

PPF Levies 2010-11 and Beyond

Background

The Pension Protection Fund (PPF) published its final determination on the calculation of levies for 2010-11 in December 2009. The Board of the PPF has proposed that total levies raised for 2010-11 will amount to £720m, based on the target for 2009-10 increased in line with earnings. The proposed levy, as before, will be split 20% (£144m) in respect of the 'scheme based' element and 80% (£576m) 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 0.0145% for 2010-11, compared with 0.0162% for 2009-10.

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 1.64 for 2010-11, compared to the 2.22 factor used for 2009-10.

The **underfunding risk** for 2010-11 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 2009. The **insolvency probability** for 2010-11 is determined by the participating employers' failure scores as allocated by Dun & Bradstreet (D&B) at 31 March 2009. However, contingent asset certificates and deficit reduction certificates will be accepted up until 31 March 2010 and 9 April 2010 respectively for the 2010-11 levy.

The risk based levy is capped at 0.5% of the value of PPF liabilities (reduced from 1% in 2009-10) and will be nil for schemes funded above 140% of the value of PPF liabilities. The PPF has estimated that the reduction in the cap on the risk based levy will impact on the most vulnerable 10% of schemes, an increase from the 5% of schemes affected under the previous 1% cap.

Actions to take to reduce levies

The PPF has highlighted a number of ways to potentially 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. Update factors impacting on 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 2010-11. 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 2010-11 levy will be based on D&B failure score(s) as at 31 March 2009, any steps taken now to improve failure scores will not reduce the 2010-11 levy. However, as the 2011-12 levy will be based on failure scores at 31 March 2010, there is still some time to take action that will impact on the 2011-12 levy.

Changes to insolvency risk measurement

The PPF has published its finalised policy statement on how the insolvency risk of sponsoring employers of pension schemes will be assessed for the 2011-12 levy year and beyond. The new policy confirms the changes previously proposed as a result of a review of the methodology and insolvency probabilities carried out by D&B.

D&B will continue to assess the risk of corporate failure by analysing five main areas as follows

- Demographics – including line of business, location and business age
- Financials – values and ratios
- Principals – how many, their age, experience and associations
- Negative public information – such as county court judgements, mortgages and charges and legal events
- Payments to suppliers compared with agreed terms

However, D&B have made the following changes to its failure score methodology

- A new Economic Index has been developed to ensure that specific industry risk is better reflected in their scores
- More regular updates will be made to the Economic Index
- Increased use of interim accounts for publicly quoted companies
- Greater weight given to certain trade and financial elements, such as levels of indebtedness and changes in payment behaviour.

The PPF has published a new table of assumed probabilities of insolvency to accompany the statement, which will be used for the 2011-12 levy, but based on failure scores as at 31 March 2010.

Future development of the levy

In July 2009, the PPF announced that it will look again at its proposals for reform of the PPF levy. The PPF had consulted in November 2008 on proposals to take account of scheme-specific investment strategy and a five-year insolvency risk factor in the risk-based levy calculation. However, concerns raised by the pensions industry during the consultation process prompted the PPF to review its plans. A group of senior industry stakeholders will be established to oversee development of the new policy, supported by a second group of technical experts. Revised proposals for consultation are now expected in early 2010, but the PPF has indicated that the new system will not be introduced before 2012-13 at the earliest.

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

