Pension
Protection
Fund

Risk Based Levy Seminar
Welcome

Partha Dasgupta
Chief Executive

www.pensionprotectionfund.org.uk

Agenda

Pension Protection Fund

- Levy background – stability, quantum and ways to reduce your levy
- Alignment of measurement dates and Scheme Maintenance Project
- Underfunding risk – s179 deadline and contingent assets
- Insolvency risk – D&B methodology and appeals process
- PPF review process – past and future
- 2010/11 and beyond

Why are we here?

Pension Protection Fund

"Life is not fair. But there can be few crueller fates than that suffered by those who spend their entire career contributing to a company pension scheme only to find their retirement plans ruined by the business's financial difficulties."

FT Oct 2005

"To have invested in my pension for 26 years and lost it all would have been a huge blow. We were very lucky that the Pension Protection Fund was set up just before the collapse … I now receive much more than I would have got if the PPF did not exist."

MG Rover Pensioner, March 2007

What we said in 2005

Pension Protection Fund

- Committed to listening to and working with industry to get the right balance
- Risk based levy will evolve over time to reflect the changing risk in the system and will be consulted on annually
- Pensions Regulator's scheme funding proposals and risk based levy are mutually reinforcing

What has been achieved?

Pension Protection Fund

- Over **7000** members of **10** schemes transferred to the PPF
- Over **100,000** members of **179** schemes in assessment
- Developed, implemented and collected a **risk based levy**
- **260** schemes took up contingent asset agreements
- **£26bn** in deficit reduction contributions
- Over **£400 million** recovered from insolvent employers
- Over **£800m** invested according to the PPF's investment strategy
- **3** consultation documents, **1** consultation update, **250 +** responses and **21 weeks** of consultation, **6** road shows, more than **150** stakeholder direct meetings and a continued commitment to consultation

Levy principles

Pension Protection Fund

- Fairness
  - Ensure schemes pay a levy reflecting the level of *risk* they pose providing *incentives* to reduce risk
- Proportionality
  - Strike the right balance between *affordability* for pension schemes and *security* for scheme members
- Simplicity
  - Applying *market solutions* to collect the data required to calculate the levy

The consultation agenda

Pension Protection Fund

- Increasing stability and certainty for levy payers
- Improving fit between levy distribution among schemes and our Long Term Risk Model
- Managing cross subsidy
- Reviewing the effectiveness and take up of incentive package
- Balancing implementation costs and challenges with the benefits of change

Key Dates

Pension Protection Fund

September 2007	RBL workshops
October 2007	2007/08 invoicing starts
November 2007	Consultation response and draft determination
31 Mar 2008	Statutory deadline for s179 certificates Data measurement date, inc. D&B scores

Your feedback to us

Pension Protection Fund

- **Variability in the levy during the initial bedding down of the PPF's processes has been problematic**
- **You have asked for greater stability, and the ability to predict your individual bills in advance**
- **We will:**
  - set a stable levy estimate for 3 years
  - ensure we collect an amount closer to this estimate each year
  - changing the levy distribution parameters to better manage cross subsidy

How will this impact you

Pension Protection Fund

- A simple fair and proportionate levy that affords certainty for levy payers
  - greater alignment between the levy estimate and the levy distribution formula
  - fairer allocation of levy costs
  - reduced volatility of levies year on year
  - a more stable scaling factor – greater predictability of individual levy bills

Levy is like an insurance premium

Pension Protection Fund

- **Levy is based on risk posed to PPF**
  - Underfunding – size of claim
  - Insolvency – likelihood of a claim
- **Levy can be reduced if risk is reduced**

How you can reduce your levy

Pension Protection Fund

1. Make a special contribution – via a deficit reduction contribution
2. Improve the strength of the covenant by using the financial strength of another group company – **type A** contingent asset
3. Pledge assets to the pension scheme in the event of sponsor insolvency – **type B** contingent asset
4. Improve the security of the fund by using the financial strength of a bank or insurance company – **type C** contingent asset

How you can reduce your levy

Pension Protection Fund

5. Check your scheme return data before submitting to ensure key fields impacting the levy are correct
6. Submit s179 valuation so we can produce most accurate estimate of your PPF liabilities
7. Make sure that the PPF has the most up-to-date list of participating employers
8. Check you have supplied D&B with any information they need to calculate employer insolvency risk

Pension
Protection
Fund

Questions?

Pension Protection Fund

Alignment of measurement dates and the Regulator's Scheme Maintenance Project

Rachel Altmann
Head of Levy Policy

www.pensionprotectionfund.org.uk

Background

Pension Protection Fund

STATUS QUO

Full set of underfunding and insolvency risk data used in levy calculation available at end March of levy year.

- Earliest schemes can calculate levy – 1 month after commencement of levy year.
- Movement between indicative and final scaling factor possible

AIM

(1) To enable schemes to be given sufficient advance notice of individual bills in advance of the levy year.

(2) To achieve greater certainty to PPF and levy payer

The 2006/07 levy year approach

Pension Protection Fund

October 05
Levy estimate calculated

December 05
Levy estimate and final scaling factor published

March 06
Deadline for data, U, P calculated

Late summer 06
Levy invoices issued

The 2007/08 Levy Year Approach

Pension Protection Fund

October 06
Levy estimate calculated
U calculated

December 06
Levy estimate and provisional scaling factor published

March 07
Deadline for data, P calculated

April 07
Final scaling factor calculated and published

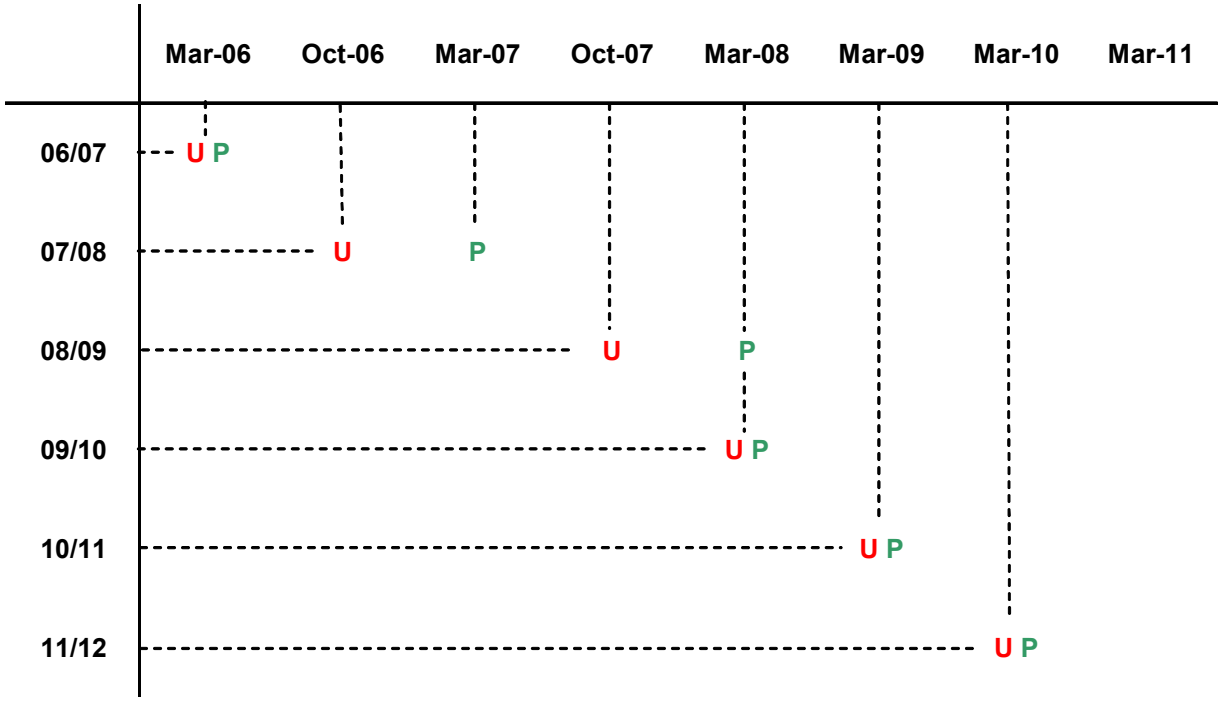
October 07
Levy invoices issued

- Crucial element of levy calculation not known until after commencement of levy year
- Mismatched data sets for calculation of levy estimate, provisional scaling factor and final scaling factor

The proposed position

Pension Protection Fund

To measure all the data at the same time, 12 months in advance of the levy year.



And its consequences…

Pension Protection Fund

- Increased certainty for schemes, employers and the PPF
- Simplicity – A single data measurement date
- Financial planning ability for schemes
- A fairer invoicing process - Reduced volatility year on year

?

- Risk reduction steps to be taken 12 months in advance

Pension
Protection
Fund

Questions?

The Pensions Regulator

On-line
Scheme Maintenance

Collection of Scheme Returns

- Submission of a scheme return is a legal requirement
- Responsibility to collect scheme returns lies with the Pensions Regulator
- Scheme Return data is important to both the Regulator & the Pension Protection Fund to meet their responsibilities
- Provides valuable information to the industry e.g. Purple Book
- the Regulator recognises the need to understand customer requirements and identify process improvements
- the Regulator is committed to enhance the customer experience through improvements to the scheme return collection process

The Pensions Regulator

What worked with current process ?

- Last year's Scheme Return collection was on-line – (earlier versions used paper)
- Pre-population was appreciated
- High volume of DB scheme returns completed and submitted :
  - 88.9% of schemes
  - 95.5% by membership

The Pensions Regulator

What did not work ?

