

The Purple Book 2007 Highlights

DB Pensions Universe Risk Profile

Background

The Purple Book was first published in December 2006 to provide for the first time comprehensive and vital information to enable employers, trustees and their advisors – as well as the Pensions Regulator and the Pension Protection Fund (PPF) – to identify and manage risks surrounding UK-based final salary pensions.

Produced jointly by the PPF and the regulator, this annual document provides an overview of the defined benefit pensions landscape, covering scheme size, membership types, industry-type, funding levels and the way assets are allocated.

This year, it contains new information about the number and size of claims on the PPF, the scale of levy payments made by eligible schemes and the number of people benefiting from PPF protection. Comparisons of 2007 data are also made with the Purple Book 2006 and with an extended Purple 2006 dataset covering almost 7,800 schemes (probably close to the universe of PPF-eligible schemes).

Highlights

2007 Dataset

The total number of schemes eligible for the Pension Protection Fund (PPF) in 2007 is estimated to be 7,800.

Analysis in the Purple Book 2007 (Purple 2007) is based on 5,892 schemes, representing:

- 76% of all schemes eligible for entry into the Pension Protection Fund,
- 90% of total liabilities, and
- 10.7m memberships.

This is slightly larger than the dataset used for the first Purple Book (Purple 2006) which consisted of 5,772 schemes covering 85% of total liabilities.

Analysis and overall funding levels

Information used for analysis comes from the returns that pension schemes have to provide to the Pensions Regulator about assets and liabilities, the way assets are allocated, the sponsoring employer, scheme type and status, membership, trustees and their advisors.

The analysis uses funding levels based on what would have to be paid to an insurance company to take on PPF levels of compensation, called the s179 basis.

If schemes cannot provide funding levels on this basis, the PPF adopts the old Minimum Funding Requirement (MFR) and uses this measure to calculate scheme funding on a s179 basis. However, all schemes will have to provide a s179 valuation by end of March 2008.

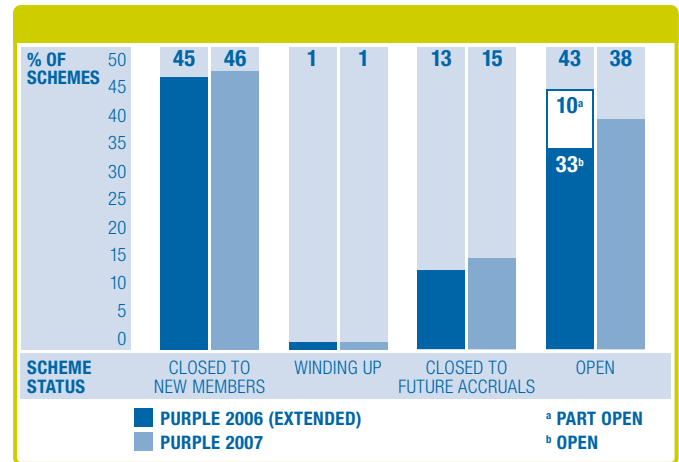
Overall, movements in financial markets mean that the s179 funding position of the Purple 2007 dataset has improved from that which would have existed in 2006. In Purple 2007, as at 30 March 2007:

- The total s179 assets of schemes in the dataset is £725bn (up by 5.2% from a year previously)
- The total s179 liabilities of schemes in the dataset is £672bn (2.4% lower than a year previously)
- This meant that the aggregate funding position of schemes in the dataset rose to a surplus of £52.9bn as at 30 March 2007 from a balance of around £200m surplus as at 31 March 2006.

Scheme status

Purple 2007 shows that 38% of schemes remain open, representing 63% of the memberships, about 4.3m. Meanwhile, 46% of schemes (comprising just over 3.6m memberships) are closed to new members in Purple 2007.

In comparison, the extended Purple 2006 dataset showed 33% of schemes as fully open, and 44% of schemes closed to new members.



