Contents

Part 1 – Effective date of guidance

1.1. This is version G5 of the guidance.

1.2. This version of the guidance should be used for valuations with an effective date on or after 1 April 2009 or for valuations with an effective date prior to 1 April 2009 to be signed on or after 1 October 2009.

1.3. This version may also be adopted in place of version G4 of the guidance for valuations with an effective date prior to 1 April 2009 to be signed on or after 1 April 2009 and prior to 1 October 2009.

1.4. This guidance should be read in conjunction with the most recent version of our *Guidance on assumptions to use when undertaking the valuation in accordance with Section 179 of the Pensions Act 2004.*

Part 2 – Overview

2.1 Introduction

2.1.1 To calculate the scheme based element of the pension protection levy, for eligible schemes, the Board of the Pension Protection Fund is required to take account of scheme liabilities, and to calculate the risk based element of the pension protection levy the Board is required to take account of the degree to which a scheme is underfunded.

2.1.2 An eligible scheme is defined by **section 126** of the Pensions Act 2004 ("the Act") and associated regulations.

2.1.3 Section 179 of the Act requires trustees (or managers) to obtain valuations at prescribed intervals for this purpose. A section 179 valuation is based on the level of assets and liabilities for the scheme. The liabilities are based on the scheme benefits taking into account key features of the levels of compensation paid by the Board of the Pension Protection Fund.

2.1.4 The actuarial valuation must be prepared and signed by a person meeting the criteria specified in **section 179(2)** of the Act and **regulation 10** of the valuation regulations.

2.1.5 The **section 179** valuation is a simplified valuation (relative to a **section 143** valuation) based on the scheme's benefits but taking into account certain key elements of the Pension Protection Fund compensation. The full details of compensation are set out in **Schedule 7** to the Act.

2.1.6 Details of the dates by which information from a section 179 valuation must be submitted in order to be taken into account in the calculation of the pension protection levy are available on the Pension Protection Fund website.

2.2 Purpose of this guidance

2.2.1. This guidance is intended to support actuaries who are undertaking valuations to determine the level of underfunding in accordance with section 179 of the Act. Such guidance was envisaged in paragraph (4) of section 179. The valuation results will be used to set and calculate the pension protection levy in accordance with section 175.

2.2.2. The legislation and associated regulations relating to these valuations originally came into force on 6 April 2005.

2.3 Legislative requirements

2.3.1. **Section 179** of the Act requires schemes to undertake a Pension Protection Fund valuation to establish the level of scheme assets and liabilities on a section 179 basis and so to determine the level of scheme underfunding that is used in the risk based levy calculation.

2.3.2. The associated regulations set out the high level principles for conducting a section 179 valuation. This guidance then provides additional detail.

2.4 Why is this valuation necessary and when is it needed by?

2.4.1. The valuation will provide the Board of the Pension Protection Fund with information on the level of liabilities and underfunding within a scheme. This will inform the calculation of the pension protection levy.

2.4.2. All schemes that were registered before 5 April 2007 should have provided their first section 179 valuation to the Board of the Pension Protection Fund or the Pensions Regulator within 15 months of the effective date or by 31 March 2008 if earlier.

2.4.3. Schemes that registered on or after 6 April 2007 must provide the Pension Protection Fund with their first section 179 valuation within 15 months of the effective date of their first section 224 valuation.

2.4.4. After the initial valuation, schemes must provide the Board of the Pension Protection Fund with further valuations at regular intervals. The effective date of each subsequent valuation must be no later than three years after the effective date of the previous valuation. The valuation information must be provided (as described in 2.5 below) to the Board of the Pension Protection Fund within 15 months of the effective date.

2.4.5. With the exception of the initial valuation for certain schemes, this time scale allows for the valuation to be undertaken in line with a scheme's normal valuation cycle; however schemes wanting to provide a valuation on a more frequent basis may do so.