- Problems with IT system resulted in:
  - A poor customer experience
  - High volume of queries
  - Some poor quality data
- A lack of understanding of the regulatory requirement for schemes to complete a scheme return resulted in delays in submission of scheme returns

The Pensions Regulator

Vision for self service scheme maintenance

- Single, end to end process developed on web-based technology to:
  - Provide a user-friendly self-service interface – to be available whenever schemes want to use it (24 hours a day)
  - Enable scheme returns and any on-going scheme updates to be easily completed and submitted
  - Lay platform for other facilities to be easily added (e.g. on-line levy payments)
  - Generate a positive customer experience

The Pensions Regulator

So what is TPR doing to achieve this ?

- In-house development of scheme maintenance website
- Independent research to understand handling issues
- Engaging with key stakeholders including industry bodies, providers and administrators
- User testing with trustees

The Pensions Regulator

Main features of Scheme Maintenance system

- Collect essential information only
- Fully pre-populate with current data
- Ensure easy to use & good response times
- Allow a tick-box approach where data is unchanged
- Provide clear guidance information to data fields
- Provide customer support using fully trained in-house staff

The Pensions Regulator

What's the feedback from the research ?

- Full pre-population welcomed
- Trustee testing of prototype provided very positive feedback
- Feedback analysed and improvements made
- Schemes comfortable with up to 6 weeks to complete return
- Final development underway – further user tests scheduled for October

The Pensions Regulator

What's the timetable ?

- System launch - late November 2007 :
  - issue 8,500 DB schemes (Dec 07- mid Jan 08)
  - issue 30,000 small DC schemes (Dec 07- mid Feb 08)
  - issue 15,000 large DC schemes (late Jan - mid Feb 08)
  - Scheme returns to be completed by 31 March 2008
  - All other data management including Registrations, Wind-ups & Notifiable events + Levy payment through 08/09

The Pensions Regulator

The Pensions Regulator

Questions ?

Pension
Protection
Fund

Section 179 valuations

David Taylor
Head of Legal Services

www.pensionprotectionfund.org.uk

Underfunding – the first two years

Pension Protection Fund

- **For 2006/07 and 2007/08, s179 valuation not mandatory**
- **So levy calculated based on:**
  - s179 rolled forward/back if there is one, or
  - MFR converted and rolled forward if not
- **From 2008/09 onwards, virtually all eligible schemes will have provided their first s179 (legal requirement)**

The statutory deadline for the first s179

Pension Protection Fund

- **No later than 31 March 2008**
- **And within 15 months after effective date**
- **Unless scheme only became registrable on or after 6 April 2007**

Pension Protection Fund (Valuation) Regulations 2005, as amended by Pension Protection Fund (Miscellaneous) Regulations 2007

How to submit a s179 valuation

Pension Protection Fund

- **Pre-Scheme Maintenance:**
  - As part of scheme return sent to tPR, or
  - On a PPF voluntary s179 certificate
- **Once Scheme Maintenance is up and running:**
  - Via scheme maintenance site
  - Will be pre-populated with existing data
- **Deficit reduction contribution certificates**
  - Can still be submitted to PPF
  - Under our proposals, by 31/3/08* for recognition in 08/09 **and** 09/10 levy

*: contributions must be made by 31/3/08; as in previous years there will be a further week to certify them to the PPF

Monitoring the deadline for submission

Pension Protection Fund

- PPF will monitor submission in the first instance
- Breach of statutory requirement is a matter for the Pensions Regulator
- But we still need to calculate a levy….

Proposed levy calculation where mandatory s179 valuation has not been submitted

Pension Protection Fund

- Starting point: 31/10/06 valuation used for 2007/08 levy (converted MFR)
- Treat as s179 submitted on that date
- Roll forward to 31/10/07* as per standard roll-forward formulae **BUT**…..
- Reduce asset value by 5% for each year between effective date of MFR and 31/10/07*

*: or 31/3/08 for the 2009/10 levy year

Failure to comply with statutory obligation suggests scheme likely to be less well run

Pension
Protection
Fund

Contingent assets

David Taylor
Head of Legal Services

www.pensionprotectionfund.org.uk

Definition

Pension Protection Fund

- An asset that will produce cash for a pension scheme contingent on certain events – in particular, insolvency of the sponsoring employer
- Not part of assets of the scheme

Fundamental objectives

Pension Protection Fund

- View positively actions taken by the scheme or employer to improve scheme funding or strength of employer covenant
- Incorporate contingent assets in a way that reflects principles of fairness, simplicity and proportionality
- Value contingent assets in line with real reductions in risk they achieve

The Effect of Contingent Assets

Pension Protection Fund

- **Contingent assets either:**
  - Reduce the level of underfunding in the calculation
  - Change the insolvency risk factor, although this is done on the underfunding side of the calculation

Type of contingent asset	Description	How affects the levy
A	Guarantee	In effect, changes the insolvency risk for the part of underfunding guaranteed
B	Security over assets	Reduces the underfunding
C	Letter of credit/bank guarantee	Reduces the underfunding

Acceptability criteria

Pension Protection Fund

- Individual types have additional acceptability criteria, but in every case:
  - Must be created as per the PPF's standard documentation (including existing arrangements)
  - Must remain in force for the long term
  - However standard documentation permits reduction or replacement as funding improves
  - For multi-employer schemes, must cover the liabilities of **all** associated sponsoring employers

Type A - Group Company guarantees to the Pension Scheme

Pension Protection Fund

- Domicile
- Beneficiaries
- If guarantor's insolvency risk is GREATER than insolvency risk of sponsor, guarantee will be ignored for purposes of RBL calculation

Type A - Group Company guarantees to the Pension Scheme (continued)

Pension Protection Fund

Five possible liability caps (from 2007/08):

- Fixed £ amount
- Fixed % funding level (s179)
- % funding level subject to fixed £ cap
- Full s75 debt
- s75 subject to fixed £ cap

Type B - Security over assets

Pension Protection Fund

- Underlying assets: cash, real estate, securities
- Valuation
- Choice of liability caps as per group company guarantees

Type C - Third party guarantees

Pension Protection Fund

- Letters of credit and bank guarantees
- Type C(i) must be renewed or replaced upon expiry ("evergreen")
- Type C(ii) support a defined schedule of deficit reduction contributions (and step down as contributions made)

Legal documentation and the role of trustees

Pension Protection Fund

- Standard form agreements
- Contingent asset certificates
- Supporting documents including **legal opinion**

Monitoring contingent assets over time

Pension Protection Fund

- **Amendment and replacement criteria:**
  - Within agreements
  - Within determination (see Annex G)
- **Mid-year changes: certificate includes undertaking to notify PPF of changes prior to next 31 March**
- **Re-certification each year (minimal requirements if nothing changed)**

Proposals for 08/09 and beyond (1)

Pension Protection Fund

- No changes to recognised asset types
- No changes to standard form agreements
- Further expansion of contingent asset guidance – autumn 2007

Proposals for 08/09 and beyond (2)

Pension Protection Fund

- Schemes/sponsors may increase caps to target revised funding levels
- Whether or not amended, contingent assets will continue to receive proportionate levy benefit
- Revised treatment of Type A?

Timing

Pension Protection Fund

- For a contingent asset coming into force no later than 1 April 2008 (including one already in force)…..
- Certify by 31 March 2008 (midnight)
- If satisfies requirements and stays in place, get credit for 2008/09 and 2009/10
- After that, next opportunity is CA in force by 1 April 2009, certified by 31 March 2009, credited for 2010/11 levy year

Conclusion

Pension Protection Fund

- What would you/your clients like to be in place in time for 08/09 AND 09/10 levy?
- What do you need to do to get there?

31 MARCH 2008

Pension
Protection
Fund

Coffee Break

Pension Protection Fund

Reviewing the levy calculation

(2007/08 invoicing and beyond)

David Taylor
Head of Legal Services

If you have concerns….