Membership

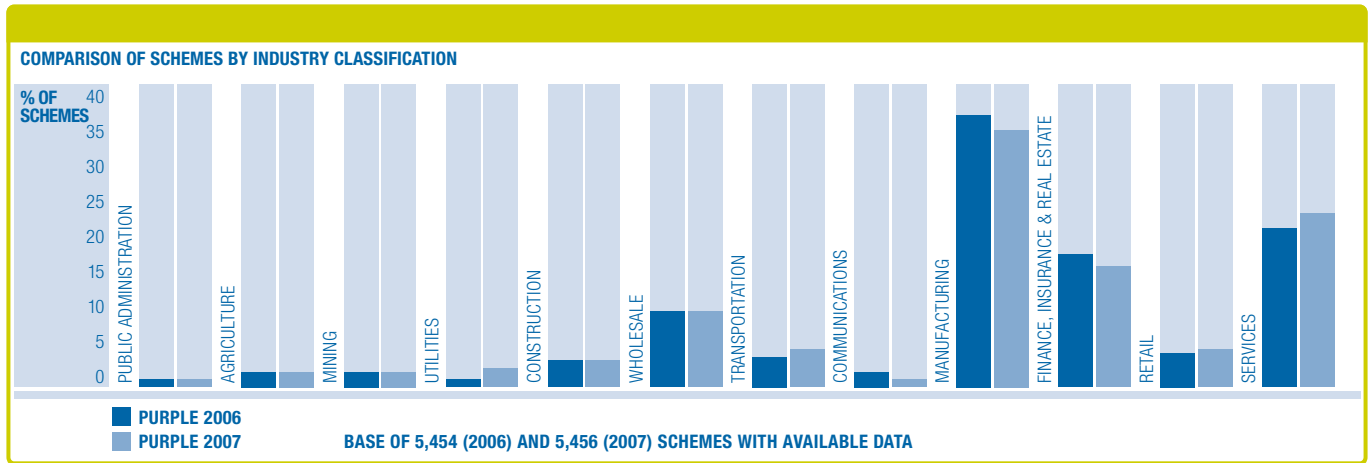
Scheme membership for Purple 2007 totals 10.7m. The largest single group of memberships is 'deferred' (41%).

There are slightly fewer 'active' members in Purple 2007 than in the extended Purple 2006 dataset, 25% (2.7m people) in Purple 2007 compared with 26% (3.6m) in the extended dataset.

Whilst the proportion of 'pensioner' memberships remains the same, 33%, the actual number of memberships has decreased from about 4.7m in the extended 2006 dataset to about 3.6m in Purple 2007.

Scheme distribution

The distribution of schemes in Purple 2007, broken down by industry, is similar to that in the original Purple 2006 dataset.



The history of DB pension provision has led to an overweighting of previously large sectors compared with their current weighting in terms of GDP. For example, in Purple 2007 the manufacturing sector made up 28% of s179 liabilities in the dataset, although it accounts for only 14% of GDP.

Scheme funding

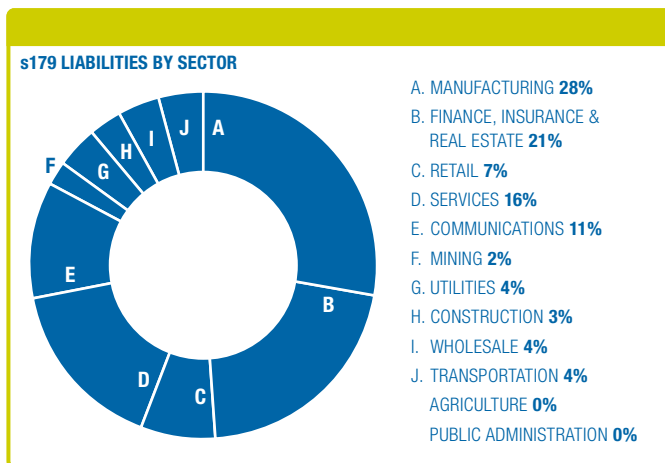
In Purple 2007, schemes with a large number of memberships tend to have higher funding levels. For the same dataset, the same picture would have been seen in 2006.

Schemes where less than 25% of liabilities represent pensions in payment (i.e. less mature schemes) are, on average, in deficit. Funding on a s179 basis tends to improve with scheme maturity.

