HOW TO REDUCE YOUR PENSION PROTECTION LEVY

Pension Protection Fund

CBI
THE VOICE OF BUSINESS

FOREWORD

We recognise that these are testing times for small and medium-sized businesses throughout the country and looking at ways of reducing your pension scheme's pension protection levy is probably high on your agenda.

This is why we have worked on producing this booklet which tells you about how the levy works.

Crucially, it also sets out the actions you can take to reduce your individual levy bills and the deadlines you must meet to make sure these actions are taken into account.

We hope you find this guidance useful.

Sara Protheroe
Director, Strategy and Policy
Pension Protection Fund

Katja Hall
Director, Employment Policy
CBI

INTRODUCTION

What is the Pension Protection Fund?

Established by the Pensions Act 2004, the Pension Protection Fund (PPF) opened its doors for business in April 2005 and is run by an independent board.

The PPF pays compensation to members of eligible defined benefit (db) – such as final salary – pension schemes whose employer has gone bust and left insufficient assets in its scheme to pay members at least PPF levels of compensation.

Which pension schemes are eligible for the PPF?

Defined benefit pension schemes are protected by the PPF unless they had been or were being wound up before 5 April 2005.

The schemes it covers are also known as occupational, work-based or final salary pension schemes.

How is the PPF funded?

The PPF collects a compulsory pension protection levy from eligible schemes – it is not funded by government.

The fund also takes on the assets of transferring schemes and generates income from recovering money and other assets from insolvent employers. It also derives income from returns on its own investments.

When would a scheme be taken over by the PPF?

When the sponsoring employer of an eligible scheme goes bust, the pension scheme will automatically enter the PPF assessment period.

A scheme will only finally transfer into the PPF if it does not have enough money, or assets, to pay PPF levels of compensation.

If the scheme is rescued – that is, a new employer takes on responsibility for the scheme or its assets increase in value so it can pay more than the PPF levels of compensation – the scheme will withdraw from the assessment process.

How does the PPF take responsibility for schemes?

The PPF monitors trustees throughout the PPF assessment period to ensure they take their scheme through the process effectively and enable it to successfully transfer to the PPF.

In certain circumstances, it can direct trustees in areas such as investment of scheme assets, incurring expenditure and legal proceedings.

It monitors the progress of insolvency proceedings, liaising with the insolvency practitioner.

If the PPF takes responsibility for a scheme it pays compensation to scheme members.

How much compensation does the PPF pay?

The total level of compensation available for scheme members is subject to an overall cap which is recalculated every year.

Members who have reached their scheme's normal pension age will generally receive 100 per cent compensation.

PPF also pays 100 per cent compensation to those who have retired on legitimate ill-health grounds, regardless of age, and those receiving a pension in relation to someone who has died.

Those members who have not yet retired will receive 90 per cent compensation on reaching retirement age. Members who have retired but have not reached the normal pension age of their scheme will receive up to 90 per cent compensation.

THE PENSION PROTECTION LEVY

What is the levy?

The PPF levy is an annual charge on eligible (db) pension schemes. Over 7,000 schemes currently pay the levy.

It is divided into two parts:

- the scheme-based levy represents 20 per cent of the total levy bill and is based on the size of the eligible scheme and its liabilities.
- the risk-based levy represents 80 per cent of the total levy bill and is based on the likelihood of the eligible scheme entering the PPF. The risk-based levy ensures that lower risk schemes pay a lower levy.

Income from the levy helps fund compensation payments.

The overall amount of levy that needs to be collected each year is calculated using the long-term risk model. This modelling tool is used to work out how much risk the PPF may face over the next five to 10 years and beyond. This enables the PPF to build long-term sustainability, ensure people get the compensation they are entitled to and set a stable pension protection levy year-on-year.

What is used to calculate the levy?

1. Scheme return data

Trustees and managers of pension schemes already have a legal obligation to supply the Pensions Regulator (the Regulator) with information about their scheme.

This scheme return data is used by the PPF to calculate levies. The Regulator uses the information to ensure its register of pension schemes is up-to-date.