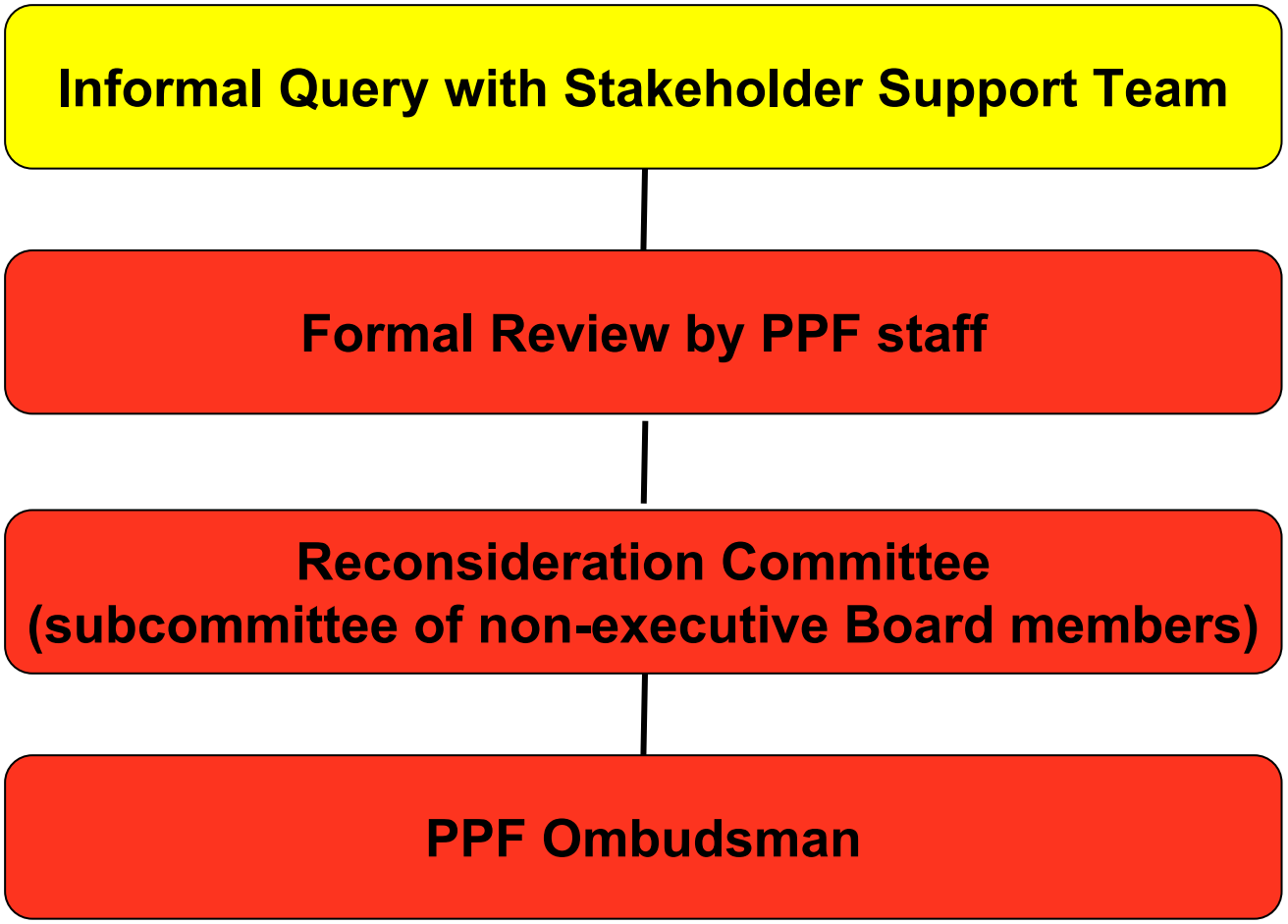
Pension Protection Fund

- **Vast majority of queries resolved informally through PPF Stakeholder Support Team**

  0845 600 2541 / levyinvoice@ppf.gsi.gov.uk
- **D&B score → D&B appeals process**
- **Formal statutory process – "reviewable matter"**

Review process

Pension Protection Fund



Time limits

Pension Protection Fund

- Payment due on invoice date and expected within **28 days**
- Informal queries – must be specific and made within **28 days** of invoice
- D&B appeals
  - must be started within **28 days** of invoice
  - raise any other issues **<u>in parallel</u>**

Formal reviews

Pension Protection Fund

- Time limits
- Formal statutory requirements
- New review form

Conclusion

Pension Protection Fund

Please get in touch promptly if you believe there is an error in your invoice – otherwise, you may lose the right to challenge

Decide with Confidence

D&B's New Predictive Scores and the Effects on the Risk Based Levy

Duncan Hale, Strategic Consultant

Agenda

Decide with Confidence

- Overview of Changes to Predictive Indicators
- Segmentation of UK Universe
- Elements in the Failure Score
- County Court Judgements
- Probability of Insolvency
- Commercial vs. Non Commercial Sub Populations
- Comparison of Scores and Probabilities for the PPF Universe
- Appeals
- Q&A

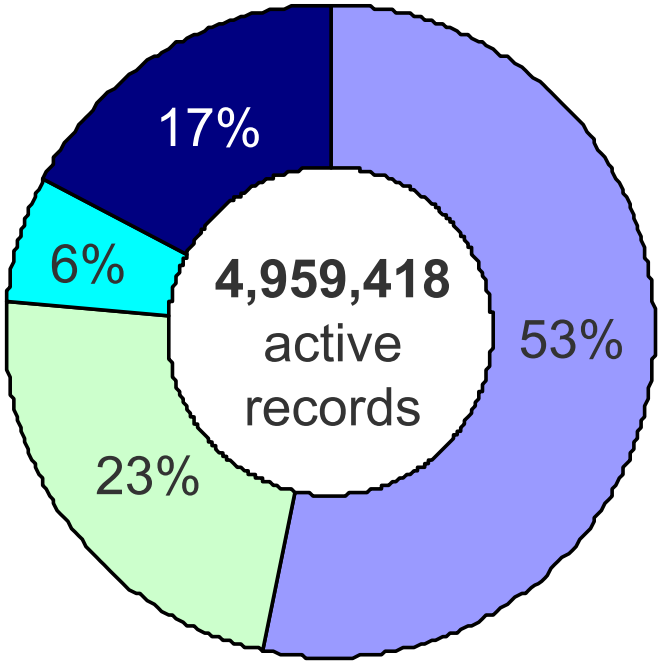
New Scores, Ratings and Limits

Decide with Confidence

- The Risk Based Levy 2007/8 has been calculated using D&B's previous Failure Score as at 30th March 2007 with PPF-specific adjustments.
- Since July 4th 2007, all UK businesses have been assessed using the new scorecards which segment the UK universe into a number of different types of businesses.
- Non-commercial organisations now have their own specific model.
- Less emphasis on County Court Judgements (CCJs) for certain types of businesses.
- The Maximum Credit calculation has been updated to more directly reflect the level of failure risk and the changing business environment (a business twice as likely to fail as another similar company will have half its credit limit).
- Increased granularity for low risk (high scoring) businesses.
- Score commentary introduced to Comprehensive Report to highlight main reasons for score and any overrides.

UK Database Profile

Decide with Confidence

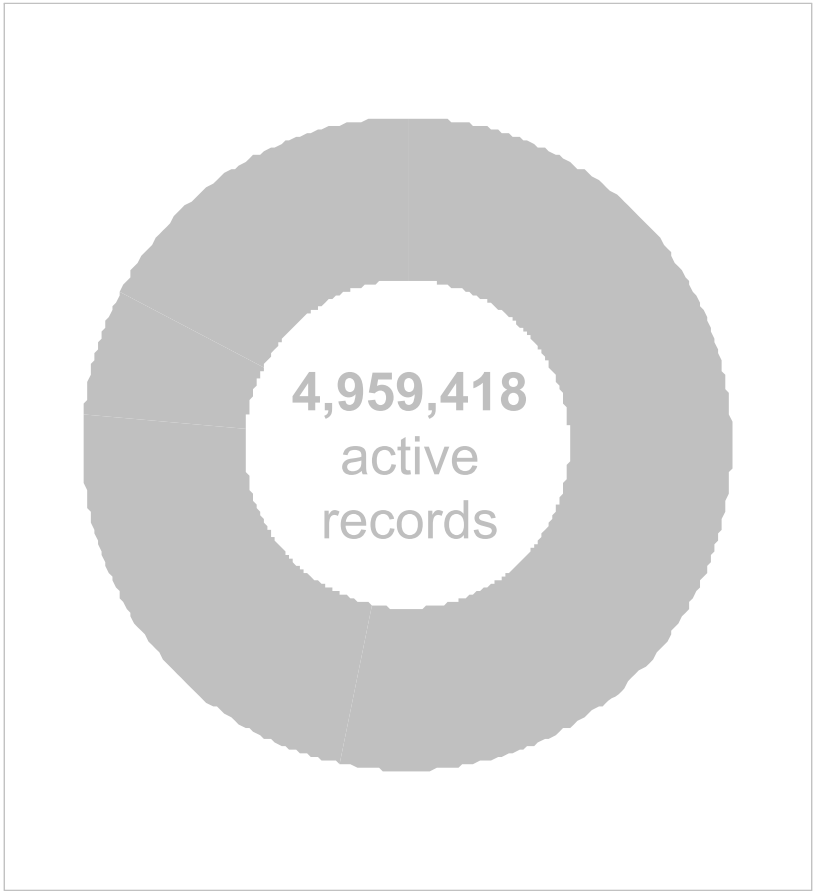


Active Corporations	
Private Ltd	*2,558,523*
Public Ltd	*11,955*
Other Types	*69,762*
total	*2,640,240*

Sole Traders	1,141,594
Partnerships	320,807
Other Forms	856,777
Trading Universe	**4,959,418**
Out of Business	**3,175,798**
TOTAL	**8,135,216**

UK Database Segmentation

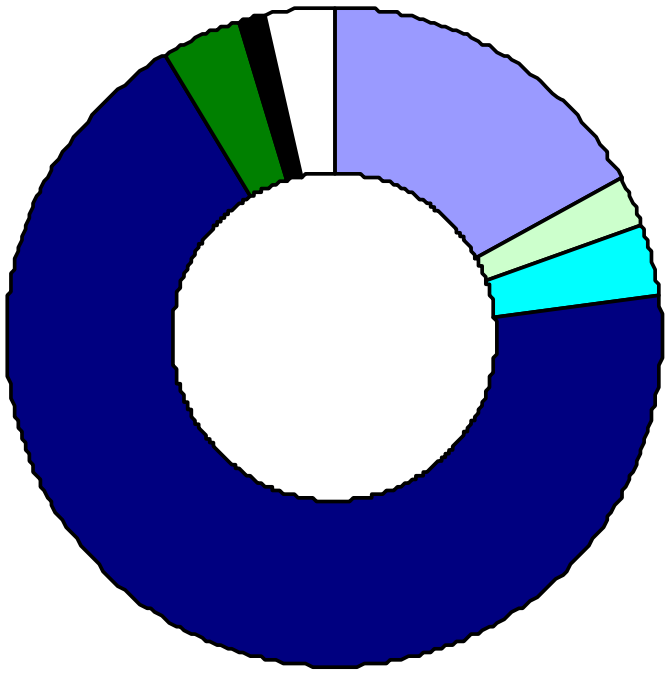
Decide with Confidence



		Insolvency Rate
Non Commercial Segment *Government Bodies* *Charities* *Education Services* *Health Services*		0.28%
Small	1 – 4 employees	2.8%
Mid-Sized	5 – 9 employees	
Large	10 – 4999 employees	
Very Large	5000+ employees	
Assumed Small		3.0%
Assumed Large		

