Pension Protection Fund

Consultation document
S143 valuation assumptions

March 2024

Contents

2024 consultation on assumptions to be used for valuations under section 143 and section 179 of the Pensions Act 2004

1. Introduction and summary

1.1 The Pensions Act 2004 requires valuations under sections 143, 152, 156, 158 and 179 of the Act to be calculated in line with our estimated price of securing PPF levels of compensation with a bulk annuity provider purchased at the best value rate available in the market. We regularly review our estimate to ensure it remains aligned with the market.

1.2 We are considering, subject to this consultation, introducing the ability for actuaries to use bespoke discount rates in section 143, 152, and 158 valuations.

1.3 We are not proposing any changes to section 179 and 156 valuations.

1.4 As previously, we have considered whether to introduce a minimum level of assumed wind-up expenses, but have again concluded that the ability to use a bespoke assumption for this is sufficient for purpose.

1.5 Throughout the document, we use 's143' to refer to the proposed approach to determine liabilities for sections 143, 152, and 158. Similarly, 's179' refers to the proposed approach to determine liabilities for sections 156 and 179.

1.6 This consultation document sets out our proposed changes. The closing date for responses to this consultation is 5pm on Monday 6 May 2024. The proposals are described in detail in sections 3.

1.7 Subject to the outcome of this consultation, we propose to introduce this change for valuations with an effective date on or after 31 May 2024.

Consultation question CQ1: Do you agree that we should introduce the new s143 valuation guidance from 31 May 2024? If not, what date(s) would be more appropriate?

2. Review process

2.1 We have adopted ten principles for the setting of assumptions for s143, s179, and other similar valuations. These are set out in appendix 2. Two of particular importance are:

- Principle 8 – the assumptions should deliberately err on the side of understating the liabilities.
- Principle 9 – they should be informed by regular meetings with market participants.

2.2 Erring on the side of understating liabilities means that for section 143 valuations we reduce the risk of taking schemes into the PPF that, as at the date of the employer's insolvency, could have bought out better benefits in the market.

2.3 We regularly review market changes and developments to ensure our assumptions remain appropriate. The current assumptions were set following a review of market pricing carried out in Q4 2022, following which the section 143 and section 179 assumptions came into effect on 1 May 2023.

2.4 We recently held discussions with six bulk annuity providers and eight PPF-panel trustee and advisory firms, concluding that, for schemes of sufficient size, our current standard assumptions and insurers' buy-out bases are close enough to not warrant considering more specific amendment at this time.

2.5 However, for smaller schemes our assumptions are likely to be understating the liabilities to the degree that marginally overfunded schemes are unable to obtain an affordable buy-out quotation for even PPF levels of compensation. This may occur even where a bespoke expense assumption has been used.

2.6 The appropriateness of the standard s143 assumptions for smaller schemes was a particular focus of our recent review, based on feedback received in response to our last consultation (in early 2023) on s143 assumptions. By 'smaller' we currently mean liabilities of less than around £50 million, although different insurers may define it differently, and this may change in the future.

3. Approach to setting the assumptions

3.1 Currently we only permit actuaries to use bespoke s143 assumptions for mortality, some other demographic assumptions, and expenses, where there is sufficient evidence to justify them. And only where the result would be a change from a funding level over/under 100 per cent to under/over 100 per cent. For example, a scheme large enough to have its own statistically reliable mortality experience analysis may use that, or a small scheme may have reasonably different expectations of what would be an appropriate expenses assumption.

3.2 From our discussions with insurers and our panel firms, and expenses aside, there aren't consistent disconnections between our standard assumptions and small scheme pricing. In the absence of anything more specific, we therefore suggest adjustment to the discount rate is a suitable way to allow for small scheme pricing differentials.

3.3 We are therefore considering, subject to this consultation, introducing the ability for actuaries to use bespoke discount rates in s143 valuations.

3.4 We expect that a bespoke discount rate leading to lower liabilities (compared to the standard assumption) is not currently appropriate, and for larger schemes it is not currently suitable for actuaries to consider a bespoke discount rate at all, as our existing standard discount rate assumptions should remain appropriate.

