Written submission from the Pension Protection Fund (PPF)
Work and Pensions Select Committee inquiry
Defined benefit pension schemes

Summary points

- The improved overall health of DB schemes is welcome. This allows greater focus on the next phase as more DB schemes mature and approach their endgames.
- The revised DB Funding Code will help manage risks and support schemes in reaching their ultimate funding goals.
- However, challenges remain in certain areas – a small subset of stressed schemes endures; smaller schemes may struggle to achieve suitable endgame solutions relative to bigger schemes.
- Consolidation, particularly for smaller and stressed schemes, could have an important role to play, but this may be challenging to achieve through existing market-based arrangements.
- Consolidation can also support a change in investment objectives, away from reaching a particular endgame as quickly as possible, towards growing value over time and could lead to investment in a wider range of asset classes.
- The PPF's financial strength brings greater certainty to members and has enabled us to bring down costs for sponsors (through reduced levy).
- We recognise this has increased focus on our own endgame, including member outcomes.
- Changing PPF compensation levels, specifically to provide improved indexation protection, would have significant financial impacts for the PPF and wider implications for DB schemes and potentially the taxpayer (if applied to FAS).
- Given our unique capabilities, we stand ready to support, and if needed deliver, any suitable prospective solutions to drive better member outcomes in the future.

About the Pension Protection Fund (PPF)

The PPF protects the 10 million members of defined benefit (DB) pension schemes in the UK. In the event a sponsoring employer of a DB scheme becomes insolvent, if the scheme can't afford to provide its members at least PPF benefit levels, we will take it on and pay compensation to members on their lost pensions.

The PPF is a statutory corporation, established under the provisions of the Pensions Act 2004 (PA04). We became operational on 6 April 2005.

The PPF is funded principally through four main sources:

- Taking on the assets of the schemes which transfer to us,
- The returns we make from investing our assets,
- Charging an annual levy paid by PPF eligible schemes, and

- Recovering money, and other assets, from the insolvent employers of the schemes we take on.

Over time the fund has grown significantly in scale. Since 2005, we have taken on over 1,000 schemes with more than 295,000 members. Our assets have grown over time – as at 31 March 2022 we had £39bn in assets under management (AUM), placing us among the largest pension funds in the country.

We additionally manage the Financial Assistance Scheme (FAS) on behalf of the Department for Work and Pensions (DWP), which performs a similar role to the PPF, paying assistance to members of underfunded schemes which began winding up between January 1997 and April 2005.

We also are responsible for the Fraud Compensation Fund (FCF) which pays compensation to pension schemes where the employer is insolvent and the scheme has lost out financially as a result of dishonesty. The FCF is funded by a separate levy on all occupational DB and defined contribution (DC) schemes.