PPF Universe Segmentation

Decide with Confidence



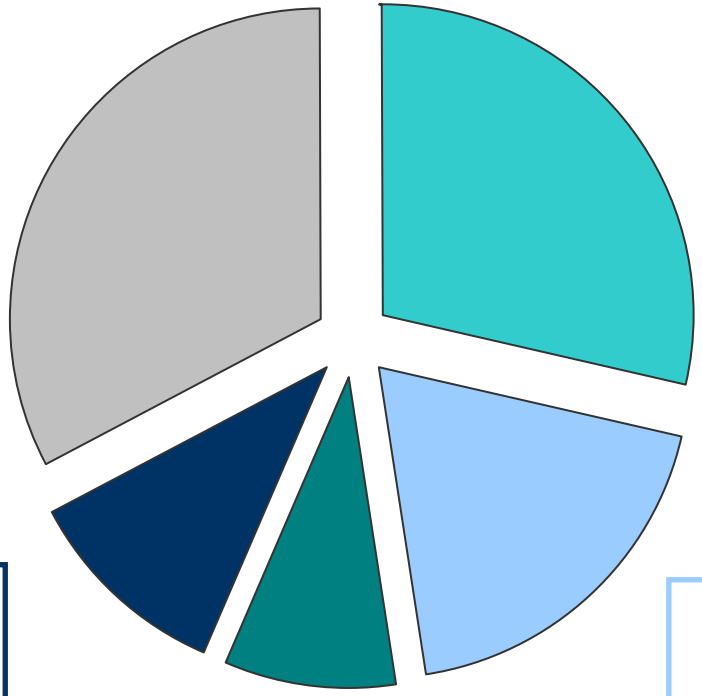
Non Commercial Segment	17%
Small	2.8%
Mid-Sized	3.7%
Large	68%
Very Large	4%
Assumed Small	1.3%
Assumed Large	3.3%

The D&B Failure Score

Decide with Confidence

Financials

- Liquidity / cash
- Solvency
- Profitability
- Late filing / age of accounts



Demographics

- Age and size of business
- Primary industry sector
- Number of Employees
- Geographic Region

Trade Payments

- Payment Score (Paydex)
- % of trade experiences paid promptly or beyond terms
- Volatility of payments

Principals

- Number
- Age and Experience
- Associated Failures

Public Negative Data

- County Court Judgements
- Mortgages and Charges
- Recovery and Debt Claims

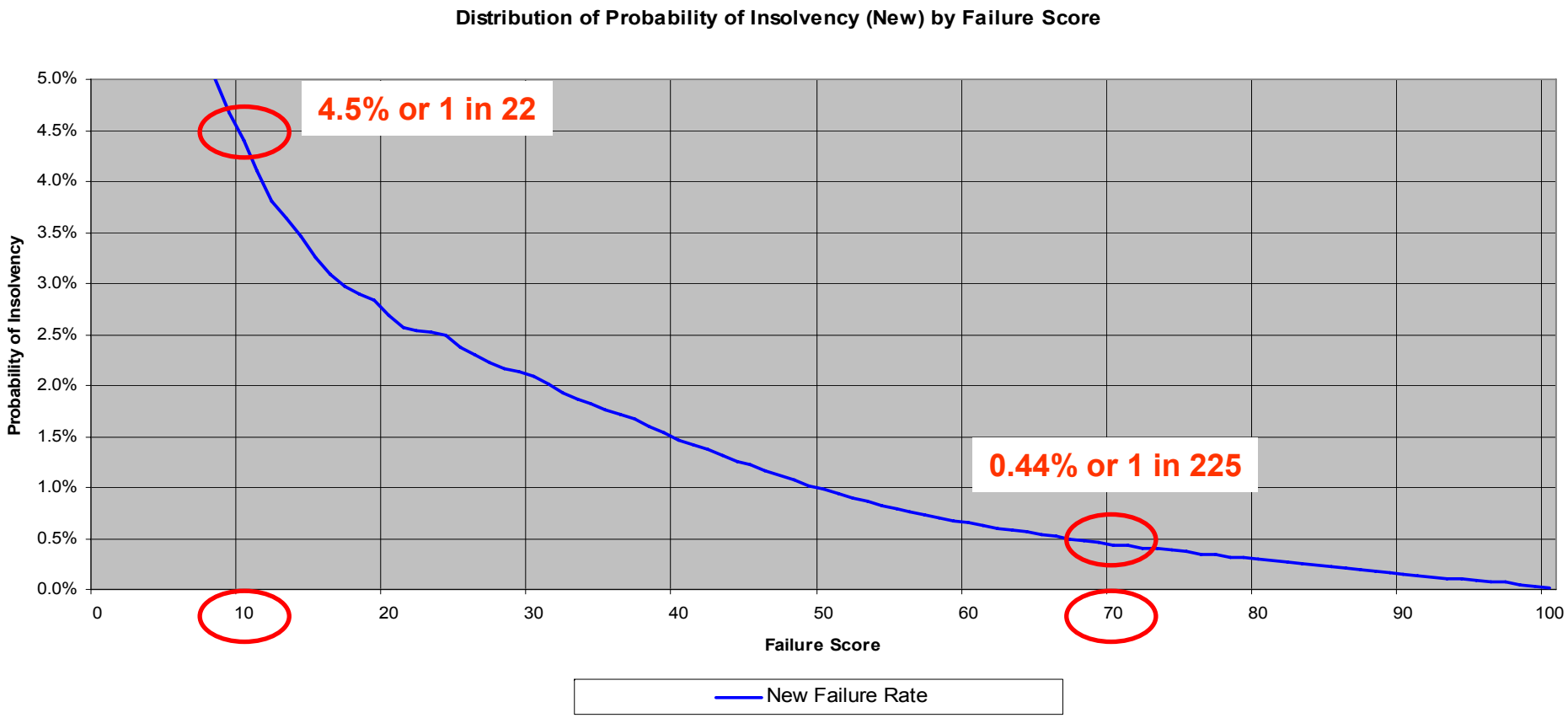
County Court Judgements

Decide with Confidence

- D&B extensively studied and analysed the effect of CCJs and Scottish Decrees on a large sample of UK businesses and insolvencies.
- As a result, the new UK scorecards treat CCJs according to the size of the business, along with the number, value and timing of any judgements.
- For large businesses (500+ employees OR £50m+ turnover OR £50m+ total assets), all CCJs are ignored.
- For mid-sized businesses (10 - 499 employees), the first £750 of any outstanding CCJs in the last five years are ignored.
- For small businesses (1 - 9 employees), the first £100 of any outstanding CCJs in the last five years are ignored.
- Otherwise any other outstanding CCJs are assessed by a number of different characteristics such as:
  - How recent are they?
  - How many have there been in the last 12 months?
  - How many have there been in the last 5 years?
  - How much are they for?

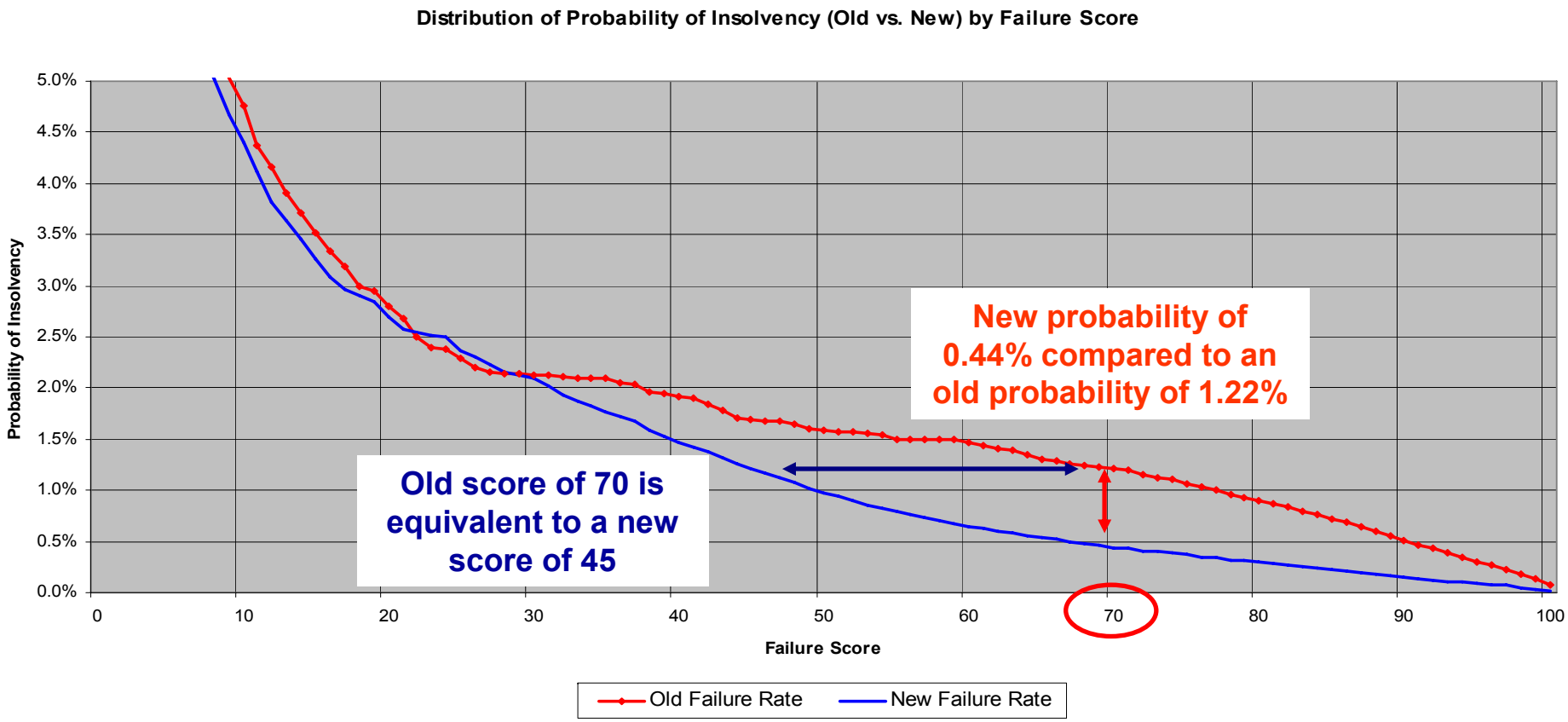
Probability of Insolvency

Decide with Confidence



The new Failure Score identifies more insolvencies at the low score end, and hence the probability is lower for the high scores.

