Pension Protection Fund

Charting a Course for the Future: PPF Funding Strategy and the Levy

Overview – PPF at 5 years

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- Manage portfolio of £5bn, with 50,000 members transferred in and £200m compensation paid out.
- Time to reflect on experience
  - Strategic framework (April 2010) set out new vision, mission and strategic objectives.
  - Funding Strategy (August 2010) establishes long-term target of self-sufficiency by 2030.
  - Consultation for New Levy Framework published 7 October.
  - 2009/10 Annual Report and Accounts.

2009/10 Annual Report and Accounts: Highlights

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- Annual report for 2009/10 shows improved funding over 2008/09 (£1.2bn deficit).
- Strong investment performance and fewer claims than in 2008/09.
- Demonstrates PPF's sustainability.
- While short-term balance sheet positions are important measures of our strength, PPF's role is not a short-term undertaking: we have set our sights on the years and decades ahead.

The PPF Long-Term Funding Strategy

An explanation

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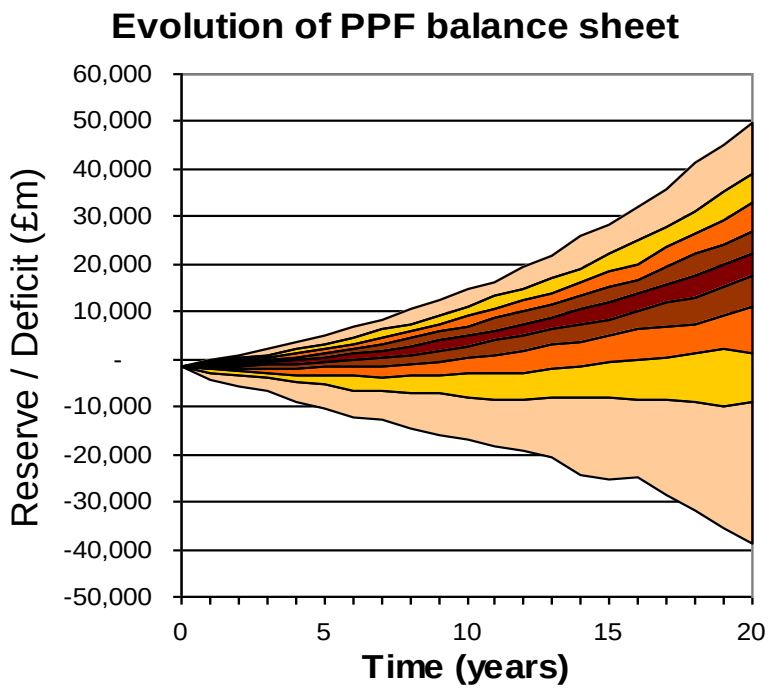
- The PPF has considered long-term risk since inception
- *PPF Long-Term Funding Strategy* published in August 2010
- We expect risk to decline significantly over the next 20 years:
  - Size of the insured population
  - Scheme de-risking
  - Liability duration
- PPF must reinforce balance sheet as scope for levy recedes
- Our funding objective is '**self-sufficiency**' by 2030:
  - Zero market risk
  - Zero interest rate and inflation exposure
  - Reserve (10% of liabilities) to hedge future claims and longevity risk

How we use the strategy…

Tracking progress towards the funding objective

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- Using our Long-Term Risk Model (LTRM), we can estimate our probability of meeting this funding objective
- Projections at 31 March suggest a probability of **83 per cent**
- The Board has expressed a desire to maintain a probability of at least 80 per cent
- But: projections also suggest a one-in-ten chance of PPF developing a deficit of more than £14 billion



How we use the strategy…

Guiding Policy: Levy and Investment

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Levy

- Increased risk (e.g. worsening funding, increased likelihood of claims) will be reflected in lower 'probability of success'
- May result in Board opting to increase levy (and vice versa)
- Long-term view enables **smoother levy path**

