Pension Protection Fund

PPF Restructuring and Insolvency Team
Guidance Note 13
Guidance for trustees on their approach on PPF consideration in distressed employer situations

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1. Background

1.1. There is a long-established principle first set out in the case of ITS v Hope that "gaming" the Pension Protection Fund (PPF) is unlawful. However, that case concerned an elaborate plan to use a disproportionate amount of scheme assets to discharge the liabilities of one part of the membership, leaving the rest to be supported by the PPF. In reality, those circumstances are rare and it is more common for the trustees to have to consider the impact of PPF protection in everyday situations with a distressed employer.

1.2. The decision in *B v H and the Board of the Pension Protection Fund* brings clarity that when doubts arise as to the ability of an employer to repair a deficit, trustees cannot take advantage of the existence of the PPF lifeboat to justify conduct that would otherwise be improper. Trustees must proceed strictly on the basis that any undue delay in winding up the scheme, which diminishes the scheme's assets will ultimately result in a reduction to members' benefits, and they must take decisions on that basis.

1.3. The PPF has therefore produced guidance on the tests that it believes trustees should apply and the matters to be considered in applying those tests. This guidance has been prepared in co-operation with Hogan Lovells International LLP and Michael Tennet K.C.

2. PPF best practice – the tests

2.1. Where a scheme is (or could become) in deficit on a PPF basis (PPF Deficit), any consideration of whether to wind up the employer (or wind up the scheme) must <u>not</u> take account of the availability of PPF compensation and must instead proceed on the basis that any increase in the PPF Deficit caused by delaying the winding up will be borne by the members who are adversely affected by PPF Deficit Drift (as defined below) and who will as a result suffer a reduction to the benefits that would otherwise be payable to them on a winding up of the scheme.

2.2. Where and for so long as an employer is in non-trivial breach of any obligation to make contributions to a scheme which is in deficit on a PPF basis[1] or technical provisions

[1] A deficit on the valuation basis prescribed by s179 of the Pensions Act 2004

basis[2] , the trustees of the scheme must consider and keep under consideration whether to petition to wind up the employer (or wind up the scheme), crystallising the section 75 debt and bringing about a PPF assessment period.

2.3. In considering whether to wind up, trustees must balance the upsides against the downsides of delay (proceeding on the basis set out in paragraph 2.1 above). This will involve an assessment both of the potential benefit and potential damage to the scheme (and its members) and the likelihood of such benefit or damage materialising.

3. Matters to consider

3.1. In the PPF's view, to address the tests above, trustees need, unless impracticable, to inform themselves of, and take into account, the matters set out below.

3.2. Funding levels and drift:

a. The extent of the deficit on the solvency[3], technical provisions and PPF bases.
b. "Scheme Drift", namely the rate at which a deficit on the technical provisions basis or solvency basis deficit is increasing and will increase as result, inter alia, of paying benefits in full and incurring any professional fees associated with monitoring the scheme and attempts to get contributions paid or to secure the scheme's position as creditor, if such payments and costs are not covered by contributions.
In addition to 3.2(a) and 3.2(b) above, where the scheme is in, or at risk of being in, deficit on a PPF basis:
c. "PPF Priority Drift": the rate at which the level of the PPF Deficit is increasing and will increase as a result of some members qualifying for higher benefits under the scheme's winding up rule (and under the PPF compensation rules) either because they have reached National Pension Age or as a result of benefits being indexed at a greater rate than would apply if the PPF had assumed responsibility for the scheme.
d. "PPF Deficit Drift": the rate at which the PPF Deficit is increasing and will increase as result of both PPF Priority Drift and the same factors (see above) that contribute to Scheme Drift.

3.3. Volatility, hedging and the prospects of future investment returns:

a. Whether and to what extent the scheme's funding position on the solvency, technical provisions and PPF bases has been hedged against future investment, economic and demographic risks.
b. To the extent that the investment risk is hedged, the impact this will have on future investment returns and the ability of the scheme to recover from its position of deficit.
c. To the extent that any risks are not or cannot be hedged, the risks of a further deterioration in funding caused by the materialisation of such risks.

3.4. The nature and extent of the employer's breaches:

a. Whether there has been a deliberate or reckless breach of the employer's obligations or any evidence of unwillingness, rather than simply inability, to fund the scheme.

[2] A deficit on the valuation basis prescribed by s225 of the Pensions Act 2004
[3] A deficit on the basis prescribed by s75 of the Pensions Act 1995

b. Whether there has been a history of defaults.

3.5. Recoveries on winding up:

a. To what extent will the dividend from the section 75 debt on a winding up of the company cover the scheme's solvency deficit and (if not) the PPF Deficit.
b. If there is insufficient cover, whether the estimated recoveries on insolvency are likely to improve within a reasonable time frame (or whether the position could get even worse).

4. Working together with the PPF

4.1. The PPF would expect trustees to work with it in a fully transparent manner where there is a real risk of employer failure.

4.2. This is on the basis that the PPF's interest in ensuring that the scheme's protected liabilities do not exceed its assets or, if they do exceed its assets, that the excess is kept to a minimum, is essentially the same as the collective interests of scheme members in avoiding or minimising any reduction to their benefits on a winding up (if one does not assume that the reduction will be covered by PPF compensation).

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