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PPF consults on 2023–24 levy and reviews long-term funding strategy

Pensions analysis: The Pension Protection Fund (PPF) has published a consultation on the draft rules for its 2023–24 levy as well as the outcome of its long-term funding strategy review. While no major changes to the levy rules are proposed for the 2023–24 levy, the PPF is moving to a new phase of its funding strategy where its focus will shift from building to maintaining its financial resilience. It believes that it will also be able to move over time to a simpler levy methodology. Katherine Carter, professional support lawyer in the pensions team at Mayer Brown International LLP, considers the consultation, the review and the implications for pension schemes.

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What is the background to the PPF's consultation on the 2023–24 levy rules and long-term funding strategy review 2022?

Unless exempt, all defined benefit (DB) pension schemes that are eligible to enter the PPF must pay an annual levy to the PPF. The levy is made up of a scheme-based element and a risk-based element. The scheme-based element reflects the size of the scheme while the risk-based element reflects the scheme's level of underfunding and employer insolvency risk. The PPF publishes an annual levy determination which sets out, for that levy year:

- the total levy that it expects to require
- the rules for calculating the individual scheme levies

In 2010, the PPF set its first formal long-term funding strategy. This focussed on building the PPF's reserves to protect it (and its members) against adverse future experience and set a target for the PPF to be self-sufficient by 2030. The funding target and strategy are reviewed annually and, prior to 2022, had remained unchanged.

What are the key aspects of the PPF's long-term funding strategy review?

The review notes that to date the PPF's funding strategy has been successful, with its reserves increasing from £400m in 2010 to £11.7bn in 2022. Its investments have performed ahead of target and this, combined with levy collection and reduced risks, has put the PPF in a strong financial position. As a result, the PPF is moving into a new phase in its funding strategy where its focus will move from building its financial resilience and the explicit target of achieving self-sufficiency by 2030 to a new funding objective of maintaining its financial resilience.

In addition, the PPF feels that, given its financial strength, it can now take steps to reduce the levy without risking the long-term security of current or future PPF members. The PPF also plans to reform the way that the levy is calculated. The PPF expects a transition to a lower levy environment over several years.

What are the key consultation proposals?

According to the consultation, the PPF intends to set a levy estimate for 2023–24 of £200m, down from £390m in 2022–23. No major changes are proposed to the levy rules for 2023–24. As previously announced, the 25% cap on individual risk-based levy increases that was introduced for the 2022–23 levy year will not be continued. The PPF's other proposals include the following:

- halving the band-to-band increase in levy rates for levy bands two to ten
- a reduction in the levy scaling factor that, other things being equal, will reduce risk-based levies by 23%
- a 10% reduction in the scheme-based levy multiplier

- no change to the risk-based levy cap meaning it will remain at 0.25% of scheme liabilities

The consultation also includes more detail on the PPF's proposed reforms to the levy methodology. The PPF will aim to develop a simpler methodology over time that:

- gives the PPF greater flexibility in the amount of levy that it collects
- places more weight in the risk-based element of the levy on underfunding and less on employer insolvency risk
- makes greater use of the scheme-based element of the levy
- differentiates between schemes of very different sizes

What are the implications of the PPF's proposed 2023–24 levy rules and long-term funding strategy review?

The proposed levy estimate and levy rules for 2023–24 are expected to result in a levy reduction for almost all schemes. Similarly, the PPF's proposed move to a new levy methodology in light of the changes to its funding strategy should mean that the methodology becomes simpler and results in lower levies.

What are the next steps?

The consultation closes on 10 November 2022. The consultation document, and details of how to respond, are available at: 2023/24 levy rules. The PPF expects to publish the finalised 2023–24 levy rules in December 2022.

The PPF will work with stakeholders and the government over 2023 to inform its proposals in relation to the levy methodology. The PPF is also working with the government to explore legislative change to support its intended changes as the current legislation poses some challenges, for example:

- the Pensions Act 2004 (PeA 2004) imposes a 25% cap on year-on-year levy increases which would impede the PPF's ability to raise the levy again more freely if this was needed
- the PeA 2004 also limits the scheme-based element of the levy to 20% of the total levy which would restrict the PPF's ability to make greater use of a scheme-based levy

Interviewed by Banita Kalia

Katherine Carter is a professional support lawyer in the pensions team at Mayer Brown International LLP. Katherine has wide-ranging experience in all aspects of occupational pension scheme provision, including ongoing administration and compliance, investment issues, the pensions aspects of corporate transactions and scheme mergers and winding ups.