Other levers

- Better able to judge if, when and how to deploy

Investment

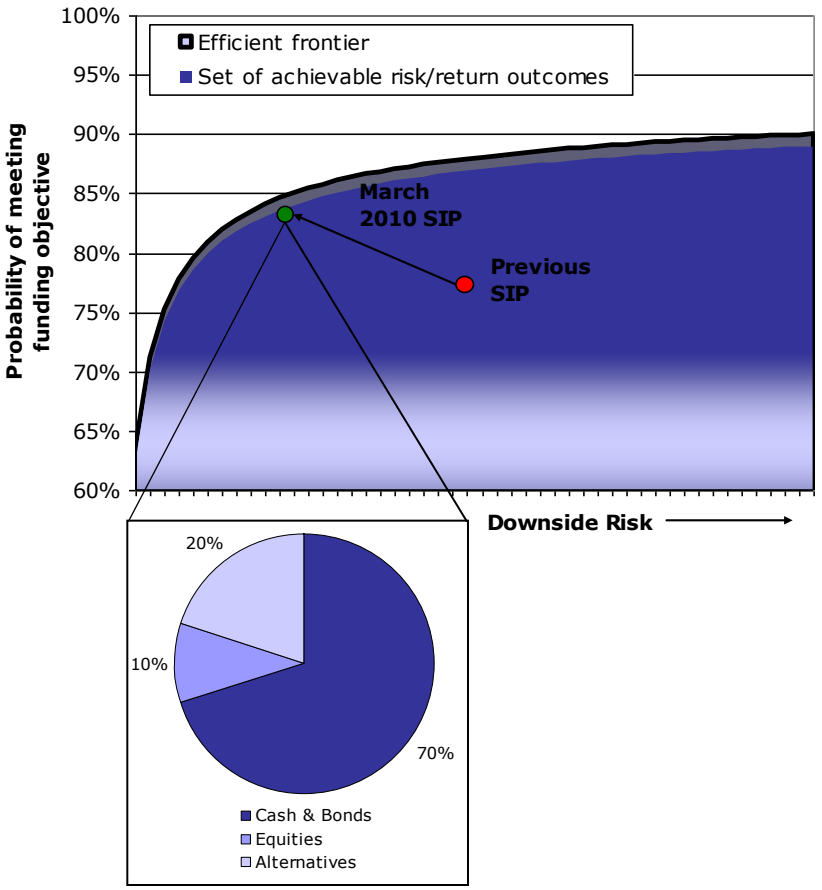
- New investment strategy adopted in March 2010
- Approach selected to **maximise 'probability of success'** while minimising risk of a large loss

How we use the strategy…

Enhancing our investment strategy

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- Portfolio optimisation exercise for **2010 SIP**
- **Efficient frontier** generated from 1.8m competing allocations
- **Diversification** improves expected return (LIBOR + 1.8%) within risk budget
- Targeting exposure to **alternative assets** (infrastructure, private equity)



Highlights of the 2011/12 Levy Consultation

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Consultation period to 4 November.

- Levy estimate of £600m

Needed to adjust levy parameters to achieve fair distribution

- Taper shift so it applies from 135 per cent - 155 per cent funded
- Risk-based levy cap at 0.75 per cent of liabilities
- Changes to insolvency risk policy (consulted on in 2009)

Why change?

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Worked with Steering Group of industry experts

- Feedback from Steering Group published March 2010

Messages from the Steering Group

- Wanted more predictability in individual bills - bills should respond to changes in the scheme's risk, not others' risk
- Stability of levy bills also a priority – so schemes would be less likely to experience large changes between years.
- Levy should focus more on things schemes can actually control:
  - Funding position
  - Potentially investment strategy
- More transparency on cross-subsidy
- Stronger link to commercial charging – market consistency

Key Features of New Framework

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Bottom-up approach

- Fixed scaling factor for three years, only adjusted in limited circumstances
- Total levy not set – will be sum of individual levies
- More predictable levy bills

New approach to how insolvency and underfunding risks measured

- Changes smoothed by using average values
- Market-consistent rates for insolvency

