to the scheme and its circumstances in order to meet our objectives of fairness and proportionality. It should also not be unduly complicated.

3.7.9 The disincentive will therefore be applied as follows:

- the estimated section 179 assets and liabilities as at 31/10/06 used in the 2007/08 levy invoice calculation that was obtained by converting a minimum funding requirement (MFR) valuation will be treated as if it had been submitted to the Board in the usual way
- this will be rolled forward to the calculation date (31 October 2007 for 2008/09 and 31 March 2008 for 2009/10) in accordance with our standard roll forward formulae, but
- we will reduce the value of a scheme's assets by 5 per cent for each year between the effective date of the MFR and the calculation date, pro-rated for part years.

3.7.10 The following example illustrates the process to be used for 2008/09:

| | |
|---|---|
| Only valuation data is MFR valuation at 06 April 2004. | Assets £237m Liabilities £228m |
| Roll forward to 31 October 2006, on s179 basis | Assets £296m Liabilities £369m This will form the input data for 08/09 |
| Roll forward to 31 October 2007, on s179 basis | Assets (A) £302m Liabilities (L) £354m (illustrative figures) |
| Calculate time difference in years between date of last MFR valuation and 31 October 2007 | $(31/10/2007 - 06/04/2004) = 3.57$ years 365 |
| Adjust assets for period 06 April 2004 to 31 October 2007 | Underfunding before asset adjustment = $1.21L - A = £126m$ Adjusted asset value = $302 \times (1 - 0.05 \times 3.57) = 302 \times 0.8215 = £248m = B$ Underfunding after asset adjustment = $1.21L - B = £180m$ |

3.7.11 It is not intended that this policy place an additional burden on schemes in an assessment period. While these schemes are still required by law to submit a s179 valuation, the Board has confirmed (see below) its intention to charge a nil scheme and risk based levy for these schemes, and therefore schemes in assessment will not be affected by the calculation specified above. For precise details of qualification criteria see 3.10 below and the Board's draft determination.

3.7.12 However, where a scheme has been charged a nil levy as a result of its being in an assessment period, and that scheme is subsequently rescued, any levy payable will become due and payable by the rescued scheme.

3.8 Insolvency Risk

Summary of the Proposal

- 3.8.1 In 2005 the Board conducted an EU procurement exercise for an insolvency risk provider. As a result Dun & Bradstreet Ltd (www.dnb.co.uk), a global provider of business information, was appointed in August 2005 for two years with an option to extend for a further two years. Dun & Bradstreet Ltd (D&B) has been the Board's sole insolvency risk provider for the 2006/07 and 2007/08 levy years. The Board has exercised its option to extend its contract with D&B to cover the 2008/09 and 2009/10 levy years, and implementing D&B's revised failure score methodology.
- 3.8.2 The Board is required under EU Procurement Regulations to conduct an open tender for the contract to measure insolvency risk for the 2010/11 and 2011/12 levy years. Although in practical terms this proposal is not concerned with the 2008/09 and 2009/10 levy years, the appointment of insolvency risk providers requires certain actions to be taken from 2007 to meet the deadline to appoint insolvency risk providers and for these providers to be in a position to deliver insolvency probabilities from 2010/11.
- 3.8.3 The Board has previously received feedback from stakeholders that the measurement of insolvency risk should be tailored to reflect the different types of sponsoring entities of pension schemes. This creates a tension between simplicity and proportionality; the transaction costs of this approach in terms of finance and resource are substantial. The Consultation document asked stakeholders to comment on whether they felt it was appropriate to appoint more than one insolvency risk provider to measure the insolvency risk for different populations. Those who supported this view were asked to nominate the populations they felt would be best serviced by differing approaches. Stakeholders were also asked to comment on the proposed selection criteria for the procurement of an insolvency risk provider. The Board also sought views as to whether the PPF should move towards measuring long-term probability of insolvency on an employer specific basis.

The Consultation Responses

- 3.8.4 The majority of respondents supported the use of a single insolvency risk provider. A number of respondents expressed a view that the principle of simplicity would be compromised if multiple providers were appointed, with further implications for consistency and equity. It was noted that increased complexity would be likely to be accompanied by increased transaction costs. A number of respondents felt that the principle of fairness would be compromised due to potential inconsistencies in approach.
- 3.8.5 Only one large single employer scheme gave unqualified support to the use of multiple providers. Similarly, although one multi scheme representative group responding to the consultation does support this proposal, the remaining two multi scheme representative groups do not. The response below is indicative of the broader views expressed:

“Since 2005, firms feel that they have invested a great deal of time working with the single provider model and the PPF to understand the methodology and would like the upcoming procurement process to be used to address persistent problems and to inject stability, predictability and relevance into the system, without resorting to the complexity of an additional provider at this stage”.

- 3.8.6 The consultation document requested that any respondents supporting the appointment of multiple providers nominate which populations would be best serviced by which methods. The clear response from the minority in support of multiple providers was that the PPF universe be divided into those schemes with sponsoring employers who have a credit rating (generally but not exclusively large employers) and those that do not.
- 3.8.7 The majority of respondents support the proposed selection criteria outlined in the document. It was noted explicitly by several respondents that transparency of methodology was paramount, and could be improved upon. For example, one large multi employer representative group supported multiple providers because: *“While D&B have improved their rating criteria over the last two years, the ratings are still not transparent”*. One respondent, however, noted quite rightly that the tender criteria do not currently make explicit reference to proven ability accurately to assess insolvency risk.
- 3.8.8 There was some support for a move to using a long-term measure of insolvency probabilities, although concerns were expressed about the likely accuracy of such a measure, as illustrated by the following response:

“We recognise that the task being attempted by D&B is complex and unprecedented, especially as regards achieving greater validity for larger businesses. The problems with assessing larger businesses’ risk currently are one reason for firms’ doubts about a move to the 5 year model at this stage.”

The Board’s Confirmed Policy

- 3.8.9 In accordance with the responses received, the Board intends that:
- 3.8.10 For the 2008/09 and 2009/10 levy years the insolvency probability for each participating employer will be measured by taking the insolvency probability associated with the standard D&B 1 to 100 failure scores as at 31 March 2008, except that the Board has instructed D&B to disregard the “severe parent risk” override. The override for accounts filed in foreign currencies and the override when a company has negative net worth are no longer part of the methodology and so the Board does not need to instruct D&B to disregard the associated rule. The rules concerning County Court Judgements have been amended broadly as per the approach taken by the PPF in 2007/08 and are now part of the standard D&B failure score.
- 3.8.11 D&B has produced a revised probability of insolvency table for the PPF which maps each of the 1 to 100 failure scores to an appropriate probability of insolvency which will be used in the 2008/09 and 2009/10 calculations. This revised table of failure score mapping to insolvency probabilities is included as part of the draft determination. It is

the probability of insolvency, not the failure score that will be used in the levy calculation.

- 3.8.12 Failure scores for participating employers are available free of charge directly from D&B by calling their helpline for PPF related queries on 0870 850 6209 or by e-mailing customerhelp@dnb.com. We would encourage all schemes to obtain their participating employers' failure scores and associated probabilities of insolvency based on the revised methodology as soon as practicable. This will allow the insolvency risk assessment made by D&B to be based on the most accurate and up-to-date information available. The scheme return now asks for the D-U-N-S number for each participating employer to ensure that the insolvency risk calculation uses the insolvency probabilities associated with the correct participating employers.
- 3.8.13 International probabilities of insolvency are unaffected except for a small number of countries. The associated probabilities of insolvency for particular failure scores or equivalents in all countries are available, where applicable, from the PPF Stakeholder Support Team on 0845 600 2541 or information@ppf.gsi.gov.uk.
- 3.8.14 The Board considers that the position best able to meet the needs of our stakeholders, as well as those of the PPF, is one that provides a fair, simple and transparent solution. Hence, the Board will appoint a single insolvency risk provider for the provision of insolvency risk measurement in 2010/11. A number of valuable lessons have been learned through the initial period of the current contract with D&B, and reiterated in the responses received to the consultation. One example is the importance of any insolvency risk provider spending a substantial degree of time ensuring their policies and processes are adequate for dealing with the wide range of scheme sponsors.
- 3.8.15 Given that the PPF universe is unique in terms of its insolvency risk profile requirements, it follows that any appointed provider must be allocated sufficient time to understand the PPF measurement requirements, and calibrate and verify its scoring methodology prior to their measure of insolvency risk being incorporated into the levy calculation. Therefore although the first year in which any appointed provider will provide a measure of insolvency risk for use in the risk based levy calculation will be the 2010/11 levy year, the tender activity to secure the services of this provider will be concluded by March 2008. It is vital that this provider is appointed with sufficient time to engage with employers and schemes prior to initial measurement of insolvency risk.
- 3.8.16 The Board will amend the insolvency risk provider selection criteria to reflect the importance of transparency of methodology and customer service and that the weighting of the selection criteria reflect the majority of stakeholders' views that accuracy, transparency, and stability of measurement are paramount. The current selection criteria are attached as Annex A.
- 3.8.17 While the Board wishes to ultimately measure longer term probabilities of insolvency, it is vital that coverage and customer service are not compromised in doing this. It is vital that the market provider used to measure insolvency risk is able to provide full coverage of the PPF universe, and the selection criteria will be weighted to reflect this. The Board will therefore request that those providers responding to the tender provide an indication of their capability to measure long-term risk and the details of this

methodology, and any alternative routes to measure long-term risk on an employer specific basis. Evaluation of any such proposals will be subject to scrutiny against the selection criteria published in Annex A, inclusive of coverage of the PPF universe.

3.9 Electronic Data Submission

Summary of the Proposal

- 3.9.1 The Board's objective for data submission is that a single point of contact be established for schemes wishing to submit data to be used by either the Pensions Regulator or the Pension Protection Fund or both organisations. This is consistent with the Board's principle of simplicity and with the recommendations made in the *Thornton Review of Pensions Institutions*.
- 3.9.2 Basic scheme and employer data is collected via an annual Scheme Return process conducted by the Pensions Regulator. This process has been evolving over time, from paper scheme returns in 2005/06, to electronic forms in 2006/07 and 2007/08.
- 3.9.3 In response to feedback from stakeholders on the scheme return process, the Pensions Regulator has developed an online system for submitting scheme returns. This system will go live from the end of 2007, thereafter, upon receipt of an initial Scheme Return notification, schemes will be able to submit and monitor the entire range of data that is collected via the Scheme Return, including the data that is used in the calculation of a scheme's pension protection levy.
- 3.9.4 Following that initial submission, schemes will then be able to log on to the Scheme Maintenance application at any point during the year to update the data held. The deadline for submission of scheme data in respect of both the 2008/09 and 2009/10 levy years has been set at midnight at the end of 31st March 2008 and so, making any such updates by that deadline will ensure that the 2008/09 and 2009/10 pension protection levy calculations are based on the most accurate data available.
- 3.9.5 In previous levy years we have allowed schemes to correct information up until 28 days after they have received their levy invoices. We believe schemes should now understand the importance of getting their scheme return information right. **For 2008/09 therefore we will not allow any corrections to the scheme return data held by the Pensions Regulator on its scheme maintenance system, Exchange on 31 March 2008.** If you are concerned that any of the information held by the Pensions Regulator may be incorrect (including where you have previously notified the PPF of a correction to an earlier year's scheme return) you will need to upload the correct information onto the Pensions Regulator's scheme maintenance website on or before 31 March 2008. It is the responsibility of trustees to ensure that the data submitted to the Board is accurate. All eligible schemes should be in a position to amend their data on Exchange having received their Scheme Return notification before the end of January 2008. If you haven't received a Scheme Return notification by that date please contact the Pensions Regulator on 0870 606 3636 or at: schemereturns@thepensionsregulator.gov.uk.

