

PENSIONS

REGULATORY

Levy goes bottom-up

The PPF is going ahead with a revamped levy from next April. The best funded schemes will be the main beneficiaries of the new bottom-up formula.

Employers should pay attention to their D&B failure scores on the last business day of each month until March 2012. These will determine insolvency risk for the 2012/13 levy.

The aim of the changes is to give a scheme more control by making its levy reflect the specific risk it poses to the PPF. In the past a scheme's bill has depended on the PPF's annual decision about the levy parameters (like the scaling factor and the levy cap) and on changes in the risk profiles of all other schemes. These external factors made it little more than a lottery whether a scheme's risk-reduction measures would cut its levy significantly or not.

The new levy will depend more on the scheme's funding position and less on the risk of the employer's insolvency, and it will be more stable from year to year.

What is changing

These are the main changes.

- The total levy the PPF is aiming for will continue to be set annually but the **levy parameters will be fixed for three years** at a time.

This means the scaling factor (used to increase all the individual levies to the target total) and the levy cap (the maximum a scheme can pay) should remain constant for levy years 2012/13 to 2014/15. These parameters will be published in the autumn of 2011. They will only change over the three years if the total levy estimate would otherwise alter from one year to the next by more than 25%.

One important question is how stable levies will remain in successive three year periods. There will be a lot of disappointment if volatility has merely been stockpiled.

- **Funding will be smoothed** to reduce the influence of temporary market movements. In the past, schemes' funding positions have been brought to a common measurement date by applying the relevant indices and yields on that date. In future, a five-year daily average will be used instead.

- **Investment risk will be taken into account** by stress testing a scheme's funding with hypothetical changes in asset and liability values. The test will be based on the asset allocation the scheme has reported to the Pensions Regulator. On the liability side, it will look at a reduced discount rate and an increased inflation assumption.

In most cases the PPF will do the test. But a scheme will be able to use a more elaborate, bespoke approach if it wants to. Schemes that use strategies to alter the sensitivity of their portfolios to particular risks might want to consider this option. Schemes with liabilities over £1.5bn will be obliged to use the bespoke test.

In practice, schemes investing conservatively – in gilts and bonds, say – will tend to pay lower levies.

- **Insolvency risk** will be taken as the employer's average D&B failure score over 12 months rather than on a single date. For 2012/13 the score will be taken on the last working day of each month from April 2011 to March 2012.

The employer will then be placed in one of 10 bands of insolvency risk (down from the current 100 bands). There will be no transitional provisions to protect employers that drop into a lower band from one levy year to the next.

The PPF says information D&B receive by the end of one month will be reflected in the employer's failure score by the end of the following month at the latest.

- The **scheme-based levy** will have the dedicated purpose of covering the cross-subsidy that results from the cap on what high risk schemes pay. The aim is to make this cost visible. In practice, the scheme-based levy is likely to account for about 10% of the total.

What is not changing

- The big picture stays the same. The levy will continue to be made up of a risk-based element (reflecting underfunding and insolvency risks) and a scheme-based component of up to 20% of the total.

continued overleaf

Welcome

Welcome to **Pensions**, our bimonthly update keeping you informed of developments in pensions law.

To find out more about how we can help you with your occupational pension scheme, please email richard.knight@burgess-salmon.com or call him on 0117 939 2259.

- There will continue to be a cap on the risk-based levy a scheme can be asked to pay.
- Contingent assets will continue to be recognised for levy purposes as they have been to date.
- “Last man standing” multi-employer schemes for associated companies keep their 10% discount. But there will be a change of approach to non-associated last man standing schemes.

Impact on schemes

According to the PPF’s modelling, schemes that are well funded on the smoothed and stressed measures will normally

pay lower levies in future.

The **main winners** are expected to be the best funded 20% of schemes, though the reduction in levy is small where the employer is at high risk of insolvency.

The **main losers** are expected to be those of the remaining 80% of schemes where the employer is at low (sic) risk of insolvency.

There is a summary of the likely impact in the PPF’s policy statement: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/levy_policy_statement_May11.pdf

There is more detail in an annex.

Important dates

Monthly D&B failure scores for 2012/13 levy	Last working day of April 2011 to March 2012
PPF holds public consultation on draft levy determination, including parameters for 2012/13 - 2014/15 and target total levy for 2012/13	Autumn 2011
PPF’s final determination of 2012/13 levy	December 2011
Invoicing of 2012/13 levy starts	Autumn 2012

There is a lot of detail still to come out. The consultation in the autumn should fill in most of the gaps and allow schemes to estimate their levies.

Comment

The recast levy has generally been welcomed because it gives schemes – and trustees in particular – significantly more control over their levy bills. It replaces a volatile

and unpredictable system. That said, the new formula is likely to produce some significant losers as well as clear winners.

In the long run, support for the new approach will depend importantly on the stability of the levy in successive three year periods.

Employers should work on their failure scores regularly.

Regulator’s plans

The Pensions Regulator’s latest corporate plan sets out its priorities for 2011-14:

- to help employers prepare for auto-enrolment from 2012,
- on DC, to promote successful saving for new and existing members in this increasingly important sector,
- on DB, to reduce risk to members and to the PPF,
- to raise standards of governance, particularly over administration and record keeping, and on wind ups and
- to revisit its strategy on DB funding, not least in relation to the rising number of closed and maturing schemes.

LEGAL

Abolition legislation takes shape



HMRC is publishing a series of practical guides about the ending of DC contracting out from April 2012. It published

the second *Countdown Bulletin* in April. Go to: <http://www.hmrc.gov.uk/nic/countdown-bulletins.htm>.

As you would expect, trustees will have obligations to tell members about abolition. The latest regulations about abolition set backstop dates for telling members that the scheme has ceased to contract out (by one month after abolition) and what the consequences are (four months afterwards).

The detailed legislation about abolition is incomplete but continues to take shape.

In the office

We welcome **Catrin Young** (Senior Associate) and **Helen Trethewey** (Associate) to our pensions team.



Having mixed pensions and employment law

work for several years, Catrin has specialised in pensions law for four years.



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