Analysis of Stability – Aggregate Levy

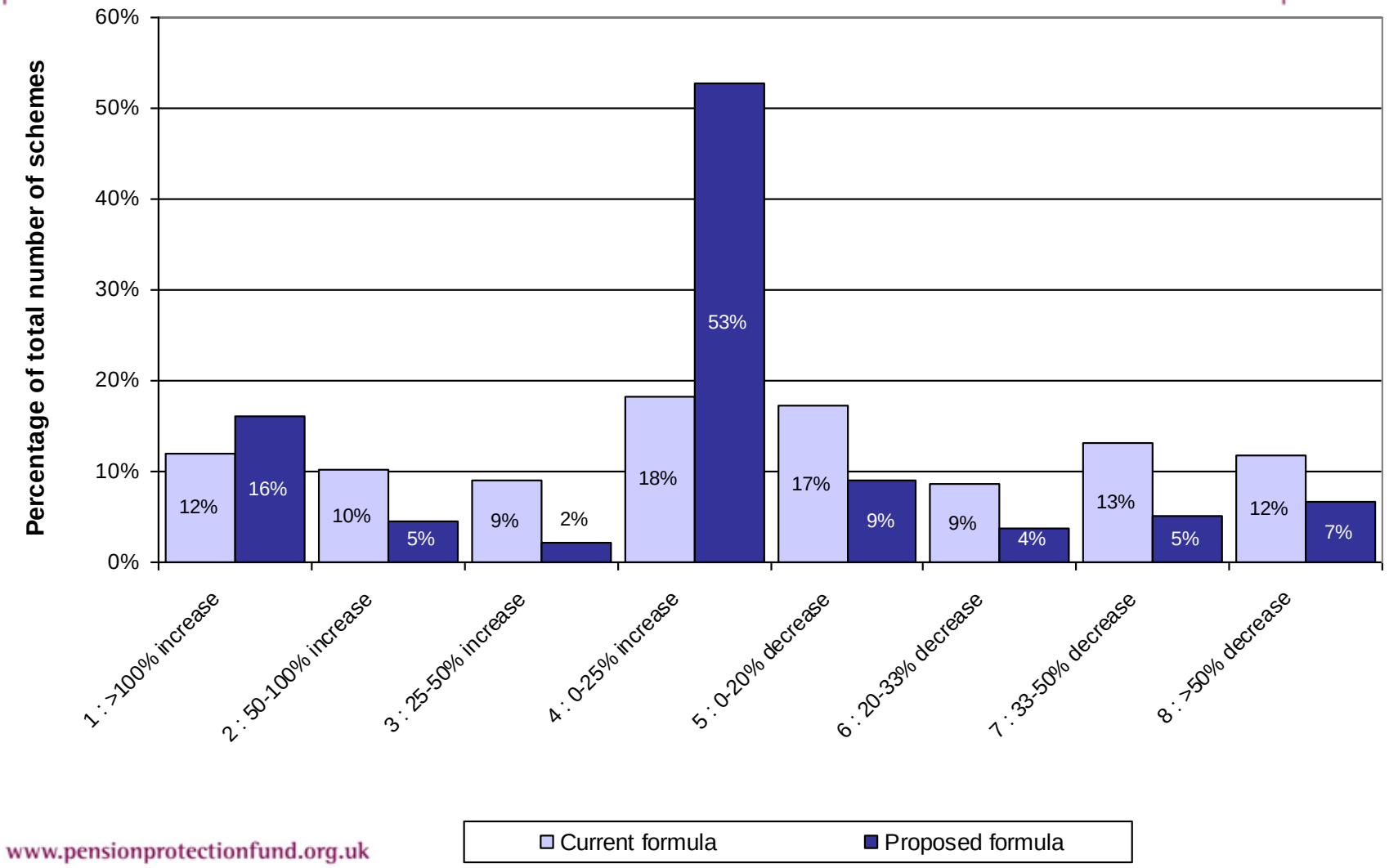
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- If the new framework had been in place for the three years from 2008/09, the total levy would have been relatively stable.
- There would not have been the need to adjust scaling factor.

Levy Year	Risk-based Levy (£M)	Total Levy (£M)	Change
2008/2009	639	675	
2009/2010	562	598	-11%
2010/2011	625	662	+11%

Analysis of Stability – Individual Levies

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Key Features of New Framework: Funding

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- Funding measurement smoothed over five years, by averaging market movements in the roll forward calculation
- Funding calculation would incorporate investment risk by applying stresses to assets and liabilities
- For great majority of schemes, this would be based on existing asset allocation data reported through Exchange.
- Largest 100 schemes required to provide more detailed analysis; optional for others.

Key Features of New Framework: Insolvency Risk

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- Failure Scores placed into six PPF levy bands – less granularity.
- Average levy band over past 12 months used so levies would be less affected by short-lived dips in employer(s) Failure Score.
- Insolvency probabilities in line with how financial markets would price PPF-equivalent risk.