3.9.6 The development of the Scheme Maintenance system will be supported by ongoing dialogue with stakeholders, including independent research to identify handling issues, and user testing with trustees to ensure a fit for purpose system.

Consultation Responses

3.9.7 We asked stakeholders whether they supported the creation of a single point of contact for data submission to the Pensions Regulator (the Pensions Regulator) and the PPF. Just under half of respondents to the consultation answered this question and those that did gave the proposal their unanimous support.

The Board's Confirmed Policy

3.9.8 In accordance with the responses received, the Board intends to work with the Pensions Regulator to ensure that data is collected in the most consistent and appropriate manner, building on the first year's experience of the Scheme Maintenance system.

3.9.9 The Pensions Regulator has a dedicated customer service centre to assist stakeholders with any queries they may have in respect of the Scheme Maintenance system. Further details are available on the website of the Pensions Regulator, at the following address:

www.thepensionsregulator.gov.uk/onlineservices/exchange/index.aspx

Submission of Voluntary Data

3.9.10 There is no change for the 2008/09 levy year in terms of the process by which schemes should submit additional voluntary information to the PPF using the following:

- The Actuarial Certificate of Deficit-reduction Contributions
- The Contingent Asset Certificates
- The Certificate of Valuation Results on a Section 179 basis following a Material Transfer (parts A and B)

3.9.11 Schemes who intend to submit a voluntary form and wish this to be taken into account in their 2008/09 levy calculation should also be aware of the following:

Actuarial Certificate of Deficit-reduction Contributions

3.9.12 There are likely to be no changes to the voluntary forms for submission of a deficit-reduction contribution for the 2008/09 levy year. This certificate is currently available on the PPF website and you will be able to submit this form from the time that the Final determination is published. **The deadline for submission of a deficit-reduction contribution certificate for the 2008/09 levy year is midnight at the end of 7 April 2008.**

Contingent Asset Certificates – New Certifications

3.9.13 Images of the 2008/09 Contingent Asset Certificates are appended to the draft Determination are available on the PPF website (http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/voluntary_certificates.htm). The electronic versions of these certificates will be available for submission on the PPF website from the date that the final Determination is published. Prior to publication of these electronic versions, schemes should not submit hard copy certificates to the Board. **The deadline for the submission of contingent asset certificates for the 2008/09 levy year is midnight at the end of 31 March 2008.**

Contingent Asset Certificates – Re-certifications

3.9.14 All schemes that have existing contingent asset arrangements which have been previously certified to the Board and subsequently approved by the Board, will be contacted individually by the Pension Protection Fund, and asked whether they wish to rectify these assets to take effect for the 2008/09 levy calculation.

Block Transfer Certificates

3.9.15 Images of parts A and B of the Certificate of Valuation Results on a Section 179 basis following a Material Transfer are also available on the PPF website (http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/voluntary_certificates.htm). These certificates should also be submitted electronically, electronic versions will again be available upon publication of the final Determination and in the interim hard copy submissions should not be made. The Board believes that schemes should now understand better the effect of block transfers on schemes' levies. In addition, the previous June deadline did not allow the PPF to take into account block transfer in the levy scaling factor calculation, adding to the risk of under/over-collection. The Board has therefore decided to move **the deadline for completion and submission of a block transfer form to midnight at the end of 7 April 2008**, the deadline for deficit-reduction contribution certificates. Schemes planning a transfer shortly before that date should make preparations to enable them to complete the certificates within that timescale. Both parts A and B will need to be submitted by the transferring out and transferring in schemes respectively in order for that transfer to be taken into account for either scheme's 2008/09 levy calculation.

3.10 Levy waiver and eligibility policy – Schemes in Assessment

Summary of the Proposal

3.10.1 The Pension Protection Fund (Waiver of Pension Protection Levy and Consequential Amendments) Regulations 2007 (SI 2007/771) do not allow the PPF to waive the pension protection levy for schemes in assessment. This reflects the fact that there is no certainty when a scheme enters an assessment period that it will not be rescued, and therefore pose an ongoing risk to the Pension Protection Fund.

3.10.2 When a scheme in assessment is funded above PPF levels, but is not rescued, paying the pension protection levy during the assessment period simply leads to lower

annuities for scheme members. Charging a levy to schemes that transfer to the PPF makes no net difference to the PPF's overall funding.

3.10.3 The Board considers these to be convincing arguments to waive the levy for schemes in an assessment period. If a scheme is rescued during assessment and continues outside the PPF, any waived levies would be recouped. Stakeholders were asked whether they support this proposal.

Consultation Responses

3.10.4 The proposal was supported by 96 per cent of respondents, many of whom explicitly stated that they would like the PPF to recoup any levy waived during assessment should a scheme ultimately be rescued. A few responses stated that levies should be due from schemes that enter assessment during the levy year in question.

"It is ... true that, where the scheme is rescued, payment of the levy during assessment will simply lead to lower annuities becoming available for members. We therefore support the proposal to waive levy payments in these circumstances, together with the proposal to subsequently recover any levy which has been waived in the event that the scheme is rescued and remains an ongoing risk to the PPF".

The Board's Confirmed Policy

3.10.5 In view of the magnitude of responses supporting this proposal, the Board confirms its proposal not to charge a levy to schemes in assessment. Further, the Board believes that it is in the best interests of schemes to implement a solution that minimises administrative burden. To this end, in contrast to the original proposal to calculate, and then waive, a levy for schemes in assessment, the Board considers it within the scope of its current powers, and appropriate, to charge a nil rate of pension protection levy for these schemes from 2008/09. It should be noted that the Board will only set the nil rate of levy for schemes in assessment where a **scheme failure notice** has been issued on or before 31 March 2008. Trustees whose scheme is not likely to be rescued should ensure the relevant Insolvency Practitioner is aware of this deadline. If a scheme is rescued during assessment and continues outside the PPF, any waived levies would be recouped.

3.11 Levy waiver and eligibility policy – Treatment of Annuities

Summary of the Proposal

3.11.1 The law requires that all annuity contracts held by a scheme in the name of the scheme trustees should be valued as assets as part of the s179 valuation, since the benefits they are covering remain liabilities of the scheme, and should be valued accordingly. This applies even where all scheme benefits have been bought out in the name of the trustees.

3.11.2 However, the Board has discretion to waive the levies where the scheme satisfies the test in the regulations for a fully insured scheme.

3.11.3 The possibility of waiver exists because schemes in this position are perceived to pose a very low risk to the PPF, since the assets and liabilities are matched, and even the insolvency of the insurance company would present little risk, given the capital adequacy requirements for insurance companies and the existence of a separate compensation regime. The Board sought stakeholders' views as to whether fully insured schemes should in fact cease to be eligible, rather than a discretionary waiver of their levies.

Consultation Responses

3.11.4 This is a complex question on which a number of different views were reached by stakeholders. Some respondents believe that these schemes should remain eligible but have their levies waived. Others believe they should be ineligible outright as they are risk-free.

The Board's Confirmed Policy

3.11.5 The Board does not currently propose to request legislation to render fully insured schemes ineligible. It is clear from the responses received that this is a complex area, and if the breadth of responses received is indicative of the complexity of the issue, there is considerably more analysis required to be performed before the Board is able to make a clear policy statement on this issue.

3.11.6 These schemes do represent a low risk to the PPF. Whether these schemes actually represent no risk at all to the Board will depend on the precise terms of the contracts involved, and particularly whether such contracts are irrevocable. As the market develops substantially, it becomes increasingly difficult to ensure that one has a legal definition that is watertight and does not expose the PPF and therefore levy payers to undue risk.

3.11.7 There are a number of questions to be answered in examining this proposal more fully, including a thorough exploration of the consequences, intended and unintended, of any new policy direction. Importantly, the Board needs to consider fully the implications of the number of new and emerging products in the market which seek to provide insurance type solutions for pension schemes and also consider how to treat schemes which have a significant proportion, but not all, of their assets invested in annuities. To this end, the Board has committed to a research exercise, which will include an element of stakeholder discussion of new market solutions.

3.11.8 Following this exercise, the Board will present a proposal to stakeholders as part of a future levy consultation exercise.

4 Evolution of the Pension Protection Levy

4.1 Introduction

4.1.1 In addition to the changes planned for 2008/09 and 2009/10, the Board consulted on its plans for the longer term development of the levy. It made clear in doing so that its thinking was embryonic and that it was therefore setting out broad propositions rather than detailed proposals. This approach makes it difficult to provide full detail on the potential impact of changes and the Board therefore recognises responses as representing organisations' initial views which may be subject to change. The Board will further involve stakeholders in developing its thinking, and will consult again with a more detailed proposition before instituting further change.

4.1.2 Based on stakeholder feedback, the Board set the following objectives for reviewing the options for change:

- increasing stability and certainty for levy payers
- improving the fit between the way the total levy estimate is distributed between all eligible schemes and the theoretical levy produced by our Long-Term Risk Model (LTRM)
- managing cross subsidy
- reviewing the effectiveness and the take up of the Board's incentives package, and proposing adjustments, and
- balancing implementation costs and transitional challenges against the benefits of change.

4.1.3 The objectives led the Board to explore a number of issues, most significantly:

- the principle of a move to a long-term measure of risk instead of a short term one for charging – to better match the basis used for determining the Board's aggregate risk
- the use of the "theoretical levy" as a tool for evaluating the total long-term risk to the PPF, for providing an attribution to average or catastrophe risk, and assessing the contribution of an individual scheme to those risks
- how much importance do schemes place on having a relatively simple formula – rather than a formula which precisely matches the long-term risks
- whether an approach which used multiple scaling factors to recognise the different contribution of schemes to the PPF's catastrophe risk was attractive, and
- questions around hedging and the funding level the Board might target.