2.4.6 Details of the deadlines by which details of a section 179 valuation must be provided, in order to be taken into account within the pension protection levy calculation for a particular levy year, are available on the Pension Protection Fund website (see 2.5.2 below).

2.5 Where to send valuation information

2.5.1. The results of the section 179 valuation should be provided to the Board of the Pension Protection Fund as part of the annual scheme return via the Pension Regulator's system "Exchange". It is possible to update the section 179 valuation pages of Exchange at any time. Changes should be made as soon as possible bearing in mind any "cut-off" dates for the provision of information set out on the Pension Protection Fund website.

2.5.2. For further details about the valuation process please go to the Pension Protection Fund website at: www.pensionprotectionfund.org.uk

2.5.3. The contact address for the Pension Protection Fund is:

Pension Protection Fund
Knollys House
Level 9
17 Addiscombe Road
CROYDON
CR0 6SR
Tel: 0845 600 2541

2.5.4 **The results of the section 179 valuation should not be sent directly to the PPF**. The PPF Board will ignore any s179 information submitted in error directly to the PPF and will not take it into account in levy calculations.

2.5.5 Should the Exchange system be unavailable for any prolonged period, details of the alternative arrangements for the provision of section 179 valuation information will be published on the Pension Protection Fund website.

2.6 Legislation or authority for actuarial valuations

The Pensions Act 2004 (the Act)

The Pension Protection Fund (Valuation Regulations) 2005 SI 2005/672 ('the Valuation Regulations')

The Pension Protection Fund (Partially Guaranteed Schemes)(Modification) Regulations 2005 SI 2005/277

The Pension Protection Fund (Pension Compensation Cap) Order 2005 SI2005/825 ('the Cap regulations')

The Occupational Pension Schemes (Modification of Pension Protection Provisions) Regulations 2005 SI 2005/705

The Occupational Pension Schemes (Levies) Regulations 2005 SI 2005/842

The Pension Protection Fund (Compensation) Regulations 2005 SI 2005/670

The Pension Protection Fund (Entry Rules) Regulations 2005 SI 2005/590

The Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005 SI2005/441

The Pension Protection Fund (Hybrid Schemes) (Modification) Regulations 2005 SI2005/449

The Pension Protection Fund (Pension Compensation Cap) Order 2006 SI2006/347 ('the Cap Regulations')

The Pension Protection Fund (Pension Compensation Cap) Order 2007 SI2007/989 ('the Cap Regulations')

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2007 SI2007/782

The Pension Protection Fund (Pension Compensation Cap) Order 2008 SI2008/909 ('the Cap Regulations')

The Pension Protection Fund (Entry Rules) Amendment Regulations 2008 SI2008/1810

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2009 SI 2009/451

The Pensions Act 2008

Note: The above list may not be comprehensive. It is the responsibility of the scheme actuary to ensure the valuation is compliant with all relevant legislation in force at the date of signing their report.

Part 3 – Protected liabilities

3.1. The scheme's protected liabilities are defined in **section 131** of the Act. The amount of the protected liabilities relating to benefits for or in respect of members and to wind-up shall be determined in accordance with **section 179** of the Act, the valuation regulations, this guidance note, and the most recent version of the "*Guidance on assumptions to use when undertaking a valuation in accordance with Section 179 of the Pensions Act 2004"* as published by the Board.

3.2. The definition of protected liabilities includes "liabilities of the scheme which are not liabilities to, or in respect of, its members". Such external liabilities might include items such as professional advisers' fees which have been incurred prior to the date of the **section 179** valuation but had not been paid from the pension scheme's assets by that date. External liabilities may be zero if there are no such items.

3.3. The scheme actuary may use prudent approximations in calculating the protected liabilities. For example liability data from a previous valuation may be used and those liabilities may be rolled forward on a prudent basis to the relevant time i.e. the effective date of the valuation.

3.4. The scheme actuary is required to certify in his report to the trustees that, in his opinion, the calculated value of the protected liabilities is unlikely to have been understated. The Pension Protection Fund will accept approximations, for instance approximations necessitated due to lack of data, provided the actuary is able to give the required certification.