3.5 As with all bespoke assumptions, a bespoke discount rate would need to be agreed with us.

3.6 We believe that this approach provides additional flexibility and the ability for s143 valuations to reflect the reality of buy-out quotations, while minimising disruption and additional burden on actuaries and the schemes they advise – particularly given our most recent update to the s143 assumptions was in 2023 and principle seven of our assumptions-setting policy (appendix 2) is to try to avoid frequent changes.

3.7 Other approaches we considered included providing explicit thresholds for what constitutes a small scheme and then either the different discount rate margins or liability loadings to be used. The proposed approach avoids explicitly publishing insurers' private information about their discount rate assumptions, and also permits future flexibility without the need to consult on and publish new s143 assumptions and guidance.

3.8 We do not believe it is necessary or helpful to mirror this for s179 valuations, on the grounds of simplicity. Apart from anything else, it would complicate matters for our levy calculations if we had assumptions that varied by size of scheme. Further, since the introduction of yield curves for s143 valuations, we have been monitoring the relative strength of the s143 and s179 assumptions. This has remained within acceptable margins and so this has also not suggested a need for a change to s179 assumptions.

3.9 The proposed revisions to the s143 valuation and assumptions guidance are set out in appendix 3. This also includes additional wording to clarify the existing flexibility for other assumptions.

Consultation question CQ2: Do you believe that the proposal is appropriate and helpful? If not, why not? What would you propose instead, and why?

Consultation question CQ3: Do you foresee any undesirable consequences of the proposal?

4. Additional comments

4.1 Based on feedback received, we would like to take this opportunity to clarify the revaluation rate adjustments that are in (current) s143 assumptions guidance version B10. These are:

- Pre-1 March 2030: Adjusted inflation rate = BoE Inflation Rate – 0.2%
- Post-28 February 2030: Adjusted inflation rate = BoE Inflation Rate – 0.1%

4.2 These adjustments are made up of the following components:

Component	Pre-1 March 2030	Post-28 February 2030
RPI/CPI wedge	-80bps	-10bps
IOTA – difference between swaps and gilts-based inflation	+40bps	-
Difference in Inflation Risk Premium between RPI and CPI markets	+20bps	-

5. Consultation questions

5.1 We would be grateful to receive responses to the following questions:

CQ1. Do you agree that we should introduce the new s143 valuation guidance from 31 May 2024? If not, what date(s) would be more appropriate?

CQ2. Do you believe that the proposal is appropriate and helpful? If not, why not? What would you propose instead, and why? By ‘proposal’, we mean a) introducing the ability to use a bespoke discount rate assumption for s143, s152, and s158 valuations, b) including additional wording in the guidance but otherwise making no changes to the assumptions, and c) making no changes to s179 and s156 valuations.

CQ3. Do you foresee any undesirable consequences of our proposal?

CQ4. Do you have comments on any other matter in this consultation document which is not included in responses to the questions above?

6. Process for responding

6.1 The consultation will end at 5pm on 6 May 2024. Please ensure that your response reaches us by that date. For further copies of this document, see the Valuation Guidance section of our website: https://www.ppf.co.uk/

6.2 Respond to the consultation by emailing responses to:

AssumptionsConsultation@ppf.co.uk

or by contacting:

Shalin Bhagwan, Chief Actuary & Interim CFO
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon
CR0 2NA
Email: shalin.bhagwan@ppf.co.uk

6.3 Please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

6.4 We will publish a summary of responses on our website at https://www.ppf.co.uk/ before 31 May 2024. At the same time, we will also publish our decision about future assumptions for section 143 and section 179 valuations.

6.5 We would welcome feedback on the consultation process. If you have any comments, please contact:

Georgina Watson, Stakeholder Manager
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon
CR0 2NA
Email: Georgina.Watson@ppf.co.uk

6.6 The requirements of the Freedom of Information Act 2000 state that all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication. If this is not the case, the respondent should limit any personal information which is provided or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with the Freedom of Information Act 2000 obligations and general law on this issue. Further information about the Freedom of Information Act 2000 can be found on the website of the Ministry of Justice.