4.1.4 There was a good level of response to these ideas, though it was clear that a number of respondents found it difficult to comment on proposals without fuller information on the potential financial impacts. Overall, of those expressing an opinion, a majority supported the principle of a move to longer term measurement of risk. A majority also agreed with the Board's view that the theoretical levy was a sound basis for assessing the fairness of the levy, but would be too complex to be an ideal tool for actually distributing the levy.

4.1.5 The Board intends to undertake further work to evaluate the options for aligning the levy more closely with long-term risk. It will offer those responding to this consultation an opportunity to be involved in that development, ahead of consulting on a more detailed proposal in summer 2008.

4.2 Summary of Consultation Responses

General & Stability

4.2.1 A high proportion of respondents replied to the questions on longer term development of the levy – set out in chapter 2 of the consultation document. Catastrophe risk presented itself as a theme that ran through many respondents' comments.

4.2.2 There was wide support for the Board's proposition on increasing levy stability. However a number of respondents commented that, while there was some merit in a stable total levy, what schemes most wanted to see was stability at the level of individual schemes' levies. The Board recognises the force of this point and, though it sees real limits on what can be done short term, it will be one of our objectives in developing the levy longer term to seek to achieve greater stability for schemes' individual levies. In assessing potential changes to the levy formula the Board will have regard to the extent that they render individual bills more or less volatile.

The Long-Term Approach

4.2.3 Overall, just under two thirds (62%) favoured the Board's proposal to move to a levy distribution formula that was based on long-term risk. This included representative bodies and a number of pension schemes and other stakeholders.

4.2.4 A number of large pension schemes (and consultancies that work with large schemes) voiced concerns about the proposed movement to charging a levy based on the measurement of long-term risk. This is perhaps understandable as the consultation document indicated that moving to a long-term approach had the potential to increase costs for at least some of the larger schemes. A number of arguments were raised by respondents against introducing a longer term approach, principally:

- that the existing levy represents some element of cross-subsidy from stronger to weaker schemes – especially at expected claim levels – and the proposals would increase the extent of that cross subsidy. Respondents making this point also questioned the inclusion of allowance for catastrophe risk in the levy
- that it was inappropriate to charge further in advance of the risk that was being covered than a single year. Under this argument the PPF should not allow for expected changes in insolvency risk but rather wait to see which currently secure schemes do in fact experience deteriorating credit quality. Using the existing model for charging the levy would then see a rise in levy where credit quality decreases over time. Some making this point described charging now for a potential decline as amounting to a cross subsidy from those who stay well rated to those who suffer reduced credit quality, and

- that basing charges on long-term risk (covered in specific question below) is complex and potentially difficult to implement.

- 4.2.5 The issue of catastrophe risk is dealt with below (4.2.10 – 4.2.12) as most responses around catastrophe risk were given in discussing the merits of the PPF’s analytical tool, the theoretical levy, and it is an area where the PPF intends to develop its thinking further in the coming months.
- 4.2.6 The Board does not agree with the proposition that it is wrong, in principle, to charge for risks more than one year in to the future; to reject making preparation for a potential large claim in advance would be mistaken. Indeed the legislative framework, which places restrictions on the speed at which levy charges can respond to alterations in risk, practically requires a multi-year approach.
- 4.2.7 Furthermore, to continue to collect levy that is designed to allow for longer term risks, through a charging mechanism that measures risk on a purely short term basis – even though the Board now knows that long-term risk is not distributed in the same way – would be unjust. However, the Board will look at the extent to which the natural evolution of credit ratings will achieve the same effect over time as charging for long run insolvency now – and assess the scale of the potential risks of such an approach.
- 4.2.8 There are also practical reasons for moving to a long-term approach: if schemes are charged for short term risk, and see a weakening in their sponsor’s credit position, there is a greater chance that the employer will be unable to raise contributions to meet the levy when it is at its highest and therefore that the assets of the scheme are used. If the scheme then comes into the PPF it will be less well funded as a result. The consequence is that schemes face an increased risk of paying for claims in arrears.
- 4.2.9 The Board recognises that taking account of the average reduction in credit quality over time when charging does mean that those schemes whose employers remain strong subsidise those whose credit ratings decline. This could be considered to be a legitimate insurance risk, since it is impossible to say in advance which schemes will benefit or otherwise: unlike the cases of cross-subsidy identified above where the winners and losers can be distinguished in advance.

The Theoretical Levy as an Analytical Tool

- 4.2.10A majority of the schemes responding to the question on the theoretical levy supported the approach outlined, though a significant proportion of respondents raised doubts about the approach taken to catastrophe risk, either arguing that:
- catastrophe risk was overstated as it did not take account of the new scheme funding regime or as allowance was not given to the trend for large schemes to adopt risk reducing strategies such as liability driven investment (LDI) , or
 - that it was inappropriate to charge at all / or in full for catastrophe risk as such an outcome would have to be met by either reductions in compensation or government support (e.g. one stakeholder argued that charging for catastrophe risk is unsustainable).

4.2.11 The Board has given further thought to the issues flagged which might cause catastrophe risk to be overstated, as it indicated it would do in the information paper on the long-term risk model. Reflecting external feedback, the Board is now aiming to make allowance for the use of differing investment strategies in the analysis of long-term risk that underpins its decisions on the levy quantum for 2008/09 to 2010/11, though its capacity to do so is limited as it lacks the information to make sophisticated modelling assumptions. An exercise to explore schemes' use of LDI is currently underway, which should help address this (though in the interests of minimising burdens on schemes this research has been limited to larger schemes, is voluntary in nature, and the questions have been kept to a minimum). In the meantime, to inform the estimate of aggregate long-term risk it has been assumed that 5% of total liabilities (i.e. around £50billion) were completely hedged but, lacking information on which schemes use LDI, this was applied as a blanket adjustment to larger schemes' risk. The asset allocation of individual schemes was used as part of the assessment of their contribution to the PPF's long-term risk, though it does not impact their levy (and is therefore a factor in cross-subsidy).

4.2.12 The Board has made significant allowance for the potential reduction in risk that can be expected to result from the implementation of the Pensions Regulator's scheme specific funding regime, and associated recovery plans, in its latest modelling. Data from the Pensions Regulator has been used to estimate the pace of future deficit recovery contributions. This represents the Board taking account of risk reduction that has not yet taken place, so a limited reduction on the full commitments employers have been making was made for reasons of prudence. The reduction in risk affects both the aggregate risk to the PPF and at present the contribution to that risk that is assessed as arising from each scheme, but we would not necessarily include it in the levy formula (as a careful assessment of the incentive effect of such a step would be needed).

Maintaining Simplicity and Improving Fairness

4.2.13 There was widespread agreement with the Board's view that the formula it had developed for the theoretical levy was too complex to be appropriate for allocating the levy. This was consistent with responses to previous consultations, which have emphasised the desirability of a relatively simple formula. As indicated in August, the Board does not consider that the theoretical levy satisfies the levy principle of simplicity and intends to use it to measure the relative fairness of simpler allocative mechanisms rather than apply it directly.

4.2.14 Responses to the question on the creation of multiple scaling factors, which could allow for the different contributions of large and small schemes to the catastrophe risk of the PPF, showed a similar pattern to earlier questions:

- those opposed to charging for catastrophe risk in principle, or who argued that schemes should pay the same regardless of size, were opposed, and
- there was concern from some who thought it might prove too complex, or that it might lead to difficult boundary issues – since a small increase of scheme size could lead

to a significantly larger increase in levy if it leads to the use of a different scaling factor.

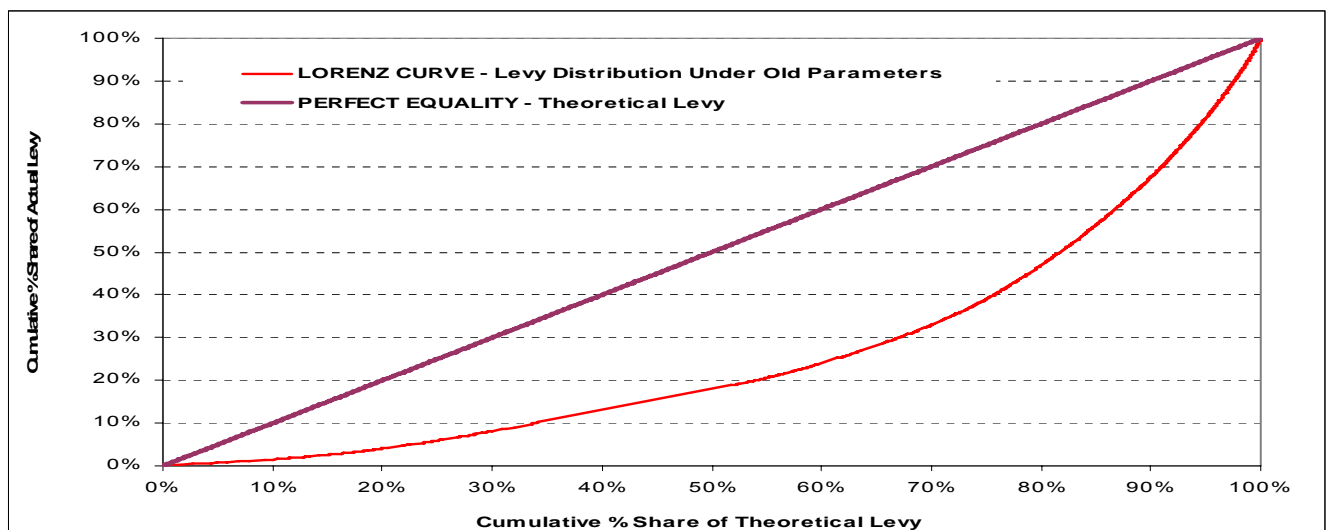
Overall, there were slightly more responses that were against this proposal than in favour, though only half of all respondents expressed a view.

4.2.15 The Board does not wish to rule out the development of a proposal that involves the use of multiple scaling factors, but does recognise the concerns raised by stakeholders, particularly around complexity and the potential problems arising from discontinuities at the boundary of one factor and the next. In respect of the argument that a large scheme should pay no more than a number of small schemes whose size is similar in aggregate, the Board considers that in such a situation it faces a concentration risk that is absent where the risk is spread across a number of schemes. Whether this concentration risk in itself would justify a more complex charging structure will require further analysis as will whether multiple scaling factors, or perhaps a continuous function related to the liabilities, would be a proportionate solution to the issue.

4.2.16 There was opposition to the idea of hedging catastrophe risk if it might involve additional cost. Generally, those responding felt that hedging, which a number of responses supported in principle, should be accommodated within the PPF's basic costs. The Board's considered view is that it would only be appropriate to use hedging where this would reduce risk, as measured through the theoretical levy. In principle that should mean that hedging is reducing the costs that need to be charged to schemes through the levy, or where the Board has taken a decision to charge less than would be justified by the theoretical levy (which was the case last year) that it improves the Board's confidence that it will not face a deficit within a given level of levy.