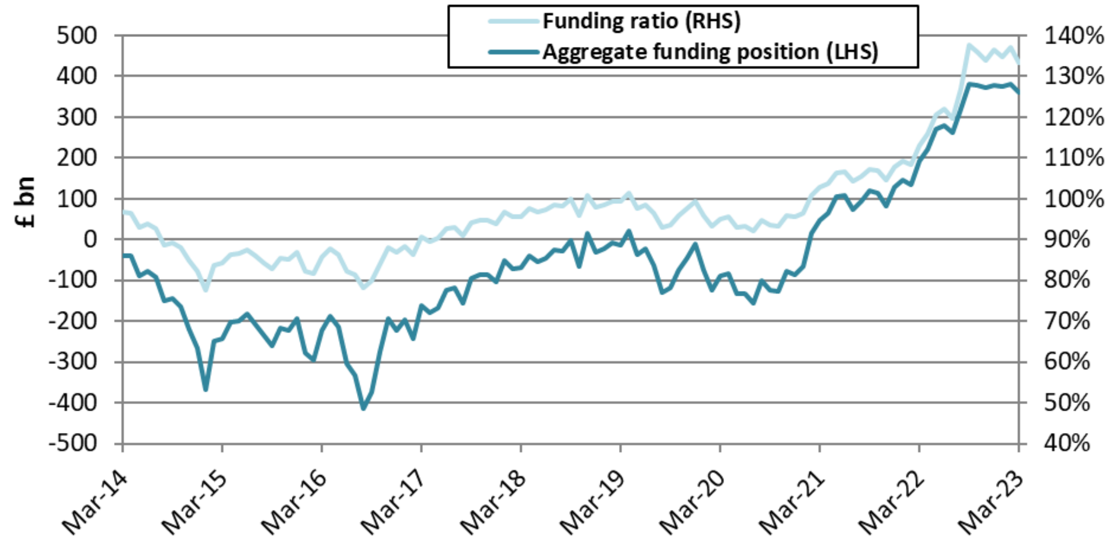
Introduction

We welcome the opportunity to contribute to this important inquiry.

As the Committee rightly notes, DB pension schemes collectively stand in a better position today than they have done for over a decade. Years of historically low interest rates and rising life expectancy put pressure on DB funds, contributing to rising costs for sponsoring employers and long periods of persistent underfunding. The last few years have seen a significant improvement in overall scheme funding. Employer contributions over many years have boosted scheme assets, and rising interest rates have helped reduce schemes' liabilities. Substantial recent rises in gilt yields have further accelerated this already improving trend. We estimate that the aggregate funding position of the remaining 5,100 schemes (on a s179 basis)[1] now exceeds the previous peak seen around 15 years ago, prior to the 2008-09 financial crisis.[2] The recent improvements in aggregate funding are illustrated in the chart below taken from our most recent PPF 7800 publication.[3]

[1] s179 valuation basis estimates the cost of securing PPF levels of compensation with an insurer.
[2] 7800 Index – c.118% funding ratio in May 2007 CF 137% in March 2023
[3] The PPF 7800 Index - April 2023 (ppf.co.uk) To note, our scheme funding index reflects both the improvement in the position of schemes and that buyout pricing has become more competitive.

Chart 1: Historical aggregate funding position (assets less s179 liabilities) and funding ratio of schemes in the PPF universe



This is clearly positive and welcome news – it gives greater confidence to scheme members over the security of their promised benefits, and ultimately to the PPF and our levy payers. Furthermore, our modelling suggests DB scheme funding, in the majority of scenarios, should continue to improve over time. This is because employers will continue to fund any deficits which arise and actual investment returns are expected to increase scheme funding over time.

While it is vital to avoid complacency – there are some scenarios where scheme funding could deteriorate, and last autumn's gilt market stresses show greater resilience is needed – the more positive outlook we find today enables greater consideration of the next stage.

As more schemes mature and approach their endgames, it is increasingly important to consider how best to manage remaining risks, and to weigh the merits of different approaches on how to respond to funding gains. These are important considerations too for the PPF, particularly given the recent improvement in our own funding journey.

We also recognise that the current high inflation environment, coupled with our own improved financial strength, brings questions specifically for the PPF, and renewed interest in our compensation levels.

Overall regulatory framework – DB funding code

We believe the current regulatory framework, underpinned by the PA04, remains broadly appropriate. That said, we recognise there are still opportunities to better manage risks and improve member outcomes. To that end, we are supportive of the work, led by DWP and the Pensions Regulator (TPR), to introduce a revised DB Funding Code.

Scheme underfunding is one of the biggest risks we face. While recent years have seen a welcome improvement in overall scheme funding and a reduction in overall investment risk, this is not true across all schemes. For example, we know that around 15 per cent of schemes still have over 50 per cent of their assets in equities, meaning that some volatility in funding positions and continued risk to the PPF is still expected. Given this, we believe there is an opportunity to capitalise on recent funding gains. We'd encourage schemes whose funding has improved to consider reducing their investment risk to give greater assurance to members.

But despite recent positive trends, there are still a small portion of DB schemes who are funded below PPF levels and may pose a claims risk to us for some time to come. We want these schemes to close their deficits as quickly as reasonably possible to avoid unnecessary risks to both members and the PPF.

