Technical Briefing

No. 24

PPF Announces Levy Scaling Factor for Risk Based Scheme Levies from 2008-2009

Summary of PPF Announcement

The Pension Protection Fund (PPF) published its 2008-2009 Levy Determination in February 2008, setting out some significant changes to the rules for calculating the pension protection levy for the coming year. In particular it set out revisions to the calculation basis for the Risk Based Levy ("RBL"). The changes were outlined in our Technical Briefing 23 ("TB23").

The announcement in February did not, however, give a value for the Levy Scaling Factor, stating that it would be announced in May once the data on which the actual calculations will be made had been collected. The Scaling Factor is, in effect, a balancing item to match the formulae to the aggregate target levy of £675m for all UK schemes.

The Scaling Factor was projected in October last year by the Board of the PPF to be an estimated 1.6, compared to 2.47 last year. The announcement made on 30 May 2008, however, set the Levy Scaling Factor for the 2008-2009 levy at 3.77, which is almost 2.5 times the estimated factor.

The result of this announcement is that schemes and sponsors will be subject to a risk based levy in 2009 of almost 2.5 times what they will have estimated they need to reserve to meet their 2008-2009 levy based upon the previous announcements.

Implications of the Changes to RBL Basis

In TB23, we set out how we expected the revised calculation basis to affect a range of schemes. Based upon the estimated Scaling Factor, it was expected that the change in basis would result in what is in effect a rebalancing of the application of the levy. Some schemes (those capped and those who are particularly poorly funded) were expected to end up paying less, whereas those who are relatively well funded were expected to pay a little more.

In reality, the revised Scaling Factor is more likely to have led to an increase in levies for all but the most poorly funded schemes and/or those with the weakest sponsors. The following table compares some sample cases before and after the announcement:

	Case 1	**Case 2**	**Case 3**	**Case 4**
Assets (£m)	50	100	120	150
PPF Liabilities (£m)	120	120	120	120
Funding Level (%)	41.66	83.33	100.00	125.00
Insolvency Risk (%)	1.690	0.905	0.513	0.303
2007–2008 Basis (£k)	1,500 (Capped)	465	60	nil
2008–2009 Basis (1.6 Factor) (£k)	1,200 (Capped)	524	165	3
2008–2009 Basis (3.77 Factor) (£k)	1,200 (Capped)	1,200 (Capped)	389	7

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It is clear from these sample cases that many schemes, and in particular those which are relatively well funded with good (rather than excellent) sponsor covenants, will see their levies for 2008-2009 at significantly higher levels than they had expected. Indeed, many more schemes than before, even with reasonable funding levels and reasonable sponsor covenants, will see their levies rising to the cap level.

The PPF have produced some statistics on the effect of the revised calculations. For example:

- More than half of schemes are expected to pay higher levies than last year, with around 40% expected to pay less.
- 14% of schemes are expected to pay more than double their 2007-2008 levy.
- 6% of schemes are expected to pay levies at the capped level of 1% of liabilities.
- On average, levies will be at around .25% of scheme assets. This takes account, however, of a weighting for the largest schemes with blue chip sponsors.

These statistics, together with various others available on the website: *www.pensionsprotectionfund.gov.uk,* show that there is significant variability in the effects of the new basis depending upon particular scheme circumstances.

Why is the Scaling Factor so much higher than the estimate?

The final Scaling Factor, at 3.77, is significantly higher than the 1.6 estimated by the PPF last October. The PPF have stated that this difference is due to a number of factors:

- Short-term risk has decreased for many schemes, so the PPF say they have needed to scale up individual levies by more to match them to the total levy estimate, which is based on long-term risk to the PPF.
- The published figure takes into account the actual contingent assets ("CAs") and deficit reduction contributions ("DRCs") certified to the PPF. These were **not** built into the indicative Scaling Factor in any way.

cprm Commentary

The announcement of the revised scaling factor on 30 May immediately attracted significant negative comment from the pensions industry, the final figure of over twice the initial estimate coming as something of a surprise to all. Immediate press comment has included a range of angry statements that the PPF is simply adding to the misery of running pension schemes with others accusing them of "sheer incompetence" for "failing to forecast the scaling factor with any degree of accuracy whatsoever".

The PPF have dismissed such comments as "scaremongering" but there is no doubt that, although the body have stated "the levy estimate remains unchanged at £675million so schemes overall pay no more based on the final Scaling Factor than on the provisional one" this entirely misses the point for individual schemes. Based on the announcements to date, schemes and sponsors will have estimated what they need to reserve for next year only to learn now that reserve they hold is less than the half what will be required. The fact that the total levy for all schemes is unchanged is no consolation.

It would seem fair to challenge the PPF on the validity of their previous estimate which, it would seem, totally ignored the potential for CAs and DRCs. The PPF have stated that, between October 2007 and April 2008, approximately 240 new CAs were certified to the PPF and DRCs worth £2.4bn were submitted. This has been a key factor in moving the goalposts. Indeed schemes have made decisions on whether to allocate CAs or make DRCs based on this estimate, only to find their decision process was flawed as a result of the misguiding estimate.

As a result of these changes, it is likely that more and more schemes will seek to take action with CAs and/or DRCs. Trustees and sponsors should be considering options to minimise the potential for future volatility and uncertainty arising from the PPF levy. As experience has grown of the PPF levy, with many schemes being left with significantly higher than expected levies due to the vagaries of the PPF's continual changes, there is more and more focus on building plans to counter an increasing levy liability. This, in turn, means that those schemes who do not fully investigate the options open to them are likely to suffer more as policy develops in the future.

If you have any questions, do not hesitate to contact your usual cprm consultant.