4.3 The Board's Developing Outlook

4.3.1 The Board has considered the arguments put forward for retaining the existing approach to levy distribution, but continues to believe that it is necessary to look to align the levy distribution more closely to the long-term risks that it faces. New analysis available to the Board, comparing the relative risk to the PPF (measured by the economic levy, scaled to £675million) and the estimated actual levy schemes will pay for 2008/09, emphasises this. The graph below shows that, without a change to the levy parameters, schemes posing only 5% of our risk would be billed for 20% of the levy, and a group of schemes representing over 20% of our risk, would pay only 5% of the levy.



4.3.2 In particular, the Board does not agree with the proposition that strong schemes currently cross-subsidise weak ones. In fact, the reverse is the case: schemes constituting 60% of our aggregate long-term risk (generally large, stable schemes) are charged only 40% of the total levy.

4.3.3 However, in part this comes down to a judgement about how much allowance the Board should make for adverse claims outcomes in seeking to ensure that it is appropriately funded. Some respondents argued that no allowance whatsoever should be made for claims that exceed the expected (average) claim and others that any allowance should be very limited, for example:

“Catastrophe risk should not be covered by the levy calculation – the power to adjust compensation increases (or even compensation itself) is supposed to deal with catastrophe risk”

4.3.4 The Board’s view is that it would be irresponsible to make no allowance for catastrophe risk, though there is clearly a debate to have about the level of allowance that should be made. Catastrophe risk is in essence simply the risk that claims are above the expected level, to any extent. To make no allowance for the possibility that claims are above the expected level would mean a significant chance (based on LTRM projections in either of the last two years, at least a one in four chance) that the PPF found itself in deficit and was faced with either raising funds from surviving schemes or reducing compensation or the indexation thereof. Neither is an attractive proposition:

- raising levies in arrears essentially penalises surviving sponsoring employers for the failure of others, and
- reductions in compensation undermine PPF’s core purpose of security for members. It would mean that the risk of a member’s pension being reduced or lost is replaced by a risk derived from the whole sector.

4.3.5 A balance needs to be made between protecting the interests of those who depend on PPF compensation and affordability for levy payers. But while there has to be some provision made for the possibility that claims will be above the expected level, there would be merit in exploring further the extent of that provision. At one extreme the PPF could chose only to cover expected claims and at the other extreme to allow only a one in a thousand or one in ten thousand chance of a deficit emerging. In practice, the competing demands of security for compensation recipients and affordability for levy payers require a compromise between the two extremes.

4.4 Next Steps

4.4.1 The consultation made clear that the propositions being tested were initial thoughts in a complex area, and a range of views were to be expected. The Board plans to carry out further work, with the next consultation in summer 2008.

- 4.4.2 The Board plans to look further both at the level of capital appropriate to meet potential adverse claims scenarios, and at the appropriate allowance to make in relation to that capital requirement in the levy.
- 4.4.3 The Board will then review will how most effectively to create a workable levy formula which combines improved fairness in distribution with greater expected stability of individual levy over time, without undue complexity. This work will include seeking to assess the contribution to our overall risk of :
- long-term insolvency risk
 - funding changes over time (which will include consideration of the impact of deficit-reductions and of investment strategy); and
 - concentration risk.
- 4.4.4 Consideration will need to be given to how to measure the factors that prove sufficiently significant – given any issues involved in their inclusion in a revised levy formula (e.g. complexity, data collection / verification issues).
- 4.4.5 We will involve stakeholders in the work to develop the levy in three ways:
- firstly, discussing the ideas contained in the levy consultation (and this policy statement) further with those who responded to the consultation over the coming months
 - secondly, from amongst those commenting on the consultation document and on the LTRM paper we will aim to establish an industry technical group to comment on the more detailed analysis as it develops; and
 - thirdly, through a formal consultation on the longer-term development of the levy.
- 4.4.6 In implementing any change, the Board will give consideration to phasing it in. This could mean maintaining a steady movement towards a fairer levy, beginning with the changes to the levy taper for 2008/09, over the next two to three years.

5 The Consultation Process

5.1 Responding to the Consultation

- 5.1.1 This consultation response document sets out what are now, in the light of previous consultation, the Board's firm proposals for the structure of the 2008/09 and 2009/10 risk based levy, so that schemes can estimate their levy, and consider whether to take actions that are likely to reduce it. The Board will consider any comments on the document which are received by 5.00pm on 11 January 2008. However, the Board does not at this stage expect to make fundamental changes to the proposals.
- 5.1.2 The consultation period for the draft Determination begins on **29 November 2007** and will end at 5.00pm on **11 January 2008**.

5.2 Arrangements for Written Submissions

- 5.2.1 The Board of the Pension Protection Fund welcomes your views on the draft Determination for the 2008/09 levy, attached to this document as Annex B. Please ensure that your response reaches us by that date. If you would like further copies of this document, it can be found on our website at www.pensionprotectionfund.org.uk. Please send all consultation responses to:

Rachel Altmann
Head of Levy Policy
Board of the Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
CR0 6SR
Tel: 020 8633 4900
Email: consultation@ppf.gsi.gov.uk

- 5.2.2 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation please make it clear who the organisation represents and, where applicable, how the views of members were assembled. If responding on behalf of a pension scheme, please include your Pension Schemes Registry (PSR) number.
- 5.2.3 The requirements of the Freedom of Information Act (2000) state all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purposes of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication. 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 Freedom of Information Act obligations and general law on this issue.

- 5.2.4 Queries should be sent to Paul Reynolds at the address below. Further information about the Freedom of Information Act can be found on the website of the Department for Constitutional Affairs – <http://www.dca.gov.uk/foi/guidance/exguide/index.htm>.
- 5.2.5 This consultation is being conducted in line with the Code of Practice on Consultation. The code can be accessed at:
<http://www.cabinetoffice.gov.uk/regulation/Consultation/Code.htm>
- 5.2.6 The Board would value any feedback on the effectiveness of this consultation process. If you have any comments then please contact:

Paul Reynolds
Director of Corporate Affairs
Board of the Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
CR0 6SR
Tel: 020 8633 4968
E-mail: paul.reynolds@ppf.gsi.gov.uk

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CDS/500410

Annex A – Suggested Selection Criteria for an Insolvency risk assessment provider

| Criteria | What This Could Cover |
|--|---|
| Customer Service | <p>Measurable service standards</p> <p>Rigorous, transparent and accessible appeals process compliant with industry best practise complaints management</p> <p>Willingness to perform representational duties as appropriate and applicable to a high profile Government sector contract</p> |
| Methodology | <p>Transparency of methodology</p> <p>Proven ability accurately to assess insolvency risk</p> <p>Preparedness to establish, or use an existing, customer appeals process which adheres to best practise principles and processes customer appeals within agreed timescales</p> <p>Ability to determine suitable insolvency probabilities where no existing measure can be applied</p> <p>Ability to freeze insolvency risk measures and associated data at a fixed date each year</p> |
| Data | <p>The applicant should be able to demonstrate the ability to gather data from an appropriate range of sources for all employers, including charities.</p> |
| Coverage & Ability to Deliver Against Legislative Requirements | <p>Ability to provide a measure of insolvency risk by March 2009 for all schemes within the universe of sponsoring employers covered by their contract, and in compliance with all terms and conditions of the proposed contract.</p> |
| Value for Money | <p>The expectation will be that while value for money is a significant consideration, it will be secondary to suitability of methodology and provision of customer support.</p> |

Annex B – The 2008/09 Draft Determination

The Board of the Pension Protection Fund

**Determination under
Section 175(5) of the Pensions Act 2004
in respect of the financial year
1 April 2008 – 31 March 2009**

[] 2008

CONSULTATION DRAFT: 29 NOVEMBER 2007

Introduction

Section 175(5) of the Pensions Act 2004 requires the Board of the Pension Protection Fund (the **Board**), before the beginning of each financial year, to determine in respect of that year:

- (a) the factors by reference to which the pension protection levies are to be assessed;
- (b) the time or times by reference to which those factors are to be assessed;
- (c) the rate of the levies; and
- (d) the time or times during the year when the levies, or any instalment of levy, becomes payable.

The consultation draft of the 2008/09 determination is attached as pages 3-18 of this document. The draft Appendices and Annexes may be accessed via the links on page 19.

DRAFT

Determination by the Board under section 175(5) of the Pensions Act 2004

The Board of the Pension Protection Fund hereby makes the following determination in respect of the financial year 1 April 2008 to 31 March 2009:

- (1) That in respect of that year, the factors and times by reference to which the pension protection levies are to be assessed, and the rate of the levies, are to be as set out in the Schedule to this determination;
- (2) That the levies in respect of a scheme are to become payable on the earliest of the following dates: the date upon which the person liable to pay the levies in respect of the scheme is sent notification of the amount of the levies in respect of the scheme (or, in the cases in which this Schedule provides for a revised notification to be issued, the date upon which that person is sent a revised notification); the date on which the scheme ceases to be an eligible scheme; or 31st March 2009.

SCHEDULE

Part 1 – general

1. The scheme-based levy and the risk-based levy in respect of a scheme shall be calculated in accordance with Part 2 and Part 3 respectively of this Schedule, subject to the modifications contained in Part 4 of this Schedule in the cases to which those modifications apply. Where this Schedule refers, in whatever language, to something which is to be done or decided by the Board, then any necessary action or decision may be taken on behalf of the Board either by the Chief Executive of the Board or by such member of the Board's staff as he may appoint for the purpose.
2. The matters referred to in this Schedule shall be assessed, measured, quantified or estimated at such dates and in such manner as is provided for below. In the absence of such provision, it is intended that this Schedule shall be applied in accordance with the factual position as it existed at midnight on 31 March 2008. All references to dates and times in this Schedule relate to Greenwich Mean Time or, at the times when it is in force, British Summer Time. For the avoidance of doubt, references to midnight on a day are to midnight at the end of that day.
3. References in this Schedule to "the Act" are to the Pensions Act 2004. Unless the context otherwise requires, terms used in this Schedule bear the same meaning as in the Act. References to "defined benefit members" of a scheme shall be taken to mean members of that scheme who are entitled to defined benefits under that scheme. References to "pension credit members" of a scheme shall be taken to mean individuals who have rights under a scheme attributable to a pension credit and such pension credit members shall be deemed to have been employed by the same employer as the member from whom their rights under the scheme are derived. References to the "Scheme

Maintenance system” are to the system maintained by the Pensions Regulator for the online submission of scheme return and other information by or on behalf of pension schemes, also known as “Exchange”.