Through this lens, we support the proposed structure and key expectations of the proposed Code. We welcome the expectation that schemes set a Long-Term Objective (LTO) and a journey plan of how they will get there. Reliance on sponsors should reduce as schemes reach maturity; once schemes have reached maturity, they should have minimal dependency on the employer, and be fully funded on a low dependency basis. Setting clear, objective standards will help provide clarity to schemes and consistency in assessment. The twin track approach – Fast Track and Bespoke – will help enable greater regulatory effort to focus on those schemes which fall below the benchmarks.

The funding approach for open schemes is important to the PPF given that many of the larger schemes in the DB universe remain open and have considerable deficits on a s179 basis. For example, the PPF 2022 Purple Book shows that open schemes are around 20 percentage points worse funded than closed schemes, as measured by the aggregate s179 funding ratio, and their aggregate s179 deficit in the Purple Book 2022 was £7.4 billion. This means they may significantly impact the PPF's funding if they were to claim. Overall, we consider that the DB Funding Code takes a pragmatic approach to open schemes by allowing population changes to be reflected for a limited amount of time, influencing the amount of investment risk schemes can take.

While the new proposed Code will, in our view, help ensure many, particularly bigger, schemes are appropriately funded and reduce risks to scheme members and the PPF, challenges of a more structural nature will likely remain.

Sub-scale schemes, comprising the long tail of small and a subset of stressed schemes, collectively constitute over a third of the remaining 5,100 DB schemes. These schemes face enduring headwinds in operating efficiently and effectively. Given the relative cost of professional advice and support, and the lack of economies of scale, they can face greater challenges planning and executing the best possible investment strategies. Added to this, we believe there are specific barriers for sub-scale schemes in securing the best outcomes for their members, namely a lack of access to endgame solutions, such as buyout.

We think there is merit in considering the role consolidation might play in supporting smaller schemes, and a wider opportunity to start discussing the possibility of system changes to achieve the best possible outcome for members in the sub-set of stressed schemes.

Buy-out market capacity

It is welcome that more schemes, through improved funding, are finding themselves able to secure members' benefits with an insurer through a buyout. When a scheme completes a buyout, members' entitlements are fully protected through the insurance regime and it is no longer a risk to the PPF. However, we believe this option is, in reality, not equally available to all schemes.

Industry estimates suggest annual capacity in the buyout market of c.£50-100bn. With £1.7 trillion in DB scheme liabilities outstanding, it is open to question whether current and future market capacity – both financial and administrative – is sufficient to cater for all schemes who might want now and in the coming years to secure a buyout.

We believe there are specific barriers faced by smaller schemes in securing buyouts, namely practical issues such as insufficient administrative resources to get schemes 'buyout ready,' as well as relatively high costs in transacting, such as accessing legal advice and cleansing scheme data. These factors may help explain what we are increasingly seeing (through dealing with growing numbers of overfunded schemes in our assessment process), namely insurers focusing their administrative resources on concluding bigger deals, with less appetite in transacting with smaller schemes.

Where we can, we are using our influence and expertise to facilitate solutions for smaller schemes in this position. However, in the expectation that more smaller schemes may want to engage the buyout market in future, we believe this is an area which requires further consideration to ensure smaller schemes have the same access to endgame solutions (including buyout) as bigger schemes.

DB scheme consolidation

As the PPF is itself a form of consolidation vehicle, we well recognise the potential benefits of consolidation. Consolidation offers opportunities to drive greater efficiency from scheme assets, reduce costs, and improve governance and customer service to members. There are also potentially benefits for regulatory oversight, enabling TPR to better assess systemic risks.

Given the highly fragmented nature of the universe of DB schemes, consolidation could play an important role in the future. The majority of DB schemes are relatively small – 80 per cent have fewer than 1,000 members [4] – but the vast majority of all assets are held by a small number of large schemes.

[4] Purple Book, figure 3.11, pg.11.

In recent years, commercial consolidators – often known as 'superfunds' – have emerged, as well as other models (such as DB master trusts and Capital Backed Journey Plans). We have welcomed both TPR's interim regime for superfunds and the government's commitment to introduce primary legislation. One consolidator has met TPR's expectations under its interim regime, but no superfund transactions have yet been completed (i.e. a scheme transferring to a superfund).

