buck issues

MAKING SENSE OF THE WORLD OF PENSIONS

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The Pension Protection Fund levy
Update

Almost as soon as our last Buck Issues (Number 98) had left our offices, the PPF board published further documents on levy calculations for the year from April 2006. These revised and additional proposals take on board many of the concerns raised during consultation and add some welcome flexibility.

What they do not provide is any clearer indication of the overall amount of levy the PPF will require for next year, so we are no nearer to making even a sensible guess at the implications for any particular scheme – this is likely to have to wait until the end of November.

Revised proposals – key points

- The deadline for submission of more up-to-date data for use in the 2006/7 risk-based levy calculation is put back from 31 December 2005 to 31 March 2006.
- The employer insolvency risk will also be assessed at this later date.
- It may be possible to take into account any deficit-reducing contributions paid since the last valuation used for levy calculation purposes.
- Updated valuations can be produced using rolled-forward liabilities.

Original proposal for assessing scheme underfunding risk

Unless there's more up-to-date data, the scheme underfunding risk will be assessed by adapting the last MFR valuation data as submitted to the Pension Regulator on the scheme return form for 2005. The PPF themselves will carry out the restatement of liabilities, using a methodology that is spelt out in some detail in the latest documents.

This restatement will inevitably be rough and ready, as the specific scheme data available to the PPF will be very limited. Broad allowance will be made for the significantly different assumptions prescribed for an MFR valuation compared to a PPF levy valuation (a Section 179 valuation) and asset and liability figures will be notionally updated to 31 March 2006.

Standard assumptions will be used to adjust full scheme liabilities to a figure that might more closely resemble the lesser PPF benefits. These standard adjustments could often significantly fail to provide an accurate conversion to a scheme's true PPF position (either positively or negatively). In addition, they do not try and take account of any deficit-reduction contributions paid to the scheme since the MFR valuation. It is therefore now proposed that schemes will have the following options to provide additional data prior to 31 March.

Options for providing upgraded data on the scheme underfunding risk

1. Submit an Actuarial Certificate of Deficit-Reduction Contributions

If contributions over and above the cost of ongoing accrual have been paid to the scheme since the effective date of the last valuation (whether on the MFR or PPF valuation basis), the scheme actuary may be able to complete such a certificate, showing the amount of additional contributions paid. This amount would then be taken into account as an asset of the scheme when determining the scheme's underfunding risk. It should be noted, however, that no investment gain (or loss) on such contributions would be taken into account.

2. Obtain a PPF levy valuation as at a date subsequent to the last MFR valuation date
Such a valuation could be on the basis of either:

- determining PPF liabilities from scratch as at the effective date, or
- rolling forward liabilities from the last valuation and adjusting to PPF benefits. The scheme actuary would have to certify that these were not undervalued.

In either case, the asset values used should be on the basis of audited accounts. The PPF regard it as best practice that such accounts are as at the new effective date of the valuation, but the regulations do allow, if they are not available, the latest such accounts available at that time. (They also allow, if the scheme actuary is satisfied that it is reasonable to do so, the use of audited accounts at a date subsequent to the valuation date.)

Contingent assets

The PPF have indicated that they will be looking to make some allowance for contingent assets (eg letters of credit or a charge over unencumbered property that would revert to the scheme on an employer insolvency event) in the assessment of the scheme underfunding risk. Full details are still to be worked out and are not expected to be in place before 2007/8 at the earliest.

Multi-employer schemes and assessment of employer insolvency risk

As explained in our earlier Buck Issues, the default method for assessing the employer insolvency risk in a multi-employer scheme will be to look solely at the risk of the largest employer (in terms of the aggregate number of members), as declared on the 2005 scheme return. However, schemes will have the option of submitting details of scheme structure and all the participating employers by 31 March, to allow an alternative assessment to be made.

In a typical non-segregated multi-employer scheme for associated employers, the alternative would be based on the weighted (by number of members) average insolvency risk of all the participating employers. In a true "last man standing" scheme where there is no requirement or option to segregate on cessation of participation, the weighted average insolvency risk would be reduced by applying a factor of 0.9, to recognise that some degree of cross-subsidy exists within the scheme.

For 2006/7, the rating used will not be worse than under the default method.

Conclusion

With the additional information now available on the PPF's methodology for rolling forward past valuation results and the extra options (and time) available to schemes to provide more up-to-date data, it is likely that most schemes should now discuss with their actuary the likely advantages of providing updated information in some form or other. What we would stress, however, is that we are still no nearer to being able to provide an indication of the absolute level of levy that might be payable next year.

We await 30 November with much interest and some trepidation.

Reminder of key features in the original proposals for the 2006/7 levy

- The PPF will assess the total levy they need to raise.
- 20% of this – the scheme-based element – will then be collected by a flat percentage charge on the PPF liabilities of all schemes.
- The balance of 80% – the risk-based element – will be collected using a formula that depends on the solvency of schemes in relation to their PPF benefits and the perceived risk of the sponsoring employer suffering an insolvency event during the year.
- To the extent that accurate solvency figures for PPF liabilities have not been calculated and submitted to the PPF, assumptions will be made from the minimum funding requirement (MFR) data that will have been submitted on the new scheme returns.
- The risk of an employer insolvency event will be determined by an external credit rating agency. D&B has subsequently been appointed by the PPF for an initial period of two years.
- At this stage, it is not possible to give an indication of the monetary amount of levy that any individual scheme will incur, as the PPF has yet to assess its levy requirement for next year.
- Nevertheless, all schemes will be expected to pay something, and it is clear that the differential between well-funded schemes for very strong employers and weakly-funded schemes for very weak employers will be sizeable. The riskbased levy as a percentage of a scheme's PPF liabilities could range from 0.001% to 3.0% – a factor of 3,000.

160 Queen Victoria Street
London EC4V 4LA
Tel: +44 (0)20 7163 6000
Fax: +44 (0)20 7163 5063

marketinguk@buckconsultants.com
www.buckconsultants.co.uk

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