Pension Protection Fund

Strategic Plan 2011

Management Plan 2011/12 – 2013/14
Business Plan 2011/12

April 2011

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Chairman's Foreword

I am very much looking forward to the year ahead, my first full year as Chairman of the Pension Protection Fund. The next 12 months will be a crucial period in our history as we put into action many of the projects for which we created the infrastructure during 2010/11. Over the last two years, the PPF has remained resilient in a turbulent economic climate. As the economy now continues an uncertain recovery and the Government's deficit reduction measures begin to take effect, we will capitalise on the successful foundations laid since 2005 and ensure the PPF is as efficient and secure as our levy payers and members require.

I joined the PPF at an exciting and interesting time, during a year in which we began to make significant progress in accelerating the assessment period for the typical profile of pension scheme that transfers to us. The publication of our funding strategy, another major achievement, will give transferring members confidence in the source of their compensation.

We will build on these successes in the year ahead and there are a number of exciting developments to come. We will continue to improve the process for assessing schemes for transfer to the PPF, to modify our hedging strategy in line with the latest Statement of Investment Principles and to develop a new levy framework, for the benefit of both levy payers and members.

Maintaining the momentum we built last year will be difficult at a time when our resources will be stretched, but over the course of my first nine months here I have been encouraged by the dedication of PPF employees and the strong relationships the organisation has built with Government, the pensions industry, schemes and levy payers. I am confident, therefore, that the PPF remains in a strong position to fulfil our goal of paying the right people the right amount at the right time, now and in the future.

Barbara Judge

Lady Judge
Chairman

Chief Executive's Foreword

As we begin the 2011/12 financial year, over 70,000 people are receiving PPF compensation, or will do in the future, and we have already paid over £250 million in compensation. We have demonstrated our resilience during the recession, but economic recovery remains uncertain and the public sector spending environment is challenging. While our sustainability is not in doubt, therefore, we expect our capacity to deliver to be tested over the next 12 months.

In our first five years of business we recruited rapidly as our caseload grew, but as we mature as an organisation we now need to focus more on retention and development. For this reason, we will make a greater investment in staff training than in previous years. We'll also continue our culture change programme, which began with the introduction of the ICARE values last year and is aimed at promoting an environment which encourages and values high performance.

The quality of our people means we can continue to set our sights high. In 2011/12 we aim to complete assessment periods for more schemes than in any previous year. This ambition is made possible by the success of our *Assess & Pay* programme, piloted last year and now to be implemented as our standard model for the assessment period. To help realise its full potential, we will continue working closely with the Pensions Regulator and the Department for Work and Pensions to improve the quality of pension scheme data.

We're also targeting a higher expected investment return as we implement the Statement of Investment Principles we published last year. This will involve increasing our pool of fund managers and further developing our risk management framework. With our assets under management set to increase by 50 per cent over the next year as more schemes transfer to the Fund, these developments will be crucial in ensuring we meet our commitments.

Our investment strategy and the pension protection levy are both now explicitly tied to our funding strategy, which was also launched in 2010. Finalising the rules for the calculation of invoices within the new levy framework will be a key activity for the year ahead. Within the current framework, we aim this year to collect and invest levy bills more quickly than in previous years, thereby shortening the invoicing period. This will benefit both levy payers and members.

It is an exciting and challenging year ahead for the PPF. I'm looking forward to working with PPF staff and stakeholders to build on the success of 2010/11 and continue to protect peoples' futures.

Alan Rubenstein
Chief Executive

1. What we do

We were set up by the Pensions Act 2004 and opened our doors for business in April 2005. We are a public corporation run by an independent Board, which is responsible to Parliament through the Secretary of State for Work and Pensions.

We pay compensation to people belonging to certain defined benefit (such as final salary) pension schemes, when the employer became insolvent and where there are not enough assets in the scheme to pay protected levels of compensation or above.

The compensation we pay to scheme members and the administration costs of the PPF are paid for through a pension protection levy and an administration levy on those pension schemes that could make a claim on the PPF now or in the future.

We also generate income from our own investments, taking on the assets of schemes that transfer to the PPF and through the recovery of money, and other assets, from insolvent employers of schemes we take on.

Since July 2009, we have been the scheme manager for the Financial Assistance Scheme (FAS) which was announced by the Government in May 2004 and began operating in September 2005.

The FAS provides financial assistance to members of certain defined benefit pension schemes who lost all, or part of, their pensions before April 2005 because their schemes wound up underfunded between January 1997 and April 2005. The Financial Assistance Scheme is funded by the Government.

We are also responsible for providing compensation to pension schemes of all types whose employer has become insolvent where the scheme has lost out financially owing to dishonesty. The assets held for this purpose are ring-fenced within the Fraud Compensation Fund. Fraud compensation is paid for by a levy on all eligible pension schemes (both defined benefit and defined contribution).

2. Our strategic framework

Our staff are united in pursuit of our vision, mission, values and strategic objectives, which are only a year old but have made a significant impact on our organisational culture since they were introduced. Our vision will be realised as we fulfil our mission; to do this we must also be successful in delivering our strategic objectives. These are underpinned by the values that all PPF employees share and which drive everything the we do.

Vision: Protecting people's futures.

This is what the PPF is about. Our assistance provides a secure future for people of all ages.

Mission: Pay the right people the right amount at the right time.

This mission statement goes to the heart of what the PPF has been established to do: to pay compensation under the PPF and assistance under FAS to those people who are entitled to receive them.

