

The Pension Protection Fund
Regulation and Risk Management

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Pension Protection Fund in Context

Mega Trends

- **Climate Change**
 - Rise of financial economics
 - International accounting standards
 - The risk society
- **Economics**
 - Low interest rates
 - Longevity
 - Volatility of asset returns, currency movements
- **Reliability and Confidence**
 - Failure of security leading to failure to save

Why are we here?

“Life is not fair. But there can be few crueller fates than that suffered by those who spend their entire career contributing to a company pension scheme only to find their retirement plans ruined by the business’s financial difficulties.”

Financial Times October 2005

Role of the PPF

The Pension Protection Fund is a focussed solution to a specific problem of:

- significantly under funded pension schemes whose sponsoring employer is insolvent

Its role:

- To pay compensation to members of defined benefit schemes which are under funded and whose employers are insolvent
- By paying the right amount of compensation to the right people at the right time the Pension Protection Fund may improve confidence in defined benefit schemes more generally

Compensation levels

- **100% level of compensation for those over the scheme's normal retirement age**
 - Indexation for service after 6 April 1997 capped at 2.5%
- **90% level of compensation for those below pensionable age, with a benefit cap of £26,050 aged 65**
 - Revaluation in line with Retail Price Index capped at 5%

How will the PPF be funded?

- **PPF takes in the remaining assets of schemes for which it assumes responsibility**
- **Returns on PPF investments**
- **Raising an annual levy on all eligible DB and hybrid schemes**

Risk Based Levy

Guiding principles

Fairness

- Best evidence
- Incentivise risk reduction

Simplicity

- Data relevant and material to the risk being managed
- Market solutions

Proportionality

- Balancing interests of employers and members
- Levy reflects risks of a scheme

Risk Based Levy

- 2006/2007 introduction of the risk based levy
- 20% of overall levy is based on Pension Protection Fund liabilities
- 80% of overall levy is based on underfunding risk, insolvency risk and contingent assets
- Levy capped at 0.5% of a scheme's PPF liabilities to protect weaker schemes and their sponsoring employers
- Proposals developed through open and transparent consultation with the UK pensions industry

Risk Based Levy

Proposals provide **INCENTIVES** to reduce risk

- Special deficit repair contributions made since last scheme valuation up to 31 March 2006 to be recognised
- Recognition of contingent assets – parental guarantees, letters of credit, pledged assets
- Risk based levy rate of NIL if assets, including relevant contingent assets, are at least 125% of PPF liabilities
- Stepped incentive for schemes funded above 104% PPF liabilities

Investment Strategy

- Statement of Investment Principles revised in October – “Safety First”
- Asset portfolio to be diversified to enhance returns
- Liability driven approach targeting a 1.4% pa out-performance over the benchmark
- Lower risk budget than typical UK DB schemes
- Strategy balances security for scheme members and the interests of levy payers
- Reduces impact of unrewarded risks
- Limits exposure to the risk of underperforming at the same time as UK DB pension schemes

First Year Experience

- **The themes of the 1st year have been:**
 - Complexity not volume
 - Balance between security and affordability
 - Positive action by sponsoring employers
- **87,000 scheme members already benefiting from protection**
- **First schemes to transfer into the PPF by the end of the year**
- **Introduction of the risk based levy – a world first**

Conclusion

- Difficult and complex issues – affecting us all
- We are a new regime, but hopefully one seen as a landmark development
- Reasonable approach which is open and transparent
- Incentivising and encouraging risk reduction in the system
- Striking the right balance between affordability and security
- **Working with the UK pensions industry we can deliver security in retirement for millions of UK pension scheme members**