We have engaged with market participants, including the main superfund propositions, particularly in regard to overfunded schemes in our assessment process. From our experience to date, the emerging propositions appear to be targeting the better funded end of the DB market.

We believe there is an opportunity for consolidation to drive better outcomes where there are remaining issues within the DB universe, namely for stressed and smaller schemes, and changing the nature of scheme investments.

Stressed schemes

Despite improvements in scheme funding, there remain a small sub-group of stressed schemes. These schemes can be defined as having a combination of poor funding and weak sponsors, meaning they likely can't reach an endgame with acceptable levels of risk (i.e. within what the new Code deems permissible). It is difficult to say exactly how many schemes are in this category, but to give an indicative sense of how many there could be, we estimate there are around 240 schemes which are less than 80 per cent funded (on a s179 basis) and have sponsors in levy band 8 or worse (indicating a high prospect of making a claim on the PPF).

There is a high risk they will be unable to reach a secure endgame for their members. Their only current path is to run-on and hope, or wind up (if they even can) – there is no alternative solution available to them. We recognise there is no easy answer – any solution would likely require compromises, including potentially on member benefits. But if the alternative is to do nothing and wait until many, in all likelihood, eventually claim on the PPF, we believe the time is right to find better outcomes for these schemes, their members and the PPF.

Small schemes

There are approximately 1,800 DB schemes with fewer than 100 members and a total of c.£15bn in assets. These schemes potentially face a range of issues around their ability to effectively operate sophisticated investment strategies (as evidenced by the difficulties faced by schemes with LDI in pooled funds last autumn), to access endgame solutions, and the general cost-effectiveness of managing the scheme.

There are insurers specialising in providing buyouts for small schemes – so it's not a clear-cut case of there being a market failure (in terms of buyouts). As noted above, in our experience we see the difficulty faced by small schemes, e.g. stand-alone schemes with less than £20m in liabilities, to achieve buy-out. We've also not observed any direct interest to date from existing/emerging commercial consolidators in small schemes.

Consolidation of small schemes could lead to better outcomes through economies of scale, greater professional trustee oversight and administrative expertise. Benefits could also include improved investment management and access to a larger range of assets. Employers of small schemes would also be freed from the 'burden' and risks of scheme management. Through our own engagement with smaller schemes, including through our SME Forum, we are aware anecdotally of cases where pension scheme costs are said to constrain the ability of sponsoring employers to develop and grow their businesses.

We believe further consideration should be given to how consolidation of small schemes could be facilitated. Given our unique capabilities, skills, and experience – in asset management, pensions administration and winding up and transferring schemes – we stand ready to explore, and if required to actively support, the development of any potential solutions in this area.

DB assets

More broadly, we note the increased interest, and encouragement, from policy makers for pension schemes to increase their domestic investment – particularly in alternatives such as infrastructure and private equity – with a view to supporting the wider British economy. To date, policy action has focused more towards supporting DC, rather than DB, funds.

DB scheme trustees are rightly focused on their fiduciary duties, ensuring their scheme is in the best possible position to pay members their benefits in full. This means trustees want their schemes to become fully funded on a prudent basis as quickly as possible (and once there to minimise risk and volatility). This objective also makes sense from an employer perspective given they stand behind all the downside risks associated with the scheme but don't benefit from any upside. As a consequence, many schemes see 'buy-out' - securing benefits with an insurer – as an attractive 'endgame' target (including because, in the event of employer insolvency, schemes *must* seek to buy-out with an insurer).

All of this leads schemes to heavy investment in low-risk assets – such as Government and corporate bonds – that match their liabilities and also match an insurance funding basis. (A further advantage for employers is that accounting standards require scheme liabilities to be discounted using corporate bond yields, so this investment strategy also removes balance sheet volatility). As more schemes approach their endgames, this may drive more investment allocation towards a narrower range of assets.

We do not think this is the wrong approach for schemes. However, we invest differently. We have a responsibility to ensure we are able to pay compensation in full to our current and future members. However, we are not focused on reaching a set funding position and then locking down risk. Instead, we focus on growing our reserves as efficiently as possible (within the risk budget set by our Board) over a long time horizon. This leads us to invest in a very broad range of asset classes including alternatives.