Part 4 – Benefits for and in respect of Members

4.1 General

The benefits for and in respect of members of the scheme should be valued as at the relevant time. For the purposes of this valuation the benefits to be valued are the scheme benefits, but taking into account the adjustments contained in the five bullet points below. This reflects the requirement of the Valuation Regulations that scheme benefits, rather than the levels of Pension Protection Fund compensation, are used in a section 179 valuation.

- applying the appropriate cap (in force at the effective date of the valuation) to the benefits for members under normal pension age. Please note the cap does not apply in the case of ill health and survivors' benefits in payment at the valuation date;

- reducing the benefits in respect of those members under normal pension age by 10% (as above, this does not apply in the case of ill health and survivors' benefits in payment at the valuation date);

- disregarding any indexation applicable to benefits in respect of pre 6 April 1997 service;

- allowing for indexation up to RPI but capped at 2.5% on benefits in respect of service from 6 April 1997; and

- allowing for death benefits consistent with those provided under compensation (see section 4.8 below).

4.2 Liabilities to be included

4.2.1. In accordance with **section 179(5)** of the Act the value of liabilities should not be limited to the value of the assets, even where the scheme rules may so provide.

4.2.2. For schemes with a partial Crown guarantee the valuation must only be of that part of the scheme that is not covered by a Crown guarantee.

4.2.3. The liability in respect of money purchase benefits shall be disregarded for the purposes of determining the protected liabilities. The definition of what constitutes a money purchase benefit is a matter of some uncertainty. Please refer to the Pension Protection Fund website for further information.

4.2.4. Except in prescribed circumstances (see paragraph 5.5 below) benefits secured under contracts of insurance should be valued for a **section 179** valuation, provided the insurance policies are held in the name of the trustees.

4.2.5. Where a scheme with more than one employer operates a sectionalised scheme, separate valuations will be required for each separate section of the scheme setting out the assets and liabilities attributable to each section.

4.3 Normal pension age

4.3.1. Normal Pension Age should be determined as provided in paragraph 34 of **Schedule 7** to the Pensions Act 2004. Please see further guidance on this on the PPF website. Benefits for non-pensioners must be valued as payable at the Normal Pension Age applicable to each part of the benefit.

4.3.2. For a non-pensioner over Normal Pension Age for all or part of their benefit, it should be assumed that payment of that benefit, for which the normal pension age had been reached, commenced immediately before the valuation date with the application of any scheme late retirement factor.

4.4 Non-pensioner members

4.4.1. For **section 179** valuation purposes, benefits for an active member should be calculated as though the individual had become a deferred pensioner immediately before the valuation date. In practice Pension Protection Fund compensation may be calculated slightly differently.

4.4.2. A non-pensioner with less than 2 years service may not be entitled to a deferred pension under scheme rules. In such cases, the benefits to be valued are those which the member is entitled to under the rules of the scheme (subject to the adjustments detailed in paragraph 4.1).

4.4.3. The pre-retirement decrements to be used to value benefits for non-pensioners are retirement at Normal Pension Age and death before Normal Pension Age.

4.4.4. It should be assumed that there is no commutation of pension at retirement for non-pensioners. However, where a scheme provides for a defined separate lump sum to be paid at retirement, not as a result of commutation, these benefits should be valued.

4.4.5. Except for where provided under 4.4.6 below, all pensions (including any non-revaluing pension, GMP, fixed pension payable from normal pension age, , pensions with fixed increases in deferment) should be treated for revaluation purposes in the same way as deferred compensation increases i.e. the relevant assumption set out in the assumptions guidance for compensation increasing in deferment should be used. Between the date of leaving and the date of valuation, deferred pension increases should be valued as per the scheme rules.