Values: ICARE

Our values define the way we work: they are integral to our success in fulfilling our mission and realising our vision. In demonstrating them, we maintain an environment where our staff value each other, enjoy our work and produce excellent results.

The quality of performance in every job, every activity and every action is assessed in terms of these value statements:

Integrity
'Do the right thing'

Collaboration
'Work as one'

Accountability
'Own your actions'

Respect
'Value every voice'

Excellence
'Be your best'

Strategic Objectives

Manage schemes through the assessment and wind-up processes in a timely and efficient manner

The PPF assessment and FAS wind-up processes form the heart of our operations, and managing these processes efficiently will provide certainty to members as soon as possible, while controlling costs.

Meet our funding target through prudent and effective management of our balance sheet

Our long-term funding strategy, including our funding target, was launched in August 2010. Since this strategy will guide our approach to ensuring we can meet our compensation commitments over time, we thought it was important to revise this strategic objective to make reference to it. To meet our funding target, and therefore our commitments to members, we will need to avoid a mismatch between our assets and liabilities by managing our balance sheet prudently and effectively.

Set and collect an appropriate levy and allocate it fairly

Levy is an important contributor to our funding target and our only interaction with the majority of eligible pension schemes. We will continue to improve the fairness of the levy distribution.

Maintain our reputation by communicating clearly what we do and why

Communication is central to our work, particularly in a period of continuing economic uncertainty. For levy payers we must continue to explain how their levies are calculated and spent, and the protection their scheme members receive. For many scheme members their accrued pensions benefits are an assurance of security in retirement; maintaining the PPF's reputation and providing reassurance around PPF compensation and FAS assistance gives confidence to these members.

Be an efficient and effective organisation where staff are recognised and valued

As a well-established organisation, we must demonstrate our efficiency. This year we have revised this objective to refer to effectiveness too, the concept that underpins the operational improvements we are striving to deliver over the next three years. We must also continue to embed a culture where people strive for excellence, and feel their contribution is valued.

Maintain effective risk management in all areas of PPF business

Effective risk management will mean we are best placed to deliver our objectives, and meet any challenges we encounter.

We can only pay the right people, the right amount, at the right time if we move schemes through PPF assessment and FAS wind-up efficiently, set and collect an appropriate levy, manage our assets and liabilities effectively, communicate clearly, and manage the risks within our control. Through successfully achieving these objectives we will continue to build confidence in the PPF and its resilience.

3. Management Plan 2011/12 — 2013/14

3.1 Introduction

This section summarises our key priorities over the next three years in relation to each of our strategic objectives. These objectives were articulated for the first time last year, so we are one year into a three year plan. Our priorities therefore remain largely the same, though we have refined them in response to developments in our environment.

3.2 Manage schemes through the assessment and wind-up processes in a timely and efficient manner

Transforming the way we manage schemes through the assessment process continues to be one of the PPF's major goals. Last year we launched our pilot *Assess & Pay* programme, which is designed to dramatically reduce the assessment period from 35 months to less than two years. The three years ahead will be about implementing *Assess & Pay* as our standard operating model. Our focus for the first two years of the period covered by this plan will be implementation of processes and systems and development of our people. We will then concentrate on refining the new operating model as we monitor its effectiveness.

A series of strategic priorities that underpin *Assess & Pay* will transform the way we manage schemes from the point of entry into the assessment process to the point of payment of compensation to eligible scheme members. These priorities include:

- refining our operating model to focus internally on our core activities and deliver non-core activities through partnerships that provide value for money
- empowering the teams that facilitate schemes through the assessment process to take decisions within an acceptable risk profile, that expedite schemes' transfer to compensation
- taking greater control over delivery through enforceable arrangements with our partners that reward good and penalise poor performance, and
- clearly articulating efficient processes to external audiences and developing integrated systems that enable us to ensure that individuals and partners are doing what we ask of them.

Fundamental to the success of this programme of work, and ultimately the speeding up of the assessment process, is improving the quality of data held and managed by pension schemes and their administrators. We will seek to work with the industry and the Regulator to bring about the sea-change in data quality standards that is required. We will also improve our capabilities in respect of member tracing, as we seek to become a market leader in pension scheme data quality assurance. Specifically, the process we're developing will go beyond the industry norms of mortality screening and existence checking to establish whether members are financially active. We will compare the PPF with pension schemes of a similar size to measure our success in this area.

FAS is now a fully integral part of our business and as previously signalled we will spend the next three years focusing on ensuring:

- correct FAS payments are paid to all eligible people as they fall due in accordance with the latest set of regulations, and to specified service standards
- the wind up of pension schemes, and where appropriate, transferring assets to government speedily and efficiently, within a four year timeframe for the majority, and
- we maximise efficiencies wherever appropriate thus providing value for money for tax payers.

As with last year our overriding priority is to ensure that FAS beneficiaries receive excellent customer service, and we have worked with our outsourced provider, Capita, to ensure that accurate and timely payments are provided as standard. We are pleased to report that to date all of the service level agreements with Capita have been met. We will continue to work with Capita to ensure these very high standards are maintained, identifying as necessary key areas for improvement.

We propose providing information to deferred members about future assistance payments, as part of our standard service once schemes transfer. This should help members in planning for their retirement. We propose providing this information from 2011/12, and it will be available to those members for whom we hold the necessary data.

