Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

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Defined Benefit Arrangements

Assignment 5 Notes

(Part 5 – Winding Up and the Pension Protection Fund)
Recommended Time: 3 hours

1. Identify and describe the two main situations where an occupational pension scheme will terminate and describe the circumstances in which the Pensions Regulator may give directions to facilitate the wind up of a pension scheme.

15 marks

A pension scheme may start to be wound up, either:

- on the occurrence of the circumstances identified in the Trust Deed, or
- at the direction of the Pensions Regulator

Under a scheme's Trust Deed winding up would commonly be triggered on:

- the principal employer giving notice that it intends to cease contributing to the scheme
- the principal employer ceasing to trade or becoming insolvent
- when there are no beneficiaries left to benefit from the scheme; or
- where the trustees have received advice from the scheme actuary that the employer will be unable to fully fund the scheme

The Pensions Regulator has power under section 11 of the Pensions Act 1995 to direct that a scheme be wound up if:

- the scheme, or part of it, ought to be replaced by another scheme
- the scheme is no longer required; or
- it is necessary to protect the interests of the generality of the members

The circumstances include the following:

- the trustees or managers are not taking steps that the regulator considers would be taken if they were acting reasonably
- steps are being taken by the trustees or managers that the regulator considers to be causing unreasonable delay
- the winding up is being obstructed or unreasonably delayed by the failure of any person to provide information to the trustees or administrator or to take any action that he has been asked to take by the trustees or administrators; or
- the winding up is likely to be facilitated or accelerated by someone (other than the trustees or managers) taking a particular action or step

(The relevant sections of the Study Manual are Part 5, Chapter 1.1 and Chapter 1.3.7.)

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2. You are the consultant to a scheme that has just started to wind up. Prepare a short paper for the trustee board outlining the current priority order which applies to the scheme.

10 marks

The current priority order is as follows:

- first, payment of scheme expenses, if the scheme rules provide for these to be the first priority
- second, benefits under insurance policies issued before 6 April 1997 which may not be surrendered
- third, any liability for pensions or other benefits that does not exceed the corresponding PPF liability (except where covered under the second head, above)
- fourth, any liability for pensions or other benefits derived from members' voluntary contributions (where these provide a defined benefit such as added years of pensionable service); and
- fifth, any other liability for pensions or other benefits

Be clear on the need for these priority orders to be adhered to.

(The relevant section of the Study Manual is Part 5, Chapter 1.3.2.)

3. You are the consultant to a scheme which has just secured full benefits for its members with an insurer. There are now surplus assets and the Trustees are considering repaying the surplus to the employer. Write a short paper for the Trustees explaining what they will need to do if they decide to repay surplus.

10 marks

This is a paper setting out the actions the trustees must take and should be written in an easy to understand format.

Before making a payment of surplus:

- All benefits must have been bought out in full
- If there is a power to augment benefits, the power must have been exercised or a decision taken not to do so
- Two notices must have been given to members, the first stating that members may make representations to the trustees or employer and the second stating that they have the right to make representations to the Pensions Regulator if they think the refund requirements are not satisfied. The notices must allow a five month period in total for representations to be made

A tax charge will be levied on any refund to the employer. The scheme administrator is required to pay 35% of the amount of the refund directly to HMRC.

(The relevant section of the Study Manual is Part 5, Chapter 1.3.8.)

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4. Outline the 3 main ways in which GMP rights can be secured when a scheme winds up.

5 marks

The three main ways of securing GMP on a wind up are as follows:

- a transfer to another scheme
- the purchase of a policy (known as a section 32 buyout policy) from an insurer; or
- the purchase of an immediate or deferred annuity from an insurer

(The relevant section of the Study Manual is Part 5, Chapter 1.5.)

5. Outline the two options available on winding up in relation to insurance policies held as assets of the scheme.

5 marks

The two options available are to:

- take a surrender value and use the proceeds elsewhere. The surrender value will be calculated by the insurance company and the quoted value will usually only hold good for a short period. A surrender penalty or market value adjustment may also be charged; or
- treat the benefits under the policy as paid up so that no further premiums are payable and the policy can then be assigned to the relevant member

(The relevant section of the Study Manual is Part 5, Chapter 1.6.)

6. List five qualifying insolvency events for PPF entry and outline the main tasks that should be completed in the first 100 days of a scheme entering a PPF assessment period.

