

Pension Protection Fund Levies – past, present and future

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Initial Levy – 2005/6

- c.11,000 schemes billed
- c.£140m total levy payable

Lessons learned

- Separate scheme based and risk based levy invoice for 2006/7
- Queries on scheme based and risk based levies to be dealt with directly by PPF

Risk based levy – listening to stakeholders

- 2 consultation documents, 1 consultation update, 250+ responses and 17 weeks of consultation
- Inclusion of special deficit funding contributions
- Recognition of contingent assets - parental guarantees, letters of credit and pledged assets
- RBL rate of NIL if assets are at least 125% of PPF liabilities
- RBL cap set at 0.5% of PPF liabilities (benefits 5% of pension schemes)

The 2006/7 Pension Protection Levy formulae

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For 2006/07 levy year

Scheme based element = 20% (£115m)

Risk based element = 80% (£460m)

SBL = 0.00014 x PPF liabilities

RBL = underfunding risk x insolvency risk x 0.8 x 0.53

Underfunding risk

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If scheme is <104% funded on a s179 basis, $U = (1.05 \times L) - A$

L = liabilities on a s179 basis as at 31/03/06

A = assets as at 31/03/06 plus any special contributions and contingent assets

Information on assets and liabilities from either

- scheme return (MFR or s179)
- s179 valuations sent voluntarily to the PPF

Assets and liabilities converted if necessary to a s179 basis and rolled forward to 31 March 2006 by the Board

Underfunding risk if 104% or more funded

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PPF funding level %	Assumed underfunding %
104	1.00
104 to 111	0.75
111 to 118	0.50
118 to 125	0.25
Over 125	0.00

The D&B Failure Score

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- The Board will use the D&B Failure Score to measure the one year probability of insolvency of the sponsoring employer(s)
- Percentile score 1-100
- 1 = highest probability of insolvency
- 100 = lowest probability of insolvency
- D&B failure score mapped to PPF assumed probability of insolvency and that probability is used in the risk based levy calculation.

The D&B Failure Score

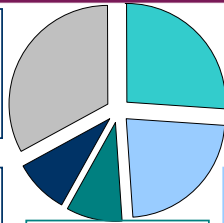
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Financials

- Key ratios and trends
- Solvency
- Profitability
- Late filing

Trade Payments

- Payment Score (Paydex)
- % of trade experiences paid promptly or beyond terms
- Volatility of payments



Principals

- Number
- Age and Experience
- Associated Failures

Demographics

- Age and size of business
- Primary industry sector
- Number of Employees
- Geographic Region

Public Negative Data

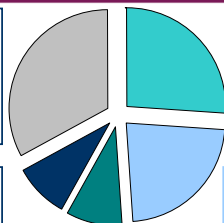
- County Court Judgements
- Mortgages and Charges
- Recovery and Debt Claims

The D&B Failure Score

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Identifies early financial stress such as administration, meeting of creditors and winding-up petitions

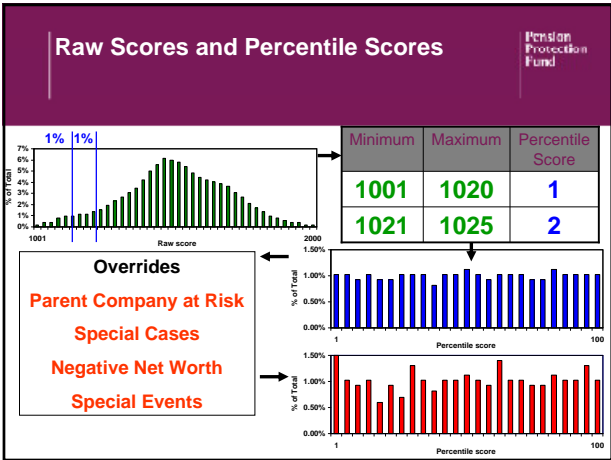
Predicts the probability of a company failing or having a failure lead-up event within the next 12 months

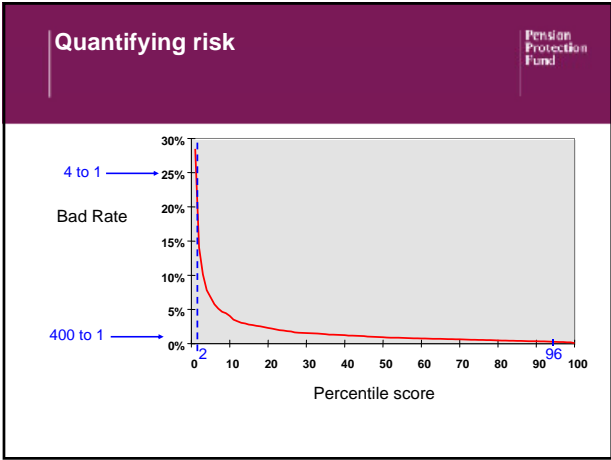


Different scoring models for different segments of the business universe

Raw Score Range
1001 – 2000

Each 40 points
halves the risk of
insolvency





Customisation of the Failure Score

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Following the consultation period and advice from D&B, the Board of the PPF decided to customise the standard D&B Failure Score in the following ways for the 2006/7 Risk Based Levy:

- Parent Severe Risk Override
Standard rule ignored, now reflects individual derived score.
- Negative Net Worth Override
Standard rule ignored, now reflects individual derived score.
- Foreign Companies Registered in the UK
Use either Failure Score of foreign HQ or average industry score.