Comparing the original Purple 2006 dataset to the 2007 dataset, the funding position has improved across all industrial sectors. As stated above, this is primarily due to favourable movements in the financial markets as well as schemes' efforts to improve their own funding.

Notably, schemes with more than 10,000 memberships:

- Account for 63% (£424.6bn) of total liabilities (£672.1bn) as at 30 March 2007
- Have an aggregate surplus of £53.4bn (the balance across all schemes in the Purple 2007 dataset was a surplus of £52.9bn) and;
- Have a weighted average funding level of 113% (the average across all schemes was 108%).



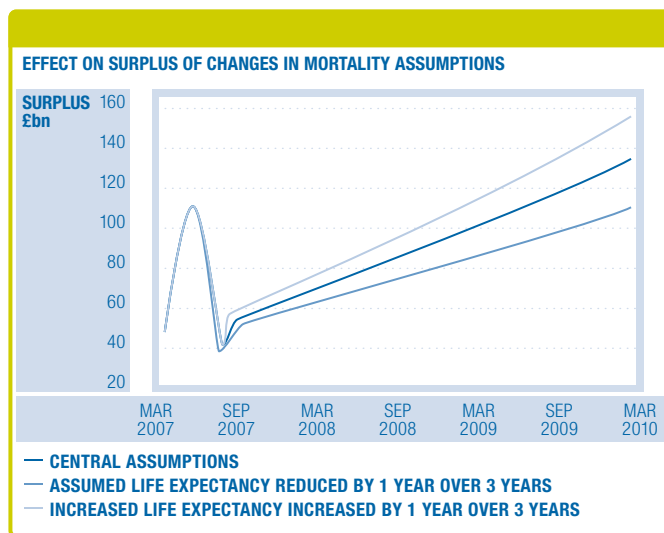
How market conditions affect funding

Changes in market conditions since December 2002 have meant that the funding position of schemes in the Purple 2007 dataset has varied by about £220bn on a PPF basis over this period. The largest deficit occurred in early 2003 (about £113bn) and the largest surplus came about in June 2007 at £107bn.

In terms of how markets conditions can affect scheme funding, a 0.1% increase or reduction in gilt yields can mean a £12bn rise or fall in scheme funding.

Meanwhile, a 2.5% increase or reduction in equity prices can also mean a £12bn rise or fall in funding.

Funding estimates are also very sensitive to changes in the way life expectancy is taken into consideration. Increasing life expectancy by one year over the next three years from 30 March 2007 could reduce the aggregate funding position of the schemes by £22bn.



Reducing deficits

By 4 April 2007, schemes in Purple 2007 had paid £9bn into their funds to reduce their deficits.

This money was paid not only by companies sponsoring the largest schemes but also some 42% of this figure was paid by companies sponsoring schemes with less than 10,000 members

Inflation

Higher inflation also affects funding as higher increases apply to benefits in deferment for non-pensioners, and higher increases apply in payment with respect to post-1997 benefits for both existing and future pensioners. If inflation increases by 0.1%, then the liabilities of schemes in Purple 2007 will increase by £6.5bn on a s179 basis.

Insolvency risk

Both the Pensions Regulator and the PPF use various measures of insolvency in their modelling but the PPF uses Dun & Bradstreet (D&B) to assess the probability of insolvency for the purposes of the levy it raises from industry.

Weighted by scheme liabilities, the average insolvency probability for schemes in Purple 2007 was 0.31%, slightly lower than the 0.38% in Purple 2006.

This figure was lower due to D&B obtaining better data on some companies, as well as a strong economic environment which has led to a steady decline in corporate insolvencies in recent years. While corporate debt in UK has also recently risen, this has not meant more companies going bust.

Asset allocation

In Purple 2007, scheme assets were again predominately invested in equities (60%) and gilts and fixed interest (29%).

Although equities dominate portfolios overall, there is again evidence this year that schemes tend to move to gilts as they mature. In addition, there also appears to be greater preference for fixed income assets (such as corporate bonds and gilts) among larger and well-funded schemes.

While equities dominate portfolios overall, interpreting data on asset allocation can be difficult given that the proportion invested in particular asset classes can be affected by flows between asset types, changes in asset prices (or market conditions), or a combination of the two.

