

Technical Briefing

No.19



PPF announces significant increase in Scheme Levies

The Pension Protection Fund ('PPF') has confirmed a significant increase in the levies to be paid by defined-benefit pension schemes for the current financial year (2007/08).

The details are that the multiplier within the Scheme-Based Levy has increased by 14% but, more significantly, the Risk-Based Levy multiplier (the so-called scaling factor) has risen by 366%. In addition, the overall cap on the size of the risk-based levy paid by each scheme to the PPF has increased by 150%. Finally, the Administration Levy collected from pension schemes to cover the running costs of the PPF and the Pensions Regulator has increased this year by 48%.

The PPF has stated that it hopes to recover a total levy (over all schemes) for 2007/08 which is a little more than double the levy which was recovered in 2006/07. Thus schemes might on average expect levies to approximately double but within that individual schemes may face considerably higher and in some instances potentially smaller increases depending on their own circumstances.

Background

Since April 2006, defined-benefit pension schemes pay an annual levy to the PPF to fund deficits in failed pension schemes, part of which is scheme-based and part of which is risk-based (which is subject to an overall limit). The PPF has significantly increased the factors within each part of the levy formula compared to the 2006/07 financial year.

The Risk-Based Levy ('RBL')

The RBL formula links the risk of company insolvency to the likely size of deficit the PPF could then be required to meet.

$$RBL = \frac{Insolvency}{Risk (IR)} \times \frac{Underfunding}{Risk (U)} \times \frac{RBL}{\%age} \times \frac{Scaling}{factor}$$

or $K\% \times \frac{Value\ of\ PPF}{Liabilities}$ if less

where
IR is the probability of employer insolvency
U is 105% of PPF liability value minus asset value
RBL %age is 80%

The PPF has increased the scaling factor from 53% in 2006/07 to 247% for 2007/08. In addition, K% has been increased from 0.5% in 2006/07 to 1.25% in 2007/08.

The Scheme-Based Levy ('SBL')

The SBL formula is much simpler.

$$SBL = Multiplier \times \frac{Value\ of\ PPF}{Liabilities}$$

The PPF has increased the multiplier to 0.016% for 2007/08, up from 0.014% the previous year.





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CPRM Commentary

The PPF over-estimated the total levies it would collect for 2006/07, and received just £324m of the £575m it had expected. This was mainly caused by issues with the initial data, schemes taking action to limit their levy payments and movements in investment markets. The PPF has therefore increased the levy formulae for all schemes in order to collect the £675m it estimates it requires this year. However, it has done this across all pension schemes, regardless of size.

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Taking a deeper look into the levy position it is likely that the actual increase in the levies which schemes face may not be quite as severe as the review of these factors at first suggests.

- The details of the RBL calculation are such that an allowance is made for the extent of any underfunding. Increasing gilt yields, over the year to April 2007, (which underpin this calculation) may well provide a moderate degree of easement to this position. There is potential for the gearing within the calculation for this to significantly offset the potential increase in the RBL calculation.
- Any additional contributions by sponsoring companies or out-performance by scheme assets will also directly reduce underfunding and the RBL.

Arguably if the aggregate levy recovered from last year's levy formulae was £324m and the target for the 2007/08 year is £675m schemes might expect their levies to, on average, increase by a little over 100% (i.e. approximately double). Within that some schemes will have significantly higher increases and some will have lower increases reflecting the details of their funding position, the strength of the sponsoring company, contributions paid, investment returns achieved and other details of their own experience.

However, even allowing for the above, it is likely that schemes will face a significantly higher levy demand for the forthcoming 2007/08 year than they did for the previous year.

If you wish to discuss this Technical Briefing, or the subject matter raised, please contact Walker Yule, Jonathan Black or Philip Wheeler on (0131) 220 8247.

May 2007