Pension Protection Fund

By Email
Sir Stephen Timms MP
Chair, Work and Pensions Select Committee

27 October 2023

Dear Sir Stephen,

Re: Pension Protection Fund compensation levels

Thank you for your letter of 18 October regarding the impact of increasing PPF compensation and indexation. We welcome this opportunity to further assist the Committee as it continues its work on the Defined Benefit (DB) pension schemes inquiry.

As our compensation levels are set out in legislation, any significant changes to them are ultimately a matter for government. However, we do recognise that our members will have been feeling the impact of high inflation in the past 18 months and some might be struggling with the cost of living. Over this period, we've increasingly heard from members on this issue, so we know how much this matters to them and have relayed their comments to the Department for Work and Pensions (DWP). We also recognise the growing interest in our compensation levels from the Committee, as well as other stakeholders, and so we want to help to inform this debate where we usefully can.

When we submitted our written evidence to the Committee's DB pension schemes inquiry in April, we set out the impact of changes to our compensation levels using figures which reflected our last reported financial position of 31 March 2022. Since then, we've published of our 2022/23 Annual Report and Accounts, and so we are now able to provide updated calculations on the impact on the PPF of paying indexation on pre-97 compensation for all schemes (irrespective of whether or not they had pre-97 indexation in their scheme rules). In **Table 1** we have set out how indexing pre-97 compensation in the future at Consumer Price Index (CPI) capped at both 2.5% and 5% could impact the PPF. Please note, our calculations for indexing pre-97 compensation in the future at CPI capped at 5% assume that the increases would also apply for post-97 service – this aspect of compensation is currently subject to CPI capped at 2.5%, but the Board of the PPF has discretion to change the level of indexation paid on this[1]. To give the Committee a complete view of the impact of potential indexation changes, we have

[1] We understand that a key purpose behind the discretion granted to our Board to alter post-97 indexation was to help reduce the PPF's liabilities in the event of a funding crisis, as the power can be used to reduce post-97 indexation down to zero.

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also provided figures on the impact of only increasing the indexation paid on post-97 service in the future at CPI capped at 5%.

As we noted in our evidence, the impact that the PPF would experience in each of these scenarios would reduce our financial resilience by increasing our current liabilities and increasing the number and size of claims we would receive in the future, as scheme funding on a s143 basis[2] would also deteriorate. These impacts could mean we need to reconsider our position against our funding objective, as well as the direction of the levy – this remains the case with these updated figures. Furthermore, for previously transferred schemes, the benefits offered by the PPF would become more generous than those offered by the scheme itself[3] in some cases. The same would apply for a proportion of new claims after the change, if there were no corresponding change to the legislative minimum level of pension increases required of all ongoing DB schemes. Changes to the indexation we pay would also have broader implications for schemes – these are set out in detail at page 12 of our written evidence to the Committee's DB pension schemes inquiry.

It's also important to recognise that the cost is sensitive to market conditions, in particular the level of nominal yields. Our Annual Report and Accounts published on 31 March 2023 shows that an increase in yields of 0.5 percentage points leads to a reduction in liabilities overall of 6.3 per cent. This applies equally to the cost of providing increases to pre-97 pension. For example, the £2.6 billion cost of providing prospective pre-97 pension increases of CPI capped at 2.5% would be closer to £2.9 billion if yields fell by 1 percentage point.

In **Table 1,** we have also set out the impact of removing the 90% factor for deferred PPF members (people who are currently under pension age and were not receiving an ill-health pension when their scheme entered the PPF). To further support the Committee's assessment of the impacts of compensation changes on the PPF, we have additionally outlined the combined impacts of changes to indexation and removing the 90% factor for deferred members. Such changes would bring the PPF closer to paying full benefits and, as you'll be aware, at the time the PPF was established the intent behind our compensation framework was to provide as high a level of protection as possible to members balanced with affordability for levy payers. While our current levels of reserves mean that we are able to withstand significant market volatility and have good protection against adverse future experience (e.g. paying future claims and longevity risk), these changes would impact the PPF's financial resilience by significantly reducing (or, if retrospective, exhausting) our current reserves. Therefore, in considering potential changes to the compensation levels provided by the PPF, careful thought should be given to the interests of both members and levy payers.

Additionally, following calls from the Deprived Pensioners Association for the PPF to pay pre-97 indexation **only to those members whose scheme rules provided for this**[4], we have set out figures demonstrating both the prospective and retrospective impact of such a change in **Table 2**. As with our calculations for indexing pre-97 compensation in the future at CPI capped at 5% for all schemes, we have assumed that the increases would also apply for post-97 service too.

[2] 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.
[3] Our indexation is broadly in line with the statutory minimum increases that schemes, by law, must provide.
[4] Written evidence from The Deprived Pensioners Association (DBP0053), p.3

I hope the Committee finds this information helpful and I would be happy to assist if you or colleagues have any further questions.