Probability of Insolvency



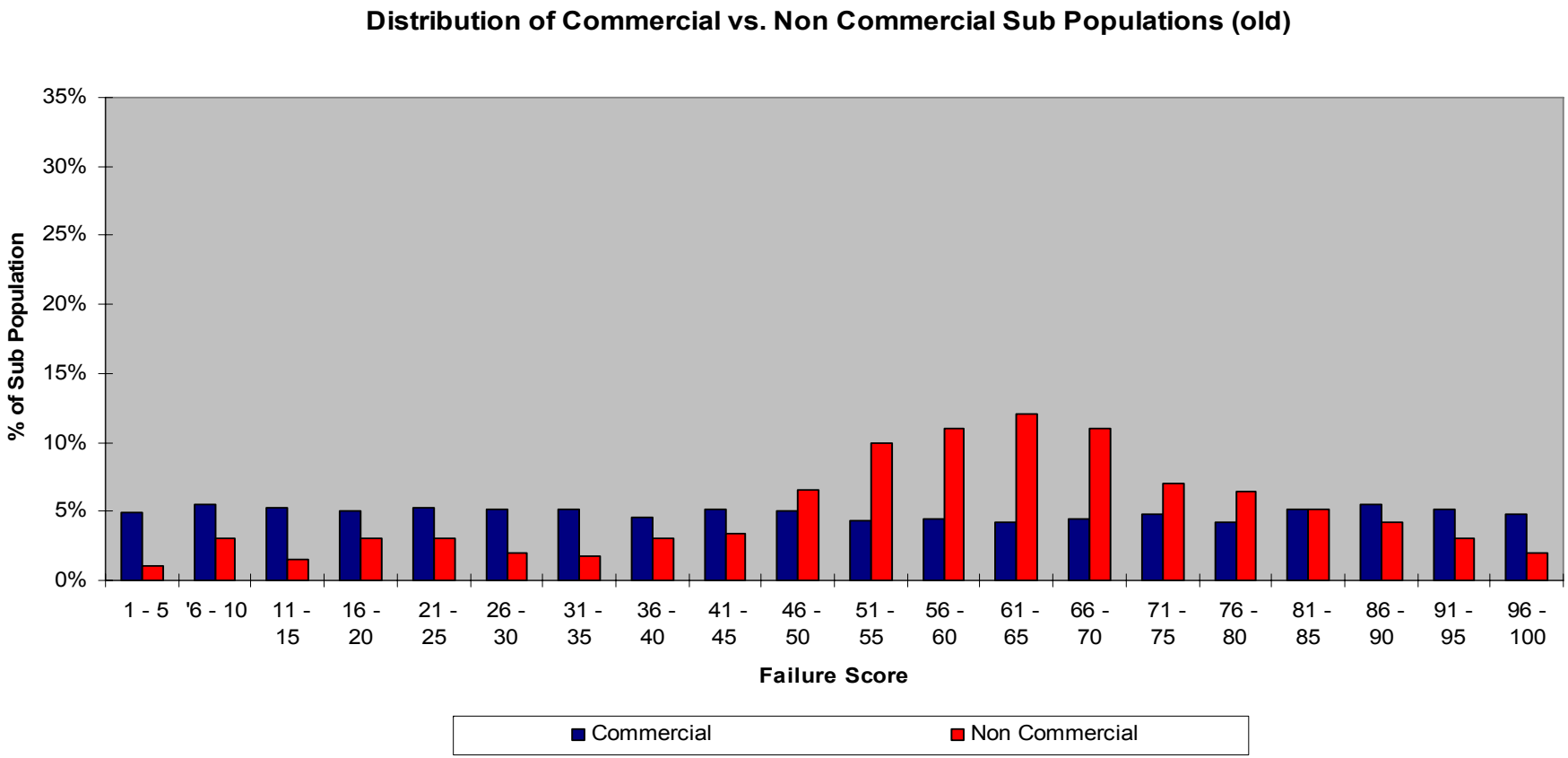
For the same Failure Score, the old probability of insolvency is generally higher than the new probability.

Shifts in the UK Population

Decide with Confidence

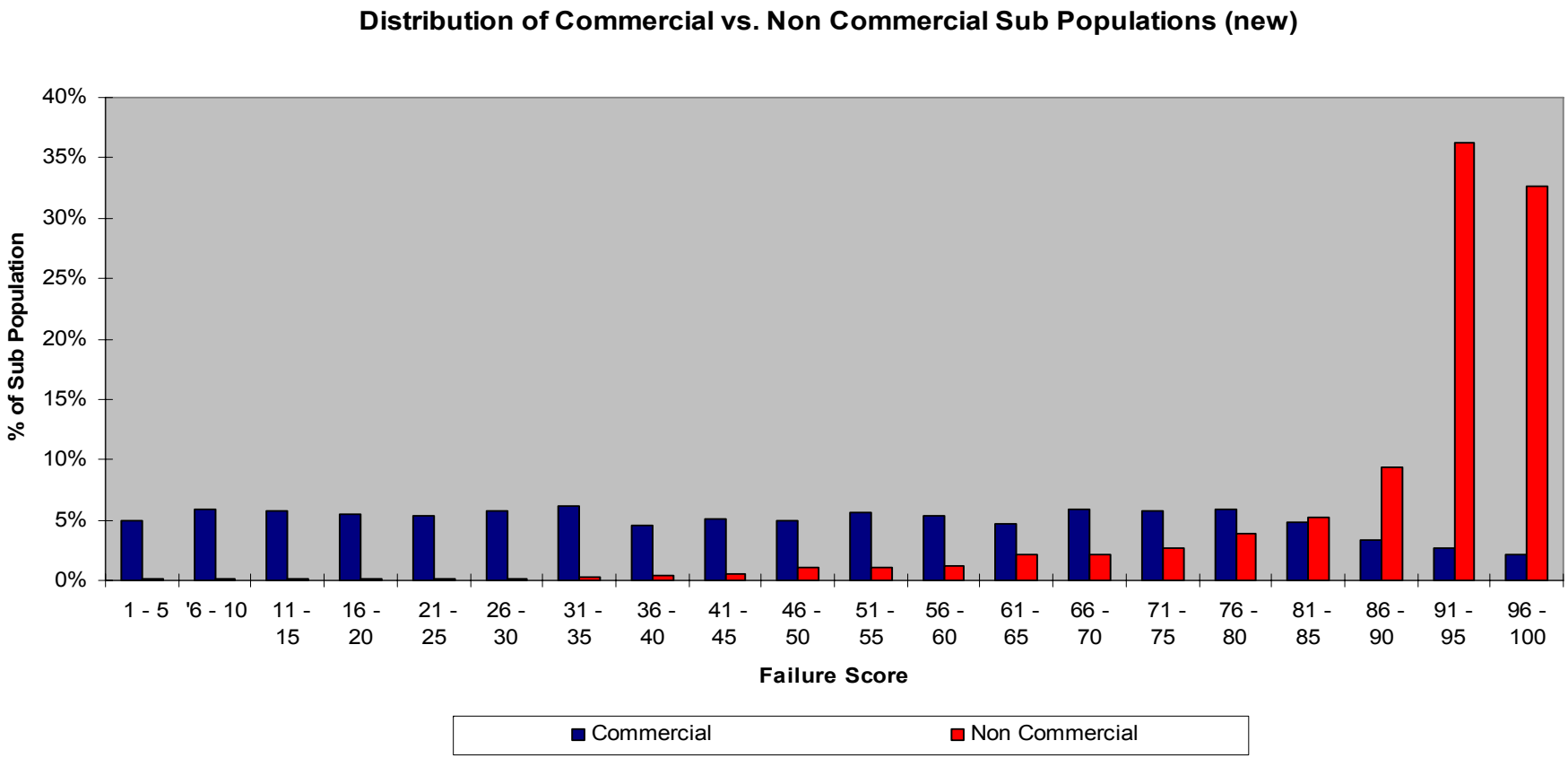
- Larger universe of UK businesses.
- Data changes
  - Underlying shifts in economy and business universe.
  - Changes in why businesses are failing.
  - Changes and depth to key data elements (e.g. more trade data).
  - New data elements (e.g. granular financial data).
  - Changes to accounting standards and filing rules.
- Improvements in statistical modelling techniques.
- Assessment of Non Commercial organisations.

