31 January 2007

Email to consultation@ppf.gsi.gov.uk
Sara Protheroe
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Dear Ms Protheroe

Consultation on the 2007/08 Pension Protection Levy Estimate

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation document.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

At £675m, the levy estimate has risen to a level that represents a considerably increased burden on scheme sponsors. Levy payments will, on average, be more than twice the amount that they were in 2006/07, and more than twice the amount that might have been supposed by Parliament when it voted through the new Fund on the basis of an estimated annual cost of £300m.

We have always said that the £300m initial estimate seemed significantly too low, and at one level we are relieved to see that steps are being taken at a fairly early stage to acknowledge that the current compensation benefits cannot be expected to be provided for anything like that amount. However, we have concerns that this year’s increase is not necessarily the end of the significant increases, and that the levy may still have some way to rise; there is insufficient information in the consultation document to draw inferences about this.

We note that (despite its length), nowhere in the document is any mention made of the facility under the Pensions Act 2004 for the Board to make (or recommend) reductions to the compensation benefits, as an alternative to increasing the levy. The implication appears to be that this possibility was not even considered, which we find disturbing; in our opinion, this option should form part of the consultation/debate.

We are also surprised that, despite the ‘long term objective’ mentioned in 4.1.2 of the document, there is no serious discussion of the arguments for increasing the risk-based element of the total estimate above the 80% minimum stipulated by legislation. This is despite the fact that, arguably, a higher risk-based percentage would have been appropriate in 2007/08 purely to offset the fact that, in practice, in 2006/07 less than 70% of the total levy raised ended up being on the risk-based formula.

Generally, we think that the document would benefit from much greater transparency. (We would like to add ‘transparency’ to the three principles of fairness, simplicity and proportionality.) There is a lot of ‘qualitative’ detail of the factors taken into account by the Board in making its proposals, but little in the way of quantification; so, for example, the figure of £675m appears in paragraph 4.2.4 without any clear link to what has been said before.

The most obvious place in which we consider that the detail in the document falls short of what we would have expected (and what would be required of actuaries in analogous reports for their clients) is the absence of any split of the £675m between an ‘ongoing’ cost and an amount to make good the ‘past service’ deficit (the inclusion of which is highlighted by the associated press release). The absence of such detail makes it very difficult to give good comment on the proposals.

We can understand the reasons why the Board wants to leave determination of the scaling factor and multiplier until April. However, we think that this ‘unknown’ sits rather uneasily with the claim at the start of Chapter 5 that the use of a 31 October date for determining scheme underfunding will “increase certainty and stability for levy payers”.

It appears that the Board’s intention is to set the final scaling factor and multiplier such that, regardless of changes in financial conditions between November and April, the amount raised will be £675m (with adjustments to this amount only in respect of new deficit contributions or contingent assets for individual schemes). It is not obvious to us why it is appropriate for the levy collected to be unaffected by changes to bond yields, equity prices and the general outlook for company insolvencies, as such changes would surely affect the risk to the PPF over the year in question. This leads us to the conclusion that it may not be as important as the Board thinks for the final scaling factor and multiplier to be deferred until after the beginning of the levy year. The two main reasons why the levy collected for 2006/07 was much less than that which was originally expected seem to be changes in financial conditions and changes in data; as we have said, the former would appear to be validly reflected in a changed total invoiced levy, and we hope that the latter problem was a ‘teething’ issue in the first year which will not recur to anything like the same extent in subsequent years.

We agree with the proposal to take most County Court Judgements out of the reckoning for determining insolvency risk. We note that this will not affect the overall levy raised, and so there will be an increase in levy paid by sponsors who have settled any CCJs to pay for the gain enjoyed by those who have unsettled CCJs; this may well not have been clear to all readers of the consultation document.

We note that the draft Determination provides that, in determining the underfunding risk for an individual scheme, deficit reduction contributions are taken into account at face value, even if they were paid over a year ago (as would be the case where the same certificate was submitted for the 2006/07 levy). Although we appreciate that, in general, investment returns are disregarded in Actuarial Certificates of Deficit-Reduction Contributions, we suggest that it may be appropriate to add an investment adjustment to contributions on a year-old certificate.

Finally, we will be happy to respond to any questions you have on our response. Please contact myself (charles.young@hymans.co.uk) or Graham Everness (graham.everness@watsonwyatt.com)

Yours sincerely

Charles Young
Chairman
Pension Schemes Sub-Committee of the Association of Consulting Actuaries