Consolidation of DB schemes could shift scheme investments to a PPF-like approach. Consolidation can provide scale and access to best-in-class asset management. In addition – by severing the link to the employer – consolidation can support a change in investment objectives, away from reaching a particular endgame as quickly as possible towards growing value over time. Altogether we believe this would lead to investment in a much wider range of asset classes.

PPF funding

As the Committee notes, we stand in a strong financial position. In our last published annual report and accounts, we reported a funding ratio of 137.9 per cent and reserve of £11.7bn as at the end of March 2022.[5]

Last autumn, we published the outcome of our review of our Long-Term Funding Strategy.[6] The review recognised that our own financial position has strengthened in recent years, chiefly on the back of exceptional investment performance, and that the risks we face have reduced. The review concluded that we have entered a new phase in our funding journey – which we call our 'Maturing' phase – where our focus will increasingly shift from building to maintaining our financial resilience. This is now our central funding objective, and we've set out new priorities to guide our approach.

Given our financial strength, and in line with our new funding priorities, the review concluded we can now actively reduce the levy without risking the long-term security of our members' benefits. (It is important to note this is predicated on our existing compensation framework.) Consequently, last December we confirmed that the amount we'll collect this year (2023-24) will be £200m, nearly half our collection in 2022/23 (£390m). This accelerated an existing trend of levy coming down – it had previously come down from £620m in 2020-21to £520m in 2021-22.

In the early years of the PPF, responding to stakeholders' desire for greater differentiation, we developed more detailed rules to distribute the levy between individual schemes, reflecting the risk that they each posed. Greater granularity in our rules fuelled greater complexity and as we stand to reduce the amount of levy we collect, we are seizing the opportunity to simplify how we calculate the levy. We believe this will benefit all levy payers, but particularly smaller schemes. We have set out our thinking on the direction of travel for a much-simplified levy and, through our rule changes for this year's levy, have taken our first steps towards a simpler future levy. As

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[5] Annual Report 2021/22 | Pension Protection Fund (ppf.co.uk)
[6] Long-Term Funding Strategy Review 2022 Review 2022 (ppf.co.uk)

we continue to develop our thinking, we will work with stakeholders to gather their feedback on our emerging proposals.

As we move into a lower levy environment, we have identified that greater legislative flexibility on the levy may be needed to support our proposed goals. We are working with DWP to explore legislative change so that we have the ability, in the unlikely event it is needed, to raise the levy again more freely, and to rebalance the weights of the scheme and risk-based elements of the levy.

PPF reserve

As our funding position has improved, we've begun to consider our own 'endgame', particularly in relation to our reserves. It is important to stress that our reserve is intended to protect us from adverse future experience (i.e. larger than expected claims on the fund and longevity risk); it is not a 'surplus' on our existing liabilities. While the risks we face have reduced in recent years, we remain vigilant that scheme funding *could* still deteriorate.

Our cautious approach to funding, coupled with our intention to continue to build our reserves (principally through our investments, not levy) to cover the most adverse scenarios, does though mean we could end up with more money than we ultimately need. It will be some time before we know the end funding outcome for the PPF – we will continue to face risks for some time to come – but we recognise the growing stakeholder interest in this, particularly from members and levy payers. In the absence of an existing legislative framework governing what we would do in this eventuality, there will be an important role for government.

We have committed to work with DWP over the course of our current Strategic Plan (2022-25) to develop an approach for utilising any excess reserves when the level of risk we face has sufficiently reduced. We expect the views of stakeholders will be important in considering this and anticipate engaging on this further in the coming years.

PPF, FAS and FCF – member outcomes

All three – the PPF, FAS and FCF – were established under the provisions of the PA04. Before commenting on each in turn, it may firstly be useful to briefly recap on the wider backdrop, and policy intent, behind the creation of the PPF, and recent developments regarding our compensation framework.

Before the PA04, there was no safety net for DB scheme members if their scheme was underfunded when their employer became insolvent. Your holiday was better protected than your pension. In these situations, members faced steep reductions in their promised benefits and the prospect of financial hardship in retirement. The PPF was established, with cross-party support, to remedy this, and has successfully done so since 2005.