We will of course continue to drive through the wind-up of as many FAS schemes as we can, given this is critical to providing members with certainty over how much assistance they can expect to receive over their lifetime. Schemes which have annuitised or committed to annuitise (FAS1 schemes) are being managed by one of our outsourced providers, Punter Southall. We have not been as successful in winding up these schemes as we would have hoped, for a variety of reasons including industry resourcing constraints, inflexible approaches by a minority of trustees and administrators and complex legal issues. Consequently, completing this work will take a little longer than originally anticipated. We have set a revised target to wind up a large majority of these schemes by the end of 2011/12, with 140 wind-ups planned for 2011/12 and an allowance for 10 newly qualifying schemes in 2011/12. This will require a step change of behaviours particularly from the insurers if we are to be successful.

We are making good progress on those schemes which have not annuitised (FAS2 schemes) and will transfer their assets to government. We expect to deliver somewhere in a range of 80 to 100 schemes in 2011/12. This means we expect to finish the majority of these schemes within the four year timescale we planned. We will continue to streamline our processes so they are as effective and efficient as they can be, and to innovate where practical to do so in order that we can finalise assistance for individuals as quickly as possible.

At the time of writing, the process to finalise requirements in respect of Guaranteed Minimum Pension (GMP) equalisation for FAS and PPF schemes is ongoing. Though we continue to encounter difficulties in data and process requirements, the Board remains committed to implementing benefit equalisation for GMP.

3.3 Meet our funding target through prudent and effective management of our balance sheet

Since our last Management Plan was published, we have launched our *Long-Term Funding Strategy*. This will be the framework within which we will assess our funding position, and specifically the way we will set investment strategy and the amount of the levy. Given its overall significance in managing our assets and liabilities, we have therefore decided to revise the wording of this objective which previously focused on the investment of the assets alone.

The Funding Strategy is based on the Board targeting self-sufficiency by 2030. Self-sufficiency means the PPF being fully funded with no exposure to interest rate, inflation and market risks and with protection against future claims and the risks of longevity improvements in excess of our best estimates.

Key to delivering this target is successful implementation of the *Statement of Investment Principles* (SIP) 2010. We aim to have much of that work completed by March 2012, when we expect to have in place a portfolio of investments with a return potential of +1.7 per cent pa in excess of liabilities. Once migration towards our new investment strategy is complete in March 2014, we expect to have a long-term return potential of +1.8 per cent pa.[1] The requisite investment in new asset classes will necessitate an increase in our pool of fund managers. This diversification will be matched by a more proactive investment capability. The risk management framework we are putting in place during 2011/12 will enable us to adapt to market conditions more quickly over the years ahead.

Two developments in external policy will have a meaningful effect on the PPF's investment management during the coming years: the European Union's commitment to implementing central clearing for over-the-counter derivatives and the Government's decision to link the indexation of pensions to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). Both of these are likely to have significant implications for our hedging strategy.

Separately, we will continue to maximise the recovery of assets from insolvent scheme sponsors, activity which has already seen significant returns in support of the funding position of the PPF.

3.4 Set and collect an appropriate levy and allocate it fairly

Our principal medium-term aim for the pension protection levy over the next three years remains to put in place changes to ensure the levy we charge to individual schemes is both more predictable and stable, and more appropriately reflects the risk they pose to the PPF through the economic cycle.

Once the arrangements are in place, future changes to the distribution of the levy should be limited, providing greater stability of overall approach and more predictable individual levy amounts (subject to significant changes in scheme risk). We will set the overall levy quantum in accordance with the Board's Funding Strategy and aim to maintain constant levy parameters[2] for a three-year period.

To support the development of the levy, we will continue to strive for improvements in the accuracy of data provision, by reviewing and updating the validation rules on the Pensions Regulator's *Exchange* system. This will ensure we have all the correct data we need, when we need it. Complete and accurate scheme information available when we want it, which can be produced efficiently and with a minimum of manual interventions, will enable us to make informed, accurate assumptions to support levy calculation and collection.

With accurate data in place, we will be in a better position to establish a consistent annual invoicing cycle. From 2011/12 we will bring this forward, with our goal being to invoice and collect at least 90 per cent of uncontested value by 31 December each year. We have also made a commitment to explore the possibility of introducing online billing so that schemes can access their bills without delay. We will research possible approaches, working closely with the Pensions Regulator to establish how the PPF can implement a cost-effective online billing service.

Finally, we will continue to improve our processes for dealing with statutory levy appeals, and communication of PPF policies and Ombudsman decisions, to bring clarity for levy payers and reduce outstanding levy debt. Last year we made significant advances in the resolution of statutory levy reviews, issuing decisions on all prior year reviews before any

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[1] This an estimated long-term target investment return in excess of liabilities, based on current estimates of the PPF's liabilities and assumptions about the performance of our asset classes.

[2] Eg. the scaling factor, levy rates (insolvency probabilities), levy caps and scheme-based levy multiplier; see, *The Pension Protection Levy: A New Framework* (October 2010)

applications for reviews of 2010/11 levy invoices were received, and we hope to build on that success as we develop our case management systems.

The Board raised its first fraud compensation levy in 2010/11.[3] As we did then, we will in future consider the need for a levy to meet Fraud Compensation Fund expenditure and, if required, the Board will set an appropriate amount to be invoiced and collected via the Pensions Regulator. As noted in Chapter 4, Regulations were recently laid in respect of the maximum amount of fraud compensation levy that the Board is able to charge.