6.7 Our Privacy notice is available on our website.

Appendix 1: Valuations covered

1. A section 143 valuation is carried out during a PPF assessment period. The assets and liabilities for the section 143 valuation are established in accordance with section 143 of the Pensions Act 2004, the Pension Protection Fund (Valuation) Regulations 2005 (SI 2005 / 672), as amended, and guidance issued by the Board of the Pension Protection Fund (the Board). The valuation is carried out by an actuary appointed by the Board and the valuation is approved by the Board.

2. A section 152 valuation is carried out following an application for reconsideration under section 151 of the Pensions Act 2004.

3. Section 156 valuations must be carried out on a regular basis by a scheme that has been granted authorisation by the Board to run as a closed scheme having demonstrated that it was over 100 per cent funded at a section 143 valuation.

4. A section 158 valuation is carried out by a scheme that has been running as a closed scheme, following an application to commence a further assessment period under section 157 of the Pensions Act 2004.

5. Valuations carried out under section 152, 156 and 158 are required to be conducted on similar principles to a section 143 valuation. Legislation provides that protected liabilities are calculated as the estimated cost of securing scheme benefits, where scheme benefits are calculated in accordance with Schedule 7 of the Pensions Act 2004 (pension compensation provisions), to the member by means of an annuity purchased at the market rate.

6. The key purpose of these valuations is to assess whether a scheme has sufficient funds to buy out, in the market, levels of benefit at least equal to PPF compensation. For a large number of schemes this position will be relatively clear cut. This is a key consideration for keeping the assumptions used as simple as possible. Certain assumptions may be varied, upon request to the PPF, to take account of a scheme’s specific circumstances. This is a further reason for maintaining simplicity in the standard assumptions.

7. Section 179 valuations are carried out on a regular basis by all schemes eligible for PPF protection and the results are used in the calculation of PPF levies.

8. A section 179 valuation is in principle very similar to a section 143 valuation but contains simplifications. The PPF levy calculation requires each section 179 valuation to be rolled forward from its effective date to a later date. More complex valuation assumptions would tend to lead to more complex roll-forward calculations, and hence higher costs associated with performing such calculations.

Appendix 2: Policy principles around setting assumptions

The Board of the Pension Protection Fund (the Board) has adopted the following ten principles to underlie the setting of assumptions for section 143, section 179 and similar valuations:

1. Compliance with the regulations (see appendix 1). In particular, the assumptions are required to reflect insurance company buy-out pricing terms for PPF compensation.
2. Seeking evidence from confidential dialogue with market participants.
3. Seeking anecdotal evidence from consultants of the state of the market; a significant shift would indicate the need for a review of assumptions.
4. If the need for a review under principle 3 has not been invoked, nonetheless reviewing the market by speaking to market participants every year to eighteen months.
5. Proportionality (balancing the degree of precision with the cost, taking into account the purpose of the valuation).
6. Adoption of new tables and techniques as appropriate, having regard to the principle of proportionality.
7. Reasonable stability in the assumptions over time; i.e. frequent changes are undesirable.
8. Deliberately erring on the side of understating liabilities; i.e. assessing section 143 liabilities at a level that is believed for most schemes to be somewhat below the best market price.
9. Consulting with the pensions industry to check proposals.
10. Providing sufficient notification of changes.

These principles are not binding but the Board has made a commitment to follow them as far as possible.

Appendix 3: Proposed revised s143 valuation guidance

Valuation guidance

Changes from the existing guidance (version H8, January 2024) are highlighted. We would also update the effective date in part 2, but have not set that out below. Equivalent changes will also be made to the s152 valuation guidance, current version D5, January 2024

"Part 4 – Alternative assumptions

4.1 The appointed actuary may be permitted to use different assumptions from those prescribed in the relevant assumptions guidance where:

- it is considered that the assumptions set out in the assumptions guidance are not appropriate to the particular circumstances of a scheme; and
- the result would be a change in the funding level from greater than 100% to less than 100%, or vice versa.

