Lane Clark & Peacock
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Little change for next year as the PPF finalises the 2009/10 levy

The Pension Protection Fund (PPF) has confirmed that the 2009/10 pension protection levy will go ahead with little alteration from its September proposals (see Pensions Bulletin 2008/41).

In its conclusions on the consultation and its final determination, the PPF makes clear that the pension protection levy estimate for 2009/10 will be that which was proposed in September – ie £700m (last year's £675m increased in line with earnings) – and that it will be divided between schemes as previously proposed. This means that:

- the risk-based element of each scheme's levy will be calculated with reference to its shortfall against a 121% section 179 funding level – schemes which are better than 140% funded will avoid the risk-based element entirely and a taper will operate for those with funding levels in between;
- the cap on the risk-based element of the levy will be 1% of section 179 liabilities; and
- the scaling factor used in the risk-based element of the levy will be 2.22 (3.77 in 2008/09) and the separate multiplier used in the scheme-based element of the levy will be £162 per £1m of section 179 liabilities (£165 per £1m of section 179 liabilities in 2008/09).

The deadlines for submitting information are all as previously proposed other than for block transfers where there has been some relaxation for both the 2009/10 and 2010/11 levy seasons.

Comment *The starting gun has been fired for this year's levy season. Schemes have just over four months in which to take action to minimise the amount they will have to pay, not only for 2009/10, but also for 2010/11. This also may be the last chance for well-funded schemes with strong employers to get the best possible deal given the direction in which the PPF wishes to take the levy from 2011/12 (see article below).*

Big changes afoot as the PPF sets out its vision for the future of the levy

The Pension Protection Fund (PPF) has now published its widely-trailed proposals for the next stage in the development of the pension protection levy. This paper is about how the levy will be apportioned between PPF-eligible defined benefit schemes in the future, rather than the total levy to be collected.

The key intention is to better reflect longer-term risks when apportioning the levy. Under the PPF's revised approach, it is likely that well-funded schemes with strong employers will lose out to less well funded schemes with weaker employers. Furthermore, schemes with defensive investment strategies are likely to be rewarded relative to those who with more aggressive strategies. The PPF intends to bring in this new system from 2011/12.

The consultation paper (with a combined Annex) sets out in some detail the PPF's view of the way forward. The consultation, originally intended for release in October (see Pensions Bulletin 2008/41), proposes:

- A second risk-based element to the levy to reflect the longer-term risks that a scheme poses. The PPF's concern is that schemes appearing to present little risk to the PPF in the short term could, assuming very unfavourable market conditions, enter the PPF over the next five years. In particular, the failure of the largest schemes could have a devastating impact on the PPF's finances. The case study in point is the PPF's US counterpart – the Pension Benefit Guaranty Corporation.

Adding this "long-term" (or catastrophe) risk element will increase the levy for most well-funded schemes with strong employers, particularly the larger schemes, and decrease the levy for many underfunded schemes with weaker employers.

- Making allowance for scheme-specific investment risk in both the current "short-term" risk-based element of the levy and the proposed "long-term" component. The idea of reflecting investment risk in the levy was considered, and rejected, by the PPF in 2007 (see Pensions Bulletin 2007/23), but the PPF now thinks that this decision should be revisited.

  The initial proposal is to base the analysis of investment risk on information already held on the Pension Regulator's online "Exchange" data system. Schemes more heavily invested in return-seeking assets (such as equities and property) will be penalised relative to those invested in assets such as gilts.

The scheme-based element of the levy will be retained but not necessarily at the existing 20% proportion.

Responses to the consultation should be received by 13th February 2009.