3.5 Maintain our reputation by communicating clearly what we do and why

Communicating what we do and why will continue to remain at the heart of the work of the Pension Protection Fund. Our reputation is key to maintaining confidence in the protection we provide and therefore effective two-way communication with all of our stakeholders, beneficiaries, levy-payers and others remains a key objective for us.

While our approach remains one of responsive continuous improvement, our communications strategy will continue to:

- support the ‘core values’ and delivery of our functions
- maintain our reputation
- develop and maintain stakeholder relationships, and
- increase confidence in the long-term resilience of the PPF.

We will also continue to deliver our messages and information using a range of communication channels and activities. We will seek to do so in a coordinated manner, using the most appropriate means for our different audiences, while delivering value for money. This will include, for example, our in-house stakeholder support team, targeted, tailored written communications for pension scheme members, and electronic communications.

Through a co-ordinated programme of communications activities we will:

- provide information that is trusted and respected
- have a leadership team that is accessible to stakeholders
- identify opportunities to work with industry to achieve best results, and
- demonstrate openness and transparency in all our actions and decisions.

The increasing number of PPF and FAS members either in payment or deferment with us also provides a challenge in ensuring that communication with these individuals is timely, informative and responsive. We will therefore be looking to strengthen the clarity and quality of the customer service provided by both ourselves and our key suppliers.

In recognition of the importance of our staff and the contribution they make to the success of the PPF we will also continue a strong approach to internal communications which mirrors the importance of external communications.

3.6 Be an efficient and effective organisation where staff are recognised and valued

[3] Fraud compensation levies were raised in 1997 and 2005 by the Pensions Compensation Board, which preceded the Fraud Compensation Fund.

As a public organisation, funded by levy payers, we recognise the importance of demonstrating efficiency in everything we do. Over the period of this plan, we will seek to increase efficiency by embedding a high performance culture throughout the organisation, recognising and valuing individuals, leaders and teams who strive for excellence in delivery. Specifically, we will continue to:

- support strong leadership at all levels
- identify potential and performance
- develop the talent management programme throughout the organisation, and
- promote a culture of coaching and mentoring, providing development activity where needed.

3.7 Maintain effective risk management in all areas of PPF business

In pursuit of our strategic objectives, we need to manage a combination of risks that we can control and risks that we cannot. During 2010/11 we published the first version of the Board's annual risk appetite statement, which will be central to our risk management in the years ahead.

We have successfully developed the PPF's risk management processes for both financial and non-financial (strategic and environmental, reputational, operational and legal) risks, but it is imperative that we continually update our processes to ensure that they remain fit for purpose and manage all of the risks that may impact on us achieving our strategic goals.

Over the next three years, we will evolve our risk management processes to reflect the scale and complexity of the risks we manage. We need to ensure that ownership of these risks and the key controls to mitigate them are clear. Both owners' performance and the control assurance framework itself will need to be appraised and developed, which will involve developing processes that enable us to understand our performance against the Board's risk appetite.

4. Key assumptions underlying the management plan

4.1 Legislative regime

We anticipate that measures in the Pensions Bill will alter aspects of PPF and FAS legislation during the period of this plan. At this stage it is not possible to know whether the measures will ultimately become law. If they do, however, they will simplify operational practice and remove bureaucracy in relation to assessment, compensation and assistance and the associated processes.

Further secondary legislation is also expected, both following on from the provisions of the new Bill and under the Pensions Acts 2004 and 2008. Recent changes to PPF regulations will also take effect during the period of this plan, these are:

- On 31 January 2011 (FAS) and 3 March 2011 (PPF) the Financial Assistance Scheme and Pension Protection Fund (Valuation, Revaluation and Indexation Amendments) Regulations 2011 were laid, amending the measures of revaluation indexation for compensation and assistance.

- On 21 February 2011 the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2011 regulations were laid, permitting the Board to charge a maximum fraud compensation levy of 75p per member

- On 10 March 2011 the Pension Protection Fund (Prescribed Payments and Investment Costs – Amendment) Regulations 2011 were laid, requiring the Board to pay some insolvency and investment costs from the Pension Protection Fund

- On 6 April 2011 the Pension Protection Fund (Pension Compensation on Divorce etc) Regulations 2010 and The draft Pension Protection Fund (Pensions on Divorce etc: Charges) Regulations 2010 are expected to come into force, permitting the Board to share compensation on divorce.[4]

These are likely to require changes to our processes, but will not have a significant impact on our planning. We continue to engage with the Department for Work and Pensions (DWP) to ensure that the legislative framework is consistent with delivering the objectives of the organisation.

4.2 Pension scheme environment

Scheme funding

The Purple Book 2010[5] noted that:

- There was a significant improvement in scheme funding between 31 March 2009 and 31 March 2010;
- The aggregate section 179[6] funding position at 31 March 2010 was a surplus of £38.3 billion, compared with a deficit of £200.6 billion at 31 March 2009 (the

[4] See the Government response to the consultation on draft regulations: http://www.dwp.gov.uk/docs/ppf-divorce-compensation-response.pdf

[5] The Purple Book is published annually by the Pension Protection Fund and the Pensions Regulator. It provides comprehensive data and analysis on the defined benefit pensions' landscape. The Purple Book 2010 was published on 11 November 2010.

aggregate funding ratio rising from 80 per cent to 104 per cent). The improvement reflected a recovery in equity markets, rise in bond yields, rise in deficit reduction contributions encouraged by the pension protection system, and change in actuarial assumptions;

- 57 per cent of eligible defined benefit (DB) schemes were in deficit at 31 March 2010 and had an aggregate s179 deficit of £49 billion (at 31 March 2009 the corresponding figures were 85 per cent and £217 billion);
- Schemes in surplus had a total s179 surplus of £87 billion, compared to £16 billion at 31 March 2009.

