

Risk Based Levy

Presented by : Martin Clarke
Association of Consulting Actuaries
20th September 2007

www.pensionprotectionfund.org.uk

It is worth remembering why PPF was established?

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“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 has been achieved?

- **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**

PPF has just completed a nationwide series of roadshows on risk based levy topics:

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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	

PPF is currently consulting on future levy policy

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- **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**

Our consultation also covered some direction setting based on our analysis of risks to PPF

- **Signalled stability in levy quantum at the macro level**
- **Alternative approach to insolvency risk measurement – although early feedback suggests that simplicity is favoured**
- **Opened Long Term Risk Model to public scrutiny**
- **Suggesting separate ‘premiums’ for catastrophe risk exposure**

Key timeline for levy activities

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

The key theme of the levy consultation is stability

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- **Variability in the levy during the initial bedding down of the PPF's processes has been problematic**
- **We have been asked for greater stability, and the ability to predict 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

Our consultation includes proposals to realign dates within our levy process

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STATUS QUO

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

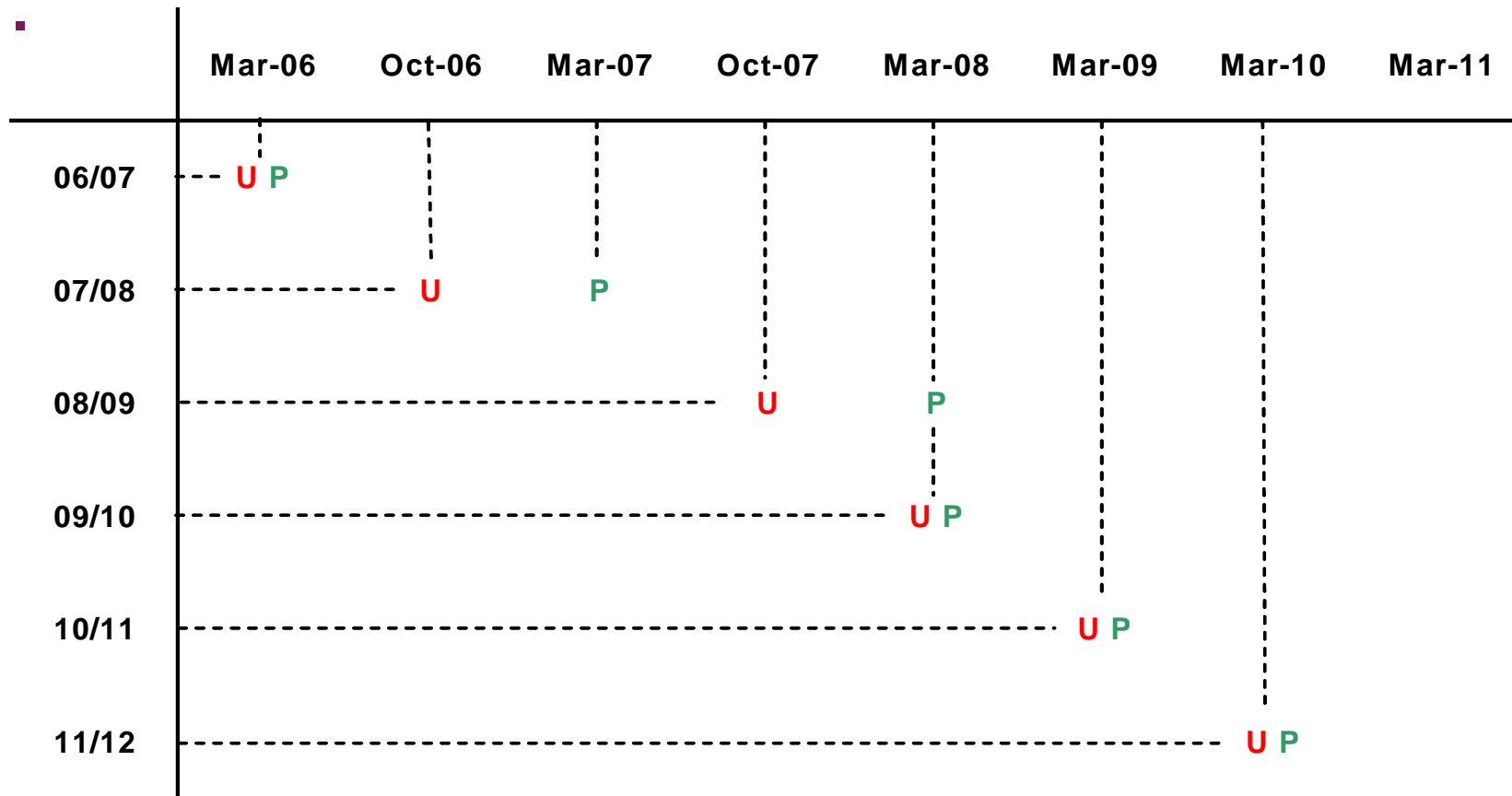
- Earliest schemes can calculate levy – 1 month after commencement of levy year.
- Movement between indicative and final scaling factor possible