Key Features of New Framework: Insolvency Risk

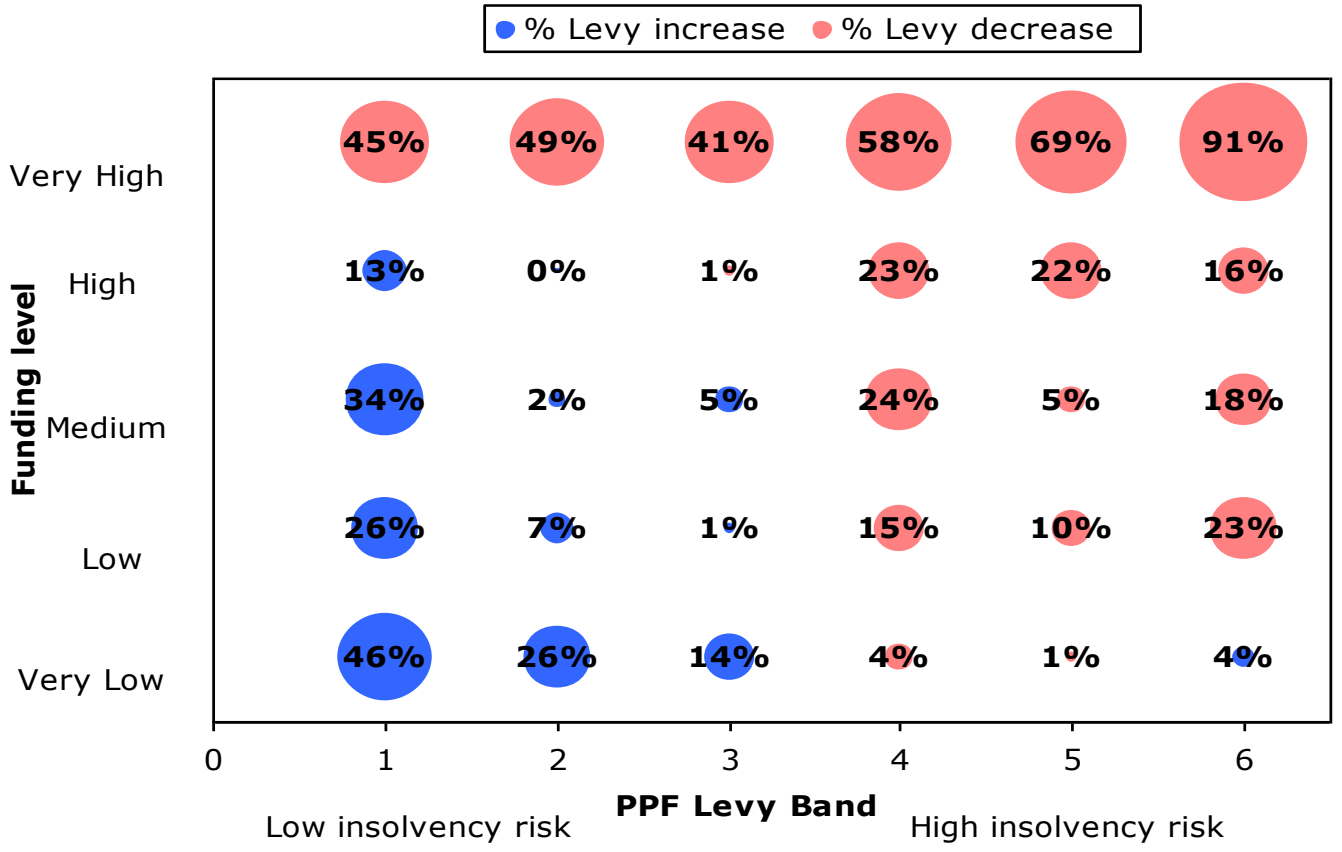
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PPF Levy Band	1	2	3	4	5	6
D&B Failure Score	100-97	96-90	89-69	68-42	41-6	5-1
Average D&B probabilities	0.04%	0.10%	0.30%	0.80%	2.80%	13.00%
Risk Margin	0.16%	0.40%	0.80%	0.80%	1.20%	1.20%
Indicative Levy Rate	**0.20%**	**0.50%**	**1.10%**	**1.60%**	**4.00%**	**14.20% (capped at 4%)**

Impact of Proposal - Funding Trumps Covenant

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Change in levy for 2011/12: Current formula compared to new formula



Consultation on New Framework: Key Dates

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Consultation ends 20 December

Policy Statement in spring 2011

Final parameters published late 2011

Implementation for levy year 2012/13

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Questions?