2. Probability of insolvency of the sponsoring employer

Dun & Bradstreet (D&B) measures insolvency risk and provides the PPF with a probability of insolvency for every sponsoring employer of an eligible scheme. This figure is used to calculate a scheme's risk of insolvency.

3. Levy scaling factor

The insolvency and underfunding risks are multiplied by a scaling factor which is set annually. This adjusts the outcome of the levy formula to ensure it adds up to the amount the PPF board set out to raise.

What is the scheme-based levy formula?

Scheme-based multiplier x estimated liabilities.

What is the risk-based levy formula?

Underfunding risk x insolvency risk x levy scaling factor x 0.8 (80 per cent risk-based)

The risk-based levy takes two types of short-term risk into account:

- insolvency risk – the likelihood of the scheme's sponsoring employer going bust within the next year
- underfunding risk – the likelihood that the scheme will not be able to pay benefits at the same level as the PPF pays compensation.

The amount of risk-based levy a scheme is eligible to pay is subject to an overall cap – a percentage of liabilities which is also set annually. The cap is designed to protect the weakest schemes and their sponsoring employers from disproportionately high levy bills.

Risk reduction measures

Schemes can reduce the amount of levy they pay by putting in place contingent assets, such as parent or bank guarantees, or security over property. The PPF also considers deficit reduction contributions – block transfers of assets and special contributions to bolster the scheme – as reducing the risk of the scheme, which also reduces the amount of the levy bill.

10 WAYS TO REDUCE YOUR PENSION PROTECTION LEVY

1. Make sure the PPF and the Regulator hold the correct data on your scheme

Before submitting your scheme return data, check it carefully to ensure that all factors used in your levy calculation, such as scheme structure, are up-to-date and accurate.

Once you have submitted your data, you can log on to the Regulator's scheme maintenance system and update the information until the data deadline on 31 March.

Don't forget: the PPF will not generally accept corrections to the data it receives from the Regulator after the 31 March deadline.

2. Check that D&B holds the right data on the sponsoring employer

You can phone D&B to check your failure score and get information about how it can be monitored over time (see 'Useful Contacts' for details).

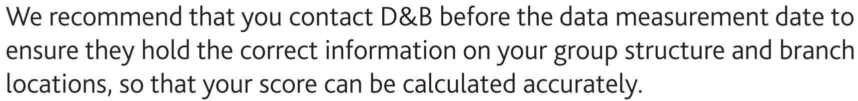
If you have not submitted your audited accounts to Companies House, you can submit them directly to D&B.

3. Understand your insolvency risk and appeal your failure score if you think it is wrong.

The way the sponsoring employer's insolvency score is calculated is based on a number of things.

They include: the number and profile of directors and the registered address of the company, financial statements, supplier invoices, audited accounts, secured charges and demographic information such as regional location or company directors.

In addition, from 2011/12, a subsidiary's score may be affected by the score of its parent company, if that parent is at severe risk of failure; and businesses with branches in three or more different UK regions can benefit from being classified as nationwide.



We recommend that you contact D&B before the data measurement date to ensure they hold the correct information on your group structure and branch locations, so that your score can be calculated accurately.

Improving performance in one or more of these areas could reduce the probability of insolvency the PPF would use when working out your levy.

Some of these are weighted more heavily than others. For example, payments to suppliers are weighted heavily for commercial businesses by D&B. Pay any outstanding invoices and your score could improve.

4. Make a deficit reduction contribution

A deficit reduction contribution is a payment you can make to your scheme between s179 valuations to reduce the scheme's s179 deficit and underfunding risk.

These contributions need to be certified to the PPF by the relevant deadline each year in order for them to affect your levy.

5. Use a group company guarantee

You can improve the strength of the covenant (contract) between employer and pension scheme by using the financial strength of another company in your group.

This is called a type A contingent asset and it affects the insolvency risk part of the levy calculation.

In this situation, the company guarantees part of the scheme's liabilities. Its insolvency probability is then used in the scheme's levy calculation, taking into account the level of liability guaranteed.

6. Pledge company assets to the scheme

A sponsoring employer, or group company, can pledge assets which will go to the pension scheme if a sponsoring employer goes bust. This affects the underfunding risk part of the levy calculation.