OUR AIMS

- (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

Our proposal is to measure all the data at the same time, 12 months in advance of the levy year

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We believe this will aid stability but we must address concerns over adverse impacts

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- **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**
- **Transition arrangements mean next set of data used for two years' levy**

From 2008/09 all eligible schemes will have had to provide their first s179

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- **Statutory deadline for the first s179 - no later than 31 March 2008 (and within 15 months after effective date)**
- **Breach of statutory requirement is a matter for the Pensions Regulator**
- **But we still need to calculate a levy....**
- **... which will thus be based on a roll forward of MFR valuation with an “adjusted “ asset value**

Future funding of PPF is critical to its success and fraught with jeopardy

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- **Changes in 2008/09 and 2009/10 designed to respond to identified stakeholder needs – stability and certainty**
- **“Taper” arrangements under review to preserve fairness and equity in levy distribution**
- **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)**

Our current levy formula is based on “one year” risk

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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 contribution
- reflects likelihood of insolvency in next 12 month period (P)

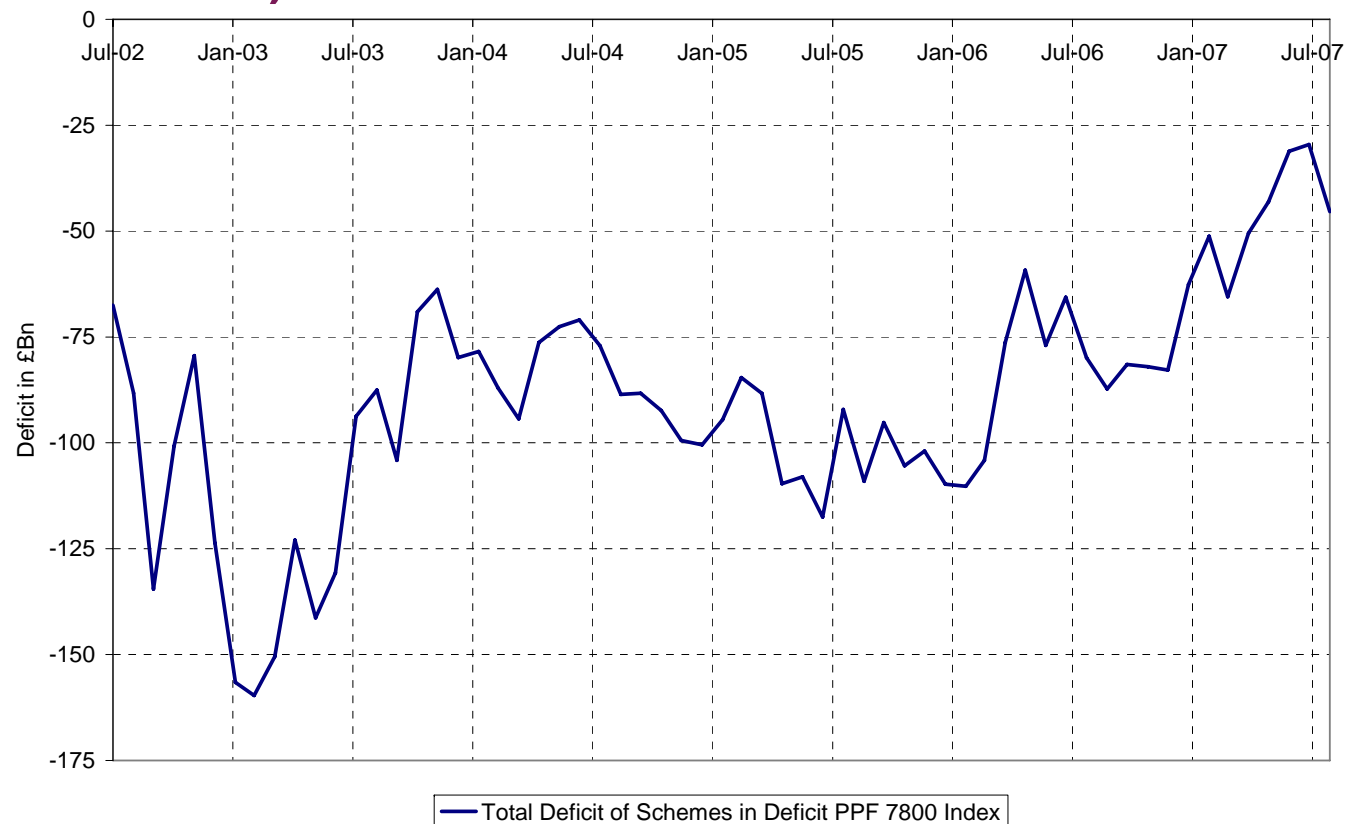
$U \times P$ (Short Term Risk) = approx. expected claim value over 1 year

