

Pension
Protection
Fund

The Pension Protection Levy

Policy 2008-2009 to 2010-2011

Background

The Pension Protection Fund (PPF) was established by Parliament in the Pensions Act 2004 as a public corporation, much like organisations such as Channel 4.

This means we are independent of Government and have a Board which sets our business strategy and plan.

We exist to pay compensation to people belonging to eligible pension schemes whose employer goes bust without enough assets in the pension scheme to pay PPF levels of compensation.

How we are funded

We are funded through four sources of income:

- taking on the assets of schemes that transfer to us
 - returns on our own investments
 - recoveries of money, and other assets, from insolvent employers of schemes that we take on, and
 - an annual pension protection levy on defined benefit and hybrid pension schemes.
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The levy

We split the pension protection levy into two parts.

1. The scheme-based levy – this represents 20 per cent of what schemes have to pay in total.

This is calculated on the amount they would have to reduce their liabilities to, in order to pay out PPF levels of compensation to their members.

2. The risk-based levy – this represents 80 per cent of what schemes have to pay in total.

This is calculated by working out:

- how much a scheme is underfunded, taking into account actions by employers to reduce their risk through deficit reduction contributions
- how much the employer is at risk of going bust, and
- the contingent assets such as parent or bank guarantees or security over property that have been put in place by the scheme.

We then scale up the levy figures based on the short-term risk to the full amount of the risk-based levy estimate.

Pension Protection Levy 2008-2009 to 2010-2011

Principles

In setting out the way we calculate the levy, we work to three important principles.

- Fairness – we want to ensure schemes pay a levy which reflects the level of long-term risk they pose while providing them with incentives to reduce risk.
- Proportionality – striking the right balance between affordability for pension schemes and security for scheme members.
- Simplicity – applying market solutions to collect the data needed to calculate the levy.

Levy estimate

The levy estimate for 2008-2009 is £675 million – the same as last year.

This is made up of £135 million scheme-based levy and £540 million risk-based levy.

The main difference this year is that this £675 million figure will remain stable for the next three financial years, subject to indexation against earnings and there being no significant changes to the level of risk that we face.

This is a simple, fair and proportionate levy which offers the stability that levy payers have asked for.

The risk-based scaling factor

The scaling factor is a crucial element of the levy calculations as it enables us to distribute the levy proportionately among eligible schemes.

It does this by scaling up levy figures based on short-term risk to the full amount of the risk-based levy estimate.

So that we collect as close to our levy estimate as possible, we need to set the scaling factor based on the best and latest data available.

Based on data from the end of September 2007, we have set an indicative levy scaling factor of 1.6. The final scaling factor will be determined once all scheme information, including probability of insolvency (or failure scores), deficit reduction contributions and contingent asset agreements have been received in April 2008.

Reducing risk

Like any insurance premium, the levy is based on the risk of claims being made on the PPF.

We work out the risk we face by looking at how much schemes are underfunded – which affects the size of a possible claim – and how likely the employer is to go bust.

If schemes can reduce this risk, then they will pay less levy.

Recommendations for 2008-2009 to 2010-2011

The following recommendations were designed to increase stability in the levy and assure certainty for individual scheme members.

1. We have changed the deadlines at which actions taken by pension schemes to improve their funding positions will be taken into account when calculating individual levy bills.

After listening to industry views, we will take into account for the 2009-2010 Levy contingent assets and deficit reduction contributions notified to us by 31 March 2009 and 7 April 2009 respectively.

The measurement date for underfunding and insolvency for the 2009-2010 Levy will be 31 March 2008, as originally proposed.

2. We will raise the funding limits at which schemes pay a reduced levy from 104 per cent to 120 per cent, and at which they pay no levy at all from 125 per cent to 140 per cent.

This serves to reflect the fact that even well-funded schemes pose long-term risk to the PPF – and reduces the amount that weaker schemes cross-subsidise those schemes which are well-funded.

3. To protect the weakest schemes and their sponsoring employers, we cap the amount of levy that schemes pay.

This cap is reviewed every year and, for 2008-2009, all levy payers will pay no more than one per cent of their liabilities, as opposed to the current 1.25 per cent.

This continues to protect the five per cent of the weakest schemes from disproportionately high levy bills.

Risk reduction measures

Employers can make a special contribution to bolster their pension scheme, called a deficit reduction contribution.

You can also tell us of any contingent assets you have put in place to strengthen your pension schemes. These can include:

- a guarantee from a financially stronger company¹ in your business group which will help support you if you get into trouble
- cash, property or securities which will count as assets of the pension scheme if the employer goes bust, and
- securing letters of credit and bank, or insurance company, guarantees¹.