The PPF7800 index shows that by 31 December 2010 market movements had resulted in a small deterioration in the aggregate surplus to £22 billion (102 per cent funding ratio).

The factors driving the value of assets of DB schemes at a given time are:

- market fluctuations in asset values
- the return on investment markets, and
- the choice of asset allocation.

The factors driving the change in the value of pension scheme liabilities are:

- bond yields
- changes in estimated pricing in the bulk annuity market (the Board of the PPF is responsible for keeping the assumptions for s179 valuations in line with such estimated pricing)
- inflation, and
- longevity assumptions.

With all these factors changing, total deficits are very volatile. The Purple Book 2010 showed that since January 2003 market movements and changes in assumptions have resulted in a variation in the s179 aggregate balance of around £358 billion with the largest surplus of £149 billion (121 per cent funding ratio) in June 2007 and the largest deficit of £209 billion (79 per cent funding ratio) in March 2009. Changes in actuarial assumptions in March 2008 and October 2009 improved scheme funding by around £50 billion and £75 billion respectively.

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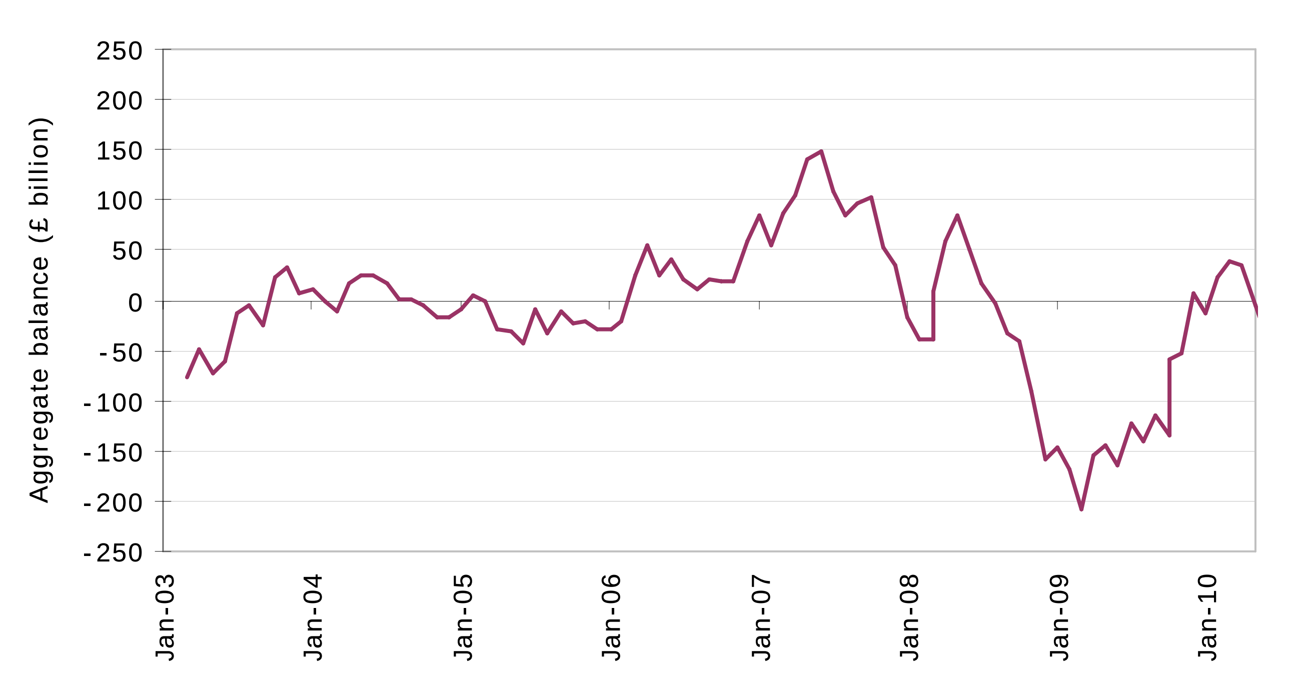
[6] A section 179 valuation determines a scheme's funding position in accordance with section 179 of the Pensions Act 2004.

Chart 1: Estimated s179 aggregate balance (assets less liabilities) of PPF eligible pension schemes



Closure to new members and accruals

The proportion of schemes open to new members and new accrual continues to decline. Purple 2010 showed that 18 per cent of DB and DB parts of hybrid schemes were open to new members and new accrual while 58 per cent were closed to new members and 21 per cent to future accrual. Although this year's figures for DB and hybrid schemes show a large shift from open schemes to closed schemes with the percentage in open schemes falling from 27 per cent to 18 per cent, this movement is strongly influenced by our improved information on hybrid status. A number of hybrid schemes which would have been classed as open using last year's methodology are now classed as closed this year.

To get a more accurate picture of trends by excluding hybrid schemes, the percentage of open schemes fell to 21 per cent from 22 per cent in 2009, and 33 per cent as recently as 2007. The number closed to new accrual rose from 20 per cent in 2009 to 23 per cent in 2010 while the percentage closed to new members fell from 55 per cent to 54 per cent.

