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New Levy Framework from 2012/13: delivering stable, predictable levies

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Agenda

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- The PPF: Current Position and Future Evolution
- The New Levy Framework (NLF)
- Consultation on 2012/13 Levy Rules
- Points for schemes / advisers to consider

The PPF today

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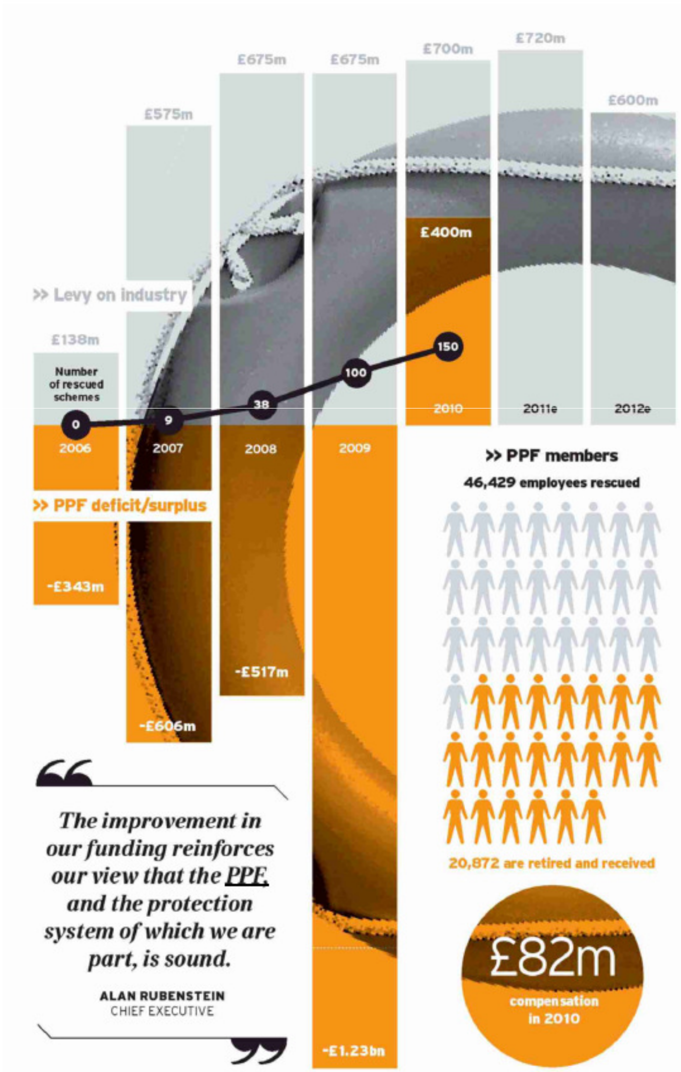

Graphic: Daily Telegraph, 2010

Members

- 110,000 members protected (PPF & FAS)
- A further 215,000 PPF members from around 350 cases in assessment

- Financials
- £14bn balance sheet and £7.4bn investment portfolio
- £1.15bn assets recovered from employers
- £3.3bn assets transferred from schemes
- £2.9bn levy collected

Looking to the future: PPF Funding Strategy

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- Published August 2010 – update shortly
- We expect risk to decline significantly over the next 20 years:
  - Size of the insured population
  - Liability duration
  - Scheme de-risking
- PPF aims to reinforce balance sheet as scope for levy recedes
  - No reliance on levy when aims for 2030 realised

Funding Strategy

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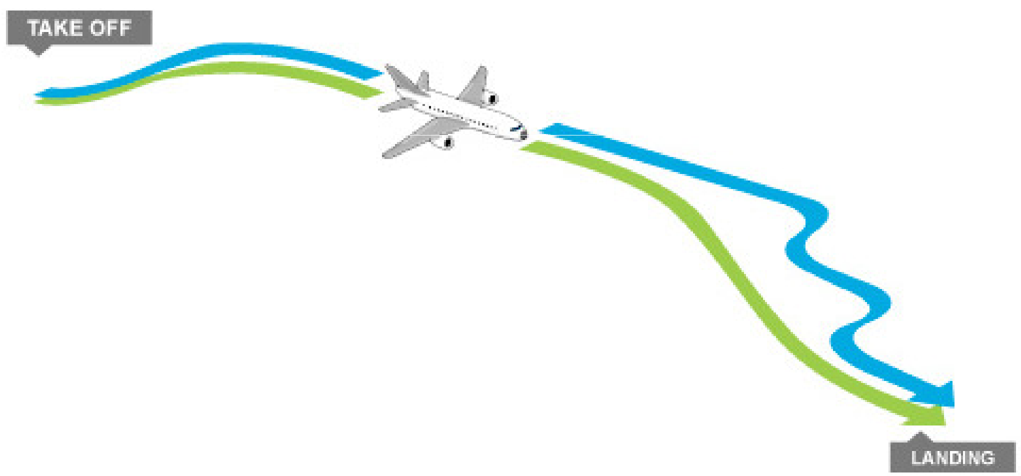
A flight-path to self-sufficiency by 2030:



Measured as *probability of success*

- Fully funded on a 'risk-free' measure of liabilities
- Fully hedged against key market risks:
  - interest rates
  - inflation
- Reserve (10% of liabilities) against future claims and longevity risk

Why the levy needed updating

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- Quantum vs distribution
  - Quantum based on funding strategy – takes account of risk of adverse claims
  - Distribution doesn't
- Consumer feedback:
  - experience of volatility in individual bills
  - difficulties in planning and budgeting
- Established Steering Group

Messages from the Steering Group

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- More predictability in individual bills
  - i.e Levy reflects their own risk, not others.
- Stability of levy bills also a priority
- Speak our language & focus more on things schemes can actually control:
  - Schemes typically have 3 year cycle
  - Funding position
  - Potentially investment strategy
- More transparency on cross-subsidy
- Stronger link to commercial charging – market consistency

Key Features of New Framework

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Bottom-up approach

- Fixed scaling factor for three years, only adjusted in limited circumstances
- Total levy free to change – will be sum of individual levies.
- More predictable levy bills at ‘consumer’ level

New approach to risk measurement

- Changes smoothed by using average values, so more levy bills more stable
- Market-consistent rates for insolvency
- Takes account of investment risk for the first time

How we will assess underfunding risk

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- Funding measurement to start of levy year
- Funding smoothed over 5 years, by averaging market movements in roll forward calculation
- Funding calculation incorporates investment risk by applying stresses to assets and liabilities
- For great majority of schemes, based on existing asset allocation data reported through Exchange
- Largest 100 or so schemes required to provide more detailed analysis; optional for others. Consulted on draft guidance for bespoke test.

How investment risk will be measured

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- For all schemes, PPF will adjust liabilities reported through Exchange by applying risk factor stresses

Inflation	Interest rate
+34bps	-61bps

- Largest 100 schemes (approximately) required to submit additional information on stressed assets in scheme return

- The PPF will apply stresses to assets for all other schemes, although they may choose the bespoke approach

Investment risk: Standard approach

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- PPF will adjust assets reported through Exchange by applying the following stresses

Corporate bonds	Nominal gilts	Index-linked bonds	UK Equity	Overseas Equity	Property
0%	+10%	+16%	-22%	-16%	-6%
Cash	**Hedge Funds**	**Commodities**	**Insurance Funds**	**Annuities**	**Other**
0%	-7%	-16%	-22%	+16%	-22%

How will schemes measure bespoke investment risk?

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- Schemes likely to need advice
- Outcome similar to standard model, except for those with derivatives
- Two stage process
  - Expanded set of asset categories
  - Assessment of sensitivity to risk factors for derivatives
- Received 20 submissions on draft guidance

How we will assess insolvency risk

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- Employers placed into ten PPF levy bands – instead of 100 failure scores
- Risk margin added to insolvency probabilities (in line with how financial markets would price PPF-equivalent risk)
- Average score over last 12 months used to put employers in bands, so levies less affected by short-lived dips in score
- Greater recognition of reduced risk for non-associated last man standing schemes