4.4.6 Where:

- the scheme does not provide for any revaluation of benefits for, or in respect of, any member in deferment; **and**
- the effective date of the section 179 valuation is on or after 1 April 2009,

then the assumption for compensation not increasing in deferment may be used.

Note that if a **single** scheme member receives revaluation on **any** part of their pension then this paragraph does **not** apply. .

4.4.7 Any post-retirement guarantee period provided by a scheme should not be included within the protected liabilities (but see 4.4.8).

4.4.8 However, it would be acceptable to include the benefits described in 4.4.7 as doing so would not understate the protected liabilities.

4.5 Pensioner members

4.5.1. Where a member is already in receipt of a pension in respect of excess over GMP only and is entitled to an increase equal to the GMP coming into payment when they reach their GMP age, the value of that future increase in benefit should be included within the protected liabilities.

4.5.2. GMP step-ups and anti-franking increases do not need to be valued for other pensioners and non-pensioners.

4.5.3. Where a pension will stop being paid prior to the pensioner's death, that pension should be included in the valuation of the liabilities as a temporary pension, but should not be included when testing against the compensation cap (see 4.7).

4.5.4. Any post-retirement guarantee period provided by a scheme should not be included within the protected liabilities (but see 4.5.5).

4.5.5. However, it would be acceptable to include the benefits described in 4.5.4 as doing so would not understate the protected liabilities.

4.6 Splitting benefits into pre 1997, 1997–2009 and post 2009 parts

4.6.1. For schemes with non-uniform accrual of benefits, an accurate split of benefits should be made for non-pensioners into:

- pre 6 April 1997 pension;
- post 5 April 1997 to pre 6 April 2009 pension; and
- post 5 April 2009 pension.

This split should allow for different accrual rates and different pensionable earnings definitions; however, this is subject to paragraphs 3.3 and 3.4 of this guidance.

4.6.2. For pensioners a similar split should be made into pre 6 April 1997 and post 5 April 1997 pension. Where pensioners have previously commuted part of their pension for a lump sum and the scheme makes no distinction between pre and post 97 benefits, the member's pension should be pro-rated by service into pre and post 97 pension.

4.6.3 Fixed pensions and pensions based on notional service should be allocated between the constituent parts in accordance with normal scheme practice. Where there is no such practice, the whole of this benefit should be treated as post 1997 for pensioners or accrued between 6 April 1997 and 5 April 2009 for non-pensioners.

4.7 Compensation cap

4.7.1. On grounds of prudence, the compensation cap can always be ignored. Please refer to paragraphs 3.3 and 3.4 for further details.

4.7.2. For non-pensioners under normal pension age, the compensation cap applicable at normal pension age and in force at the effective date of the valuation should be applied as at the valuation date (unless the compensation is non-revaluing in deferment – see paragraph 4.4.6 above). Where a member has more than one normal pension age applicable to different parts of their benefit, the compensation cap applicable at the latest normal pension age should be used. This cap should be applied on a pro-rata basis across the different parts of benefit for which the relevant normal pension age has not been reached, based on the amount of benefit at the valuation date.

4.7.3. Under this methodology, the compensation cap is effectively assumed to increase at the same rate as the average rate applying to the member's compensation. Please note that this is different from the rate of increase assumed for a section 143 valuation and in practice the compensation cap would only be applied when a member's compensation came into payment.

4.7.4. For a member in receipt of a normal health early retirement pension who is under their normal pension age, the appropriate cap should be applied for the age of the member as at the valuation date.

4.7.5. For pensioners below normal pension age the actuary does not need to consider previously taken cash lump sums. This is in contrast with a section 143 valuation where the actuary would need to consider such lump sums.

4.7.6. In schemes where cash lump sum benefits based on service and salary accrue separately alongside pension benefits, the cash benefits for non-pensioners below normal pension age should be incorporated into the comparison of benefit levels with the compensation cap. This should be undertaken by converting the lump sum into an equivalent pension using the factors required to calculate the annualised value of a lump sum available from the Pension Protection Fund's website.