15 marks

Your list of qualifying insolvency events should include five of the following:

- a proposal for a voluntary arrangement is made by the employer
- there is an application for a moratorium where a voluntary arrangement is proposed
- an administrative receiver is appointed
- the company enters into administration
- the company enters into a voluntary wind up without a declaration of solvency
- a members' voluntary liquidation is converted into a creditors' voluntary liquidation
- a winding up order is made by a court

Main tasks in first 100 days of entering a PPF assessment period – your answer should include the following:

- How the 0 to 100 days links in with the whole term of the assessment period

- Key task is an initial review of scheme details and membership data

- At the end of this 100 days, all the relevant parties get together to:

    - formalise the project plan
    - set timescales for each project
    - agree budgets for each project, and
    - assign roles and responsibilities

This is a key driver for the whole of the assessment period and the PPF is keen that everything which needs to be done in this period is done.

(The relevant sections of the Study Manual are Part 5, Chapter 2.2 and Chapter 2.3.3.)

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7. You have been asked to describe the main reasons for completing a Data Audit in the PPF assessment process. Write a short paper in response.

10 marks

Reasons for completing a Data Audit - include details of the following:

- Reasons why data quality is so important in deciding the length of the whole assessment period
- There may have been changes of data storage media over time and/or changes in administrators over the life of the scheme
- All other tasks in the assessment period are affected by the results of this task
- How data gaps need to be cleansed, e.g. by carrying out a personal details verification exercise or a member tracing exercise
- The relationship with the Pensions Regulator's record keeping guidance
- Specialist software is available to analyse membership data in order to satisfy PPF assessment period needs

This should be written as a paper for an individual who may have very little understanding of what this process is and what the implications are for the scheme.

(The relevant section of the Study Manual is Part 5, Chapter 2.3.2.)

8. Describe the 3 levies that the PPF raises and outline the 3 different types of contingent assets that are potentially recognised in the PPF levy calculation.

15 marks

The 3 levies are as follows:

- **Pension protection levy –** paid annually by DB schemes eligible for PPF entry. It is split into two elements: the scheme-based levy and the risk-based levy. The amount due depends on a number of factors including the level of underfunding in the scheme, the likelihood of the employer becoming insolvent and the structure of the scheme. The pension protection levy goes towards paying for the cost of compensation payable to members of schemes which have transferred to the PPF

- **PPF Administration levy** – amount payable annually is based on the number of members in the scheme. The levy funds the PPF's operating expenditure on administering the PPF levy and taking schemes through the assessment process

- **Fraud compensation levy –** covers compensation payable out of the Fraud Compensation Fund to occupational schemes with insolvent employers, where a dishonest offence has occurred. The levy is raised only when there is a need to do so

The different types of contingent assets are as follows:

- Type A contingent assets - parent or group company guarantees
- Type B contingent assets - security over cash, UK property or securities
- Type C contingent assets - letters of credit or bank guarantees

Where a Type B or Type C contingent asset is being used, it must be appropriately certified as reducing the level of underfunding in the scheme for PPF levy purposes.

(The relevant sections of the Study Manual are Part 5, Chapter 2.6.1, Chapter 2.6.2 and Chapter 2.6.3.)

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9. You are the consultant to a DB scheme. The Trustees of the scheme have asked for your assistance in helping them to understand how the PPF works out the pension protection levy due from a scheme. Write a brief paper for the Trustee Board describing the calculation basis for the pension protection levy.

15 marks

Include details of the following:

- Scheme-based levy
- Risk-based levy
- Capping

The calculations can appear complicated by looking at the formula, but the key is to think about what each part represents, for example:

- Underfunding risk – represents the difference between the value of a scheme's assets and its liabilities, and hence the size of a potential claim on the PPF
- Insolvency risk – represents the likelihood of a scheme's sponsoring employer becoming insolvent and potentially giving rise to a claim on the PPF
- Scaling factor – ensures that the total levy collected by the PPF from all schemes roughly matches the amount of levy the PPF estimates it will collect

The levy is subject to a cap to ensure that the most vulnerable of schemes are not required to pay an excessive levy.

This is a paper covering a complex issue and needs to be written in a straightforward easy to understand manner.

(The relevant section of the Study Manual is Part 5, Chapter 2.6.3.)