4.2 The assumptions where changes may be permitted are:

- discount rate – adjustments to the unadjusted yields (but not the yields themselves)
- base mortality including age ratings (but excluding mortality improvements);
- proportions married;
- age differences between members and dependants;
- children's pensions; and
- expenses of wind-up and/or benefit installation / payment expenses.

In such cases, the appointed actuary must obtain the prior agreement of the Board to the use of different assumptions from those prescribed in the assumptions guidance. Please contact your Scheme Delivery Associate to discuss the evidence that will need to be provided to the Board."

Assumptions guidance

Changes from the existing guidance (version B10, March 2023) are highlighted. We would also update the effective date in part 1, but have not set that out below.

Part 1 – Effective date of guidance

1.1 This is version B10 of the guidance. Updates to some of the wording, but not to the standard assumptions, were made in May 2024. These updates were primarily done to draw attention to those assumptions where, in some cases, alternatives may be used.

1.2 This version of the guidance applies to valuations with an effective date on or after 1 May 2023, except for the use of an alternative discount rate, which applies to valuations with an effective date on or after 31 May 2024.

1.3 This guidance should be read in conjunction with the most recent version of our Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004.

"2.2 Purpose of this guidance

2.2.1 This guidance on assumptions is intended for actuaries undertaking valuations to determine the level of funding in accordance with section 143 of the Act.

2.2.2 Our *Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004* sets out those assumptions where actuaries may use alternatives to those set out in this assumptions guidance, including the circumstances that permit it."

"3.2 Discount rates

Separate yields are used for pensioners and for non-pensioners. The liability must be obtained by reference to the following (adjusted) yields.

Non-pensioners: Adjusted yield = BoE Nominal Yield

Pensioners: Adjusted yield = BoE Nominal Yield + 0.4%

The BoE Nominal Yield is the GLC Nominal daily forward rate provided at https://www.bankofengland.co.uk/statistics/yield-curves/. The yields are shown at six-monthly intervals up to 40 years. Only those shown for integer maturities should be used. For periods beyond 40 years, the 40-year forward rate should be adopted.

For valuations with an effective date on or after 31 May 2024, the adjustments to the BoE Nominal Yield may be permitted to be different to those shown above. Further details are available in the latest version of our *Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004*."

"Part 4 – Mortality for use when undertaking valuations

The mortality baseline in respect of an active, deferred or pensioner member, pre and post retirement, shall be:

Gender of first life	First life	Contingent life
Men	S3PMA	S3DFA
Women	S3PFA	S3DMA

The mortality baseline in respect of a current dependant shall be S3DMA (men) and S3DFA (women).

Base mortality may be permitted to be different to that shown above. Further details are available in the latest version of our *Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004*."

Future changes to mortality in line with CMI_2021_M [1.50%; A=0.25%; w2020=10%; w2021=10%] and CMI_2021_F [1.25%; A=0.25%; w2020=10%; w2021=10%] for men and women respectively (from 2013)."

“5.1 Assumptions for contingent benefits

a) Proportions married

…

b) Age difference between member and dependant

Females are assumed to be 3 years younger than males.

c) Children’s pensions

No specific additional allowance is to be included for prospective children’s pensions. Children’s pensions already in payment should be assumed to cease at age 18, or age 23 if currently aged over 17.

Assumptions for contingent benefits may be permitted to be different to those shown above. Further details are available in the latest version of our *Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004*.”

“5.2 Expenses

This calculation of expenses is intended to give an estimate of the cost of securing a full buyout with an insurance company. The expenses must be applied whatever the investment strategy of the scheme and, in particular, even if all scheme benefits are secured by immediate and deferred annuity policies.

a) Estimated wind-up expenses

…

b) Benefit installation / payment expenses

…

If a member has two or more records, e.g. a pension and a deferred pension, then only one expense allowance (the highest) should be calculated.

Assumptions for expenses of wind-up and/or benefit installation / payment expenses may be permitted to be different to those shown above. Further details are available in the latest version of our *Guidance for undertaking the valuation in accordance with Section 143 of the Pensions Act 2004*.”

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