Shifts in the UK Population



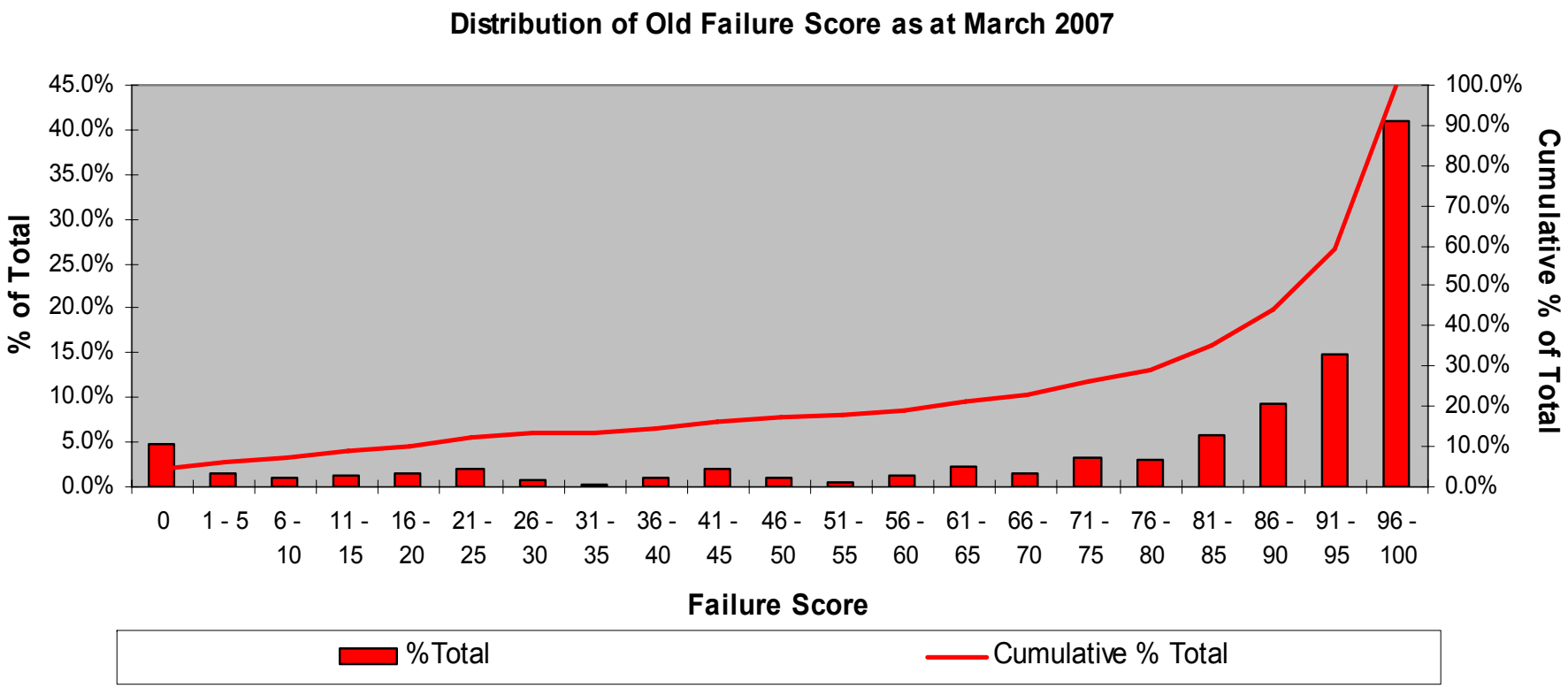
The old Failure Score generally rated the Non Commercial segment in the mid–high score ranges due to a lack of financials.

New Distribution of Commercial vs. Non Commercial Sub Populations



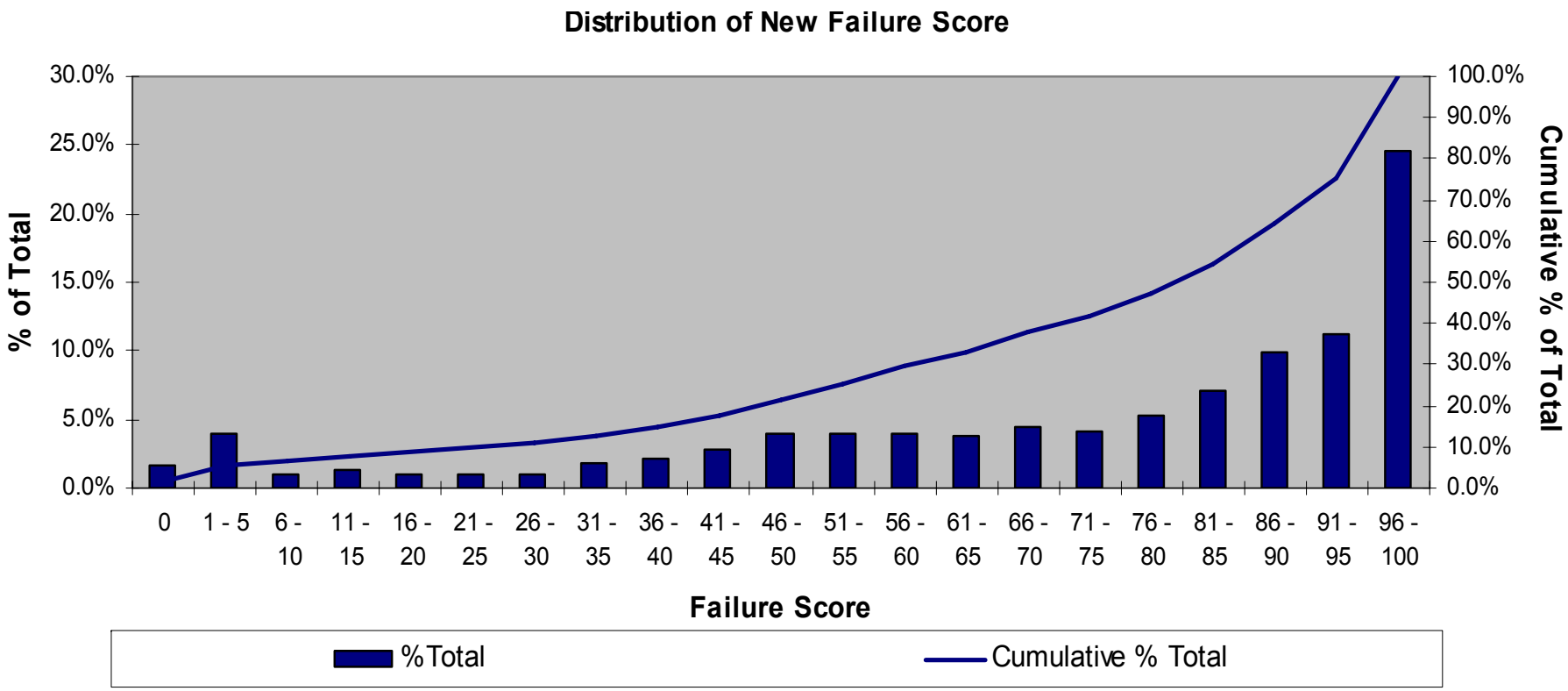
The new Failure Score now rates Non Commercial organisations in the top score ranges to reflect their very low insolvency rates.

PPF Universe – Failure Score as at March 2007



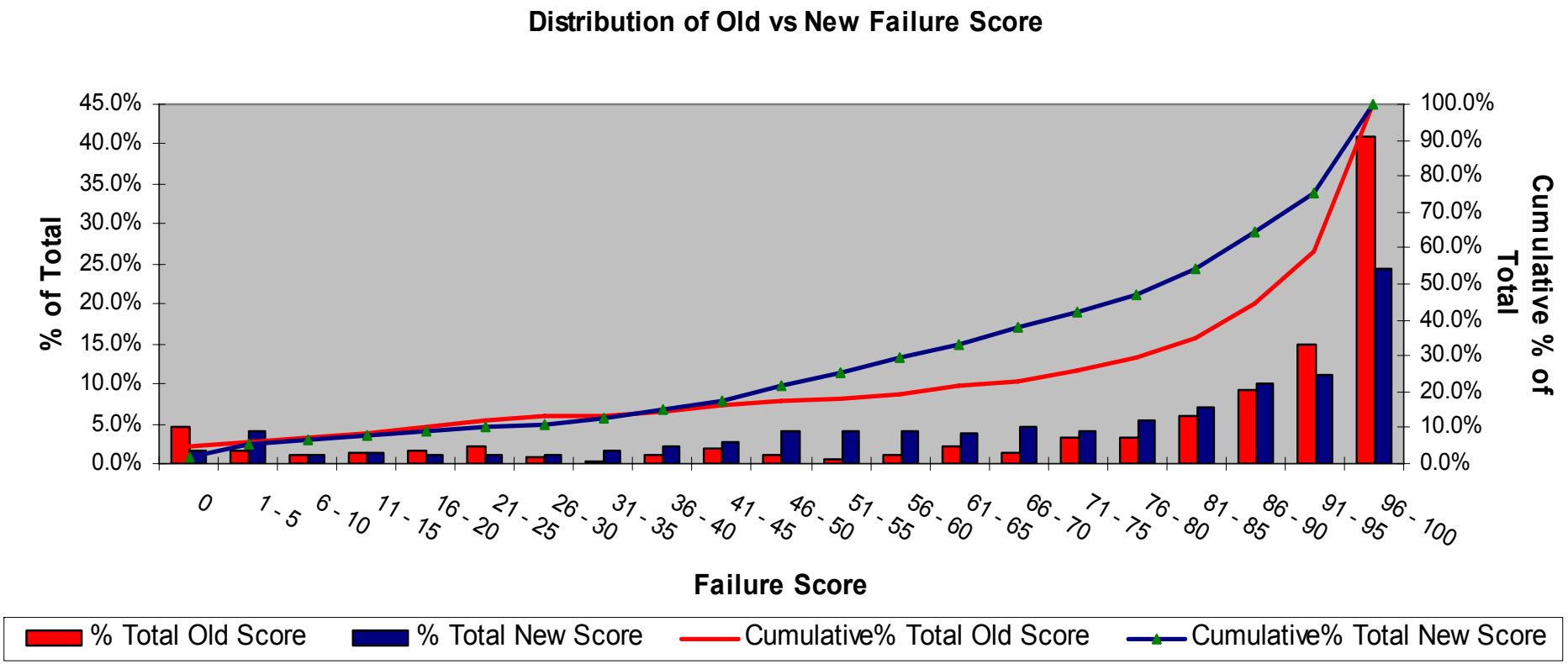
The old Failure Score was heavily skewed towards the top score range.