Through paying compensation on members' lost pensions, our existence has already delivered better outcomes to our current c.300k members, and c.150k FAS members, than if we weren't here. Today, members of eligible DB schemes can be reassured that their benefits are protected to at least PPF levels if their employer ever became insolvent and take comfort in the security of our protection given our financial strength.

The PA04 also set out PPF and FAS compensation levels. In very broad terms, for PPF members who had reached their retirement age at the point of insolvency we pay compensation equal to 100 per cent of their scheme pension; for members who hadn't reached their retirement age at this point we pay 90 per cent of their promised scheme pension. We pay inflationary increases on payments relating to service after 6 April 1997, subject to a maximum of 2.5 per cent.

Under existing FAS rules, all members are entitled to at least 90 per cent of their expected pension – broadly speaking, what they had built up in their former pension scheme before it began winding up, revalued to their FAS normal retirement age – subject to cap. Similar rules apply in respect of indexation.

At the time that the PPF was created, the intent behind our compensation framework was to provide as high a level of protection as possible for members balanced with affordability to levy payers (who help fund the compensation we pay). We fully recognise that this means in practice our compensation, particularly with regards to increases, does not mirror members' promised full scheme benefits – the policy intent at the time was not to.

In more recent times, court judgments (such as the *Hampshire* and *Hughes* cases) have resulted in revisions to our compensation framework. The former requires members to receive at least 50 per cent of the value of the pension benefits that they had accrued at the point of their employer's insolvency; the latter has resulted in the disapplication of the PPF cap. We have been working to implement these judgments, calculating and paying uplifts to affected PPF and FAS members.

PPF – pre-97 indexation

We recognise that the current high inflation environment, coupled with the acceleration in our own financial strength, has understandably generated renewed focus on our compensation framework. We are acutely aware of the impact high inflation may have on our members, especially those whose compensation relates solely to pre-97 pensionable service which does not receive increases once in payment.

Over the past year, we've seen an increase in queries from members, MPs, and trade unions. Many of these have centred on the absence of increases applied to compensation in payment that relates to pensionable service before 6 April 1997 (which we commonly refer to as 'pre-97 indexation').

It is important to stress that the levels of compensation we pay are set in legislation. Changes to these levels are therefore a matter for government, not the PPF. The PA04 is clear that no indexation is payable in respect of pre-97 service. We have no discretion on this – we must pay what the law says.

Given the interest in this issue, and to assist the Committee, we have set out what the impacts would be if the law were changed to introduce indexation on compensation linked to pre-97 service.

This would have two financial impacts on the PPF:

1. it would increase the PPF's current liabilities (as the compensation paid to its existing members would increase); and

2. it would increase the number and size of claims the PPF would receive in the future (as more schemes that enter an assessment period would be expected to be in deficit on the s143 basis[7] and therefore transfer to the PPF rather than exiting overfunded).

We have calculated that, as at 31 March 2022 (our last reported financial position), indexing pre-97 compensation in the future at CPI subject to a cap of 2.5% would increase our current liabilities by £4.3bn, reducing the PPF's funding level by 17 percentage points (i.e. from 138 per cent to 121 per cent, a level broadly equivalent to where we stood three years prior).[8]

For additional comparison, we have run similar calculations if we were to pay indexation on pre-97 compensation at CPI subject to a (higher) 5% cap – this would increase our liabilities by £7.7bn, reducing the PPF's funding level by 28 percentage points (i.e. to 110%).[9]

(This assumes any increase applies to all existing PPF members on a prospective basis i.e. no backdating of indexation payments for prior years). These estimates are based on our best estimate of future inflation, and the costs could be materially higher if actual inflation was higher than we have assumed.

[7] A s143 valuation is carried out within an assessment period to assess whether the scheme has sufficient funds to pay at least PPF levels of compensation

[8] ARA 2018/19 – funding ratio 118.6%
Pension Protection Fund Annual Report & Accounts 2018/19 (ppf.co.uk)

[9] All of the numbers listed in this section have been based on our latest reported financial position at 31 March 2022. It is important to note that these numbers are very sensitive to the assumptions used as well as the market conditions at the date of calculation and can therefore only be used as a guide to the expected costs. Also, the numbers quoted are best estimate figures, and the costs could be materially higher if experie nce deviate from expectations; for example, in a high inflationary environment the numbers could be much higher.

