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# Pension Scheme Termination – PPF and Wind-Up

How to calculate PPF Compensation

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# Agenda

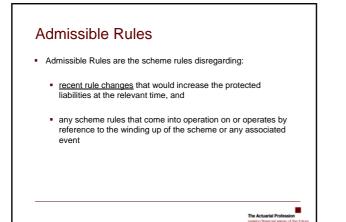
- Admissible Rules
- What is Compensation?
- Compensation Levels
- Compensation Cap
- Worked examples

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## Agenda Worked examples

- 1. Compensation Cap
- 2. Tranches
- 3. Determining the deferred pension to value as part of a s143 valuation
- 4. Compensation where a pension is already in payment
- 5. Compensation where a pension (not yet in payment) is subject to multiple tranches





# Admissible Rules Recent rule changes

Recent rule changes means:

- Changes to the scheme rules which took effect or were made in the period of three years prior to the assessment date, and
- Any scheme rules that operate by reference to an insolvency event in relation to the employer or any prescribed event relating to the future of the employer as a going concern

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## Admissible Rules

- Further guidance and examples are provided on the PPF website
- http://www.pensionprotectionfund.org.uk/financial\_management\_-\_appendix.pdf



## What is Compensation?

#### Relevant legislation

- Schedule 7 of Pensions Act 2004
- The Pension Protection Fund (Compensation) Regulations (2005 No. 670)
- Amending regulations as appropriate

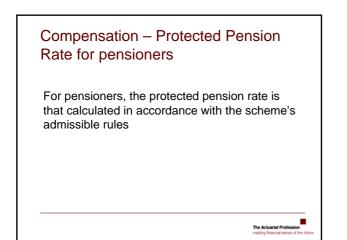
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# What is Compensation?

Compensation can be reduced:

- Revaluation and indexation can be reduced by the Board.
- Levels of compensation can be reduced by the Secretary of State on the recommendation of the Pension Protection Fund.

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# Compensation – Protected Pension Rate for postponed pensioners

For postponed pension scheme members, the protected pension rate is that calculated in accordance with the scheme's admissible rules as though postponement had ceased immediately before the assessment date

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## Compensation – Protected Pension Rate for deferred pensioners

For deferred pensioners, the Protected Pension Rate is the deferred pension at exit in accordance with the scheme's admissible rules; plus revaluations

- from exit to the assessment date, and then
- from the assessment date to Normal Pension Age



## Compensation – Protected Notional Pension for active members under NPA

 Notional pension rate for all active members = Accrual rate \* Pensionable Earnings \* Pensionable service (excluding pension credit service);
 plus revaluations from the assessment date to

Normal Pension Age



## **Definition – Normal Pension Age**

It is the earliest age from which members can retire from the scheme without consent or reduction (see paragraph 34 of Schedule 7).

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## Definition - Indexation & Revaluation

Indexation

Compensation increases only apply to compensation accrued after 5 April 97 service entitlements. They take place on 1 January. The amount of the increase is the increase in the RPI to the preceding 31 May, capped at 2.5%.

Revaluation

Deferred member's benefits are revalued at the lower of the RPI increase between assessment date and date of retirement and 5% p.a. over the same period.

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# Compensation Levels – 100% payment level

- Who are eligible to receive Compensation equivalent to 100% of their pension as at the assessment date?
  - Those who are over their scheme's normal pension age as at the assessment date.
  - Those who are under the scheme normal pension age and in receipt of an ill-health pension as at the assessment date.
  - Those who are in receipt of a survivor's pension.

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# Compensation Levels – 90% Payment Level

- Who are eligible to receive Compensation equivalent to 90% of their pension as at the assessment date?
  - Those who are under their scheme's normal pension age as at the assessment date; and not in receipt of an ill-health pension or survivor's pension as at the assessment date.
- Compensation for these members is subject to the compensation cap before the application of the 90% factor.

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# **Definition - Compensation Cap**

What is it?

- The Compensation Cap is an upper limit to the amount of Compensation that can be paid to a member before the application of the 90% compensation payment level.
- The Compensation Cap is age-related and subject to actuarial adjustment factors if the pension scheme member is above/below age 65.
- The Compensation Cap at age 65 is set annually by order of the Secretary of State.

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## **Compensation Cap**

- When does it apply?
  - · At the point at which the Compensation comes into payment; or If the Compensation was already in payment – at the assessment date.

