

## Pension Protection Fund Levy Actions for companies to avoid substantial increases

Update – 16 February 2007

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Companies face substantial increases in their Pension Protection Fund (PPF) levy as the PPF intends to collect more than double the amount it collected last year. Companies have until 30 March 2007 to implement actions that may result in a lower levy.

This Pension File provides an update on how companies can take control of their levy by considering recent changes announced by the PPF.

### What you need to know

1. The PPF is an insurance-type arrangement that provides benefits to members of pension schemes whose employers become insolvent. In simple terms, non-retired members are covered for 90% of their pensions up to about £27,000 a year, and pensioners are covered for 100% of their pension, excluding certain pension increases.
2. Benefits payable by the PPF are financed from:
  - the assets of the pension funds it takes on from insolvent employers;
  - other assets that the PPF may have claimed as a creditor to the insolvent employer;
  - investment returns on PPF assets;
  - a levy on solvent employers with UK defined benefit pension schemes.
3. For the 2007/08 year, the PPF intends to collect £675 million and will issue invoices in late summer 2007 for settlement within 28 days.
4. Strictly, the PPF levy is payable by the pension scheme. However, most trustees will seek for the employer to meet its cost through additional contributions. Some employers are considering passing the costs onto the scheme members themselves.
5. 80% of the levy will be based on:
  - the size of the scheme's PPF deficit; and
  - Dun & Bradstreet's (D&B) assessment of the employer's risk of insolvency that applies as at 30 March 2007.

The remaining 20% will be proportional to the amount of the scheme's liabilities.

6. D&B places each company into one of 100 insolvency risk bands. The insolvency risk for multi-employer schemes is the average of all the employers' risks, weighted by each one's number of scheme members. This approach differs from 2006/07 when the insolvency risk could default to that of the employer with the largest number of members.
7. D&B base their ratings on a combination of four factors: demographic information, who are the principals of the business, trading data and financial information.
8. The PPF deficit is the shortfall of assets compared to the cost of buying-out with an insurance company the liabilities covered by the PPF. For 2007/08, the appropriate calculation can be determined by either:
  - undertaking a specific valuation (section 179) of the PPF covered liabilities;
  - rolling forward (by more than one year if necessary) the results of a previous such valuation of liabilities and updating asset values; or
  - adjusting the most recently calculated minimum funding requirement (MFR).

A first section 179 valuation must have been submitted to the PPF by 31 March 2008.

9. There are three ways a company can influence its PPF levy:
    - use the valuation basis that is most favourable; and/or
    - reduce the size of the PPF deficit; and/or
    - take actions to improve the D&B risk rating used by the PPF.
  10. The PPF will also take into account the following voluntary information in calculating the levy (if it is provided):
    - **contingent assets:** demonstrating pension scheme trustees have access to assets, guarantees or other means (e.g. from parent companies or other third-parties) that would support the scheme deficit in the event of insolvency of the employer(s); and
    - **additional payments:** special contributions made since the most recent valuation in order to reduce the scheme deficit will be recognised, provided calculated and certified by the scheme actuary.
  11. If an employer is a branch of a foreign registered company, the PPF will use the D&B score of the foreign company of which the employer is a branch. If the PPF are unable to obtain a failure score for that company, they will use the average industry score instead.
  12. The levy is capped at 1.25% of the liabilities calculated using the PPF basis. This will exacerbate the increase for 2007/08 for companies whose levy was capped in 2006/07 (when the cap was only 0.5%).
  13. No risk-based levy is payable for schemes that are over 125% funded on a PPF liability calculation basis.
4. Determine what information to provide to the PPF by 30 March 2007 if you want them to consider any of the issues highlighted above.
  5. Consider which of an adjusted MFR valuation, a rolled forward PPF valuation or a new PPF valuation produces the smallest PPF deficit.
  6. Consider the position if your business is a branch of a foreign registered company.
  7. Consider whether there is any impending corporate activity that could improve your failure score (e.g. M&A activity, legal reorganisations, changes in directors). If so, provide D&B with the relevant information.
  8. Prepare for the possibility of using contingent assets (e.g. parental guarantees, asset security and escrow accounts) to reduce your levy.
  9. Prepare to make a one-off contribution ahead of 30 March 2007 to reduce the scheme deficit. Any actuarial certificate relating to this must be completed and submitted to the PPF by 5 April 2007.
  10. Discuss with your trustees how the levy is to be financed, and whether some or all of the costs are to be passed onto pension scheme members.

### What you need to do

1. Ensure you complete all relevant actions by 30 March 2007.
2. Review the way your PPF levy was calculated a year ago to ensure you take account of any previous arrangements agreed with D&B.
3. Engage with D&B now to understand their basis for determining your risk

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