Obtaining and appealing 31 March Failure Scores

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- Call the new **D&B dedicated PPF helpline** on **0870 850 6209**
- This helpline can provide Failure Scores, and the data elements they're based on
- You can also appeal a Failure Score via that number

The Effect of Contingent Assets

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- A contingent asset is an asset that will produce cash for a pension scheme contingent on an event (insolvency) occurring to the sponsoring employer
- Included in asset calculation: $A = S + C + (N \times z)$
- Contingent assets either:
 - Reduce the level of underfunding in the calculation
 - Change the insolvency risk factor

Type of contingent asset	Example	How affects the levy
A	Parent Guarantee	In effect, changes the insolvency risk for the part of underfunding guaranteed
B	Security over securities	Reduces the underfunding
C	Letter of Credit	Reduces the underfunding

Data collection for 2006/7 – scheme returns

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- Lengthy, paper-based form
- Sent out from June '05, so lots of updates necessary
- Not clear what data would be used for levy calculation
- Limited up-front validation, so cleansing needed

**Scheme returns 2007/8 –
Lessons learned**

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- Shorter, web-based form
- Validation rules up front
- Pre-populated
- Data for levy calculation clearly identified
- Sent nearer to start of levy year

Voluntary forms – take-up and lessons learned

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Take-up

- Over 3000 voluntary forms received
- £400bn of liabilities covered by section 179 valuations
- 7,500 employers covered by participating employer forms

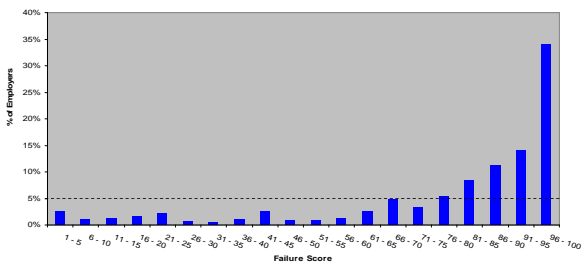
Lessons learned

- Minimise the number as far as possible (e.g. no two-part multi-employer form)
- Ensure technological solution can be used by all

D&B employer universe

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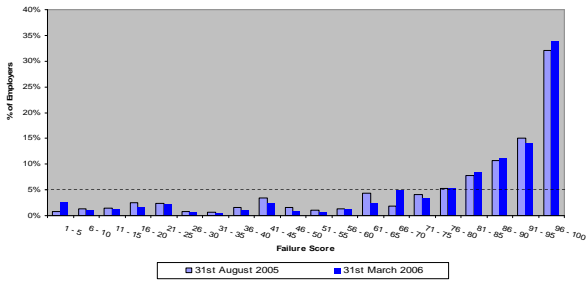
Failure Score Distribution as at 31st March 2006 for Participating Employers



D&B employer universe

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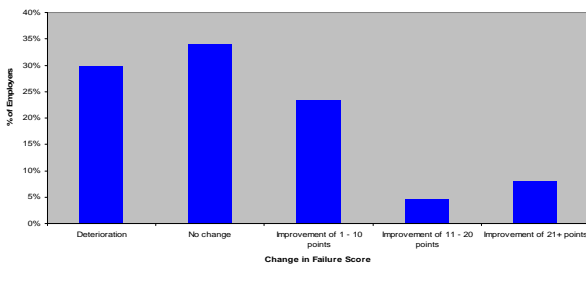
Failure Score Distribution as at 31st March 2006 compared to 31st August 2005



D&B employer universe

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Change in Failure Score Distribution from 31st August 2005 to 31st March 2006



Next steps – calculation and invoicing

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- Calculation in batches, depending on when data received and cleansed;
- Invoicing from late Summer;
- Detailed scheme-specific supplementary info with invoices, showing:
 - Data provided to us;
 - How it has been transformed (e.g. results of roll-forward calculation).

Policy developments for 2007/8

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- *Single consultation on 2007/8 levy proposals and Board's levy estimate*

Underfunding

- Revised s179 guidance

Contingent assets

- Credit default swaps?
- Minor modifications
- Requirements for repeat certification

2007/8 policy developments – insolvency risk

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- Generic Models are regularly reviewed and refined
- These updates consider:
 - Shifts in economy and business universe
 - Changes in why businesses are failing
 - Changes to key data elements
 - New data elements (e.g. FRS17 pension deficits)
- Averaging of scores around single observation point
- Further customisation of models for the Risk Based Levy

Asset allocation risk

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- **Defer introduction of asset allocation as a risk factor until at least 2008/9**
- **Take into account the timing of the introduction of the scheme funding requirements**
- **Behavioural impact and orderly transition for markets**
- **Consult broadly on practicalities and measurement in 2006**

Key dates

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31 Mar 2006	D&B Failure Score measured Deficit measured
From late Summer	Levy invoices issued
From Nov	2007/8 scheme returns
Nov-Dec	2007/8 levy consultation