Open schemes tend to be relatively large in terms of membership. In Purple 2010, 34 per cent of DB and hybrid scheme memberships were open to new members, 60 per cent were closed to new members and only 5 per cent were closed to future accrual. Excluding hybrid schemes, 38 per cent were open, unchanged on 2009, but down from 55 per cent in 2007.

Asset allocation

Purple 2010 data show a further continuation of trends seen in recent years: a falling equity allocation and rising allocations to bonds and 'other investment'; within equities, rising overseas and falling UK allocations; and within bonds, rising corporate bond and falling government allocations. In other words schemes continue to de-risk and diversify their portfolios:

- The equity allocation as a proportion of total scheme assets fell to 42.0 per cent from 46.4 per cent in 2009. Meanwhile, the share of gilts and fixed interest increased to 40.4 per cent from 37.1 per cent in 2009.

- The share of 'other investments' rose from 4.5 per cent to 5.4 per cent.

- The overseas share in total equities rose from 53.8 per cent in 2009 to 55.3 per cent in 2010, the UK share falling from 44.2 per cent to 40.1 per cent. The share of unquoted equities increased from 1.9 per cent in 2009 to 4.4 per cent in 2010.[7]

- Within gilts and fixed interest, the corporate share rose from 38.3 per cent in 2009 to 42.2 per cent in 2010. Meanwhile, the share of government fixed interest fell from 29.0 per cent to 24.6 per cent. The index-linked share rose slightly after a decline in 2009.

Movements in asset shares reflect both movements in relative asset prices and decisions to allocate more or less to particular asset classes. Flow data from the Office of National Statistics show that, since the third quarter of 2003 there have only been three quarters of net investment in equities and only five quarters of net disinvestment in gilts and fixed interest.

Pension schemes are also increasingly favouring Liability Driven Investment (LDI) strategies. These usually rely on fixed income and derivative products as a means of hedging inflation and interest rate risk. The NAPF reported that 26 per cent of schemes it surveyed were implementing an LDI strategy in 2009, up from 23 per cent in 2008. Furthermore, 45 per cent of schemes had considered adopting an LDI strategy.

The PPF published a Consultation Document "The Pension Protection Levy: A New Framework", in October 2010. In Annex D it was concluded that the introduction of investment risk as a factor in the new risk-based levy formula would not affect schemes investment strategies to a significant degree. To the extent that the new formula would change schemes' optimal asset allocation, the largest effect would be on schemes whose levy was not capped but with weak employer's covenant. These schemes would have the most incentive to pursue lower risk investment strategies as a result of the new formula.

Other elements of risk reduction

The total number of recognised contingent assets (CAs) put in place by scheme sponsors has risen by 16 per cent, from approximately 620 for the 2009/10 levy year to 720 for 2010/11. Meanwhile, schemes in the Purple 2010 dataset had by 7 April 2010 certified approximately £29.1 billion of deficit reduction contributions (DRCs) to reduce deficits for the 2010/11 levy year. This represents an increase on the £26.5 billion certified for the previous levy year.

The Pension Regulator's scheme funding regime is important in reducing PPF risk. In the third tranche of recovery plans, covering schemes with valuation dates between 22 September 2007 and 21 September 2008, the average recovery plan length was 8.2 years with technical provisions 113 per cent of s179 liabilities (compared with 6.2 years and 119 per cent in tranche 2 and 8.9 years and 108 per cent in tranche 1).[8]

Buy-out and buy-in transactions provide schemes with the opportunity to remove risk relating to all or part of their liability. Under a buy-out deal, a scheme transfers its entire liability to an insurer in exchange for all scheme assets. Insurers tend to require assets significantly in excess of scheme liabilities to compensate for the risk transferred. Buy-in deals are effectively partial buy-outs where the insurance policy is a scheme investment.

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[7] These do not sum to 100 per cent in 2009 and 2010 due to rounding.
[8] http://www.thepensionsregulator.gov.uk/docs/scheme-funding-analysis-2009.pdf

The value of liabilities insured in buy-out and buy-in deals was lower in 2009 (£3.7 billion) than 2008 (£7.9 billion), in part due to poorer scheme funding.[9] Volumes appear to have picked up in 2010, however, with £3.3 billion transacted in the first six months.[10]

While both longevity swaps and buy-in/buy-out can mitigate the risk of greater than expected life expectancy, under the former there is no transfer of the underlying scheme assets to a counterparty. Longevity swaps entail the pension scheme exchanging fixed payments for cashflows that vary in accordance with the longevity experience of a reference population (either the named scheme members or a wider sample).

Interest and participation in the longevity market has grown significantly in 2009 and 2010. Total liabilities of £7.1 billion were hedged in the year to June 2010, with the majority of deals relating to larger schemes and pensioner liabilities.[11] The set of providers, including both banks and insurers, has grown simultaneously.