Other steps

- When completing details about your scheme to send to the Pensions Regulator (tPR), please make sure all the necessary information which may affect the size of your levy is included and correct.
 - This year, your scheme information must be uploaded into tPR's Scheme Maintenance website known as Exchange. Where you submit information to both us and tPR, we will always use the information submitted to tPR.

¹ For full details of the asset that will qualify as contingent assets please see our website www.pensionprotectionfund.org.uk

- Previously, we allowed schemes to correct information until after they have received their levy invoices. Schemes should now understand the importance of getting their scheme return information right. Therefore, for 2008-2009 we will not allow any corrections to the scheme return data held by the tPR on 31 March 2008.
 - If you are concerned that any of the information held by the tPR may not be correct (including where you have previously told the PPF about a correction) you will need to upload the correct information on to the Scheme Maintenance website on or before 31 March 2008 (tPR will inform you in due course when you will be given access to the Scheme Maintenance website).
 - Submit your s179 valuation – that is, the value of your scheme based on being able to pay PPF levels of compensation.
 - **IMPORTANT:** Every scheme must, by law, have submitted its first s179 valuation to tPR via the scheme return by 31 March 2008 to ensure schemes' levies are calculated on the best possible information.
 - Make sure that we have the most up-to-date list of participating employers.
 - Check that you have supplied our insolvency risk provider, Dun & Bradstreet, with all the information they need to calculate the risk of the employer going bust.
 - Speak to Dun & Bradstreet about other ways that an employer can reduce the risk of going bust.
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HOW SCHEMES MAY BE AFFECTED BY CHANGES TO FUNDING LIMITS

The funding limits at which schemes pay a reduced levy is raised from 104 per cent to 120 per cent – and at which they pay no levy at all from 125 per cent to 140 per cent.

The following examples demonstrate how these changes may affect schemes.

→ **Example 1 – a scheme which paid no risk-based levy still pays no risk-based levy**

- Scheme A was 128 per cent funded as at 31 October 2006. This means it paid no risk-based levy during 2007-2008.
- The scheme does not change its investment strategy, nor takes any risk reduction measures by 31 October 2007 – the valuation date for the 2008-2009 levy year.
- But market changes mean that scheme is expected to be 141 per cent funded by the valuation date.
- Under the new limits, Scheme A would again pay no risk-based levy.

→ **Example 2 – a scheme which paid a risk-based levy and will now pay no risk-based levy**

- Scheme B was 111 per cent funded as at 31 October 2006. This means it paid a risk-based levy during 2007-2008.
- The scheme does not change its investment strategy BUT does make an additional contribution to its fund which increases scheme assets by 15 per cent.
- This – combined with market movements – means that the scheme is expected to be 141 per cent funded by the valuation date.
- Under the new limits, Scheme B would not pay any risk-based levy during 2008-2009.

→ **Example 3 – a scheme which paid a risk-based levy and will now pay a reduced risk-based levy**

- Scheme C was 100 per cent funded as at 31 October 2006. This means it paid a risk-based levy during 2007-2008.
- The scheme does not change its investment strategy BUT makes an additional contribution which increases scheme assets by 9 per cent.
- This – combined with market movements – means the scheme is expected to be about 120 per cent funded by the 2008-2009 valuation date.
- Under the new limits, Scheme C would pay a risk-based levy BUT it will reduce from approximately 0.0327 per cent of its liabilities to about 0.0042 per cent of its liabilities².

→ **Example 4 – a scheme which paid a risk-based levy and will now pay an increased risk-based levy**

- Scheme D was 104 per cent funded as at 31 October 2006. This means it paid a risk-based levy during 2007-2008.
- The scheme does not change its investment strategy and does not take any risk reduction measures.
- Market changes mean that the scheme is expected to be about 115 per cent funded by the valuation date.
- Under the new limits, Scheme D would pay a risk-based levy – a rise from approximately 0.0065 per cent of its liabilities in 2007-2008 to around 0.0719 per cent of its liabilities in 2008-2009².

2 These figures are based on the scheme having a sponsoring employer with an 'average' insolvency probability, which is assumed not to change between 2007-2008 and 2008-2009.

Pension Protection Fund

Further information

Pension Protection Fund Helpline:

0845 600 2541

Email: information@ppf.gsi.gov.uk

If you want to find out more about how Dun & Bradstreet have calculated your insolvency score then call the Dun & Bradstreet Customer Service Helpline:

0870 850 6209

Email: customerhelp@dnb.com