Death benefits

4.8.1. Where a scheme does not provide for a survivor's pension on the death of any member, no death benefits should be valued.

4.8.2. Where a scheme provides for a survivor's pension for a single member, then a survivor's pension on death before and after retirement should be valued for all members based on 50% of the members' scheme benefits (after allowing for any commutation or early retirement reduction where the member's benefit is already in payment), with the adjustments applied as detailed in paragraph 4.1 of this guidance.

4.8.3. Pre-retirement lump sum death benefits (including refund of contributions) should not be valued (but see 4.8.4)

4.8.4. However, it would be acceptable to include the benefits described in 4.8.3 as doing so would not understate the protected liabilities.

4.8.5. Where the member's benefits would have been restricted by the compensation cap (i.e. if the member is under Normal Pension Age), the spouse's benefit that should be valued is equal to 50% of the member's pension as restricted by the cap and the 90% compensation level.

4.9 Hybrid schemes

4.9.1. For a hybrid "better of" scheme, where benefits may be either defined benefit (DB) or defined contribution (DC), the assets and benefits to be included within the protected liabilities should only be those that relate to members where the DB benefits exceed the DC benefits at the relevant time.

4.9.2. The calculation for each individual should consider whether the underpin bites as at the valuation date using the current scheme methodology. Only those members for whom the DB benefits exceed DC benefits (DB members) should be included in the liability calculations. Members with purely DC benefits (i.e. the DB benefits do not exceed the DC benefits) should be excluded from both the assets and liabilities of a section 179 valuation.

4.9.3. The compensation cap and the 90% level should be applied to the DB members of the hybrid scheme (after the underpin test has taken place) and their protected liabilities valued in accordance with this guidance.

4.9.4. In a DC scheme with a DB underpin, for any period of service where the DB underpin would not apply, the corresponding assets and liabilities should be excluded from the valuation.

4.9.5. For a DC scheme with a DB underpin that only applies for a particular period of service, the member's fund in relation to that period of service alone should be compared to the underpin using current scheme methodology.

4.9.6. If a scheme does not currently have its own methodology in place then the actuary should adopt the methodology they would employ if conducting a funding valuation.

4.10 Cash balance schemes

4.10.1. For each individual under NPA aged x with a normal pension age of y and cash balance amount of (£A_1 + £A_2 + £A_3) at the valuation date (where £A_1, £A_2 and £A_3 are the cash balance amounts accrued in relation to pre 1997, 1997-2009 and post 2009 service respectively) the scheme actuary should:

- Apply a cap to (£A_1 + £A_2 + £A_3) equal to the compensation cap at age y multiplied by the annuity at age y. The annuity at age y is derived from two annuities at age y, weighted by pre 97 and post 97 service, using the appropriate yield in payment as defined in "*Guidance on assumptions to use when undertaking a valuation in accordance with Section 179 of the Pensions Act 2004*". The annuity at age y should also contain an element in respect of a contingent spouse's pension unless the scheme does not provide such a benefit. Note each of the cash balance amounts should be reduced, if necessary, by the same percentage so that the total of the capped cash balance amounts is equal to the maximum permitted.

- Discount the capped cash balance amounts payable at retirement at age y, after allowing for mortality, by a factor of $(1+i)^{x-y}$. Note i is the yield in deferment, according to the date that the compensation is accrued, as defined in "*Guidance on assumptions to use when undertaking a valuation in accordance with Section 179 of the Pensions Act 2004";*

- Similarly, discount the cash balance amount payable on death before retirement, after allowing for the probability of death, in n years' time by a factor of $(1+i)^{-n}$;

- Sum all the discounted capped cash balance amounts over all the various contingencies;

- Apply multiplier of 90%.

4.10.2. For each individual over NPA but not yet in receipt of a pension, the **section 179** liabilities should equal the cash balance amount in relation to that particular member.