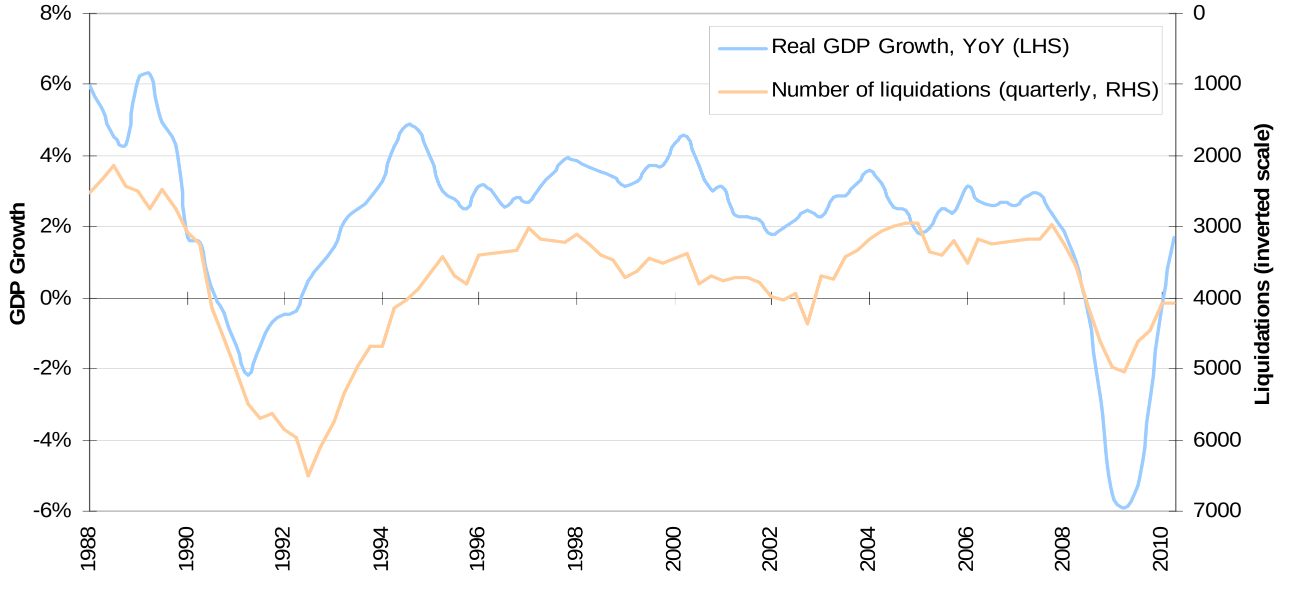
Corporate insolvency

The recession resulted in a large rise in the total level of corporate liquidations in England and Wales, from 3,241 at a quarterly rate in the first quarter of 2008 to a peak of 5,041 in the second quarter of 2009, an increase of 56 per cent. Since the second quarter of 2009, economic recovery has resulted in a 21 per cent fall in the level of liquidations. Unusually, company liquidations started falling a quarter earlier than the first quarter of positive economic growth.

In the 12 months ending September 2010, around 0.8 per cent of companies went into liquidation, compared with a recession peak of 0.9 per cent and a pre-recession trough of 0.6 per cent. In the latest recession, the insolvency rate rose by 50 per cent while in the early-1990s recession it more than doubled. A number of reasons have been advanced to explain the much smaller rise in the insolvency rate in the latest, more severe recession. These include the exceptionally low level of interest rates in the latest recession, greater forbearance on the part of banks particularly with companies finding it easier to make interest payments, tax deferral initiatives by the tax authorities, more flexible workforces, and the different nature of the company sector (the number of companies being 2.2million compared with 0.9 million in the early 1990s).

[9] 'Pension Buyouts 2010', Lane Clark & Peacock, May 2010
[10] 'Buy-outs, Buy-ins and Longevity Hedging: Q2 2010 Update', Hymans Robertson, August 2010
[11] 'Buy-outs, Buy-ins and Longevity Hedging: Q2 2010 Update', Hymans Robertson, August 2010

Chart 2: UK corporate insolvencies and GDP growth



Source: Insolvency Service, ONS

The universe of sponsoring employers for PPF-eligible DB schemes is only a small part of the total universe of UK companies (around 16,000 compared with approximately 2.2 million). The composition of the two universes differs as DB schemes are generally associated with larger, older companies, and there is a heavier weighting towards the manufacturing sector. However, the number of schemes (or parts of schemes) entering assessment shows a broadly similar picture to whole economy insolvencies with a peak in Q1 2009 and a fall of 24 per cent in the year to Q1 2010.

4.3 Updated universe assumptions

Based on the above, the following baseline assumptions about the progression of the DB universe enable forecasts to be made for future headcount and resource needs, e.g. the number of assessment team members and the costs of compensation administration.

These assumptions themselves represent our best estimate of the volumes of schemes and members going through the assessment period and are not[12] set as a target within in the business plan. Some of the figures are inherently unpredictable: the economic climate will affect the number of insolvencies and cases entering an assessment period, which will in turn affect our capacity to complete scheme assessment periods. There is therefore naturally a range of potential figures for these assumptions alongside the best estimates published in the table below; for example, our modelling outputs have demonstrated a range of between 90 and 200 cases entering assessment in 2011/12.

A scheme may leave the assessment period by a number of means, whether by transfer to the PPF, buy-out, or rescue; the resource requirement is similar in all such routes.

