

PPF Deficit-Reduction Contributions Guidance in respect of the financial year 1 April 2025 – 31 March 2026

Introduction

The Deficit-Reduction Contributions Appendix sets out two methodologies for certifying Deficit-Reduction Contributions, Option Alpha and Option Beta. Either Option Alpha or Option Beta may be used by any Scheme. Option Beta (which is covered in more detail later in this Guidance) is designed as an alternative, simplified methodology, which only requires actuarial involvement in particular circumstances.

It is intended that the Deficit-Reduction Contributions regime (under Option Alpha and Option Beta) recognises, for levy purposes, only those contributions that have the effect of reducing the difference between a Scheme's assets and liabilities (or increasing that difference where the assets exceed the liabilities). Option Beta, however, permits a straightforward certification of contributions which were made with the sole purpose of improving the Scheme's funding level.

There are set rules in Part G of the Determination and in the Deficit-Reduction Contributions Appendix which must be met in order for a Deficit-Reduction Contribution to be accepted for Levy purposes, but ultimately it is for the Board to decide to what extent such a certificate will be recognised for Levy purposes.

The Board anticipates that it will only exercise its discretion not to recognise in full for Levy purposes a Deficit-Reduction Contributions certificate in situations where the Board is of the clear opinion that the full certified contribution was not made in accordance with the Board's intention.

Where a Deficit-Reduction Contributions certificate is submitted on Exchange, this certification should be made with due regard to the requirement (set out in Rule G1.1(c) of the Determination) that:

- For Option Alpha, the certified contribution has the effect of reducing the difference between a Scheme's assets and protected liabilities where protected liabilities exceed the assets or increasing that difference where the assets exceed the protected liabilities. The Board also expects that where prudent estimation is used, the appropriate level of prudence is considered with regard to Rule G1.1(c) of the Determination.
- For Option Beta, the certified contribution has the effect of reducing the risk of compensation being payable from the Board in the event of an insolvency event occurring in respect of an Employer in relation to the Scheme.

As noted in the Deficit-Reduction Contributions Appendix, duly appointed substitutes can submit Deficit-Reduction Contributions certificates on Exchange in place of:

- a Fellow of the Institute and/or Faculty of Actuaries (under Option Alpha);
- the Scheme Actuary (under Option Beta with actuarial certification); and
- an 'appropriate person' as defined in paragraph 24 of the Deficit-Reduction Contributions Appendix (under Option Beta without actuarial certification).

However, the relevant certifications must be approved beforehand by the appropriate party above. Schemes should keep records of the delegated authority and be prepared to share them with the PPF on enquiry.

Option Alpha

Certification under Option Alpha should be approved by a suitably qualified actuary (which does not need to be the Scheme Actuary), appointed by the trustees for this purpose. The methodology totals all contributions received over the certification period and then deducts those elements which do not serve to reduce the difference between the Scheme's assets and protected liabilities (or to increase the difference where the assets exceed the protected liabilities). The relevant elements are specified in the Deficit-Reduction Contributions Appendix and the final value of each cannot be negative (i.e. each element that is deducted may serve to reduce the contribution amount available for certification as a DRC, but cannot increase it).

The methodology does not include any allowance for investment returns, and for consistency, investment expenses paid out of Scheme assets should be ignored in the calculations. This relates to all investment expenses, both explicit and implicit.

The contributions pertaining to investment expenses should be included within the overall total and do not need to be separately identified and excluded. There may be situations where such contributions are, in any event, not clearly distinguishable. This could arise if, for example, they are contained within a single overall expense allowance which includes general administrative expenses, or if the investment expense allowance is implicit and allowed for by a reduction in the valuation discount rate.

We recognise that this calculation element (i.e. the exclusion of investment expenses and the inclusion of the corresponding contribution allowance) does not, in isolation, appear to reduce the difference between a Scheme's assets and protected liabilities (or to increase the difference where the assets exceed the protected liabilities). Our approach to DRCs envisages such individual simplifications and approximations in order to provide Schemes with a proportionate mechanism for levy credit within the context of overall prudence.

With respect to other expenses paid out of scheme assets, the overall amount which is deducted from the contributions received over the certification period should reflect the net position. This means that allowance may be made for rebates of expenses, provided that the gross expenses to which the rebates relate are also included in their entirety within the calculation of the net expense amount. This means that, for example, credit cannot be given for rebates of investment expenses nor for rebates in respect of other expenses incurred before the certification period. As noted above, the final net expense amount to be deducted must be at least zero.