Part 5 – Assets

5.1. Assets must be taken into account in a section 179 valuation in accordance with the valuation regulations. The valuation regulations specify that for the purposes of determining a **section 179** valuation the appropriate person shall adopt the value of the scheme assets stated in the relevant accounts, and that value shall be taken to be the value of those assets at the effective date.

5.2. Relevant accounts must be audited accounts prepared in respect of a period ending on the effective date of the **section 179** valuation. The definition of relevant accounts can be found in Regulation 1 of the Pension Protection Fund (Valuation) Regulations 2005.

5.3. The assets in respect of money purchase benefits should not be included in the assets in accordance with **section 179(6)** of the Act. Where these assets are in respect of the conversion of money purchase funds to pension paid directly from scheme assets, the amount deducted should be the scheme actuary's estimate of the cost of buying out the scheme pension with an insurance company at the effective date.

5.4. Insurance polices held in the name of the trustees (except as detailed in 5.5 below) should be included in the assets for **section 179** purposes. Regulation 7 (2) of the Pension Protection Fund (Valuation) Regulations 2005 contains some detail on how this valuation should be carried out. The value of these assets might not be equal to the value of liabilities for section 179 purposes, however the Board would have concerns about any valuation that understated liabilities or understated underfunding.

5.5. Where any liabilities are covered by a relevant contract of insurance (as defined by the Act) which was taken out before 6 April 1997, but insufficient information now exists for the contract to be taken into account in a valuation, then the value of that contract (and the value of the corresponding liabilities) should not be included in a section 179 valuation. The legislation requires all reasonable steps to be made to obtain sufficient information regarding insurance policies to enable a valuation to be carried out before concluding that they should not be taken into account.

Part 6 – Data

6.1. The Pension Protection Fund regards it as best practice for trustees or managers to take appropriate action to ensure that, as far as is practicable, all potential scheme beneficiaries have been identified and that the associated membership data is correct. To the extent that there are residual uncertainties about the membership data (after having excluded any relevant contract of insurance satisfying the conditions in paragraph 5.5 of this guidance), prudent approximations by the scheme actuary will be acceptable. This is an aspect of the prudent estimation of protected liabilities described in Part 3.

Part 7 – Valuation method

7.1. Any reasonable age definition may be used for the purpose of the calculation provided consistency with the revaluation and increase periods can be demonstrated.

7.2. For each scheme member the protected liability must be calculated as the present value of the accrued benefits using the assumptions specified in the relevant version of *"Guidance on assumptions to use when undertaking a valuation in accordance with Section 179 of the Pensions Act 2004".*

Part 8 – Expenses

8.1 Expenses must be determined as specified in the relevant version of *"Guidance on assumptions to use when undertaking a valuation in accordance with Section 179 of the Pensions Act 2004"*.

Part 9 – Reporting

9.1 The scheme actuary's report on the **section 179** valuation should be addressed and sent to the trustees. The Pension Protection Fund does not need to be sent a copy of this report. The certificate on the Pension Protection Fund website should form part of the scheme actuary's report. The results of the **section 179** valuation should be provided to the Pension Protection Fund via the Pension Regulator's system "Exchange". It is possible to update the section 179 valuation pages of Exchange at any time (although see 9.3 below).

9.2 Regulation 2 of the Valuation Regulations requires the trustees or managers to provide the Board or the Pensions Regulator on the Board's behalf with the valuation within 15 months of the effective date of the valuation.

9.3 Details of the deadlines by which details of a section 179 valuation must be provided, in order to be taken into account within the pension protection levy calculation for a particular levy year, are available on the Pension Protection Fund website.

9.4 The Pension Protection Fund currently only requires information on s179 liabilities to be separately identified between pre and post 1997 service. In future it may introduce a requirement to separately identify the post 2009 proportion. The actuary's report should therefore include sufficient information to enable the trustees to meet this requirement if this is introduced.

Part 10 – Review

10.1 This guidance note will be reviewed at regular intervals as the Board of the Pension Protection Fund deems appropriate.