

## **PPF Levies 2009-10 and Beyond**

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### **Background**

The Pension Protection Fund (PPF) published its final determination on the calculation of levies for 2009-10 in November 2008. The Board of the PPF has proposed that total levies raised for 2009-10 will amount to £700m, based on the target for 2008-09 increased in line with earnings. The proposed levy, as before, will be split 20% (£140m) in respect of the 'scheme based' element and 80% (£560m) in respect of the 'risk based' element of the levy.

### **Scheme based levy**

The scheme based levy is calculated as **value of PPF liabilities x scheme multiplier**. The PPF has confirmed a **scheme multiplier** of 0.0162% for 2009-10, compared with 0.0165% for 2008-09.

### **Risk based levy**

The risk based levy is calculated as **underfunding risk x insolvency probability x 80% x scaling factor**. The PPF has confirmed a **scaling factor** of 2.22 for 2009-10, compared to the 3.77 factor used for 2008-09.

The **underfunding risk** for 2009-10 remains as **121% of the value of PPF liabilities less the value of assets** (including any relevant contingent assets and deficit reduction contributions), but assessed as at 31 March 2008. The **insolvency probability** for 2009-10 is again determined by the participating employers' failure scores as allocated by Dun & Bradstreet (D&B) at 31 March 2008. However, contingent asset certificates and deficit reduction certificates will be accepted up until 31 March 2009 and 7 April 2009 respectively for the 2009-10 levy.

The risk based levy is again capped at 1% of the value of PPF liabilities and will be nil for schemes funded above 140% of the value of PPF liabilities.

### **Actions to take to reduce your levies**

The PPF has previously highlighted a number of ways to reduce your levy.

1. Use a Type A contingent asset – group company guarantee
2. Use a Type B contingent asset – security over assets
3. Use a Type C contingent asset – letter of credit or bank guarantee
4. Submit a Deficit Reduction Contribution Certificate
5. Submit up to date Scheme Return information
6. Submit a revised Section 179 valuation
7. Update the list of participating companies
8. Monitor D&B failure score(s)

Contingent asset arrangements are only valid for one levy year and therefore any existing arrangements will have to be re-submitted for the levy year 2009-10. New contingent asset arrangements can be complex and time consuming to agree and put in place and so Trustees and sponsoring employers should start to progress these discussions with their lawyers as early as possible.

As the 2009-10 levy will be based on D&B failure score(s) as at 31 March 2008, any steps taken to improve failure scores will not affect the 2009-10 levy. However, as the 2010-11 levy will be based on failure scores at 31 March 2009, there is still some time to take action to reduce the 2010-11 levy.

### **Future development of the levy**

The PPF has issued a consultation document on the future development of the PPF levy from 2011-12 onwards. The proposed new elements of the levy formula are an investment risk measure and a five-year insolvency risk factor.

The aim of the proposals is to distribute levy costs more fairly between schemes with an increase in levies payable by stronger employers/better funded schemes but a reduction for other schemes.

### **Proposed new formula**

The proposed new formula for calculating the risk based element of the levy aims to take account of the risk associated with scheme-specific investment strategy. There are two components to the calculation:

- 1-year underfunding measure x 1-year probability of insolvency x 'rate' for short-term risk
- 5-year underfunding measure x 5-year probability of insolvency x 'rate' for longer-term risk

The 1-year probability of insolvency is derived from D&B failure scores, as currently, and the 5-year probability of insolvency is taken from a PPF table converting the 1-year probability to a 5-year probability.

The underfunding measures are calculated by comparing liabilities with assets, where the assets are reduced based on the investment risk.

The 'rates' are scaling factors that will be adjusted by the PPF each year in order to collect the desired total amount of levy.

Investment risk will be assessed by comparing the actual investment strategy with a notional matching strategy.

### **Impact on levies**

The PPF's own analysis indicates that levies will increase where the scheme is well funded and/or the employer has a good credit rating. Smaller scheme with weaker employers stand to gain from the changes.

Assuming the same total levy is collected, the PPF expects half of eligible schemes to see an increase in levies under the revised approach, with 11% seeing their levy double. However, the proportion of schemes paying a levy of more than 0.5% of liabilities would drop by more than a third and 70% of schemes would pay annual levies of between 0.04% and 0.5% of their liabilities.

The consultation ends in February 2009, with final proposals expected to be published in late spring 2009.

The information in this note should not be relied upon or taken as an authoritative statement of the law.