For the avoidance of doubt, when calculating the DRC amount to certify under Option Alpha, it is not necessary to consider any impacts arising from the following judgments:

- the 2018 Court of Justice of the European Union in the case of *Hampshire v Board of the Pension Protection Fund*; and
- the 2017 High Court in the case of *Beaton v Board of the Pension Protection Fund*.

In particular, any potential increase to members' PPF compensation levels as a result of these judgments does not need to be treated as either an augmentation or an item of benefit accrual.

The judgment of the Court of Appeal in July 2021 in the case of *Hughes and others v Board of the Pension Protection Fund* established that the PPF compensation cap should be disapplied. Therefore, any resulting increase to members' PPF compensation levels should not, of itself, be treated as either an augmentation or an item of benefit accrual. However, the removal of the cap and the impact of this on members' PPF compensation levels should be reflected when calculating the cost of augmentations and benefit accrual.

The 2018 and 2020 High Court judgments in the case of *Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank Plc and others* established, respectively, the requirement for Schemes to equalise Guaranteed Minimum Pensions between men and women, and the extent to which this requirement applies to certain past transfers.

When certifying DRCs under Option Alpha, allowance should be made for employer contributions and associated expenses in respect of additional scheme liabilities arising as a result of these judgments, to the extent that these liabilities are reflected in the valuation to which the DRC certificate relates. For this purpose, a valuation may be deemed to fully reflect the additional scheme liabilities arising from both judgments if it was prepared in accordance with either version G9 or G10 of our s179 valuation guidance or our earlier information note '*How recent court judgments impact s179 valuations*'.

We anticipate that the majority of DRC certifications will relate to valuations which satisfy the above provision. However, to the extent (if any) that a valuation is deemed not to reflect the additional scheme liabilities arising as a result of the two *Lloyds* judgments mentioned above, any corresponding employer contributions and associated expenses should be excluded from the certification of DRCs. Any increase to members' PPF compensation levels in respect of these unreflected scheme liabilities does not need to be treated as either an augmentation or an item of benefit accrual.

Option Alpha examples

- (i) A Scheme has undertaken an enhanced transfer value exercise. The total enhancements amounted to £1,000,000 but the corresponding employer contribution was only £600,000. The scheme sought to certify the £600,000 as a Deficit-Reduction Contribution. However, the net effect to the Scheme of the exercise was a £400,000 loss. Therefore, the Board did not accept the Deficit-Reduction Contributions certificate as the Scheme should not be treated as having reduced its deficit if it had in fact created a new set of liabilities and partly paid contributions towards those. The net loss to the Scheme should have been reflected in the Deficit-Reduction Contributions certificate, by allowing for the amount paid to the Scheme (£600,000) as a contribution and the new liability as an augmentation. In these circumstances, as the augmentations were discharged by payments to third parties, the associated cost is the total amount of such payments, namely £1,000,000.

- (ii) A Scheme has undertaken an exercise with Scheme Members where pensioners have agreed to forego non-statutory pension increases in exchange for a higher, non-increasing pension. The Scheme asked whether this benefit change would be counted as an augmentation. The Board agreed that this should be treated as an augmentation, as the Scheme had amended benefits by replacing a benefit that the Board would not provide for in PPF compensation (i.e. pre-1997 pension increases) with a fixed amount that the Board would have to cover in the event of the Board assuming responsibility for the Scheme. The Board's potential liabilities had therefore been increased by the exercise and the associated cost should be deducted when determining the contributions to be certified for deficit-reduction purposes.¹

¹ Individual pension increase exchange options (and other options exercised at retirement on a member-by-member basis under provisions in the Scheme rules) would not be treated as augmentations.

- (iii) A Scheme secured a buyout of pensioner liabilities with an insurance company. As part of this transaction, the employer paid an additional contribution to the Scheme in order to maintain the funding level on a scheme specific funding basis pre and post buyout. The Scheme asked whether the additional contribution could be certified as a Deficit-Reduction Contribution. The Board noted that the buyout was not reflected elsewhere in the calculation of contributions to be certified for deficit-reduction purposes, as there had been no additional benefit accrual or augmentations as a result of the transaction. Therefore, as the contribution was made purely to offset the impact of the buyout transaction, it was not certifiable for deficit-reduction purposes.

