16 December 2005

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PPF LEVIES COMETH

1 INTRODUCTION

Following its October 2005 update[1], the PPF Board has finally published its proposals for assessing the risk-based levy. (The risk-based levy, which is relevant to all schemes potentially eligible for the PPF[2], will apply from financial year 2006/07.) The final proposals include "incentives to reduce risk, measures to ensure affordability for weaker schemes and refinements".

Any comments on the consultation document should be made by 23 January 2006. A copy can be found at:

http://www.pensionprotectionfund.org.uk/rbl_dec_05.pdf

2 KEY POINTS (RISK-BASED LEVY)

- The *overall* pension protection levy estimate is £575 million (any action taken by employers over the next few months to reduce their risk is expected to affect the figure collected).
- Schemes over 125% funded on a PPF basis will be exempt.
- The number of insolvency bands is to be increased from 10 to 100.
- Contingent assets can count for the 2006/07 calculation.
- The levy will be capped at 0.5% of a scheme's PPF liabilities.

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[1] See our Sackers Extra Alerts: "PPF News – Risk-based Levy" dated 13 July 2005 and "PPF Levy Concessions Announced" dated 14 October 2005

[2] Broadly, defined benefit occupational pension schemes

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3 THE LEVY AMOUNT

With the figure for the overall pension protection levy estimated at £575 million for 2006/07, the PPF Board has confirmed that the risk-based levy will comprise 80% of this total, with the scheme-based levy accounting for the remaining 20% (the legislation requires the risk-based levy to amount to at least 80% of the overall total). In cash terms, this means an estimated levy of £460 million and £115 million respectively.

Given the “wealth of support for the proposed structure for the risk-based levy calculation”, the Board is set to retain its proposal to calculate risk exposure by a combination of underfunding and insolvency risk.

4 THE UNDERFUNDING RISK

The Board has built in “incentives to support fuller funding into the structure of [the] levy, and it [will] now [be] possible for a scheme to pay no risk-based levy at all”. Such incentives include recognising any special contributions paid into the scheme since the last actuarial valuation so as to reduce a section 179 valuation deficit (namely, a deficit on the PPF valuation basis).

The Board expects such contributions to be calculated and certified by the scheme actuary and a form would need to be completed electronically. To receive credit for special contributions “paid into a pension scheme in March 2006, notification…should be made to the [Board] **by 7 April 2006**, for inclusion in the 2006/07 levy calculation”.

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No risk-based levy will be payable by schemes which are over 125% funded on a PPF basis (although the scheme-based levy will still apply[3]). For schemes between 104% and 125% funded on this basis, there will be a stepped approach using the following table:

Pension Protection Fund funding level %	Assumed level of underfunding for levy formula %
104	1.00
Over 104 to 111	0.75
Over 111 to 118	0.50
Over 118 to 125	0.25
Over 125	0.00

If a scheme "is less than or equal to 104% funded, then the underfunding will still be calculated as the difference between 105% of the value of [PPF] liabilities and the value of scheme assets".

5 INSOLVENCY RISK

To measure insolvency risk the Board will be estimating the probability of the sponsoring employer's insolvency over a 12 month period. A banding approach will be established for this with the aim of both mitigating the impact of any short-term volatility in insolvency risk and reducing the effect of discrepancies between assessments made by different credit risk specialists.

In its original consultation paper back in July 2005, the Board stated that it would use 10 bands for this purpose. But, in the light of responses to consultation, it has decided to increase the number of bands it will use to 100 (which will correspond

[3] Not to mention the Administration levy and the possibility at some point in the future of a PPF Ombudsman levy

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with D&B failure scores). Failure scores for the 2006/07 levy will be measured as at 31 March 2006 so the Board "would like to encourage all sponsoring employers to obtain their D&B failure score as soon as possible, so that queries can be raised with D&B before [then]".

In respect of multi-employer schemes, a weighted average probability of insolvency will generally be used. The weighted average "will then be multiplied by a factor to ensure the correct hierarchy of risk is maintained between the various types of multi-employer schemes". The Board believes that schemes with an option or requirement to segregate pose a greater risk to the PPF than those in which the last man standing picks up the tab.

6 CONTINGENT ASSETS

The Board has been considering to what extent reductions may be made in the risk-based levy for schemes holding contingent assets (alternative forms of security). Expressing its support for the development of risk management products, the Board will recognise the following contingent assets given directly to pension schemes in the 2006/07 levy calculation:

- "Contingent assets within a group structure – group company guarantees;
- Contingent assets provided by the sponsor company – security over cash, real estate or securities;
- Contingent assets provided by third parties – letters of credit and bank guarantees".

For each type of contingent asset there will be "certain acceptability criteria to protect the [PPF] and levy payers against enforceability and valuation risks". To be recognised for levy purposes, there will need to be

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standard legal documentation (and certificates). Also, for inclusion in the 2006/07 levy calculation, the Board will need to be notified of the contingent assets held by a scheme **by 31 March 2006**.

The consultation document also refers to the duties and responsibilities which scheme trustees have "that align their position substantially with that of the Board" and, as a consequence, "trustees should exercise discretion in the management and evaluation of contingent assets".

7 THE CAP

So as to help out weaker schemes, "after the application of the levy scaling factor", the risk-based levy will be capped at 0.5% of a scheme's PPF liabilities. The Board believes that a cap "set at this level strikes an appropriate balance between its principles of fairness and proportionality".

8 SECTION 179 VALUATIONS

The Board is to revise its original intention of requiring all schemes to complete a section 179 valuation by 31 December 2006. It will now approach the Department for Work & Pensions seeking new legislation requiring all schemes to submit a section 179 valuation by 31 March 2008.

As mentioned in the October 2005 update, the Board has modified the guidance for completing a section 179 valuation. Actuaries will now be able to roll forward the results of a previous actuarial valuation to enable them to estimate a scheme's section 179 liabilities (this option will also remain for the 2007/08 levy year "for those who do not submit a section 179 valuation by 31 March 2007"). The deadline for sending valuation information to the Board has been extended to 31 March 2006.

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