4. Where this Schedule refers to certain information having been provided to the Board (or, as the case may be, to the Pensions Regulator) on or before a certain date, the information shall be treated as having been so provided if but only if the Board is satisfied that it has been received at the Board’s offices (or, as the case may be, the offices of the Pensions Regulator) on or before the date in question. For these purposes the only permissible means of delivery of information to the Board’s offices are:

(a) by email to the email address for the delivery of the relevant information as specified on the Board’s website at the following page:

http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/levy_contacts.htm; OR

(b) by post or hand delivery to: The Board of the Pension Protection Fund, Knollys House, 17 Addiscombe Road, Croydon, Surrey, CR0 6SR, marked for the attention of:

- (i) “Director of Legal Re: Contingent Assets”, in the case of certificates or other documentation relating to contingent assets; or
- (ii) “Director of Levy and Policy Re: 2008/09 Pension Protection Levies” in relation to all other documents.

For the avoidance of doubt, delivery by fax is not permissible. Save where this Schedule specifically provides otherwise, the deadline for any information provided to the Board otherwise than pursuant to a specific request or requirement is midnight on 31 March 2008. Without prejudice to paragraph 6 and paragraph 12 below, the Board may at its discretion take account of information provided after any applicable deadline in circumstances where it appears to the Board that:

- (a) The information was despatched at an appropriate time, but was delayed in the course of post or otherwise;
- (b) The provider of the information was prevented from meeting the deadline by the temporary inaccessibility of the Board’s website or the Scheme Maintenance system, or the interruption of electronic communications, or other like cause, and the information was provided as soon as reasonably practicable thereafter; or
- (c) The information in question serves to correct a statement previously made to the Board (or to the Pensions Regulator) in the belief that it was correct, but which was in fact incorrect at the time when it was made.

5. It is intended that the provisions contained in this Schedule should in all cases permit the calculation of the amount of the levies in respect of a scheme. However, in the event that any situation arises for which the Schedule fails to

make the provision required for a calculation to be performed, the Board hereby determines that the calculation of the levies shall be performed in such manner as, in the opinion of the Board, is reasonably practicable and best gives effect in that situation to the general approach laid down by this Schedule. This paragraph shall also apply in any case where the Board is unable to obtain some item of information which would normally be required for the application of this Schedule in accordance with its terms.

6. Nothing in the Board's determination or this Schedule shall prevent the Board from reviewing the amount of the levies calculated in respect of a scheme where it subsequently appears to the Board that the information upon which the calculation was based was incorrect in a material respect, or that a notification required by or under a certificate in relation to contingent assets has not been duly given, or that a certificate or declaration given for the purposes of this Schedule was improperly given or contained information which was incorrect in a material respect. Further, in calculating the levies in respect of a scheme the Board may disregard any such certificate or declaration if the Board believes that it has been improperly given, and may similarly disregard any information in the certificate or declaration, or in any notification or return, which is believed to be incorrect.
7. In the case of a scheme which is divided into sections (defined in the Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005 as a segregated scheme), each such section shall (except where this Schedule expressly or by implication requires otherwise) be treated as if it were a separate scheme for the purposes of this Schedule, and references to "schemes" shall be construed accordingly.
8. Where this Schedule indicates that the Board should use "relevant scheme return data", the Board will take account of the following information.
 - (a) Where the scheme concerned has either:
 - i. no later than midnight on 31 March 2008, submitted a scheme return via the Scheme Maintenance system in accordance with sections 63-65 of the Act; or
 - ii. been sent a scheme return notice requiring it to submit a scheme return via the Scheme Maintenance system, and the return date for that scheme return falls on or before 31 March 2008 (whether or not the scheme has so submitted a scheme return by that date);then the Board shall take into account the data held on the Scheme Maintenance system as at midnight on 31 March 2008.
 - (b) In all other cases the Board shall take into account the most recently submitted equivalent information provided to the Board by or on behalf of the scheme by no later than midnight on 31 March 2008.
9. References in this Schedule to a "section 179 valuation" are to the results of an actuarial valuation of the scheme carried out in a manner which is in accordance with section 179 of the Act and regulations and relevant guidance made and

issued under that section, and the results of which have (at or before midnight on 31 March 2008) been provided by or on behalf of the trustees or managers of the scheme to the Board or to the Pensions Regulator, whether that valuation has been so carried out and the results so provided as a matter of legal obligation or otherwise and provided that the results of such valuation have by that date been certified as relevant scheme return data or, in the case of a scheme which does not fall within subparagraph 8(a) above, in a certificate provided to the Board in the form attached to this Schedule as Annex A. References in the preceding sentence to the results of the valuation are to those data items required to be completed in the relevant section of the Scheme Maintenance system or other scheme return or in the certificate as the case may be. Where there is more than one valuation satisfying the requirements of the preceding sentence, the Board shall use the valuation with the latest effective date for the purposes of calculating the levies.

10. References in this Schedule to the value or amount of the assets or the protected liabilities of a scheme shall be understood as follows but subject to paragraphs 27, 41 and 44 below:

(a) Where there is a section 179 valuation, the reference is to the value or amount of the assets or protected liabilities shown in that valuation, but adjusted in a manner which in the view of the Board gives effect to the approach set out in Appendix 1 to this Schedule and results in the scheme's assets and its liabilities being consistently treated for these purposes.

(b) Where there is no section 179 valuation, the reference is to the estimated value or amount of the assets or liabilities of the scheme shown in the Minimum Funding Requirement valuation data supplied as relevant scheme return data, but adjusted in a manner which in the view of the Board gives effect to the approach set out in Appendix 2 to this Schedule and results in the scheme's assets and its liabilities being consistently treated for these purposes.

11. For the purposes of this Schedule, the employer or employers in relation to a scheme shall be taken to be such undertaking or undertakings as have been notified as such in relevant scheme return data or pursuant to Section 191 of the Act.

12. The Board may, at any time prior to the calculation or any recalculation of the levy in respect of a scheme, take such steps as it thinks fit to obtain further or amended information for the purposes of that calculation or recalculation. But the Board is under no obligation to take such steps where information has not been provided to the Board on or before any applicable deadline prescribed in this Determination.

13. If, at the time of calculation or any recalculation of the levy in respect of a scheme, any information necessary for such calculation has not been provided in the manner or format or at the time anticipated by this Determination, then the Board may instead use equivalent information provided in a different manner or

format or at a different time. But the Board is under no obligation to use such equivalent information.

14. In performing the calculations required by this Determination:

- (a) The Board shall round all monetary figures to the nearest penny at each stage of the calculation, save for the final amounts of the scheme-based levy and the risk-based levy which shall each be rounded to the nearest pound; and
- (b) The Board shall round all figures representing an assumed probability of insolvency to six decimal places (that is, to four decimal places when expressed as a percentage) at each stage of the calculation. Without limitation, this shall apply to (i) all figures derived by taking the average of assumed insolvency probabilities and to (ii) the product of the weighted average insolvency probability and a scaling factor based on scheme structure in accordance with paragraph 38 or 39.

15. In the event of any inconsistency between the Determination (including this Schedule and the Appendices) and the notes accompanying any of the certificates referred to in this Determination, the terms of the Determination shall prevail. In determining whether it is satisfied as to any matter set out in the Determination, the Board will take account of any guidance which it has published (including guidance in the form of "Frequently Asked Questions").

Part 2 – the scheme-based levy

16. Subject to paragraph 44 below, the scheme-based levy in respect of a scheme shall be:

$$L \times h$$

17. L shall be the amount of the scheme's protected liabilities. h shall be a multiplier calculated and published in accordance with Part 5 below.

Part 3 - the risk-based levy

18. Subject to paragraphs 20 and 44 below, the risk-based levy in respect of a scheme shall be:

$$U \times P \times R \times c$$

19. U shall be the underfunding of the scheme, and P shall be the insolvency probability associated with the employer(s) in relation to the scheme, in each case calculated in accordance with the remainder of this Part 3 and/or Part 4 of this Schedule, as applicable. R shall be the proportion of the pension protection levies intended to be risk-based, which for the 2008/09 levy year shall be 0.8. c shall be a scaling factor calculated and published in accordance with Part 5 below.

20. In no case shall the risk-based levy in respect of a scheme exceed K multiplied by that scheme's protected liabilities, where K is the levy cap. For the 2008/09 levy year, K shall be 0.01.

21. Where the value of a scheme's assets is less than or equal to 120% of the amount of the scheme's protected liabilities, U shall be the amount obtained by subtracting the value of the scheme's assets from the product of multiplying the amount of the scheme's protected liabilities by 1.21.

22. Where the value of a scheme's assets is greater than 120% but less than or equal to 125% of the amount of the scheme's protected liabilities, U shall be 1% of such protected liabilities.

23. Where the value of a scheme's assets is greater than 125% but less than or equal to 130% of the amount of the scheme's protected liabilities, U shall be 0.75% of such protected liabilities.

24. Where the value of a scheme's assets is greater than 130% but less than or equal to 135% of the amount of the scheme's protected liabilities, U shall be 0.50% of such protected liabilities.

25. Where the value of a scheme's assets is greater than 135% but less than or equal to 140% of the amount of the scheme's protected liabilities, U shall be 0.25% of such protected liabilities.

26. U shall be 0 (zero) in all cases where the value of the scheme's assets is greater than 140% of the amount of the scheme's protected liabilities.

27. For the purposes of paragraphs 21 to 26 inclusive, all references to the value of the assets of a scheme shall include deficit-reduction contributions (if any) to the extent set out in paragraph 28.

28. Where there is provided to the Board, on or before midnight on 7 April 2008, a certificate, given in the form attached to this Schedule as Annex B by the actuary appointed in relation to the scheme for the purposes of section 47 of the Pensions Act 1995, that a deficit-reduction contribution or contributions has been made since the date to which the section 179 or, as the case may be, Minimum Funding Requirement valuation referred to in paragraph 10 above ("the previous valuation") relates, then for the purposes of this Schedule the value of the assets of the scheme shall be increased by the aggregate amount of that contribution or contributions. For this purpose, a deficit-reduction contribution is the whole or any part of a contribution made by or on behalf of the employer in relation to the scheme (including by HM Revenue and Customs in respect of age-related National Insurance rebates) which:

(a) Has been received, irrevocably and in full, by the trustees or managers of the scheme before the actuary's certificate is signed and not later than 31 March 2008; and

(b) Is not a contribution made on account of –

(i) The cost of accrual of scheme benefits;

(ii) The expenses of administering the scheme or investment management expenses; or

(iii) The cost of augmentations of benefits granted or expected to be granted after the date to which the previous valuation relates; or

(iv) Any benefits or transfers paid out of the scheme between the end-date of the audited accounts used for the purposes of the previous valuation and, if later, the valuation date

(for which purposes the costs referred to in sub-paragraphs (i) and (iii) above shall be calculated on the basis required for a section 179 valuation).