Long Term risk addressed by application of single scaling factor

Our “PPF 7800” index shows how exposure changes over time

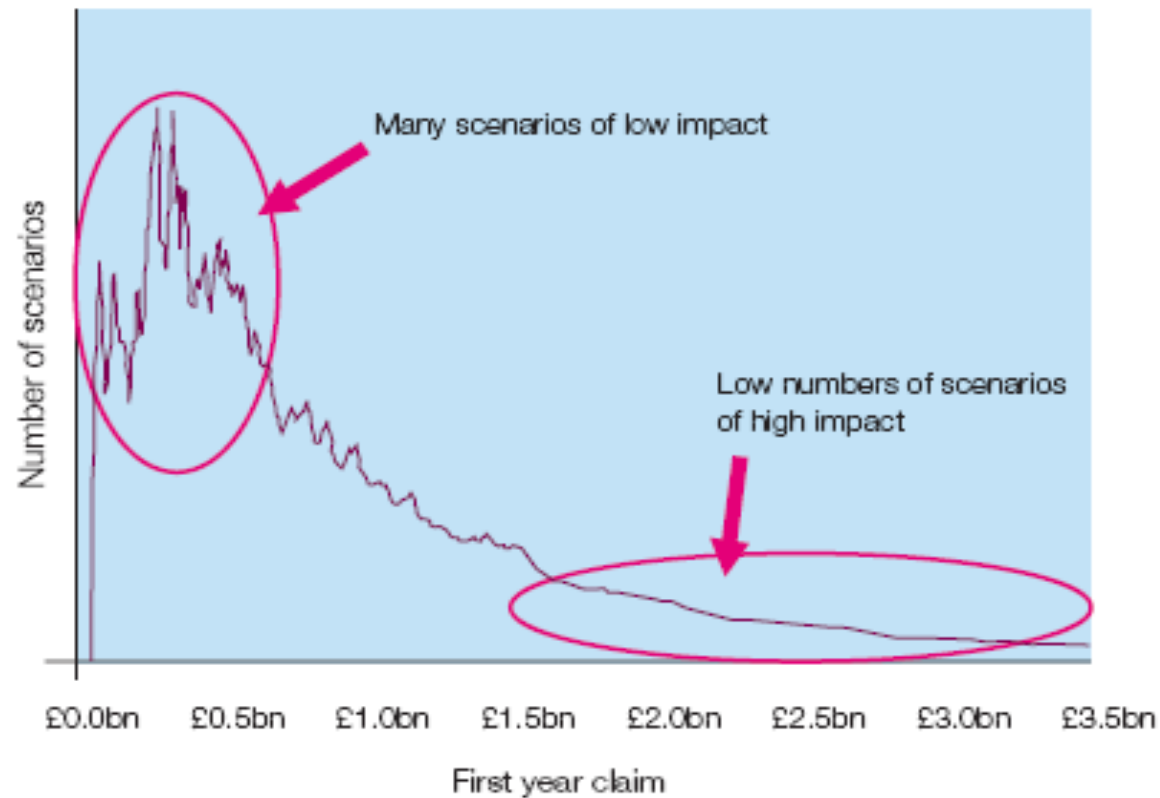
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Aggregate deficits of schemes in deficit (s179 basis)



Our analysis suggests that catastrophe risk still present even after deficits are reduced

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Our emerging hypothesis for a better levy:

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- **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**

Questions?

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