The future development of the Pensions Protection Levy
A Consultation Paper from the Board of the Pension Protection Fund

A response by

The National Association of Pension Funds
October 2007

SECTION ONE - INTRODUCTION

1. The National Association of Pension Funds (NAPF) welcomes the opportunity to respond to the *Consultation on the future development of the Pension Protection Levy*.

2. We support the Board of the Pension Protection Fund's intention to bring about greater stability and certainty for levy payers. The NAPF believes that this aim should encompass providing clear incentives for payers to reduce levy charges. This paper sets out our general comments on the five main areas identified for consultation by the Board and our answers to the specific questions raised.

3. The NAPF is the leading voice of workplace pensions in the UK. Our 1300 members provide pensions on behalf of more than 15 million people and have combined assets of around £800 billion.

SECTION TWO – GENERAL COMMENTS

Evolution of the pension protection levy

4. The NAPF broadly supports the PPF Board's intention to maintain a stable overall levy estimate over the next three levy years and to move towards a longer term (5 years) for measuring all risks. It is important, however, that incentives to reduce risk are not diminished by development of the levy.

5. While we support the principle of reducing cross-subsidy, we feel there is an element of cross-subsidy ignored in this paper. There is no consideration given to the possibility of increasing the ratio of the risk-based levy to the scheme-based levy. We believe that this is an area which should continue to be given attention in any discussion of the future development of the pension protection levy.

Measurement date of risk factors

6. The NAPF feels that the proposal to align the date of data supply to that of risk calculation is welcome, as is the idea to set that date in advance of the levy

year. But many NAPF members have expressed concerns at the 12 months proposed for the period between data collection and the start of the levy year and we outline the main ones in our answer to question 3.6.3 below. We also urge the PPF to consider an incentive for levy payers to continue to take deficit reduction measures during that period.

7. We strongly support a single point of contact for data provision to both the PPF and the Pensions Regulator.

Insolvency risk

8. The NAPF feels that adding a second provider of insolvency risk needs careful consideration. Any future provider would need to be as open to changing methodologies as D&B has been during the latter stages of the first two years of its four-year term.

9. We support the proposal to move towards a long term measure of the probability of insolvency.

Underfunding and contingent assets

10. The NAPF supports the intention to revise the measurement of underfunding risk with the aim of producing a fairer distribution of levy charges.

Levy waiver and eligibility policy

11. We fully support the proposals outlined in this chapter of the consultation paper.

SECTION THREE – NAPF COMMENTS ON SPECIFIC QUESTIONS

Question 2.8.2 - Should the PPF seek to stabilise the levy estimate over the next three years?

12. While the NAPF broadly supports this aim of the PPF, we have some concern that by fixing the amount to be collected for the next three years, encouraging employers to improve their scheme's funding position might not be given the emphasis we would like to see.

Question 2.8.3 - Do you agree that the Board should move to a levy distribution formula based on long term (5 year) rather than short term (1 year) risk?

13. We agree with this proposal. It is a measure which should help reduce the volatility of levy charges to individual schemes, an aim which we fully support.

Question 2.8.4 - Do you agree with the approach used to determine the theoretical levy and allocation between average and catastrophe risk?

14. We have questions about the proposals relating to catastrophe risk which are covered in our response to question 2.8.6 below. In essence, many NAPF members feel that it is not appropriate to include catastrophe risk in the levy allocation process.

Question 2.8.5 - Do you believe the Board should use a simple formula to allocate the levy rather than the theoretical formula?

15. We agree with the principle of introducing simplicity wherever possible without undue effect on the equity of the levy allocation.

Question 2.8.6 – We would welcome your views on the proposal to create multiple scaling factors to redistribute the levy so that those schemes that pose the greatest catastrophe or tail risk pay a fairer share.

16. We are not convinced that such a redistribution is desirable for a number of reasons. Firstly, the measurement of catastrophe risk appears to be linked to the size of a scheme's liabilities without taking into account the financial health of the scheme sponsor (which <u>is</u> recognised in the measure of insolvency risk). But a larger fund should only present a larger catastrophe risk if it is also a large liability for the sponsor.

17. Secondly, the proposed redistribution would not take into account the acquisitive employer who, rather than having, say, 10 schemes of £500m, has merged those schemes into a single entity of £5bn on the grounds of efficiency. It seems an odd result that the PPF should then punish that efficiency with an increased levy charge on the grounds of catastrophe risk.

18. Thirdly, large schemes are already paying more because of their size due to the 20% element of the charge coming through the scheme levy. We believe that the ratio of risk levy to scheme levy, an area absent from this particular consultation paper, is one which the Board should at least look at again.

19. Finally, we believe that the Government has given itself powers to adjust levels of compensation paid by the PPF in the event of a 'catastrophic' event in pensions terms. Therefore, to an extent, potential catastrophe has already been taken into account in the structure supporting the PPF.

Question 2.8.7 – We would welcome your views on whether the PPF should increase the levy estimate to include the cost of hedging market risk and insolvency risk or whether this premium should be paid out of existing funds, including assets transferred from failed schemes?

20. No comment.

Question 2.8.8 – Should the Board target a specific funding level for those liabilities and provisions it inherits? Should the PPF target an implied credit rating in a similar way to insurance companies? What time horizon should it adopt when considering these issues?

