Pensions Bulletin February 2012

PPF Levies 2012 and beyond

The Pension Protection Fund (PPF) has now published its determination setting out how it will set levies for 2012, which also confirms the new framework for levies for the next three years.

The levy is made up of two parts, the Scheme Based Levy (SBL) and the Risk Based Levy (RBL), calculated as follows:

SBL = The Scheme's PPF ("S179") liabilities x 0.000085

RBL = Stress-tested Underfunding Level x Insolvency Risk x 0.89

The RBL is capped at 0.75% of the Scheme's PPF liabilities.

The idea is that the levy should be more stable for the next three years, varying only according to the Scheme's underfunding level and the company's insolvency risk. The numerical factors in the formulae above will be fixed for a three-year period.

Stress-tested Underfunding Level

The PPF will calculate the underfunding level as previously but will then stress test this to see whether a higher deficit results if assets and liabilities are adjusted to allow for risk.

To carry out the stress test the PPF will adjust the value of the Scheme's assets according to which asset classes the Scheme invests in. Examples of the "stresses" applied by the PPF to some asset classes are shown below:

Asset class	Adjustment
UK Equities	-22%
Overseas Equities	-16%
Gilts	+10%
Index linked gilts	+22%
Corporate bonds	+0%
Property	-6%

Note that if the Scheme Return shows assets held in the "other" category the PPF will apply a -22% adjustment to such assets – so it is important to try to enter full details on the Scheme Return.

The PPF will also adjust a Scheme's liabilities to allow for deemed interest rate risk and inflation risk.

The PPF will then take the Underfunding Level as the higher of the original deficit and the deficit calculated using the assets and liabilities adjusted as above.

A further change in procedure is that the PPF will update the level of a scheme's underfunding reported on Exchange using market indices averaged over a period of five years, to derive an average level of underfunding rather than looking at a snapshot once per year.

The assets used in the calculation of underfunding will include any deficit repair contributions certified before 10 April 2012 and any contingent assets certified by 30 March 2012.

Insolvency Risk

As in previous years a Scheme's Insolvency Risk is determined by the employer's D&B Failure Score. However, going forward the PPF will use an average insolvency risk score over a 12-month period ending 30 March rather than looking at only the failure score on a given date in the year.

The following table shows how the smoothed D&B Failure Score will translate into "insolvency risk" for use in the formula to calculate the risk-based levy:

Band	D&B Failure Score	Insolvency Risk
1	99-100	0.18%
2	96-98	0.28%
3	92-95	0.44%
4	87-91	0.69%
5	73-86	1.10%
6	66-72	1.60%
7	46-65	2.01%
8	38-45	2.60%
9	30-37	3.06%
10	1-29	4.00%

For a scheme where there is a guarantee by a related company, the Failure Score of the guarantor will be used to determine Insolvency Risk.

Key Deadlines

Key deadlines relating to the 2012/13 levy are:

Certification	Deadline
Contingent assets	30 March 2012
Deficit repair contributions	10 April 2012
Block transfers	29 June 2012

Who is likely to be affected by the change in levy formula?

According to the PPF's analysis:

- Well-funded schemes will generally pay lower levies (all other things being equal).
- Schemes with weaker employers will see a reduction in their levy, but many stronger employers are expected to have to pay more.
- Poorly funded schemes, even where the employer is strong, will pay higher levies.
- Most schemes should find the new structure delivers greater stability.

The general theme of the new structure is that the levies should reflect a scheme's funding position and investment risk to a greater extent than currently, with less importance being placed on the company's Failure Score. Strong employers with poorly funded schemes are given an "incentive" to fund the scheme to a higher level.

How can you reduce your levy?

There are a number of steps that can be taken to reduce the PPF levy, for example:

- Make sure the Scheme Return contains the right information on the Scheme's asset allocation.
- Ensure D&B holds the right data on the sponsoring employer.
- Understand the company's insolvency risk and appeal if you believe it is wrong.
- Examine ways to improve your D&B rating.
- Improve funding and ensure deficit reduction contributions are certified within the required deadlines.
- Review the investment strategy, as from 2012 the underfunding risk will be calculated with reference to actual investment strategy.
- Consider undertaking an out of cycle PPF valuation if the circumstances of the Scheme have changed significantly.
- Improve the security of the scheme with a third party guarantee or contingent assets.

If you would like to discuss any aspects of this bulletin or have any other pension related query please get in touch.