In both these scenarios, the impact would have been to reduce our financial resilience, and likely trigger us to reconsider our position against our funding objective and plans to reduce the levy (as we've already begun to do). This is because:

- Our reserves would have dropped from £11.7bn to £7.4bn (for a 2.5% cap) and £4.0bn (for a 5% cap). This alone would have resulted in us failing our new 'Financial Resilience' test, suggesting the levy should be increased again. It would also likely have an impact on our investment strategy, as we would need to ensure our strategic asset allocation was consistent with our funding objectives (which might mean for instance we need to hedge more).

- The funding of the universe on the s179 basis would reduce. If we were to pay pre-97 increases in future to a cap of 2.5%, we estimate the deficit of the schemes in deficit would have increased by £76bn (as at the end of March 2022). Similarly, if we paid pre-97 increases to a cap of 5%, the deficit of the schemes in deficit would have risen by a further £49bn. This would increase the likelihood that a scheme is underfunded on our basis, therefore increasing the risk they enter the PPF if their sponsor became insolvent. Ultimately, this would likely increase the number and size of claims on the PPF. As a result, we would need to increase the amount of reserves we hold to ensure we can provide sufficient security to pay future members' benefits.

In addition to these financial impacts, there would be broader implications of any change in indexation. In particular:

- If there was no corresponding change to the level of pre-97 pension increases offered by all other DB schemes, the benefits offered by the PPF might become more generous than those offered by the scheme itself. (This reflects that our indexation is broadly in line with the statutory minimum increases that schemes, by law, must provide). If, however, indexation was only paid to those PPF members who had it in their original scheme rules, this would add a layer of complexity which would go against the underlying principle that the PPF is a simple regime.

- Changes to PPF compensation would strengthen calls for comparable increases in FAS assistance. FAS, which serves 150,000 members, is directly funded by the Government.

- Members of schemes that have wound up outside the PPF (buying out with an insurer a level of benefits at, or higher, than existing PPF compensation levels) could end up worse off compared to members of schemes that transferred to us.

- With the reduction in funding levels on a PPF basis, some schemes with insolvent employers that are currently on a path towards buyout above PPF compensation levels might find they face greater challenges in achieving their endgames.

To reiterate, any decision on pre-97 indexation is a matter for government, not the PPF. We hope this information is nonetheless useful in drawing out not just the financial impacts on the PPF, but the broader consequences for schemes and the taxpayer from significant changes to PPF compensation levels.

PPF – post-97 indexation

While the PA04 is clear on our requirement not to apply pre-97 increases, legislation does provide us with the discretion to change one aspect of our PPF compensation: the level of indexation paid on compensation related to service accrued after 5 April 1997 ('post-97 indexation'). This is currently set to be the lower of 2.5% or the annual increase in prices. When this discretion was introduced, its purpose was to act as an emergency lever to allow us to reduce our liabilities in the event of a funding crisis. Despite this, in light of the current exceptional levels of inflation, last year we carefully considered whether to exercise this discretion. Our decision not to do so was informed by a number of factors, including:

- Increasing post-97 indexation would only help some of our members who already have some inflation protection – this is because the bulk of our compensation is in relation to pre-97 service. 35% of our pensioners have only pre-97 service and so would not benefit at all from any increase.

- The financial impact of any permanent increase in indexation levels would be significant – both in terms of the impact on our funding position and the deficits of schemes when measured on the PPF basis. We estimated that introducing a post-97 indexation cap at LPI 5% could cost us around £3.6bn, and reduce our funding level by 14 percentage points (i.e. from 138% to 124%). It would have a material impact on our position against our new funding strategy and likely have required a rethink on our levy plans.

- We felt it would be difficult to justify any increase in benefits to members whilst we are still charging a levy (particularly at a time when many levy payers will be struggling with the impacts of inflation on their own schemes and businesses).

