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Helping prepare
you for change

INTRODUCTION TO THE NEW PENSION
PROTECTION LEVY FOR 2012/13

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The new levy

The Pension Protection Fund's (PPF) new levy framework comes into effect from 2012/13.

This means that when you receive your levy bill in autumn 2012, you will see a new-look invoice and, more importantly, changes to the way your bill has been calculated.

This booklet will help you prepare for the changes so that when your bill arrives, it is accurate and what you expected.

In the interests of clarity, this booklet contains a number of general statements that simplify levy rules or do not cover circumstances that only relate to a limited number of schemes.

More detailed and comprehensive information is available on our website. These include:

- policy statements - published in May 2011 and December 2011 - which explain what we are aiming to achieve
- the levy rules for 2012/13, and
- guidance on a range of issues – including putting in place contingent assets.

These are available on our website by clicking on the new levy framework link on the home page.

If, after reading these, you have any questions, please do not hesitate to contact us. Details are provided at the back of this booklet.

What is the levy formula?

The pension protection levy is split into two parts.

The **risk-based levy** (RBL) is based on the likelihood of a scheme making a claim on the PPF (which we term insolvency risk) and the potential size of that claim (which we term underfunding risk).

It is capped at 0.75 per cent of smoothed liabilities (explained on page 4).

It is calculated using the formula:

RBL = underfunding risk x insolvency risk x levy scaling factor

The levy scaling factor of 0.89 scales down bills so that – together with the scheme-based levy (SBL) – we will raise £550 million from the 2012/13 levy.

The **scheme-based levy** is based on your scheme's smoothed liabilities and a scheme-based multiplier (see page 5) and is calculated using the following formula:

SBL = 0.000085 x smoothed liabilities

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So what's changed?

1. Levy formula fixed for three years

Our new 'bottom-up' approach to calculating levies means that we intend to keep the **risk-based levy scaling factor** and the **scheme-based multiplier** fixed for three years¹.

This means it will be easier for you to work out what your levy bill will be, well in advance.

The risk-based element of your levy should only change if the risk your scheme poses to the PPF changes.

2. Averaging funding levels (smoothing)

Your levy depends on the funding position of your scheme. We will use information about the value of your assets and liabilities that you supply by 30 March 2012 to calculate your underfunding risk.

To reduce the impact of short-term volatility in the financial markets - and so all schemes are treated on a consistent basis - we will smooth the value of the assets and liabilities you report using **five year financial market averages** up to 30 March 2012.

3. Investment risk

For the first time, we will be taking a scheme's **investment strategy** into account when calculating individual levy bills. We will do this by adjusting the underfunding risk we calculate for your scheme to take into account investment risk.

This is not aimed at telling schemes how to invest but rather allowing us to reflect the risk their investment strategies may pose to the PPF.

We can generally calculate investment risk by using information about your scheme's assets that you supply to us through the **Exchange** scheme return system.

1. In the May 2011 Policy statement we set out very limited circumstances in which we would revise the levy formula within the first three years. It is fixed for three years, unless the total it is estimated we will collect rises or falls by more than 25 per cent from the previous year.

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To assess schemes with more complex strategies, we have developed rules that allow them to make their own assessment of investment risk.

For schemes with liabilities of **£1.5 billion** or more, this will be **compulsory**. But other schemes may wish to undertake their own assessment if they feel it would be beneficial.

4. Average failure scores

We will continue to use Dun & Bradstreet (D&B) to provide insolvency risk ratings, or failure scores, for all sponsoring employers of eligible schemes.

But, instead of using only the failure score at the end of March, as in the past, D&B will supply a failure score that is an **average** of failure scores at the end of each month between April 2011 and March 2012.

5. Insolvency risk levy bands

This average failure score will be used to place each employer into one of **10 levy bands**. Each band has an associated levy rate.

For schemes with one employer this will be the insolvency risk used.

For schemes with more than one employer, we will calculate an average insolvency risk, taking account of all employers.

We expect that this will mean schemes will generally find their insolvency risk assessment will vary less year-on-year.

6. Scheme-based levy and cross-subsidy

The scheme-based levy is going down. Instead of 20 per cent of the levy being scheme-based, we have set a scheme-based levy multiplier to cover the costs of capping the highest risk-based levies - about 10 per cent of the levy.

This also makes the necessary cross-subsidy in the levy more transparent as it ends the practice of scaling up risk-based levies to cover the cost of capping.

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What should my scheme be doing?

Most importantly, check and double-check the information you supply to make sure it is as accurate and as up-to-date as possible.

Not only do you have to do this by law, but it could also affect the size of your levy bill.

Don't forget: If you have already submitted your annual return, you can still update the information that is held on Exchange up to the data deadline for the levy (deadlines are in the dates to remember section on page 7).

Here are some things to look out for:

1. To calculate investment risk, we will use the details that you provide to Exchange on how your investment assets are split.

A **new help file** is available at the asset split page on Exchange to help you put your investments in the right category.
2. Assets labelled 'insurance' or 'other' should be broken down as much as possible.

This means that individual assets within **pooled funds** can be reported to enable us to make a more accurate calculation of investment risk.

If you are not sure how to do this then talk to your investment advisor or fund managers.
3. If your scheme has liabilities of £1.5 billion or more then you will need to provide **additional information** on your investment strategy.
4. If you hold **derivatives** you may want to undertake your own investment risk assessment – even if you are below the £1.5 billion threshold.

Some **Liability Driven Investment** (LDI) strategies use derivatives so, again, speak to your advisors or fund managers.

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5. Make sure that D&B has the most up-to-date information about your sponsoring employer(s). There are two aspects to this:
 - provide accurate information about the employers in Exchange, and
 - engage with D&B, where appropriate, as the information available to them at the end of each calendar month will be used to assign a failure score for that month.
6. You should also consider what risk reduction measures you can take to reduce your levy bill. These include:
 - making payments into a scheme which are recognised through **deficit reduction contribution** certificates, or
 - putting in place any **contingent assets**.
7. If you already have in place – or plan to put in place – a type A contingent asset, you will have to complete a new certification requirement on Exchange. This is explained in expanded guidance on our website.

Some dates to remember!

To calculate 2012/13 levy bills, we use information that will have to be submitted using Exchange by: **5pm on Friday 30 March 2012**

You must certify, or re-certify, contingent assets by: **5pm on Friday 30 March 2012**

Deficit reduction contributions must be certified by: **5pm on Tuesday 10 April 2012**

Full block transfers must be certified by: **5pm on Friday 29 June 2012**

D&B will use information that is provided to them at the end of a month by no later than the following month

2012/13 invoices will be sent out: **Autumn 2012**

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For further help

Visit the new levy framework page on our website at
www.pensionprotectionfund.org.uk

This will provide updates and more detailed information such as the legal rules.

If you need to talk to someone about any questions or concerns,
then contact us on:

Tel: **0845 600 2541**

Email: information@ppf.gsi.gov.uk

If you have any questions on your D&B score, please contact D&B support
directly on:

Tel: **0870 850 6209**

Email: customerhelp@dnb.com