Technical Briefing

No. 36

PPF announces conclusions on the 2010/11 levy

Introduction

The Board of the Pension Protection Fund (PPF) has now issued the final details of the 2010/11 PPF levy. Readers may recall last year's Technical Briefing No. 27 provided details of the methodology and factors for the 2009/10 PPF levy. This year's levy is based on the same methodology as last year but with changes to the factors in order to raise the £720 million levy estimate for 2010/11. The levy estimate has been calculated using indexation in line with average earnings to ensure that it remains stable and affordable to schemes rather than actually reflecting the true level of risk expected to be faced by the PPF.

Technical Briefing No. 27 advised that the PPF levy consists of two components, namely the Scheme-based Levy (SBL) and the Risk-based Levy (RBL);

1. ***SBL*** = Protected Liabilities (***L***) x Scheme-based levy multiplier (***m***)

2. ***RBL*** = Underfunding risk (***U***) x Insolvency risk (***P***) x 80% (***R***) x Levy scaling factor (***c***)

2010/11 Factors

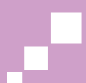
The Scheme-based levy multiplier, **m**, has been set this year at 0.000145 compared to 0.000162 in the previous two years. The Levy scaling factor, (***c***), has been set at 1.64 which is a considerable reduction on the 2.22 figure used last year to reflect the decline in scheme funding seen during 2008/09.

The Protected Liabilities (***L***) will be calculated by the PPF in a prescribed manner based on information submitted on the on-line Exchange system on or before 5pm on 31 March 2009. Similarly, the underfunding risk, (***U***), will be based on the estimate of the assets and liabilities calculated by the PPF on a prescribed manner using the data submitted. The Insolvency risk, (***P***), will be based on the probability of the sponsoring employer defaulting in the next twelve months and has been determined as the D&B Failure Score at 5pm on 31 March 2009. Information submitted after that time will not affect the calculation of the Risk-based Levy.

One significant change, however, is that the overall Risk-based levy is capped at 0.5% of the Protected Liabilities compared to 1.0% of the Protected Liabilities in previous years. The PPF has stated that the reduction in the cap is a short-term measure to help maintain the affordability of the levy for hard-pressed schemes in the current economic climate. However, this effectively means that uncapped schemes will inevitably pay more than would otherwise have been the case. The PPF have also left the levy taper boundaries and the funding level at which no Risk-based Levy applies at the same level as previous years (starting at 120%, increasing to 140%), to maintain consistency and fairness.

So, the 2010/11 PPF levy for each scheme can now be estimated with a reasonable level of accuracy based on the information submitted on the on-line Exchange system, the above confirmed factors and the prescribed methodology used by the PPF.

There are however two main methods available to pension schemes and their sponsors to reduce the 2010/11 Risk-based Levy. This can be done by submitting either an actuarial certificate for deficit



reduction contributions (DRC) or a contingent asset certificate. However, these certificates can only be submitted in specific circumstances as detailed below.

Certificate for DRC

As in previous years, a sponsoring employer can reduce the underfunding risk, (***U***), in a scheme by paying additional contributions into its defined benefit scheme. This in turn would reduce the ***RBL*** that the scheme is liable to pay.

Following receipt of these contributions the Scheme Actuary would be able to submit a certificate to the PPF that would be taken into account in determining the 2010/11 ***RBL***. This certificate must be submitted by **5pm on 9 April in 2010** (in previous years this was 7 April but this year it has been put back due to the Easter bank holidays).

Contingent Asset Certification

Contingent assets do not involve money or assets being transferred to the scheme, but rather affects the value of (***U***) and (***P***) in the ***RBL*** formulae. This is done by guarantees of some form from other parties. The fact that assets are not actually transferred to the scheme is the main advantage for sponsors over deficit reduction contributions. It does, however, restrict the use of those assets.

There are three types of contingent assets:

1. Type A – guarantee from a parent company to the sponsoring employer.
2. Type B – security over assets not belonging to the scheme.
3. Type C – letter of credit or bank guarantee.

More details of these types of contingent asset are covered in Technical Briefing No. 27 which can be found at: http://www.cprmlimited.co.uk/pdf/cprm_technical_briefing_27.pdf.

Please note that certificates submitted for the 2009/10 levy year will need to be renewed if these contingent assets are still appropriate this year. The contingent asset must result from an arrangement which becomes effective no later than 1 April 2010 and any certification or re-certification must be submitted by **5pm on 31 March 2010**.

Qualifying Transfers

Where, before 1 April 2009, a scheme has transferred some of its liabilities for two or more members to another scheme or an insurance company where the value of the assets transferred exceeds one or more of:

1. 5% of the asset value of the transferring scheme as stated in the latest Section 179 valuation before the transfer date.

2. 5% of the asset value of the receiving scheme as stated in the latest Section 179 valuation before the transfer date.

3. £1.5 million,

the PPF will make an appropriate determination of the value of the assets and Protected Liabilities of the transferring and receiving schemes as at 31 March 2009.

Future Proposals

The PPF is currently working on proposals for the future development of the PPF levy which they expect to publish in early 2010 in an effort to more accurately reflect the long-term risk that all levy-paying schemes pose to the PPF. The two key features of the proposals are to assess the probability of a scheme's sponsoring employer going bust during a five year period (as well as separately assessing the probability of it going bust during a one year period, as is the case now) and also take account of the risk that a scheme's investment strategy poses to the PPF when

calculating its individual levy. The new proposals will not come into force until 2012/13 at the earliest.

CPRM Commentary

The 2010/11 PPF levy factors are lower than last year leading, in isolation, to a reduction in the ***RBL*** of approximately 25%. However this is likely to have been offset by falls in world-wide investment markets coupled with lower D&B Failure Scores within the current recessionary environment. On average, most schemes would expect to see a small increase although this is very dependent upon individual scheme circumstances.

Implementing any of the above certificates require submission by the specified deadlines in very specific format. For contingent asset certificates, legal advice will be required, but this could be a viable opportunity for sponsoring employers to reduce the assessed risk to their scheme and hence reduce the PPF levy.

As all of the factors are now known in advance, it is now possible to accurately estimate the levy due for 2010/11 and provide an analysis on how the results would be affected if any of the above options are put in place. Please contact your usual **cprm** adviser if you would like to consider putting in place a deficit reduction contribution certificate or a contingent asset certificate in advance of the respective deadlines.