There are three categories of type B contingent asset:

B(i) – security over a bank account for the levy year

B(ii) – security over land (in the United Kingdom)

B(iii) – security over a portfolio of securities.

These must all be independently valued.

7. Get a guarantee from a third party

Pension scheme security can be improved with a guarantee from a party outside the scheme or its sponsoring employer group.

This is a type C contingent asset and affects the underfunding risk part of the levy calculation.

There are two categories of type C contingent asset:

- C(i) – letter of credit. These must be 'evergreen' – they can be renewed or replaced once they expire
- C(ii) – bank guarantee. These can be used as a guarantee against planned future contributions to the scheme.

More information on contingent assets can be found on page 12.

8. Consider an out-of-cycle s179 valuation

If your scheme circumstances have changed significantly since you submitted your last s179 valuation, you should consider whether to submit a new one. This will enable the PPF to produce the most accurate estimate of your liabilities.

This information should be included with the scheme return or entered on to the scheme maintenance system.

9. Make sure you have correctly certified your block transfer

If members have transferred in or out of your scheme, or there has been a merger of two schemes, you need to submit a block transfer certificate (parts A and B).

This ensures that the new financial strength of the scheme is reflected in your levy calculation.

10. Get involved in the development of the levy

Each year, the PPF consults on the levy calculation in order to gather feedback on its proposals for developing the levy. The PPF wants to ensure that the levy accurately reflects the risk it faces, and that the money it raises is distributed across eligible schemes.

The PPF also consults on other factors which indirectly influence the levy, such as the assumptions it uses in s179 valuations.

There are regular roadshows for levy payers and advisors to meet the PPF face-to-face and share views. These are a good opportunity to pass comments on to PPF staff directly.

If you want to find out what is happening at the PPF, register your interest at www.pensionprotectionfund.org.uk and sign up for PPF news alerts.

MORE INFORMATION ON CONTINGENT ASSETS

Contingent assets are taken into account when the PPF calculates the risk-based element of the levy.

The PPF wants to be able to:

- View positively the actions taken by the scheme or employer to improve scheme funding, or the strength of employer covenant
- Incorporate contingent assets in a way that reflects the principles of fairness, simplicity and proportionality
- Value contingent assets to represent the real reductions in risk they achieve.

While a contingent asset must represent a long-term commitment to a scheme for it to affect your levy calculation, you can replace it or make changes to the level of cover it provides.

Contingent assets can be very effective in increasing scheme security and reducing the levy. But you must make sure you have fulfilled all of the requirements for the PPF to accept them. So, pay careful attention to:

- Certificates
- Standard form agreements
- Amendment and replacement conditions
- Legal opinion

Detailed guidance can be found on the PPF website.

WHAT IF I HAVE DONE ALL THIS AND I THINK MY LEVY IS STILL TOO HIGH?

1. Appeal your failure score if you think it is wrong

D&B has a five-stage process for appealing failure scores.

If you think your failure score is wrong because it has not taken into account available information or information that you provided to D&B before the 31 March deadline, you should talk to D&B customer services to put it right.

2. Review your invoice with the PPF

If you think the PPF has made a mistake on your invoice (other than the insolvency score), you should call the PPF Stakeholder Support Team within 28 days of the date of your invoice and before you pay your invoice to review it informally.

If the problem can be resolved at this stage, you will be issued a credit note and a new invoice. Most invoice problems are resolved in this way.

If the problem cannot be resolved informally, there is a formal review process which has some legal requirements.

Also, some schemes may qualify to have all, or part, of its levy waived for one levy year.

Information on reviews and waivers is available on the PPF website.

REMEMBER: if you think you will have difficulty in paying your levy bill, you must contact the PPF immediately and they will discuss with you ways they can help.