For the avoidance of doubt, where in relation to a scheme (i) an equivalent deficit-reduction contribution certificate was taken into account by the Board in the calculation of that scheme's risk-based levy for a previous levy year, and (ii)

paragraph 10 above requires the Board to use the same valuation for the purposes of the risk-based levy for the period 1 April 2008 – 31 March 2009 as was used for the calculation referred to in (i), then the Board shall take into account the previously given certificate for the purposes of the risk-based levy for 1 April 2008 – 31 March 2009. Where in relation to the same scheme more than one certificate in relation to deficit-reduction contributions has been provided to the Board (irrespective of when provided), only the most recent such certificate shall (provided it satisfies the other requirements for recognition set out in this Determination) be taken into account.

29. Where the trustees or managers of the scheme, before midnight on 31 March 2008, provide to the Board one or more certificates, in such of the forms attached to this Schedule as Annex C as is appropriate, certifying that the scheme benefits from one or more contingent assets within the meaning of Appendix 4 to this Schedule, then the value of U for the purposes of paragraph 18 above shall, notwithstanding anything in paragraphs 21 to 26 above, be determined in the manner set out in Appendix 4. The Board shall not take into account certificates in relation to contingent assets which relate to a previous levy year when calculating the risk-based levy for the period 1 April 2008 – 31 March 2009. However the Board shall request from the trustees or managers of schemes in respect of which it has recognised one or more contingent assets for the preceding levy year information equivalent to that set out in the relevant form(s) set out at Annex C and shall take into account such information if and only if it is received in the form requested by the Board at or before midnight on 31 March 2008 or, if later, within 28 days of the date of such request.

30. P (the insolvency probability associated with the employer(s) in relation to the scheme) shall be:

- (a) In the case of a scheme with a single employer, an amount equal to the Pension Protection Fund assumed probability of insolvency for that employer determined in accordance with paragraphs 31 to 34 below; and
- (b) In the case of a scheme with more than one employer, an amount calculated in accordance with paragraphs 35 to 39 below;

provided that if such amount exceeds 0.15, then P shall be taken to be 0.15.

31. The Pension Protection Fund assumed probability of insolvency for an employer shall be the assumed probability associated with the Failure Score which applies to that employer, as shown in Appendix 3 to this Schedule, or a figure determined in accordance with paragraphs 32(f) or (g), 33 or 34 below.

32. The Failure Score which applies to an employer shall be the failure score which Dun & Bradstreet UK Ltd (“DBUK”) informs the Board that it has assigned to that employer, after taking such steps to identify or obtain data relating to that employer as the Board has required. For the avoidance of doubt, the failure

scores to be provided to the Board are to be the normal failure scores¹ which were or would have been assigned to that employer by DBUK in the ordinary course of its business on and as at 31 March 2008, based on data provided to DBUK on or before 30 March 2008, save only that –

- (a) The Board has instructed DBUK that the failure scores provided to the Board should be those which would be assigned to the employer if there were to be disregarded any rule or practice whereby DBUK normally limits the maximum failure score obtainable by a company where it is a subsidiary of another company and that parent company is regarded as being at severe risk of insolvency;
- (b) This sub-paragraph applies in any case where DBUK informs the Board that it has decided, following representations made to it by or on behalf of the relevant trustees or managers or employer, or following a request by the Board to review the failure score assigned, that the failure score assigned to an employer on and as at 31 March 2008 was either too high or too low because it was based upon information which, on and as at 31 March 2008, was incorrect or incomplete by comparison with the information which should normally have been taken into account by DBUK in assigning a failure score at that date (whether because information which should normally have been available to DBUK at that date was not available to DBUK, or because such information was available to DBUK but was nonetheless not taken into account in assigning the failure score). In a case to which this sub-paragraph applies, the Failure Score shall be the higher or lower failure score which DBUK informs the Board ought to have been assigned to the employer on and as at 31 March 2008. For these purposes, the Board shall only be obliged to take into account a change to a failure score if it results from representations made to DBUK by or on behalf of the relevant trustees or managers or employer not later than 28 days after the date shown on the original notification; and the Board shall not take into account any change to the failure score resulting from a request by the Board unless that change to the failure score is made no later than 31 March 2009. In a case to which this sub-paragraph applies the Board will where necessary issue a revised notification of the amount of the levies in respect of the scheme;
- (c) In the case of employers which are not registered in the United Kingdom, the Board has instructed DBUK to provide it with the failure score or local equivalent (if any) assigned to such employers by DBUK's relevant associated undertaking, or in the absence of such a failure score or equivalent, with the risk indicator assigned to the employer in question. In such cases the assumed probability of insolvency associated with that failure score or risk indicator will be such as the Board has been advised is appropriate for the purposes of achieving equivalence with Appendix 3 to this Schedule. Sub-paragraph (b) shall apply to such assumed probabilities of insolvency, for which purposes the Board shall only be obliged to take into account a change to an assumed probability of

¹ Note that the standard D&B methodology as at 31 March 2008 will incorporate certain rules that previously appeared in the 2007/08 levy determination as "overrides" to the standard D&B methodology as at 30 March 2007.

insolvency if it results from representations made to DBUK not later than 28 days after the date shown on the original notification.

33. In the case of an employer in relation to a multi-employer scheme in relation to which there are at least 10 employers, and where the procedure set out in paragraph 32 above has produced a failure score or risk indicator for at least 90% of those employers (or at least 50% if there are more than 100 employers in relation to the scheme), then the Pension Protection Fund assumed probability of insolvency for such an employer for whom no failure score or risk indicator has been produced shall be the average (mean) Pension Protection Fund assumed probability of insolvency of the other employers in relation to that scheme in respect of whom failure scores or risk indicators have been provided.
34. In a case where the procedures set out in paragraphs 32 and 33 above do not produce a failure score or risk indicator for a particular employer on and as at 31 March 2008, the Pension Protection Fund assumed probability of insolvency for that employer will be based upon the assignment of that employer to whatever industry group appears most appropriate, using for this purpose the first two digits of the four digit 1972 Standard Industry Classification codes. If the Board is provided with a three digit 1972 Standard Industry Classification code in respect of an employer, the first digit of that code, preceded by a zero, shall be used. The Pension Protection Fund assumed probability of insolvency for that employer shall be the probability which DBUK notifies to the Board as being the median Pension Protection Fund assumed probability of insolvency for all UK-domiciled employers within that industry group in respect of whom it has provided the Board with failure scores for the purposes of the 2008/09 levy year. Where the Board is unable to determine the most appropriate Standard Industry Classification code for an employer, it may assign that employer to an “undetermined” code. The Pension Protection Fund assumed probability of insolvency for an employer assigned to the “undetermined” code shall be the probability which DBUK notifies to the Board as being the median Pension Protection Fund assumed probability of insolvency for all UK-domiciled employers (irrespective of industry group) in respect of whom it has provided the Board with failure scores for the purposes of the 2008/09 levy year. For the purposes of the preceding three sentences, (i) such medians shall be based on the same set of probability data as used by the Board for the purposes of calculating the scaling factor as set out in paragraph 49, and (ii) the Board may instruct DBUK to exclude specified classes of failure score which it regards as unrepresentative when calculating the relevant medians. For the avoidance of doubt, in determining such medians DBUK shall not include any employer to which a scheme average probability has been applied in accordance with paragraph 33 above.

Part 4 – modifications

Multi-employer schemes

35. Paragraphs 36 to 39 below apply to the calculation of the risk-based levy in respect of multi-employer schemes, and references in those paragraphs to “the Regulations” are to the Pension Protection Fund (Multi-employer Schemes)

(Modification) Regulations 2005. Where reference is made to the number of members of a scheme of whom a person is the employer, that is to be determined by reference to the total number of active, deferred, pensioner and pension credit defined benefit members of that scheme and in relation to whom that person is (or is deemed to be) the employer in relation to the scheme, as notified to the Board or the Pensions Regulator in relevant scheme return data.

36. Which of paragraphs 37 to 39 below is to be applied to a multi-employer scheme is to be determined in accordance with relevant scheme return data. The categories referred to in those paragraphs as categories (a) to (f) are the categories so identified in the scheme return.
37. In the case of a scheme in category (a), category (b), category (d) or category (e), an assumed probability of insolvency (PP) shall be separately determined for each of the employers in relation to the scheme in accordance with paragraphs 31 to 34 above, and P shall be taken to be the weighted average of PP for each employer, where the weightings are equal to the number of members in relation to whom each employer is the employer, divided by the total number of members.
38. In the case of a scheme in category (c) or category (f) to which paragraph 39 below does not apply, P shall be 0.9 multiplied by the weighted average of PP for each employer in relation to the scheme, determined in the same manner as set out in paragraph 37 above.
39. This paragraph applies to a scheme in category (c) or category (f) which is stated in relevant scheme return data to be a scheme established as a centralised scheme for non-associated employers, and in relation to which the Board has, if requested by the Board, received satisfactory evidence in support of that statement prior to the calculation of the levies for that scheme. In the case of a scheme to which this paragraph applies, P shall be the weighted average of PP for each employer in relation to the scheme (determined in the same manner as set out in paragraph 37 above), multiplied by the largest number of members of the scheme in relation to whom any one employer is the employer, and divided by the total number of members of the scheme.

New schemes

40. This paragraph applies where a scheme (referred to in this paragraph as a “new scheme”) becomes an eligible scheme on or after 1 April 2008. In a case to which this paragraph applies:
- (a) The amount of the scheme-based levy and the risk-based levy in respect of the new scheme shall be the product of multiplying, respectively, the amounts shown in paragraphs 16 and 18 above by N divided by 365 where N is the number of days during the financial year for which the new scheme is an eligible scheme;
 - (b) References in this Schedule and Appendices to 31 March 2008 shall be read as references to the first date on which the new scheme was an eligible scheme, save that where reference is made to information or documents being provided to the Board by a particular date (whether

midnight on 31 March 2008 or on 7 April 2008 or otherwise), such references shall be treated as requiring the information or documents to be provided not later than 28 days after the scheme becomes an eligible scheme, or by such later date as the Board shall require if it calls for information or documents to be provided to it;

- (c) Where there is no valuation falling within paragraph 10 above, the Board may obtain from the trustees or managers of the new scheme such information as will allow the Board to make an equivalent determination of the value or amount of the assets or protected liabilities of the scheme. Where the Board considers that no such information is conveniently available in respect of a new scheme, and that it is unlikely that the scheme is materially underfunded at the relevant time, then the Board may determine that the rate of the scheme-based levy and/or the rate of the risk-based levy shall be nil;
- (d) If the Board is satisfied that the new scheme is the successor to the rights and liabilities of a scheme which was an eligible scheme on 1 April 2008 ("the predecessor scheme"), or to some substantial part of the rights and liabilities of such a scheme, that the levies which are or will be payable in respect of the predecessor scheme sufficiently take account of the assets and liabilities of the new scheme, and that the levies in respect of the predecessor scheme either have been paid or will be promptly paid, then the Board may determine that the levies in respect of the new scheme shall be nil.