Indeed, Office for National Statistics (ONS) data shows that schemes continued to disinvest in equities during 2006, although strong market performance meant that the share of equities in portfolios stayed fairly steady.

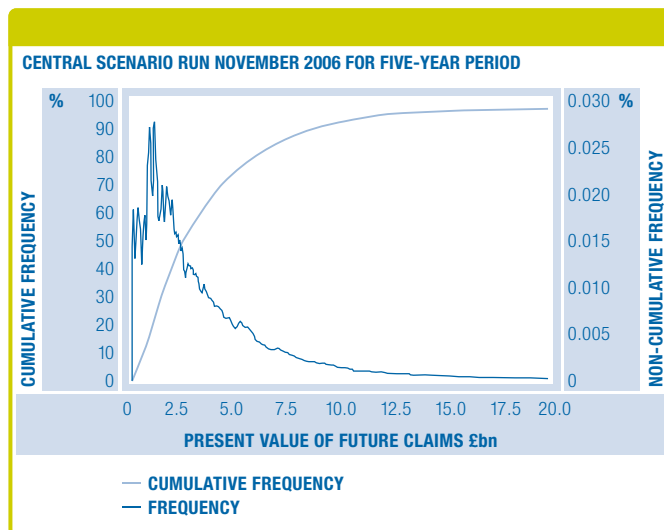
Schemes continued to invest in fixed income and other assets.

Asset class	Proportion of total assets (%) Extended Purple 2006 dataset	Proportion of total assets (%) Purple 2007
Equities	61.1	60.0
Gilts and fixed interest	27.8	28.8
Insurance policies	0.9	0.7
Cash and deposits	2.4	2.4
Property	5.0	5.4
Other investments	2.7	2.7

Long-term and short-term risk

In calculating its levy, the PPF uses its key tool, the Long-Term Risk Model (LTRM). The distribution of the levy amongst schemes is currently based on short-term risk – recent funding and the one-year insolvency probability of its corporate sponsor. The PPF consulted on using long-term risk earlier this year. Such a move would lead to a fairer levy where the distribution of the levy between schemes was a better fit with the distribution of long-term risk.

The graph shows the number of scenarios for each level of first year claim and it can be seen that there are many scenarios that lead to claims at each point in the £200m to £600m range with gradually fewer scenarios at each point at higher levels of claim.



There has been a reduction in short-term combined risk (calculated as scheme funding deficits multiplied by one-year ahead insolvency probability) among the schemes in the Purple 2007 dataset (£158m at end of March 2007 from £258m a year previously), reflecting lower one-year ahead insolvency probabilities and better funding.

A large proportion (25%) of the combined short-term risk as at 30 March 2007 is concentrated among schemes with a high insolvency probability (indeed, those with an average probability of failure of 11%).

The Pension Protection Levy

The PPF is expecting to collect £271m in respect of levy for the 2006–2007 levy year, compared to the target of £575m. Under-collection was largely due to better data (£233m), although market movements and risk reduction strategies also played a role. The PPF expects to collect £271m in total.

Overall levy payments were on average 60% risk-based, and 40% scheme-based.

Of the 7,601 schemes invoiced by September 2007, 310 schemes had their levies capped, and 476 schemes paid no risk-based levy.

The top 100 paying schemes paid 39.1% of the total levy, with the top 10 contributing 15.4%.

The manufacturing sector contributed the most towards the levy (£88.5m), with agricultural production paying the highest levy per member (£25).

Schemes in PPF assessment

There were 179 defined benefit schemes in the PPF's assessment period at end March 2007, with a total membership of 115,000. More than half the schemes in assessment came from manufacturing industry (51%), while 16% came from services.

In aggregate, these schemes have assets of £3.98bn and liabilities of £4.70bn on a s179 basis, with average assets of £22m per scheme and average liabilities of £26m.

Small schemes (fewer than 100 members) make up 35% of the schemes in assessment.

The aggregate funding level (total assets divided by total liabilities) for schemes in assessment is 84.6%, well below the 95% average funding level of the schemes in Purple 2007.

Further information

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