21. No comment.

Question 3.6.2 – We would welcome your views on our proposals for aligning the date at which the risk factors are measured and by which all data must be supplied to the PPF?

22. We support the objective of having a single consistent date in respect of providing data to the PPF and dealing with D&B regarding the failure score.

Question 3.6.3 – We would welcome your views on our proposals for setting this date 12 months in advance of the start of the levy year.

23. While we acknowledge that this would go a long way towards enabling the earlier advice of levy charges to schemes, we have concerns about the consequences which we strongly hope the PPF Board will consider.

24. Firstly, as a general principle we feel that a 12-month period during which any action to reduce deficits has no effect on the next levy bill could prove to be a substantial frustration for levy payers. Such actions might usually follow from recommendations associated with scheme valuations. But they could also come about voluntarily where an employer or trustee board wants to reduce its levy charge and knows what actions are needed to do so.

25. Secondly, and this time to the potential detriment of the PPF, there could be circumstances where corporate restructuring or a company sale concluded shortly after the beginning of the 12-month period might have produced a higher levy charge than the PPF would receive with reliance on the pre-event data.

26. Finally, there is a perception amongst some levy payers that using data determined 12 months before the levy year - against a background of most final salary schemes having falling memberships and, therefore, a theoretically diminishing scheme-based levy obligation - may not be an entirely appropriate move to make.

27. We believe that the PPF Board should consider introducing a shorter period than the 12 months proposed, if this is operationally possible. In addition, a mechanism should be included whereby the levy charge can be adjusted before the beginning of the levy year in order to take into account significant relevant events or actions.

28. As an alternative to an adjustment before the beginning of the levy year, it might be administratively easier for a post payment rebate system to be introduced in order to retain the incentive to reduce deficits.

Question 3.6.4 – What is your view on the importance of being able to calculate an individual scheme's levy bill in advance of the start of the levy year?

29. We agree that schemes and employers regard it as important to be able to budget ahead. But we also believe that this should not be at the cost of losing the agility to respond to changes in those schemes and employers. While being able to predict the levy bill is desirable, more important to employers is the ability to adjust the amount by understanding how it is determined and being able to take action to change it.

Question 3.6.5 – Do you support the creation of a single point of contact for schemes to provide data upon which the levy is based to both the Pensions Regulator and the PPF?

30. The NAPF supports this move without reservation as it will certainly reduce the burden of information provision for pension schemes.

Question 4.5.2 – What is your view on the possibility of appointing different providers to provide a measure of insolvency risk for different populations? If you support this view, which populations do you think would be best served by which methods?

31. We are a little wary at the prospect of employers dealing with either different or several providers in this area. The issues of equity and simplicity discussed in the consultation paper should be given heavy weighting in the PPF Board's consideration of a move away from a single provider.

Question 4.5.3 – What are your views on the proposed selection criteria for the appointment of a provider for the measurement of insolvency risk in 2010/11?

32. The criteria set out in Annex D of the consultation paper appear to us to be perfectly satisfactory.

Question 4.5.4 – We would welcome your views on whether the Board should move towards measuring the long term probability of insolvency.

33. We believe that such a move is consistent with the aim to introduce greater stability in levy charges, which, as already stated, we support.

Question 5.6.2 – Do you support the Board's proposed approach to allowing the funding limits and RBL cap to remain floating until the proposed levy estimate and draft determination are published in Autumn 2007?

34. This proposal leaves the determination of the two parameters in the calculations for the 2008/2009 levy year until as late as is reasonable in the process. We therefore support it.

Question 5.6.3 – Do you agree that a sufficiently strong levy disincentive should be applied to those schemes that do not submit a s179 valuation by 31 March 2008?

35. While we agree that schemes should be encouraged to meet their statutory obligation to submit a s179 valuation by 31 March 2008, we are not convinced that the threat of a PPF fine, in effect, will help schemes meet that obligation. We are not aware of any particular scheme having a problem with the s179 valuation but we understand that where a problem exists, it is generally in the area of benefit data not being split between pre-6.4.97 and post-5.497, a requirement of the s179 calculation process.

Question 5.6.4 – Are there ways the Board could reduce the barriers to the use of contingent assets, particularly of Type B and Type C contingent assets?

36. No comment.

Question 5.6.5 – The Board would welcome comments on the use of new or additional products to reduce risk, and their potential impact on the levy.

37. No comment.

Question 5.6.6 – How do you think the Board should calculate a long term measure of underfunding?

38. No comment.

Question 6.4.2 – We would welcome your views on whether the levy should be waived for schemes in assessment.

39. We agree that the levy should be waived for schemes in assessment - with the proviso that in the event of a scheme being rescued, the Board should have the right to recover any levies waived during the assessment period.

Question 6.4.3 – We would welcome your views on whether schemes that have bought out all benefits in the name of then trustees should remain eligible for the PPF.

40. We agree with the proposed waiver of the levy charge for these schemes on the grounds of the minimal risk to PPF. The logic of then seeking to make such schemes no longer ineligible for the PPF seems to us to be unarguable.

For further information:

Alan Chart
Email Alan.Chart@napf.co.uk
Tel: 020 7808 1273