Schemes not yet required to file a scheme return

41. This paragraph applies where a scheme became an eligible scheme on or before 1 April 2008 but has not by midnight on 31 March 2008 been required by legislation or by the Pensions Regulator to complete a scheme return or to file valuation information, with the result that there is no valuation falling within paragraph 10 above. In such a case the Board may proceed in the like manner as is set out in paragraph 40(c) above.

Scheme transfers

42. This paragraph applies where, on any date or dates prior to 1 April 2008, an eligible scheme ("the transferring scheme") has transferred at least the lesser of £1.5 million and 5% of its assets value as calculated in the last MFR or section 179 valuation prior to the first such transfer to another pension scheme but any such transfer or transfers is not reflected in the valuation falling within paragraph 10 for the transferring scheme. This paragraph also applies where, on any date or dates prior to 1 April 2008, an eligible scheme ("the receiving scheme") has received at least the lesser of £1.5 million and 5% of its assets value as calculated in the last MFR or section 179 valuation prior to the first such transfer from another pension scheme but any such transfer or transfers is not reflected in the valuation falling within paragraph 10 for the receiving scheme. In a case to which this paragraph applies, the Board shall where it judges it necessary obtain from the trustees or managers of the transferring scheme or the receiving scheme such information as will allow the Board to make what is in its view an appropriate determination of the value or amount of the assets or protected liabilities of the

scheme at 31 October 2007, in substitution for the valuation falling within paragraph 10 above. The Board shall not be obliged to take into account any such transfer unless it has been provided with information relating to all relevant transfers no later than midnight on 7 April 2008 in relation to the scheme concerned but may take into account such information received after that date where it considers it appropriate to do so.

Partially guaranteed schemes

43. This paragraph applies to a partially guaranteed scheme as defined in The Pension Protection Fund (Partially Guaranteed Schemes) (Modification) Regulations 2005. In a case to which this paragraph applies the Board shall where it judges it necessary obtain from the trustees or managers of the scheme such information as will allow the Board to make what is in its view an appropriate determination of the assets and protected liabilities of the unsecured part of the scheme, as defined in those Regulations, in substitution for the valuation falling within paragraph 10 above. The Board may also, in calculating the levies for a partially guaranteed scheme, apply the provisions of this Schedule with such modifications as appear to it appropriate for the purpose of ensuring that the levies payable in respect of the scheme correspond so far as reasonably practicable to the amounts which would have been payable if the unsecured part of the scheme had been a separate scheme.

Schemes in assessment

44. This paragraph applies to a scheme in relation to which:

- (i) No later than midnight on 31 March 2008:
 - a. the Board has received a scheme failure notice issued under Section 122(2)(a) of the Act;
 - b. the Board has issued such a notice pursuant to Section 124 of the Act; or
 - c. the Board has issued a scheme failure notice under Section 130(2) of the Act; and
- (ii) that scheme failure notice has become binding in accordance with Section 125(1) or, as the case may be, 130(6) of the Act prior to the calculation or recalculation of the levies for the scheme concerned; and
- (iii) the Board has not, prior to the calculation or recalculation of the levies for the scheme concerned, received a withdrawal notice issued under Section 122(2)(b) of the Act, or issued a withdrawal notice under Section 130(3) of the Act, indicating that the scheme has been rescued.

In a case to which this paragraph applies:

- (a) The scheme based levy and the risk based levy in respect of the scheme shall, subject to the following subparagraphs, be zero.
- (b) If, after the calculation of the levies in respect of the scheme, a withdrawal notice is issued under Section 122(2)(b) or 130(3) of the

Act indicating that the scheme has been rescued, and that withdrawal notice becomes binding in accordance with Section 125(1) or, as the case may be, Section 130(6) of the Act on or before 31 March 2009, then the scheme based levy and the risk based levy shall be recalculated in accordance with the remainder of this Schedule and shall become payable upon the withdrawal notice becoming binding.²

- (c) For the purposes of any recalculation of the levies in accordance with subparagraph (b) above, the assets and liabilities of the scheme shall, notwithstanding that there was no section 179 valuation by 31 March 2008, and provided that a section 179 valuation is subsequently provided within such time limit as the Board may reasonably require, be calculated in accordance with paragraph 10(a) and not paragraph 10(b).
- (d) For the purposes of any recalculation of the levies in accordance with subparagraph (b) above, if a person has assumed the former employer's pension liabilities under the scheme as described in Regulation 9(1)(a)(ii) of the Pension Protection Fund (Entry Rules) Regulations 2005, then the insolvency probability of that person, as at 31 March 2008 or the nearest practicable date, shall be substituted in place of the insolvency probability of the employer that suffered the insolvency event.

In the case of a multi-employer scheme, the Board may apply this paragraph with such modifications as appear to it appropriate for the purpose of ensuring that zero levies are applied to a scheme or part of a scheme which has been the subject of a binding failure notice but not of a subsequent binding withdrawal notice; and that where a scheme or part of a scheme has been the subject of a binding failure notice but then of a binding withdrawal notice, levies are applied to that scheme or part of a scheme in a manner that reflects the position following that withdrawal notice. Such modifications may make special provision amongst other matters for a case in which a segregated part of a scheme (as defined in Part 4 or 5 of the Pension Protection Fund (Multi-employer Schemes)(Modification) Regulations 2005) has been created by virtue of an insolvency event in relation to an employer, and each such segregated part as well as the remainder of the scheme shall be treated as a separate scheme for the purposes of calculating the levy. For the purposes of this power to apply paragraph 44 of the Schedule with modifications, the service of a non-segregation notice in accordance with those regulations may be treated as equivalent to the service of a withdrawal notice.

Revised levy invoices

45. In any case where the Board issues a revised notification of the amount of the levies in respect of a scheme, that notification shall take account of any amount already paid pursuant to a previous notification.

² In the case of a scheme which pays zero levies in 2008/09 by virtue of paragraph 44(a), but is subsequently rescued during a future levy year, it is the Board's intention that the levies would be recouped on the same basis as paragraphs 44(b) and (c) via a corresponding increase to the future year's levies. Provisions to this effect will be included in the levy determinations for future years.

Part 5 – the scaling factor

46. Q, the pension protection levy estimate, shall be £675 million.
47. The multiplier, h, shall be such quantity as the Board estimates will cause the total amount which will be payable by way of scheme-based levies in respect of the financial year 1 April 2008 to 31 March 2009, to be equal to $(1 - R) \times Q$.
48. The scaling factor, c, shall be such quantity as the Board estimates will cause the total amount which will be payable by way of risk-based levies in respect of the financial year 1 April 2008 to 31 March 2009, to be equal to $R \times Q$.
49. The Board will make its estimates of the total amounts that will be payable by way of scheme-based and risk-based levies on the basis of all the information which is available to it or to the Pensions Regulator at midnight on 31 March 2008, and which the Board considers that it is able to process in sufficient time for that information to be taken into account in making those estimates so that h and c may be calculated and published no later than four weeks after the Board receives the relevant data from the Pensions Regulator and in any case no later than 31 May 2008. For these purposes only:
- (a) the Board shall assume that any scheme failure notice that it has received or issued by no later than midnight on 31 March 2008 will become binding, and no withdrawal or non-segregation notice will be issued prior to the calculation of the levies for the scheme to which it relates;
 - (b) the Board shall assume that all voluntary certificates supplied to it are valid without further investigation unless that is manifestly not the case; and
 - (c) for each scheme in relation to which such information is available, the Board shall assume that the insolvency probability P for that scheme shall be equal to the lower of the insolvency probability calculated in accordance with this Schedule applied to the information available to the Board, and the insolvency probability used for the calculation of the risk based levy for that scheme for the period 1 April 2007 – 31 March 2008.
50. The Board will make its estimates of the total amounts that will be payable by way of scheme-based and risk-based levies by means of –
- (a) First, estimating the amounts of the levies that will be payable in respect of each of those schemes in relation to which the Board considers that it has and has processed the necessary information to make such estimates appropriately (“calculated schemes”); and
 - (b) Secondly, estimating the amounts of the levies that will be payable in respect of all other schemes (“approximated schemes”), such estimate to be made on the basis of an assumption that approximated schemes will pay a scheme-based and a risk-based levy corresponding to the average values for calculated schemes (i) in respect of which no certificate in relation to a contingent asset has been provided for the purposes of the levies for the period 1 April 2008 – 31 March 2009, (ii) in relation to which the condition set out in paragraph 44(i) above (scheme failure notice) has not been satisfied, and (iii) which are of comparable size to the expected

size of the approximated schemes in question. In determining how many approximated schemes are expected to be of a particular size, the Board will make use of data supplied by the Pensions Regulator.

51. In making the estimate of the amounts of levies that will be payable in respect of calculated and approximated schemes, the Board will (without prejudice to paragraphs 49 and 50 above) adopt an approach which is substantially equivalent to that set out in Appendix 5 to this Schedule, and which in the view of the Board most appropriately and practically gives effect to the objectives set out in paragraphs 47 and 48 above.

52. The Board shall publish the values which it has calculated for h and c in accordance with paragraphs 47 and 48 above. Those published values shall thereafter be treated as definitive, and the calculation of the amount of the levies in respect of a scheme shall be based upon the values of h and c as so published and not upon any other estimate or calculation of h and c .

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Links to Appendices and Annexes

Appendix 1

Roll-forward or roll-backward of s.179 valuations to 31 October 2007

http://www.pensionprotectionfund.org.uk/app1_s179roll_nov07.pdf

Appendix 2

Valuation methodology where s.179 valuation not filed in time

http://www.pensionprotectionfund.org.uk/app2_mfrvaluation_nov07.pdf

Appendix 3

PPF assumed probability of insolvency based on failure score (UK employers)

http://www.pensionprotectionfund.org.uk/app3_failurescores_nov07.pdf

Appendix 4

Contingent assets

http://www.pensionprotectionfund.org.uk/app4_contingent_assets_nov07.pdf

Appendix 5

Calculation of the multiplier and the scaling factor

http://www.pensionprotectionfund.org.uk/app5_calculations_nov07.pdf

Annex A

Section 179 certificate

http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/voluntary_certificates/section_179_valuation_certificate.htm

Annex B

Actuarial Certificate of Deficit-Reduction Contributions

http://www.pensionprotectionfund.org.uk/0708actuarial_certificate.pdf

Annex C

Contingent Asset Certificates

All contingent asset certificates for 2008/09 may be accessed at:

http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/voluntary_certificates.htm

Annexes D – F

Pension Protection Fund required forms of contingent asset agreement

All Pension Protection Fund required forms of contingent asset agreement may be accessed at:

http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/levy_publications.htm

Annex G

Amendment and replacement conditions

http://www.pensionprotectionfund.org.uk/annex_g_nov_07.doc

Annex C – Summary of levy distribution formula

C.1. Calculation of insolvency risk factor (P)

$$P = M \times \sum_{i=1}^K w_i p_i$$

$$w_i = \frac{E_i}{E}$$

$$E = \sum_{i=1}^K E_i$$

P = insolvency risk factor used in levy calculation for scheme/section

K = number of sponsoring employers in the scheme/section

E_i = number of members of the i th sponsoring employer in the scheme/ section

E = total number of members for all sponsoring employers in the scheme/section

w_i = weighting applied to the insolvency probability of the i th sponsoring employer in the scheme/section

p_i = implied probability of insolvency for i th employer corresponding to failure score (or equivalent) based on 2008/9 levy determination country mapping table from failure scores (or equivalent) to probabilities.