- Increasing indexation would mean departing from the basic principle behind PPF compensation – that we are intended to act as a safety net so PPF indexation is set broadly in line with the minimum legal requirements for DB schemes. Making such a change in isolation from broader government action would raise the prospect of the PPF potentially providing higher levels of indexation than schemes would provide, and alter the balance envisaged by Parliament between members and levy payers.

While we will keep this under review, we ultimately believe it is rightly for policy makers to consider, and decide on, any significant changes to our compensation framework.

PPF member experience

Beyond compensation, we have long sought to improve outcomes through our own customer service offering for PPF members, and by driving ever greater efficiency in our assessment process.

We are proud of the high customer service standards we achieve, and which are recognised both externally (through our accreditation by the Institute of Customer Service) and by members themselves (through surveys and other feedback). When the PPF was created, it typically took more than 10 years to wind up a pension scheme – we have succeeded in reducing this down to 18-24 months.

We have a culture of continuous improvement, so we recognise there is always more we can do to improve the service we provide to members and the experience for members in schemes which don't transfer to the PPF. We understand that we've been more reticent in the past about talking openly about the, often complex, work we do behind the scenes when schemes enter our assessment process. We intend to share more on this in future and how our assessment work supports better member outcomes.

Financial Assistance Scheme

The Financial Assistance Scheme (FAS) performs a similar role to the PPF but for schemes which began to wind up between 1997 and 2005. Since 2009, we have managed the FAS on behalf of DWP. There are currently c.150k FAS members – as all the eligible schemes have been transferred, we expect our FAS membership to decline over time. It is important to note that FAS and the PPF are funded in different ways. We receive funds from HM Treasury to pay FAS assistance to members. FAS assistance levels are stipulated by legislation, and consequently are a matter for government.

Fraud Compensation Fund

As the Committee is aware, the FCF has seen an influx of claims following a court ruling in November 2020.[10] This ruling clarified the eligibility of so-called 'scam schemes' – where individuals were enticed to transfer their pension into a scam scheme from which fraudsters extracted funds and pensions were liberated – to claim on the fund. Pensions liberation was not prevalent when the FCF was set up.

Up until this court ruling, the fund had received 47 cases and paid out compensation to 14 schemes, totalling £5.4m. Following the court ruling, the FCF expects to receive around 130 claims on the fund in relation to schemes with an estimated total value of circa £429m. So, the ruling has resulted in a step change in FCF activity compared with experience over its previous 15-year operation.

[10] *PPF* v *Dalriada* [2020] EWHC 2960 (Ch).

Additionally, given the novel nature of these claims – they are typically unlike those we've dealt with in the past – they pose complex new challenges for us in assessing each claim. They are though largely historic forms of scam, meaning we do not expect material new claims over and above those in our existing pipeline. This is because DWP and HMRC have taken steps to mitigate pension liberation issues.

We have been working hard to progress these new claims. Although we know we have much more to do, we are making progress on the existing claims we've received – we have now begun settling cases and reaching decisions in principle on acts of dishonesty (a key milestone towards reaching an outcome).

We know that affected members have been waiting some time for redress – once we've received all the information required to undertake our investigation, our aim is to progress claims as quickly as possible. We work closely with the trustees pursuing these claims on behalf of members, and support timely communication with members when there are material updates on their claims.

We have encountered challenges in applying the existing legislation to these new claims. This is partly due to the nature of these types of scams, which were not envisaged when the governing legislation was drafted. We have considered the relative merits of making amendments to the legislation but, given we are effectively working through a closed book of claims (we don't expect more of these types of claim) which we expect to complete in a limited period of time, we have doubts over the relative value of any changes to the operation of the FCF. We are doing our best to work quickly and effectively within the current legislative framework.

As scams have continued to evolve, when considering how to improve member outcomes in the future, we believe consideration could be given to what is the right form of compensation for scams recognising they can take place in a variety of ways. At present, the type of redress an affected member can receive is dependent on the way they've been scammed. Further thought could also be given to how industry can further deepen collaboration to address new types of pension fraud as they emerge.

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