- (iv) A Scheme has an ill-health early retirement rule with no requirement for the exercise of trustee or employer consent provided that a specified 'poor health' condition is met. This condition is defined in terms of the employer's opinion as to the Member's ability to continue working in his or her current occupation. A Scheme Member had retired under these provisions and the Scheme asked whether this would be counted as an augmentation. The Board noted that, although the employer was required to exercise a degree of subjectivity in deciding whether the 'poor health' condition was met, the ill-health benefits followed as a right from that decision. In particular, neither the employer nor the Scheme trustees were exercising a discretion, once the ill-health had been determined. Therefore, the ill-health benefits should not be classified as an augmentation.

- (v) A Scheme awarded a discretionary increase to all pensions in payment, to take effect from 1 May, following the submission of the deficit-reduction contributions certificate in April. The increase was agreed and formally documented between the trustees and employer earlier in the year with the employer funding received during March. The Scheme asked whether the exercise should be counted as an augmentation. The Board noted that all the necessary agreements to implement the increase had been obtained by 31 March (the end of the Scheme's certification period) and that the increase should therefore be classified as an augmentation, notwithstanding that it would not flow through to actual benefit payments until after the date of certification. As the additional employer funding was paid before 31 March, it should be included in the total contributions received over the certification period.

Option Beta

Option Beta is available as an alternative, simplified methodology for any scheme. Under this approach, the certified amount of deficit-reduction contributions is calculated by summing:

- the contributions received by the Scheme over the certification period under its recovery plan (excluding any contributions which relate to Scheme expenses);
- any special deficit recovery contributions which are not specified in the Scheme's recovery plan, but which are sufficiently material to trigger a new recovery plan with lower contributions and/or an earlier end date (or, in the extreme, to terminate the recovery plan without replacement); and
- any special contributions made at a time during the certification period when the Scheme did not have a recovery plan in place, and which were made with the sole purpose of improving the Scheme's funding level.

The amount of deficit-reduction contributions which may be certified therefore excludes any contributions made in respect of any incurred or ongoing costs, or in respect of newly accrued or recognised liabilities not reflected in the valuation to which the certificate relates. Examples of contributions that fall out of scope include, but are not limited to, those in respect of:

- Scheme expenses;
- benefit augmentations or amendments not reflected in the valuation to which the certificate relates;
- benefit rectification not reflected in the valuation to which the certificate relates;
- equalisation of Guaranteed Minimum Pensions, to the extent that the corresponding liabilities are not reflected in the valuation to which the certificate relates;
- ongoing accrual of benefits in relation to service after the date of the valuation to which the certificate relates;
- payments made to facilitate the purchase of an interest in an ABC Arrangement; and
- any subsequent payments made to the Scheme trustees in respect of an ABC Arrangement.

Option Beta is intended to provide a straightforward approach to certification, using information which has already been calculated for accounting and scheme-specific funding purposes and which does not therefore require further actuarial calculations. Consequently, if the certified amount of Deficit-Reduction Contributions does not exceed £1 million and the total does not include any special contributions not recorded in the recovery plan (where applicable), then certification does not have to be by an actuary. Instead, certification may be approved by a Scheme trustee or an officer of any of the sponsoring employers, based on the contributions specified under its recovery plan that have actually been paid.

If the certified amount of Deficit-Reduction Contributions exceeds £1 million and/or the total includes special contributions not recorded in the recovery plan, then the Scheme Actuary must approve the certification. This also applies to schemes which did not have a recovery plan in force at any time during the certification period, or where special contributions not recorded in a recovery plan are certified.

The Board may seek to confirm that Schemes electing to certify under Option Beta without actuarial certification satisfy the conditions for its use as set out above. If the Board's investigations establish that a Scheme does not satisfy the conditions, the Deficit-Reduction Contributions certificate will be deemed invalid and disregarded in the calculation of the Scheme's Levy. In particular, a Deficit-Reduction Contribution of over £1 million made under Option Beta without actuarial certification will automatically be disregarded, as will a Deficit-Reduction Contribution made without actuarial certification which includes a special contribution not provided for in the recovery plan.

Option Beta examples

Examples of how Option Beta would work in practice under various illustrative scenarios are set out below.