Comment *The proposals may stir up controversy because of the clear losers that will emerge. Whilst it may be difficult to argue against the PPF's intentions, the precise way in which they have gone about it may be more open to challenge. For example whether the proposed combination of short-term risk with the risk posed to the PPF over the next five years (assuming adverse market conditions) is in fact "fair"; whether the increase in complexity in the levy formula, with the inevitable increases in advisor fees and reduction in stakeholder understanding, is justified given the approximate nature of some of the inputs to the calculation – particularly the Dun & Bradstreet failure score; and whether the investment risk adjustment will affect trustees when setting asset strategies.*

On this last point the PPF assert that the introduction of investment risk should not materially affect the investment choices of a rational investor, but it remains to be seen how the message that schemes will be penalised for investing in equities from an organisation as influential as the PPF will affect the average trustee.

Transfer value guidance – Pensions Regulator response

Following the publication of its good practice guidance on the new transfer value regime (see Pensions Bulletin 2008/41), the Pensions Regulator has issued its response to the consultation on the draft guidance.

Points raised in this response include:

- **Options that benefit the scheme –** The Regulator acknowledges the argument that its guidance approach of not allowing for options that reduce an initial cash equivalent may be considered illogical in a 'best estimate' method, but, it goes on to say that it considers the issue to be settled.

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- **Investment strategy –** The Regulator's desire not to add any further level of detail to its draft guidance to assist trustees in setting assumptions that reflect the investment strategy of the scheme is expressed, the Regulator stating that any such further detail would be *"overly prescriptive"*.

- **Existing quotes** – The hope that the Regulator would express a view on the issue of how schemes should approach situations where a quote was issued before 1st October on the old basis, but the individual has not accepted the quote by this time has been quashed The Regulator has decided not to cover transitional issues in its guidance and *"on this issue does not have a view either way"* recommending only that trustees obtain legal advice.

Pensions Policy Institute – Qualifying earnings for defined contribution schemes

The Pensions Policy Institute has published a briefing note that examines the difficulties surrounding the qualifying earnings definition in the Pensions Bill being used as part of the money purchase quality requirement for auto-enrolment.

The note compares this definition (all earnings within the band £5,035-£33,540) with the reality that many private sector defined contribution schemes use a definition of basic pay without a deductible. The concerns include the need for reconciliation, which could be administratively expensive, the consequential top up contributions (from employer, member and Government through tax relief) and the fear that all this could lead to opting-out by employees and levelling down by employers.

Alternatives to the proposed legislation are examined. The note concludes by stating that a trade off will be required between a lower burden on employers but with some individuals receiving less than the minimum contributions and ensuring that all individuals receive the minimum but with the real risk of employers levelling down to circumvent administrative complexity.

Pensions Policy Institute – Early access to pension funds

Allowing early access to pensions savings could boost overall retirement provision, according to a report published by the Pensions Policy Institute.

The report examines the advantages and disadvantages of allowing early access to pension savings in certain circumstances, such as for a first home and in times of financial hardship. In examining the policy options for early access it considers the potential trade-offs between making pension saving more attractive to encourage greater saving levels, but discouraging excessive access which could leave less money available for retirement.

The report looks at four models for early access – "loans and withdrawals", "permanent withdrawals", "feeder funds" and "early access to lump sums". The impact on individuals' pension pots is assessed through three sets of assumptions whose justification is based on US research into mainly 401(k) plans. Unsurprisingly, depending upon the model chosen, the limitations on early access set for that model and the assumptions made, there is scope for either an increase or decease in the size of individuals' pension pots, but overall the direction could be positive with the scope for significant increases, especially under the loans and withdrawals model.

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***Comment**:* *This report is of some interest as there has been little or no research into this area before in the UK. While early access may present risks of adverse outcomes for retirement income for some individuals, it may also represent a previously unappreciated tool for pension policymakers to overcome resistance to pension saving.*

Review of internal controls code of practice and guidance – Questionnaire

The Pensions Regulator is reviewing the internal controls code of practice and guidance. The first stage of this review is taking the form of a short survey with the aim of gathering industry feedback to assess whether the guidance is still achieving its aim and continues to be relevant.

This Pensions Bulletin should not be relied upon for detailed advice or taken as an authoritative statement of the law. For further help, please contact David Everett at our London office or the partner who normally advises you.

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