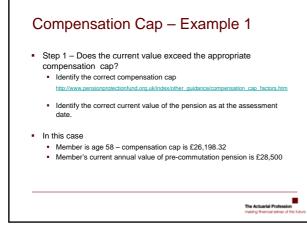
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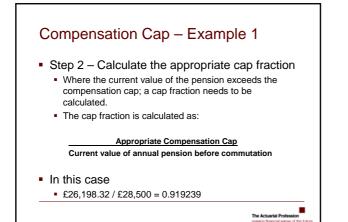
# Compensation Cap - Example 1

#### Scenario

- Assessment date is 1 October 2007
- Member is age 58 and took early retirement
- The current value of the annual rate of pension before commutation as at the assessment date =  $\pounds 28,500$
- The current value of the annual rate of pension after commutation as at the assessment date = £21,500

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# Compensation Cap – Example 1

 $\label{eq:steps} \begin{array}{l} \mbox{Step 3}-\mbox{Apply the cap fraction} \\ \mbox{The cap fraction should be applied to the annual rate of pension that is in } \\ \mbox{payment} \end{array}$ 

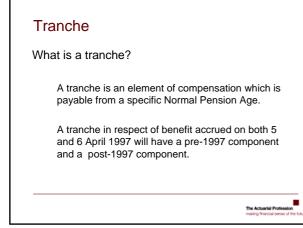
In this case 0.919239 \* £21,500 = £19,763.64

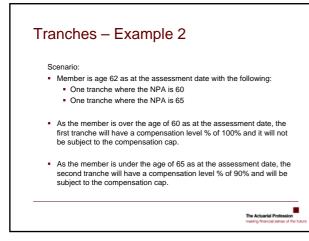
Step 4 – Apply the 90% Compensation Payment Level % The benefit after the application of the compensation cap should be reduced to 90%.

In this case

0.9 \* £19,763.64 = £17,787.28

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### Example 3 – deferred pensioner calculation for a s143 valuation

Note that this example is taken from PPF website - 'Section 143 FAQs' http://www.pensionprotectionfund.org.uk/index/faqs/section\_143\_f

aqs.htm

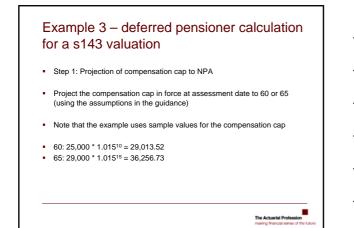
#### Scenario

- The member is aged 50 at assessment date (with 2 tranches of benefit).
- Suppose the revalued scheme benefit at assessment date is (shown on next slide)

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Benefits at assessment date				
Tranche	Pre or post 97	NPA	Benefit (£ p.a.)	
Tranche A	Pre97	60	20,000	
Tranche B	Pre97	65	8,000	
Tranche B	Post 97	65	15,000	

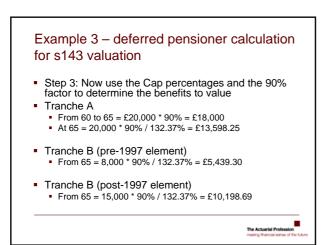
# Example 3 – deferred pensioner calculation



# Example 3 – deferred pensioner calculation for s143 valuation

- Step 2: Calculate the % of cap used at each NPA
- % cap used at 60 = 20,000 / 29,013.52 = 68.93%
- % cap used at 65 = 68.93% + (8,000 + 15,000) / 36,256.73
   = 132.37%

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# Example 4 – pensioner calculation for compensation

- Scheme Scenario
- XYZ Plc has entered the assessment period. The assessment date is 1/5/07. The scheme has a normal retirement age of 63.
- The scheme equalised on 1/1/94.
  Prior to 1/1/94 men could retire at 65
- Prior to 1/1/94 men could retire at 65 and women at 60.
  Members can retire unreduced from 60 with trustees and employer
- Members can retire unreduced from 60 with trustees and employer consent.
   Scheme's normal pension age for PPE purposes is 65–63 or 60
- Scheme's normal pension age for PPF purposes is 65, 63 or 60
   The NPA 63 tranche is actually split into two elements (pre97 and post97 not considered here)

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# Example 4 – pensioner calculation for compensation

- Member Scenario
- Mr Smith early retired on 31/8/04 taking cash and a reduced pension.
- His date of birth is 31/3/46
- His pension is currently £33,500 pa
- His full pension (i.e. pre-commutation) is currently £42,500 p.a.
- The tranches are shown in the next slide
- What is his initial level of compensation at assessment date?