(i) **Certification period covers one recovery plan, with expenses paid by employer**

Scheme specific funding valuation date = 1 January 2023

s179 valuation date = 1 January 2023

Monthly recovery plan contributions = £20,000 (£240,000 per annum)

Certification period = 1 January 2023 to 31 March 2025 (27 months)

Expenses are paid directly by the employer.

Recovery plan contributions paid over the certification period:

$£20,000 \times 27 = £540,000$

Maximum amount to be certified for deficit-reduction purposes = £540,000.

No requirement for actuarial certification.

(ii) **Certification period covers two recovery plans, with expenses paid from scheme**

Scheme specific funding valuation date = 1 January 2023

s179 valuation date = 1 January 2023

Monthly recovery plan contributions under previous scheme specific funding valuation = £5,500 (£66,000 per annum), including £500 per month (£6,000 per annum) in respect of expenses.

Start date of new recovery plan = 1 April 2024

New monthly recovery plan contributions = £10,600 (£127,200 per annum), including £600 per month in respect of expenses.

Certification period = 1 January 2023 to 31 March 2025 (27 months)

Total expenses paid from scheme over the certification period = £12,000.

The scheme had a recovery plan in place from its previous scheme specific funding valuation, under which the employer paid £5,500 per month including £500 per month in respect of expenses. The new scheme specific funding valuation was finalised and a revised recovery plan agreed by 31 March 2024, requiring increased employer contributions of £10,600 per month from April 2024, including £600 per month in respect of expenses.

Recovery plan contributions paid over the certification period (excluding contributions in respect of expenses)

$(£5,000 \times 15 + £10,000 \times 12) = £195,000$

Maximum amount to be certified for deficit-reduction purposes = £195,000.

No requirement for actuarial certification.

(iii) **Termination of recovery plan and a special contribution, with expenses paid by employer**

Scheme specific funding valuation date = 1 January 2023

s179 valuation date = 1 January 2023

Monthly recovery plan contributions under previous scheme specific funding valuation = £5,000 (£60,000 annually).

New scheme specific funding valuation finalised by 31 March 2024, disclosing a surplus.

Special employer contribution = £500,000

Date of special employer contribution = 31 December 2024

Certification period = 1 January 2023 to 31 March 2025 (27 months)

The scheme had a recovery plan in place from its previous scheme specific funding valuation, under which the employer paid £5,000 per month. The new scheme specific funding valuation was finalised by 31 March 2024 and established that the recovery plan could terminate from 1 April 2024 as the scheme was in surplus.

The employer made a special one-off contribution of £500,000 in December 2024, to assist the scheme's journey towards buy-out.

Recovery plan contributions and special contributions paid over the certification period:

$(£5,000 \times 15 + £500,000) = £575,000$

Since a special contribution was made and included in the certified amount, certification of this amount must be approved by the Scheme Actuary. Alternatively, the special contribution could be excluded to give a certified amount of £75,000 which would not require actuarial certification.

(iv) **Employer has paid additional contributions to the scheme in respect of benefit augmentation**

Scheme specific funding valuation date = 1 January 2023

s179 valuation date = 1 January 2023

Monthly recovery plan contributions under scheme specific funding valuation= £10,000 (£120,000 annually).

Contribution paid in respect of benefit augmentation = £50,000

Date of contribution paid in respect of benefit augmentation = 31 December 2024

Expenses met directly by employer

Certification period = 1 January 2023 to 31 March 2025 (27 months)

Contributions paid under the recovery plan:

$£10,000 \times 27 = £270,000$

During the certification period, a senior employee was made redundant. The employer agreed to augment the employee's benefits as part of the redundancy package and paid £50,000 to the scheme to cover the cost of the augmentation.

The £50,000 is in respect of newly accrued liabilities that were not accounted for in the s179 valuation. These cannot be certified as Deficit-Reduction Contributions.

Note that, under Option Beta, the s179 value of the liabilities in respect of the augmentation is irrelevant. The contribution is excluded simply because it was paid in respect of a benefit augmentation that was not included in the most recent s179 valuation; it is not mathematically compared to the corresponding liabilities on an s179 basis.

The scheme can therefore certify Deficit-Reduction Contributions of £270,000.

Because these were paid as part of the recovery plan, and the total value is under £1 million, actuarial certification is not required.