PPF Universe – Current Failure Score



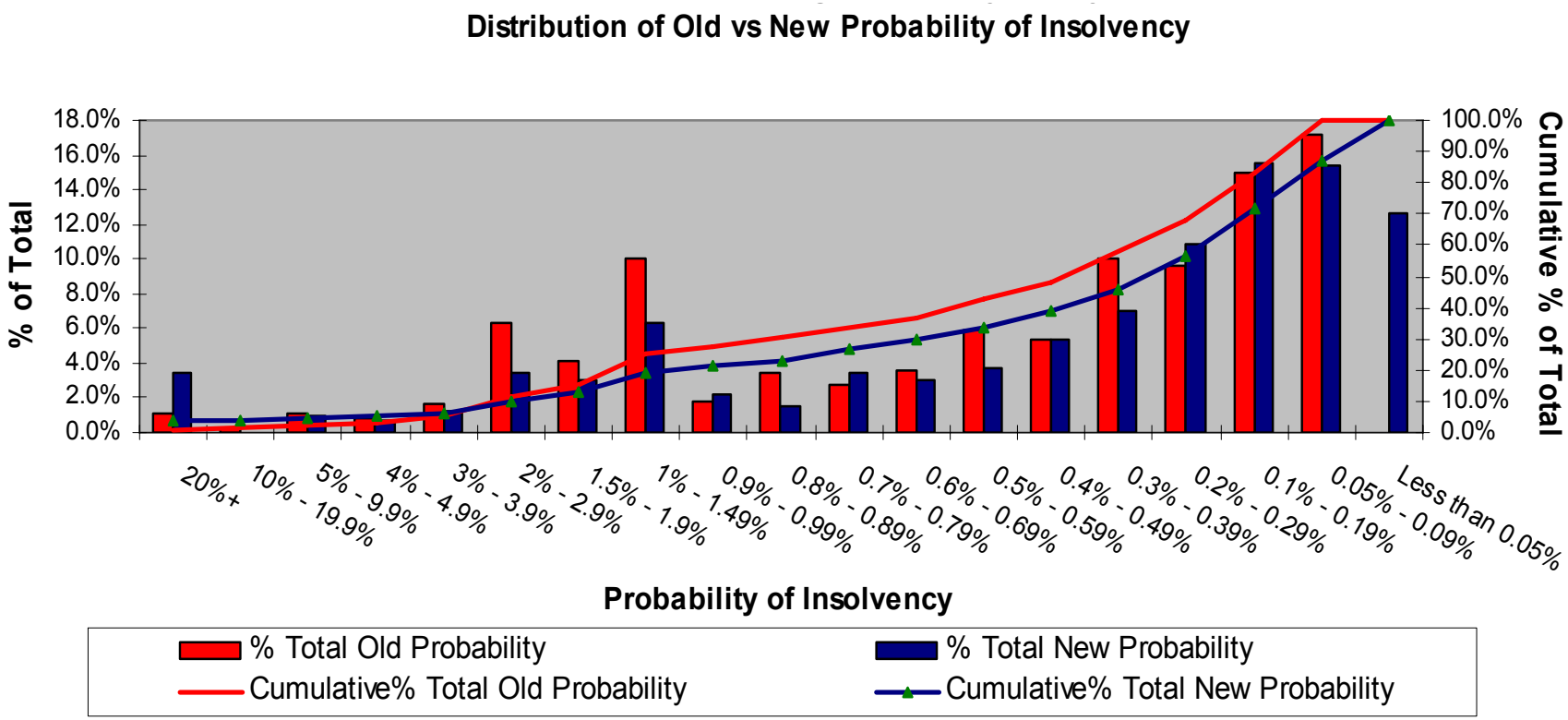
The new Failure Score is now more evenly spread across the mid to high score ranges.

PPF Universe – March 2007 vs. Current Scores



The cumulative distribution shows that the new Failure Score is generally lower across the universe than it was for the old score.

PPF Universe – Old vs. New Probability of Insolvency



The distribution of probabilities is slightly lower using the new Failure Score.

Appeals

Decide with Confidence

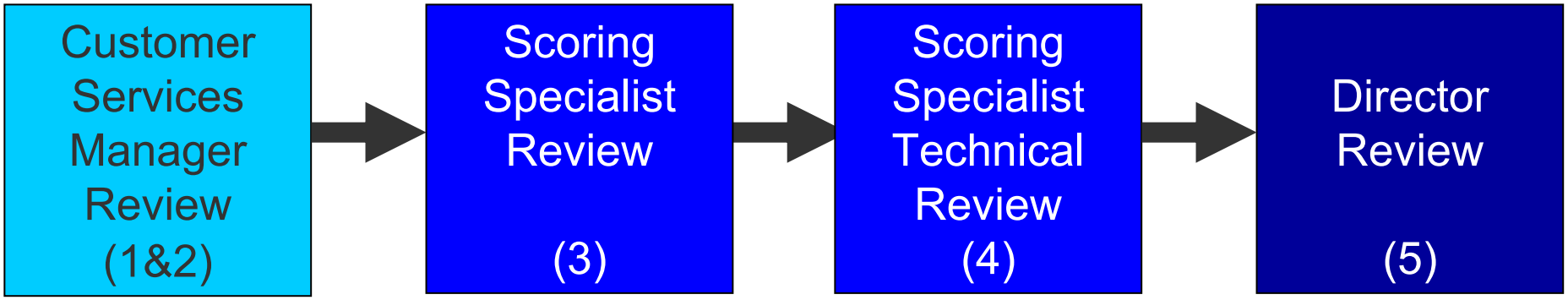
- All employers are encouraged to obtain their D&B Failure Scores in advance of 31st March 2008, and to engage with D&B to ensure that their insolvency risk calculation is based on the fullest, most up-to-date and accurate data available.
- Additional data provided to D&B after 31st March 2008 will not be taken into account in any appeal.
- However, having received an invoice a scheme may still query that failure score if it fails to take account of data that should have been available to D&B in the normal course of business.
- The employer should contact D&B's dedicated Customer Services on 0870 850 6209 or by emailing customerhelp@dnb.com .
- Appeals will only be considered if made within 28 days of the issue of the invoice.

Appeals

Decide with Confidence

Five Stage Appeal Process:

- Stage 1 & 2 — Customer Services Manager Level
- Stage 3 — Data Validation
- Stage 4 — Score Explanation
- Stage 5 — Escalation



Summary

Decide with Confidence

- D&B have introduced new scores and associated probability of insolvency tables which will be used to assess risk in March 2008.
- The new segmentation of the UK business universe includes specific scorecards for different sized businesses and non commercial organisations.
- CCJs are now ignored for large organisations.
- For the same Failure Score, the old probability of insolvency is generally higher than the new probability.
- Some businesses may experience a drop in Failure Score, even though their risk has remained the same.
- All businesses are encouraged to monitor the Failure Score of any participating employers in the weeks leading upto March 2008 and talk to D&B about ways to reduce their risk.

For further information

haled@dnb.com

Decide with Confidence

Pension
Protection
Fund

2010/11 and Beyond

Partha Dasgupta
Chief Executive

www.pensionprotectionfund.org.uk

Rationale & Objectives

Pension Protection Fund

- Changes in 2008/09 and 2009/10 designed to respond to identified stakeholder needs – stability and certainty

- Consideration has now been given to the evolution of the levy – but the speed of development is to be linked to appetite of stakeholders

- 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)

Current Levy Formula

Pension Protection Fund

Risk based levy for individual scheme

- **proportional to short term risk**
- **equal to the product of its current estimated deficit (U)**
- **adjusted for contingent assets and deficit reduction contributions**
- **reflects likelihood of insolvency in next 12 month period (P)**

U x P (Short Term Risk) = approx. expected claim value over 1 year

Long Term risk addressed by application of single scaling factor

Consultation themes

Pension Protection Fund

- Signalled stability in levy quantum at the macro level
- Alternative approach to insolvency risk measurement
- Opened Long Term Risk Model to public scrutiny
- Suggesting separate ‘premiums’ for catastrophe risk exposure
- Revise our levy incentives