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Split of benefit into tranches			
NPA	Pension of £33,500	Pension of £42,500	
65	£3,500	£6,250	
60	£3,000	£6,000	
63	£27,000	£30,000	

# Example 4 – pensioner calculation for compensation

- At assessment date member's age last birthday is 61
- Compensation cap for age 61 last birthday is £27,601.62
- Benefits subject to cap = £6,250 + £30,000
- Cap fraction = 27,601.62 / 36,250 = 76.14%
- Apply cap fraction and 90% limit to appropriate tranches (of actual benefit)
  - Tranche 65: 3,500 \* 76.14% \* 90% = £2,398.41
  - Tranche 60: £3,000
  - Tranche 63: 27,000 \* 76.14% \* 90% = £18,502.02
  - Total: £23,900.43

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# Example 5 – Multiple tranches Pension scheme member entitled to tranches of pension and lump sum at ages 60 and 65 At age 60 Periodic pension = £12,000 Lump sum = £36,000 Actuarial commutation factor, say = 18 Compensation cap, say £20,800

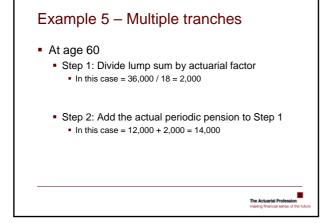
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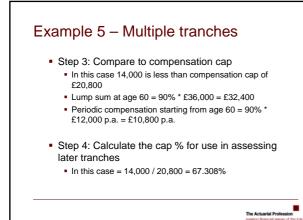
# Example 5 – Multiple tranches

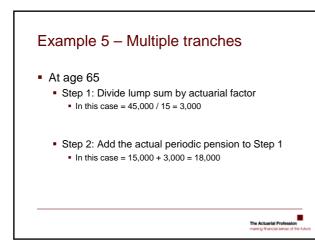
At age 65

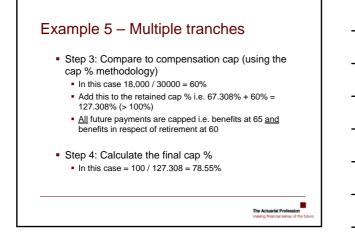
- Periodic pension = £15,000
- Lump sum = £45,000
- Actuarial commutation factor, say = 15
- Compensation cap, say £30,000











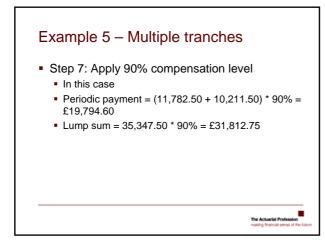
# Example 5 – Multiple tranches

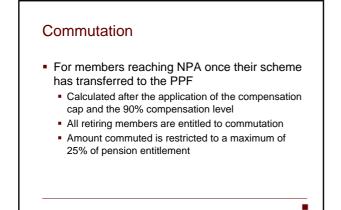
- Step 5: Periodic pension
  - In this case
  - Periodic pension (65) = 15,000 \* 78.55% = £11,782.50
    Periodic pension (60) = 13,000 \* 78.55% = £10,211.50
  - [suppose £12,000 p.a. at age 60 has increased with indexation to £13,000 p.a. at age 65]

#### Step 6: Lump sum (65)

In this case = 45,000 \* 78.55% = £35,347.50







## Commutation

- Trivial commutation
  - Governed by the Finance Act 2004
  - Value of PPF compensation and pension rights on the nominated date do not exceed 1% of Lifetime Allowance
  - No trivial commutation has previously been paid
    Extinguishes the member's entitlement to PPF
  - Extinguishes the member's entitlement to r compensation



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# Compensation for survivor's benefits

- Compensation is payable to spouses and financially dependent unmarried partners where there is a provision under the admissible rules
- Entitlement for surviving spouse and unmarried partners is 50% of member's period compensation at date of death
- Compensation is payable to member's surviving children until they reach age 18 (25 in specific circumstances)
- Entitlement of 25% of member's period compensation at date of death for first child, rising to 50% for two or more children

