The Actuarial Profession
making financial sense of the future

consultation response

Pension Protection Fund

The 2010/11 Pension Protection Levy Consultation

November 2009

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals, and advise on social and public interest issues. Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

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Chris Collins
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11 November 2009

Dear Mr Collins

2010/11 Pension Protection Levy Consultation – September 2009

We welcome the opportunity to respond to the above Consultation and focus our comments on three areas of concern: bulk transfers, levy caps and fairness.

Bulk transfers

Our main concern relates to the proposed requirements in relation to bulk transfers. Whilst the proposals are in line with those that applied last year, we nevertheless have major concerns over continuation of the approach into future years. Our concerns are summarised below.

- The PPF in effect requires full s179 valuations of the transferring and receiving schemes, not just of the liabilities transferred – which imposes a disproportionate burden on the schemes involved.
- Worse, depending on when in the year the transfer occurs, the valuation may be required over a very short timescale which may not be achievable. The short timescale would be less of a concern for a valuation of just the transferring liabilities.
- Worst of all, the proposals acknowledge that in general the valuation will not be at a date at which audited assets are available, and require the actuary in these circumstances to certify that the unaudited value of assets is not overstated. This is a certification which is normally professionally inappropriate for an actuary to give. If the proposals remain as they are the Actuarial Profession may consider writing to members asking them to consider before signing the suggested certificate whether they have an appropriate level of relevant knowledge and skill to be able to confirm that an asset value, which has not been audited, has not been overstated. In effect, this may force a full audit of the assets at an out of cycle date on a very short timescale, further increasing the costs imposed by the PPF proposals. The alternative of certification of the assets and liabilities transferred would be straightforward since the value of assets transferred would be a matter of fact.

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- The consultation document assumes that the transferring scheme can arrange the appropriate certification from the receiving scheme – but in practice it has no leverage to achieve this (and the receiving scheme generally has little incentive to co-operate).
- Conversely, where the transferring scheme is winding up, there may no longer be a scheme actuary appointed to give the required certification.

As noted above, certification of the assets and s179 liabilities transferred would be much less onerous, would not raise the professional issues, and would be far more proportionate. We do not see any disadvantages for the PPF in adopting such an approach in place of requiring full s179 valuations of all the assets and liabilities of both the transferring and receiving schemes.

Furthermore, we question whether it is appropriate to retrospectively change the basis that will apply where an "expected" block transfer certificate was not provided in the first half of 2009. Schemes will have weighed the not inconsiderable expense of undertaking full valuations against the then expected levy adjustment before deciding whether calculations should be performed and a block transfer certificate submitted. They would have taken into account the PPF's 2009/10 formulae which implied that there was no overall levy "penalty" where similarly well-funded schemes were merged without providing the necessary certificate. The latest proposals effectively rewrite the rules for this decision and impose, retrospectively, a substantially higher penalty on such schemes. Since they are past the deadline for submitting the appropriate certificate, they can take no action now to remedy the situation.

Levy caps

We note that the PPF is proposing a reduction in the caps applied to both:

- the insolvency risk used to calculate the risk based levy (to 3%), and
- the overall risk based levy (from 1.0% to 0.5% of protected liabilities)

The new level may or may not be appropriate; we do not comment on this. However, we note that the size of the overall cap has changed over the years, both in absolute terms and in relation to the proportion of schemes to which it applies. The PPF has given little justification of the size of the cap or of changes to it. We recommend that rather than continuing to make apparently ad hoc changes, the PPF should consult on a policy for setting the cap as part of its consideration of long term levy policy for 2012/13 onwards.

The PPF's announcement explained the changes as follows:

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> "We now want to help further ease the burden on employers and pension schemes during these difficult times for business.
>
> That is why, to help protect more of the most vulnerable schemes, we decided to reduce the cap on the amount of risk-based levy schemes pay."

We note that, despite the implication in the announcement that the changes "ease the burden on employers and pension schemes", the changes to the cap in fact merely transfer some of the burden from one group of pension schemes to another. It is the schemes whose levy falls just under the new cap which bear the biggest burden from this redistribution.

We suggest that it would help the PPF build a constructive relationship with its stakeholders if in future the PPF adopts an approach to communication of its proposals which acknowledges the downsides as well as the upsides of its proposals.

"Fairness"

We also note that in a number of places the Consultation Paper tests the proposals against the "economic levy" (as defined), with a statement that a levy distribution closer to that economic levy is "fairer". As set out in our response dated 13 February 2009 to the PPF's November 2008 consultation on *Future Development of the Pension Protection Levy*, we believe that PPF has not yet justified and consulted on what a "fair" distribution of the levy would look like. Until the PPF has completed this process, we recommend that the PPF refrains from assertions that a particular levy distribution is "fairer".

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via Martin.Hewitt@actuaries.org.uk.

Yours sincerely

Robert Hails
Chairman, Consultations Group, Pensions Practice Executive Committee

Please reply to Staple Inn

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