Yours sincerely,

Oliver Morley
Chief Executive

Annex A

Table 1: Impact of changes to PPF compensation and indexation for all schemes (as at 31 March 2023)

Scenario	Assets (£bn)	Liabilities (£bn)	Funding level (%)	Reserve (£bn)	Increase in liabilities relative to Actual (£bn)	Increase in liabilities relative to Actual (%)	Increase in funding level relative to Actual (%)
Actual - 31 March 2023 PPF annual valuation	33.8	21.7	156%	12.1	-	-	-
Prospective changes							
(1): Removal of 90% factor for deferred members	33.8	22.5	150%	11.3	0.8	4%	-6%
(2): Prospective pre 97 pension increases of CPI capped at 2.5%	33.8	24.3	139%	9.5	2.6	12%	-17%
(3): Prospective pre 97 and post 97 pension increases of CPI capped at 5%	33.8	27.9	121%	5.9	6.2	29%	-35%
(3a): Prospective pre 97 pension increases of CPI capped at 5%	33.8	26.1	130%	7.7	4.4	20%	-26%
(3b): Prospective post 97 pension increases of CPI capped at 5%	33.8	23.5	144%	10.3	1.8	8%	-12%
(4): (1) and (2) combined	33.8	25.2	134%	8.6	3.6	17%	-22%
(5): (1) and (3) combined	33.8	29.0	117%	4.8	7.3	34%	-39%
Retrospective changes							
(6): Arrears for retrospective pre 97 pension increases of CPI capped at 2.5%	33.8	23.0	147%	10.8	1.4	6%	-9%
(7): Retrospective pre 97 pension increases of CPI	33.8	27.0	125%	6.8	5.4	25%	-31%

capped at 2.5% excluding arrears							
(8): Retrospective pre 97 pension increases of CPI capped at 2.5% including arrears	33.8	28.4	119%	5.4	6.7	31%	-37%
(9): Arrears for retrospective pre 97 pension increases of CPI capped at 5%	33.8	23.6	143%	10.2	1.9	9%	-13%
(10): Retrospective pre 97 pension increases of CPI capped at 5% and prospective post 97 pension increases of CPI capped at 5% excluding arrears	33.8	32	106%	1.8	10.4	48%	-50%
(11): Retrospective pre 97 pension increases of CPI capped at 5% and prospective post 97 pension increases of CPI capped at 5% including arrears	33.8	33.9	100%	-0.1	12.3	57%	-56%

Notes:

1. The impact of scenario 1 is only for deferred members and doesn't include our members who are currently in payment and have had the 90% factor applied to them.
2. The impacts of scenarios 2 – 11 assume any increases would apply to all existing PPF members.
3. The impacts of scenarios 4 and 5 have been calculated by taking the compound percentage increases of the liabilities of scenarios 1 – 3. and then calculating the rest of the figures based on these compound percentage increases.

Table 2: Impact of changes to pre-97 indexation only for members of schemes that provided for indexation in their scheme rules (as at 31 March 2023)

Scenario	Assets (£bn)	Liabilities (£bn)	Funding level (%)	Reserve (£bn)	Increase in liabilities relative to Actual (£bn)	Increase in liabilities relative to Actual (%)	Increase in funding level relative to Actual (%)
Actual - 31 March 2023 PPF annual valuation	33.8	21.7	156%	12.1	-	-	-
Prospective							
(1): Prospective pre 97 pension increases of CPI capped at 2.5%	33.8	23.7	143%	10.1	2.0	9%	-13%
(2): Prospective pre 97 and post 97 pension increases of CPI capped at 5%	33.8	26.7	126%	7.1	5.1	23%	-30%
(2a): Prospective pre 97 pension increases of CPI capped at 5%	33.8	25.0	135%	8.8	3.3	15%	-21%
(2b): Prospective post 97 pension increases of CPI capped at 5%	33.8	23.5	144%	10.3	1.8	8%	-12%
Retrospective							
(3) Arrears for retrospective pre 97 pension increases of CPI capped at 2.5%	33.8	22.8	148%	11	1.1	5%	-8%
(4) Retrospective pre 97 pension increases of CPI capped at 2.5% excluding arrears	33.8	25.7	131%	8.1	4.1	19%	-25%

(5) Retrospective pre 97 pension increases of CPI capped at 2.5% including arrears	33.8	26.8	126%	7	5.2	24%	-30%
(6) Arrears for retrospective pre 97 pension increases of CPI capped at 5%	33.8	23.2	146%	10.6	1.5	7%	-10%
(7) Retrospective pre 97 pension increases of CPI capped at 5% and prospective post 97 pension increases of CPI capped at 5% excluding arrears	33.8	30.1	112%	3.7	8.4	39%	-44%
(8) Retrospective pre 97 pension increases of CPI capped at 5% and prospective post 97 pension increases of CPI capped at 5% including arrears	33.8	31.6	107%	2.2	10	46%	-49%

Notes:

1. The impacts in the table above are based on the 743 schemes that have transferred to the PPF or are relatively large schemes in assessment that provided for indexation on pre-97 pensions in their scheme rules. The impacts also include increases on post-88 Guaranteed Minimum Pensions for the 343 schemes that don't provide for indexation on pre-97 pensions in their scheme rules.
2. The impacts for scenarios 2, 7 and 8 assume that the increases would also apply to post-97 service.

Definitions:

Arrears – this relates to past payments only. It is the difference between what PPF compensation was actually paid in the past to members and what would have paid in the past if the members had received higher historical pension increases.

Prospective – this relates to future payments only. It is the difference between what PPF compensation is expected to be paid in the future to members based on current PPF compensation levels and the PPF compensation that is expected to be paid in the future if the members receive higher pension increases **in the future only (and not the past).**

Retrospective excluding arrears – this relates to future payments only. It is the difference between what PPF compensation is expected to be paid in the future to members based on current PPF compensation levels and the PPF compensation that is expected to be paid in the future if the members receive higher pension increases **both in the past and in the future.**

Retrospective including arrears – this relates to both past and future payments. It is the same as the retrospective excluding arrears figures plus the arrears figures above.