M = factor dependent on type of multi-employer scheme (see table – unchanged for 2008/09)

E_L = number of members for employer L with the largest number of scheme/section members (only relevant for non associated last man standing schemes)

| Multi-employer scheme/section type | Factor (M) |
|---|-----------------|
| Single employer | 1 |
| Option or requirement to segregate upon cessation of participation of an employer | 1 |
| Associated Last Man Standing | 0.9 |
| Non Associated Last Man Standing | $\frac{E_L}{E}$ |

C.2. Calculation of underfunding risk factor including contingent assets (U)

S = estimated scheme assets at levy calculation date based on roll forward/backward s179 valuation formula

C = certified deficit reduction contributions between date of last valuation and levy calculation date

L = estimated s179 liabilities at levy calculation date based on roll forward/backward s179 valuation formula

N_B = value of type B contingent assets

N_C = value of type C contingent assets

$$A' = S + C + N_B + N_C$$

$F = \frac{A'}{L}$ = assumed funding level taking into account deficit reduction contributions, type B and type C contingent assets

N_A = value of type A contingent asset (the calculation of which is described below)

Treatment of type A contingent assets for 2008/09

For levy calculation purposes, the insolvency risk of the sponsoring employer(s) will be adjusted to include some credit for the insolvency risk of the guarantor, recognising that it is the guarantor's insolvency that would potentially lead to a call on the Pension Protection Fund. However, for the 2006/07 and 2007/08 levy years, this was achieved in practice by applying a discount multiplier z to the deemed value of the Type A guarantee in the calculation of scheme underfunding, where:

$$z = 1 - \frac{P_{\text{guar}}}{P}$$

P_{guar} is the probability of insolvency of the guarantor, and P is the probability of insolvency of the sponsoring employer(s). The guarantee is only taken into account if $P_{\text{guar}} < P$.

The treatment of Type A guarantees for 2008/09 is, in effect, an extension of the methodology for 2006/07 and 2007/08. Readers who are not already familiar with the methodology used for previous years may find it helpful to refer to the September 2006 version of the Contingent Asset Guidance (v2.0) as background to the 2008/09 formulae.

For 2008/09, Type A contingent assets continue to be recognised on the underfunding side of the levy calculation and using a multiplicative factor "z". However, the formulae are scaled so as to ensure that a guarantee of at least 105% funding on a section 179 basis will always result in a complete switch from employer insolvency probability to guarantor insolvency probability. The formulae are intended to achieve this notwithstanding that the basic underfunding measure and "taper" are different compared with the previous two levy years. They are also intended to ensure that guarantees are consistently treated where the amount guaranteed is lower or higher than 105% funding on a s179 basis.

The formula which will apply in each case will depend on the percentage funding level on a section 179 basis, taking into account deficit-reduction contributions and any contingent assets

other than Type A group company guarantees. This funding level is referred to in the Determination and in the formulae which follow as F.

In order to achieve the effects described above, the 2008/09 Determination also makes use of another variable, M, which is closely related to the funding level, as follows:

| | | | |
|---|---|--------|------------------------------|
| M | = | F | where $0 \leq F \leq 104\%$ |
| | = | 1.04 | where $104\% < F \leq 125\%$ |
| | = | 1.0425 | where $125\% < F \leq 130\%$ |
| | = | 1.045 | where $130\% < F \leq 135\%$ |
| | = | 1.0475 | where $135\% < F \leq 140\%$ |
| | = | 1.05 | where $F > 140\%$ |

Deemed value of a type A contingent asset

Where the funding level F is no greater than 104%, the basic value of the Type A guarantee is calculated as follows.

The starting point for this calculation is a deemed value for the Type A guarantee, based on whichever liability cap has been chosen to apply to that contingent asset.

The deemed value is calculated based on asset and liability information (including deficit-reduction contributions) certified to the Board prior to the start of the relevant levy year. Valuations, which for the 2008/09 levy year and beyond will be on a section 179 basis for the vast majority of schemes, are rolled forward to a consistent date, on the basis published by the Pension Protection Fund.

The deemed value of the Type A guarantee is then calculated using a formula which broadly reflects the actual limit on the Guarantor's liability that would apply on the date referred to above, based on the asset and liability information referred to in the preceding paragraph. A guarantee of the full s.75 debt of the scheme is converted to a deemed percentage funding level on a s.179 basis for these purposes. Hence for the levy year 2008/09, any such guarantee of the full s.75 debt is treated as though it guaranteed 140% funding on a s.179 basis; for levy years 2006/07 and 2007/08 the equivalent percentage was 125%.

Where F is greater than 104%, the basic value of the Type A guarantee is calculated in the same way except that the funding level *not including any other contingent assets*, i.e. S + C, is deemed never to exceed M multiplied by the liabilities. This ensures that the value of the guarantee will always be positive.

Examples illustrating the calculation of these deemed values and a fuller description of the calculations can be found in the contingent asset guidance.

Funding up to 120%

Where a scheme is funded up to and including 120% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group

company guarantees), the formula for the underfunding U used to calculate the 2008/09 levy is as follows:

$$U = 1.21 \times L - (S + C + N_B + N_C + N_A \times Z)$$

where L, S and C have the meanings defined above and N_B and N_C are the total values of any Type B and Type C assets respectively.

As in previous levy years, the recognised value of the Type A guarantee is subject to an upper limit which ensures that the maximum effect it can have on the levy is a complete risk switch from employer to guarantor. As in previous years, the value N_A of the Type A guarantee taken into account in the levy calculation will be the lower of (i) the deemed value calculated above; and (ii) $(1.05 \times L) - S - C - N_B - N_C$ and Z in the formula is based on the discount factor used for previous levy years but is subject to a multiplicative factor designed to map the guarantee position relative to 105% onto the deemed underfunding relative to 121%. Hence:

$$Z = \frac{1.21 - F}{1.05 - M} \left(1 - \frac{P_{\text{guar}}}{P} \right)$$

The effect is that any Type A guarantee which guarantees a funding level of at least 105% will cause a complete risk switch – i.e. in calculating the levy, the whole of the underfunding relative to 121% will in effect be multiplied by the insolvency probability of the guarantor rather than that of the employer(s). Where the guarantee does not cover 105%, the underfunding relative to 121% will be multiplied in part by the insolvency probability of the guarantor and in part by that of the employer(s).

Funding over 120%

The way in which Type A guarantees will be treated for 2008/09 where funding exceeds 120% is very similar to the position which applied for funding levels above 104% in 2007/08.

If the scheme is funded to more than 120% but not more than 125% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group company guarantees), then the underfunding formula will be as follows:

$$U = (0.01 \times L) - (N_A \times z)$$

where N_A is equal to the lower of (i) the deemed value calculated as above and (ii) $0.01 \times L$; and z is calculated as follows:

$$z = 1 - \frac{P_{\text{guar}}}{P}$$

(the basic z formula as used for previous years). The effect is to cause a *full* insolvency risk switch if the deemed value of the guarantee is at least $0.01 \times L$, and a *partial* risk switch if the deemed value is lower. The deemed value of the guarantee will be at least $0.01 \times L$ if it guarantees at least 105% funding.

If the scheme is funded to more than 125% but not more than 130% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group company guarantees), then the underfunding formula will be as follows:

$$U = (0.0075 \times L) - (N_A \times z)$$

where N_A is equal to the lower of (i) the deemed value calculated in accordance with above and (ii) $0.0075 \times L$; and z is calculated as follows:

$$z = 1 - \frac{P_{\text{guar}}}{P}$$

The effect is to cause a *full* insolvency risk switch if the deemed value of the guarantee is at least $0.0075 \times L$, and a *partial* risk switch if the deemed value is lower.

If the scheme is funded to more than 130% but not more than 135% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group company guarantees), then the underfunding formula will be as follows:

$$U = (0.005 \times L) - (N_A \times z)$$

where N_A is equal to the lower of (i) the deemed value calculated in accordance with above and (ii) $0.005 \times L$; and z is calculated as follows:

$$z = 1 - \frac{P_{\text{guar}}}{P}$$

The effect is to cause a *full* insolvency risk switch if the deemed value of the guarantee is at least $0.005 \times L$, and a *partial* risk switch if the deemed value is lower.

If the scheme is funded to more than 135% but not more than 140% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group company guarantees), then the underfunding formula will be as follows:

$$U = (0.0025 \times L) - (N_A \times z)$$

where N_A is equal to the lower of (i) the deemed value calculated in accordance with above and (ii) $0.0025 \times L$; and z is calculated as follows:

$$z = 1 - \frac{P_{\text{guar}}}{P}$$

The effect is to cause a *full* insolvency risk switch if the deemed value of the guarantee is at least $0.0025 \times L$, and a *partial* risk switch if the deemed value is lower.

If the scheme is funded to more than 140% of section 179 liabilities (taking into account deficit-reduction contributions and any other contingent assets other than group company guarantees), then the underfunding will be taken to be zero and the scheme will pay no risk based levy. The existence of the guarantee will play no part in the calculation.

The case of multiple type A contingent assets is explained in the contingent asset guidance published at the same time as the draft Determination.

C.3 Risk based Levy (RBL) formula

C.3.1 The risk based levy charged to a scheme/section is calculated using the formula:

$$\text{RBL} = \min(U \times P \times R \times c, K \times L)$$

U = underfunding risk factor (including contingent assets)

P = insolvency risk factor

R = proportion of the pension protection levy that is risk based = 0.8 for 2008/09

c = levy scaling factor

K = risk based levy cap, expressed as a decimal = 0.01 for 2008/09

L = estimated s179 liabilities

C.3.2 If the Board has not received a section 179 valuation by midnight on 31 March 2008 then the asset value used in the calculation of *U* will be adjusted to reflect the application of the disincentive outlined in chapter 3.

C.4 Scheme based levy (SBL) formula

C.4.1 The scheme based levy charged to a scheme/section is calculated using the formula:

$$\text{SBL} = h \times L$$

h = scheme based levy multiplier

L = estimated s179 liabilities

The calculation of the scheme based multiplier and risk based levy scaling factor is summarised in chapter 3 and in more detail in the Board's draft determination. Indicative values of these scaling factors have been calculated as *c* = 1.6 and *h* = 0.000152. Final values will be published no later than 31 May 2008.

Pension Protection Fund

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