USEFUL LINKS

Email:

information@ppf.gsi.gov.uk for general queries

levyinvoice@ppf.gsi.gov.uk to query your PPF levy invoice

consultation@ppf.gov.uk to respond to consultation documents

neil.carberry@cbi.org.uk for further information on CBI pensions policy

Website:

Submission of voluntary certificates
http://www.thepensionsregulator.gov.uk/onlineServices/exchange/index.aspx

Contingent assets guidance
http://www.pensionprotectionfund.org.uk/levy/riskreduction/Pages/ContingentAssets.aspx

Reviews and appeals
http://www.pensionprotectionfund.org.uk/levy/invoicing/pages/reviewsandappeals.aspx

Waivers
http://www.pensionprotectionfund.org.uk/FAQs/Pages/FAQSearch.aspx

Register your interest
http://www.pensionprotectionfund.org.uk/Pages/EmailAlerts.aspx

USEFUL CONTACTS

Pension Protection Fund

www.pensionprotectionfund.org.uk

Stakeholder Support Team: 0845 600 2541

Text phone: 0845 600 2542

Knollys House, 17 Addiscombe Road, Croydon, Surrey CR0 6SR

Dun & Bradstreet (insolvency risk provider)

www.dnb.com/uk

PPF-related enquiries: 0870 850 6209

customerhelp@dnb.com

D&B Customer Services, Suite 5.3, Building 8,
Exchange Quay, Salford, Greater Manchester M5 3EJ

The Pensions Regulator

www.thepensionsregulator.gov.uk

Customer support: 0870 6063636

customersupport@thepensionsregulator.gov.uk

Napier House, Trafalgar Place, Brighton BN1 4DW

CBI

www.cbi.org.uk

Neil Carberry, Head of
Pensions and Employment:

neil.carberry@cbi.org.uk

Centre Point, 103 New Oxford Street,
London WC1A 1DU

GLOSSARY OF TERMS

Compensation – payments to scheme members who transfer to the PPF after their sponsoring employer has gone bust.

D&B (Dun & Bradstreet) – the company that will measure insolvency risk for the PPF until 2011/12.

Failure score – a percentile score which is designed to predict the likelihood that a company will go bust within the next 12 months. The score indicates a relative measure of risk, ranging from 1 to 100. 1 represents businesses that have the highest probability of failure and 100 the lowest.

Insolvency risk – the risk of a scheme's sponsoring employer going bust within the next 12 months.

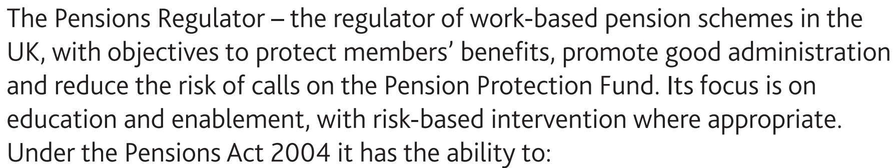
Levy invoice – this is a scheme's individual invoice for the amount of pension protection levy due for the relevant levy year.

Levy year – for example, the 2010/11 levy year will run from 1 April 2010 to 31 March 2011.

Scaling factor – a multiplier which adjusts individual short-term levy amounts so that the PPF can collect the total figures to meet its long-term requirements.

Scheme maintenance – the Regulator's online service for the maintenance of scheme information, some of which the PPF uses to calculate a scheme's levy. This works in the same way as the online scheme return but can be accessed right up until the 31st March deadline when the Regulator sends the information to the PPF.

Section 179 valuation (s179) – this is a valuation of a pension scheme to determine how well funded it would be if it had to buy out benefits at PPF levels of compensation. The name refers to section 179 of the Pensions Act 2004.



The Pensions Regulator – the regulator of work-based pension schemes in the UK, with objectives to protect members' benefits, promote good administration and reduce the risk of calls on the Pension Protection Fund. Its focus is on education and enablement, with risk-based intervention where appropriate. Under the Pensions Act 2004 it has the ability to:

- collect detailed information, including scheme returns, information through the scheme specific funding regime and reports from trustees, employers and whistleblowers
- issue notices requiring actions to be taken, freeze a scheme at risk, prohibit trustees who are judged not fit and proper to carry out their duties or appoint independent trustees, and
- issue a contribution notice where there is a deliberate attempt to avoid liabilities, or a financial support direction where the employer is a service company or insufficiently resourced.

Underfunding risk – the risk a scheme poses to the PPF in terms of the likelihood of compensation for members being required and the size of the amount, measured on a s179 basis.

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