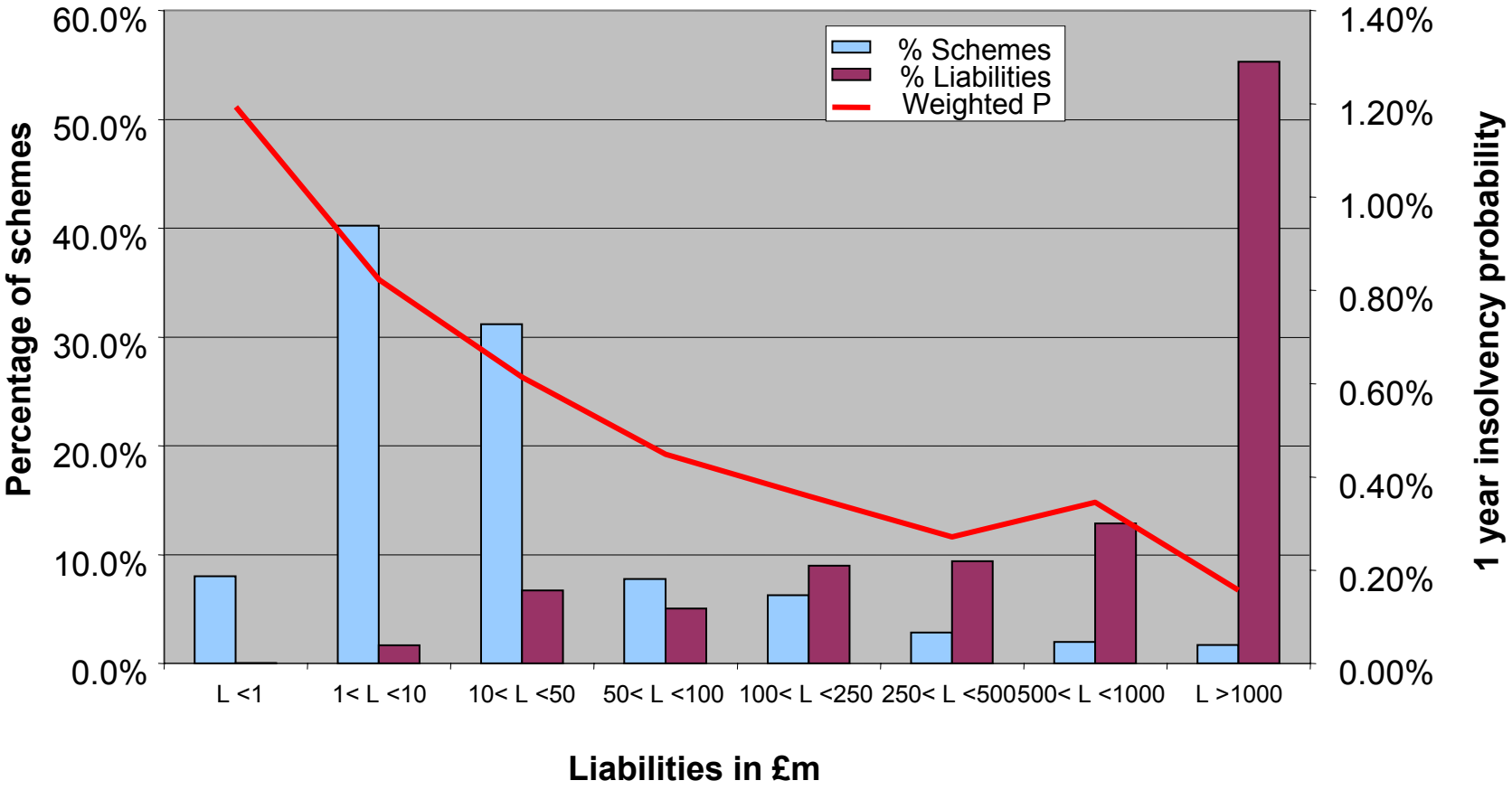
Insolvency risk measurement

Pension Protection Fund

- Revised Failure score methodology to be used for 2008/09 and 2009/10
- For 2010/11 and beyond, in line with EU procurement law, PPF must tender for an insolvency risk provider.
- Currently consulting on selection criteria
- Seeking views on the possibility of appointing <u>more than</u> one insolvency risk provider
- Seeking views on measuring insolvency probabilities over periods <u>longer than one year</u>

PPF risk universe

Pension Protection Fund



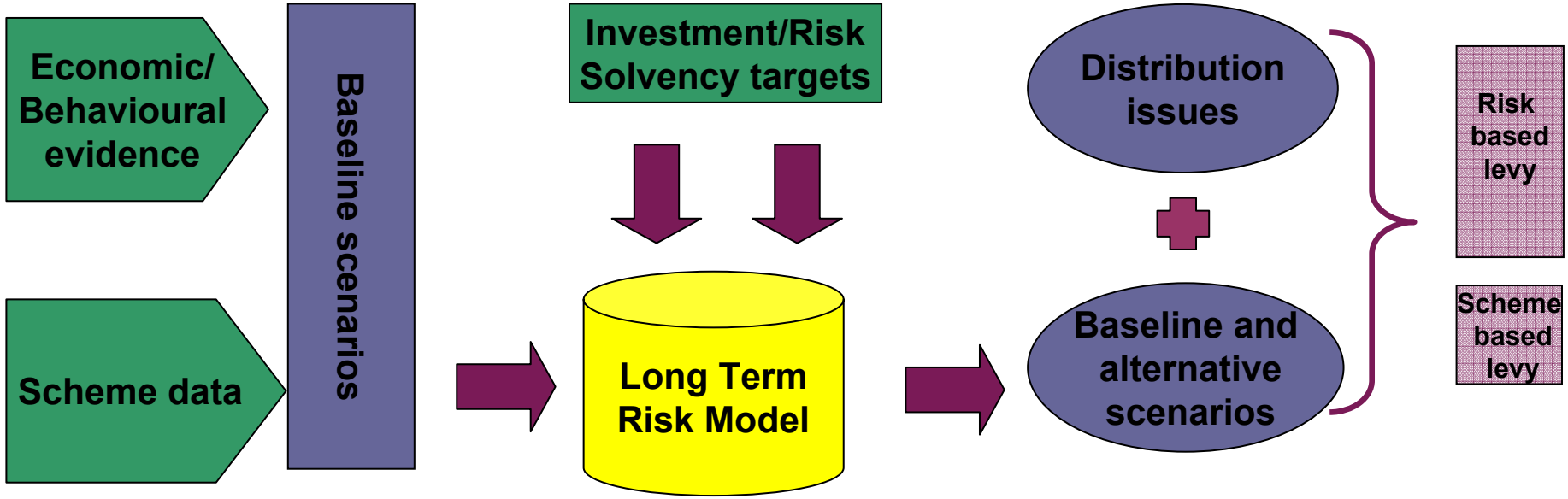
Long Term Risk Model (LTRM)

Pension Protection Fund

- PPF risk profile unique
- LTRM recently published – estimates the likelihood of different claim scenarios over the period analysed
- Views sought – transparent policy development
- Improved data set has enhanced the rigour of the model

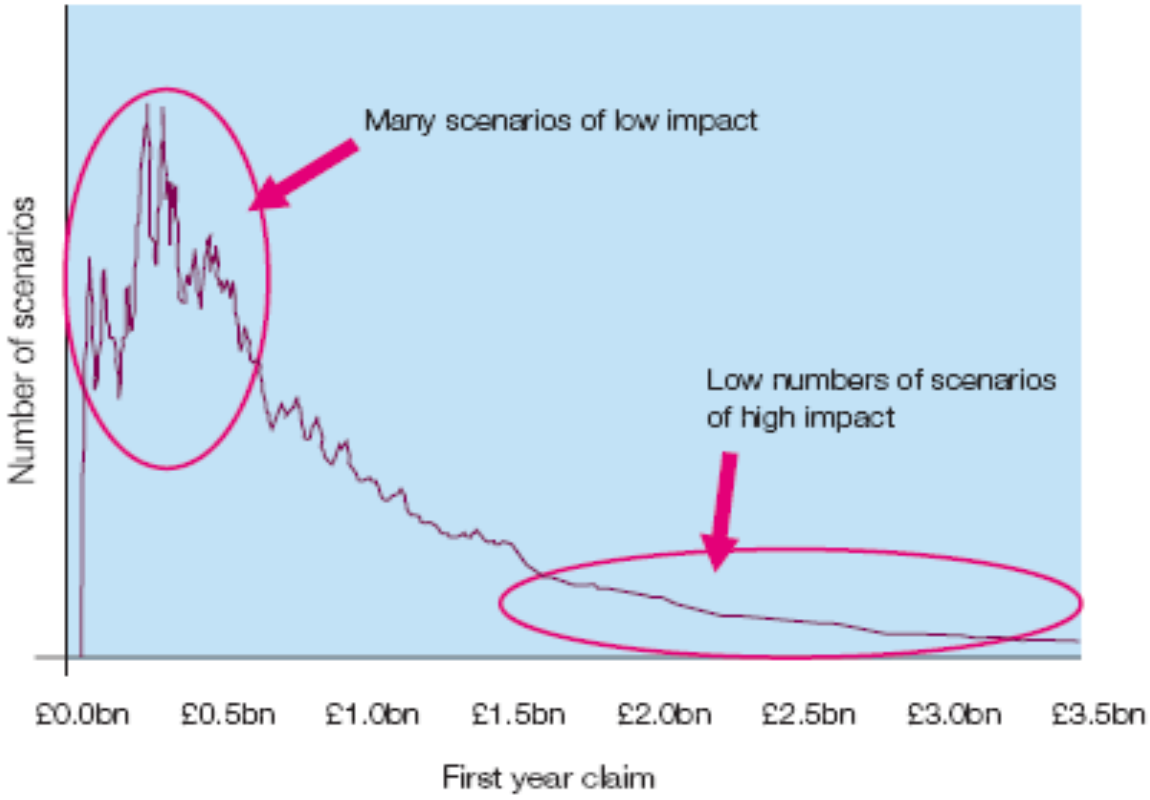
Levy setting process

Pension Protection Fund



Pricing and measuring the risk

Pension Protection Fund



Emerging hypothesis for a better levy

Pension Protection Fund

- Extreme events cause the largest claims on PPF
- Schemes contribute unevenly to claims in extreme circumstances
- Separate out our exposure to extreme events from more normal events, and
- Charge a different premium for normal and ‘catastrophe’ risk

Pension
Protection
Fund

Questions?

Pension
Protection
Fund

Closing Remarks

Reminder on Further Information

Pension Protection Fund

- **Detailed information in the pack**
- **PPF website www.pensionprotectionfund.org.uk**
  - Discussion documents
  - Certificates and Forms
  - FAQ

Key Dates

Pension Protection Fund

September 2007	RBL workshops
October 2007	2007/08 Invoicing Commences
November 2007	Consultation response and draft determination
31 Mar 2008	Statutory deadline for s179 certificates Data measurement date, inc. D&B scores