Putting it into practice – Consultation on Levy estimate 2012/13

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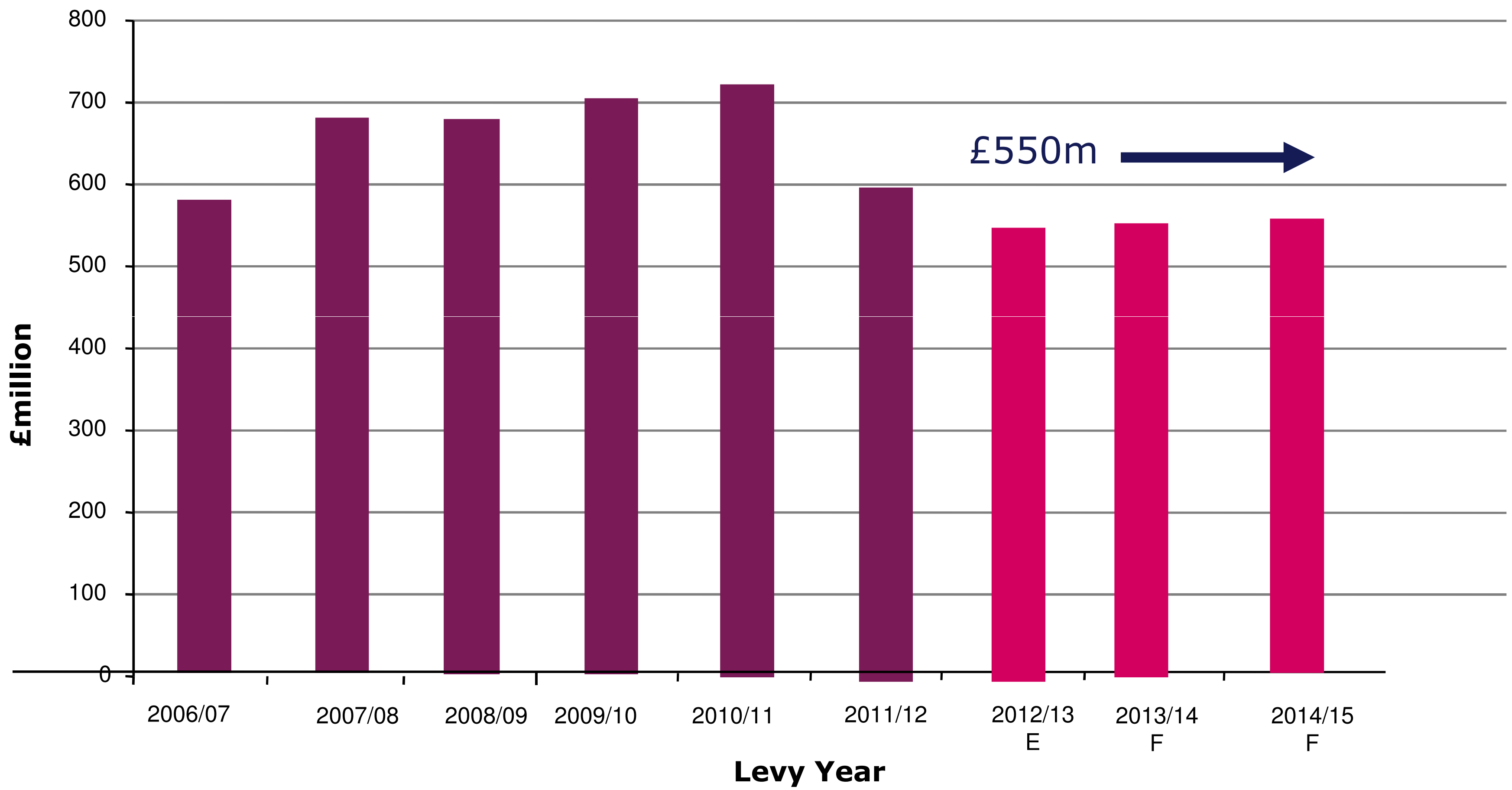

Putting it into practice – parameters

- Draft 2012/13 Determination published for consultation
  - Risk-based levy scaling factor of 0.89
  - Risk-based levy cap at 0.75 per cent of liabilities
  - Scheme-based levy set at around 11% of total levy
  - Changes to Rules for Contingent Assets
- Closing date 2 November 2011

Determination: Contingent Assets

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Key changes:

- Broader definition of ‘associate’
- Type A –application of guarantor’s insolvency risk in multi-employer schemes
- Type A - requirements regarding strength of contingent asset guarantors

What should schemes do next?

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- Respond to consultation – open until 2 November
- Ensure D&B has accurate, timely information for monthly failure scores
- Complete scheme return accurately, once available (with special attention to asset allocation info.)
- Consider whether bespoke asset stress test is appropriate for schemes under £1.5bn
- Consider risk reduction measures

Questions?