[12] With the exception of cases completing assessment, and FAS schemes completing winding-up

Estimates for March years ending:	2010/2011	2011/2012	2012/2013	2013/2014
Receipt of notices of qualifying insolvency events from insolvency practitioners or trustees[13]	3000	2000	1700	1700
New cases entering assessment in the year[14]	162	130	120	120
Cases transferred to the PPF	133	140	145	145
Cases leaving assessment by other means	37	15	15	15
Total cases completing assessment	170	155	160	160
Number of cases in assessment at year end	335	320	280	240
Number of members in assessment at year end	187,000	173,500	155,000	143,500
Cumulative members in compensation[15]	72,000	136,000	243,500	307,000
Assets under management	£6,330m	£9,690m	£14,253m	£18,855m
Number of FAS2 qualifying schemes winding-up	20	80	160	160
Number of FAS1 qualifying schemes winding-up	80	140	10[16]	0[17]

We assume the total number of FAS qualifying schemes is 1050, roughly half of which are FAS2 schemes which will transfer their assets to Government, and the remainder FAS1 schemes which have bought out benefits with an insurance company where FAS pays out a supplement. Of the annuitized schemes approximately two thirds of these have already wound up. Approximately 16,000 people are now receiving assistance payments. As FAS schemes continue to wind-up over the next three years, over a further 180,000 people could potentially qualify for assistance payments.

[13] Most insolvency notifications we receive relate to schemes that are ineligible for compensation, (e.g. defined contribution schemes or stakeholder plans). Thus, the ratio of cases accepted into assessment to estimated insolvency notices is very low.
[14] A case is our basic unit of work. It can represent a single employer scheme, a multi-employer scheme, a section of a scheme, or a segment of a section of a scheme depending on the underlying scheme structure.
[15] 'In Compensation' refers to members both in payment and deferred.
[16] This figure relates to newly qualifying schemes.
[17] It is assumed that all FAS1 schemes will be wound up at this point.

5. Business Plan 2011/12

This business plan covers the financial year 2011/12 and sets out how we intend to achieve the strategic objectives set by the Board.

5.1 Manage schemes through the assessment and wind-up processes in a timely and efficient manner.

Activity / Action	KPI / Milestone
Continue working with trustees and advisors to move schemes through the assessment and wind-up processes as quickly as possible to provide certainty for members.	1. 155 PPF schemes to complete assessment by end of March 2012. 2. Have robust project plans in place for a minimum of a further 160 PPF schemes to complete assessment by end March 2013. 3. Transfer 80 FAS2 schemes to Government by end of March 2012. 4. Wind up 140 FAS1 schemes by end of March 2012
Pay the right people the right amount at the right time	5. Errors and undue delays to payments should be less than 0.5 per cent of total payments.
Implement the Government's changes to use consumer prices indexation (CPI) as the basis for revaluing and indexing payments made by PPF and FAS.	6. This new approach will be implemented and members notified following the revaluation and indexation changes due 31 March 2011 and 1 January 2012 respectively.
Implement a process to achieve equalisation of compensation for GMP by end of March 2012	7. Provide equalisation guidance for schemes in assessment by December 2011. 8. Implement process for FAS2 schemes by March 2012.

5.2 Meet our funding target through prudent and effective management of our balance sheet.

Activity / Action	KPI / Milestone
Achieve a long-term investment return potential of +1.8 per cent pa	1. Continue to implement our programme of new investments; by March 2012 achieve a long-term return potential of +1.7 per cent (net of fees). 2. Throughout the year, identify and implement opportunities to further improve the risk adjusted return on the Fund by 10 per cent beyond plan. 3. Apply new cash flows promptly, and ensure a timely and efficient transition of assets into PPF investment mandates. 4. Maximise recovery of assets from insolvent scheme sponsors.

Embed our new Funding strategy	5. Monitor long-term funding with quarterly Long-Term Risk Model runs and stress-tests. 6. Report monthly the PPF funding position against the threshold 80 per cent likelihood of achieving our long-term target. Consider relevant risks and controls.
Respond to relevant changes	7. Review our hedging strategy in the light of CPI indexation by June 2011, to be implemented by March 2012 8. Assess the impact of central clearing and make proposals by June 2011, to be implemented by March 2012.

5.3 Set and collect an appropriate levy and allocate it fairly.

Activity / Action	KPI / Milestone
Work with stakeholders to ensure the levy provides the resources the PPF needs, while delivering as much certainty as possible for levy payers on their bills.	1. Publish the Consultation on the rules on which the levy will be charged in 2012/13 (including the levy scaling factor) by end of October 2011, and the final rules by end of February 2012.
Issue schemes with accurate levy bills in a timely and efficient manner.	2. Invoice 90 per cent of 2011/12 schemes and collect 90 per cent of the outstanding uncontested 2011/12 levy by 31 December 2011.
Effectively manage the levy interest, review and appeal processes.	3. Reduce total legacy blocked debt, excluding ongoing PPFO and court cases, below £10M by end of March 2012.
Set and collect a Fraud Compensation Levy.	4. Work with tPR to invoice and collect 90 per cent of the 2011/12 FCL by end of March 2012. 5. Consider the need for and if required set an appropriate 2012/13 levy by end of January 2012.

5.4 Maintain our reputation by communicating clearly what we do and why.

Activity / Action	KPI / Milestone
Maintain a proactive and integrated communications and stakeholder engagement programme aimed at supporting the delivery of the PPF's strategic objectives.	1. At least 80 per cent of stakeholders agree that the PPF communicates effectively through all communication channels. 2. At least 80 per cent of stakeholders are aware of, and understand, their main roles and responsibilities in relation to the PPF.
Operate effective points of customer contact to ensure that high standards of service are delivered and sustained.	3. 80 per cent of respondents that contact the Stakeholder Support Team, Capita and D&B feel that they are handled in a professional way.
Maintain an integrated and proactive internal communication strategy.	4. 80 per cent of staff feel that the internal communications plan achieves its objectives.

5.5 Be an efficient and effective organisation where staff are recognised and valued.

Activity / Action	KPI / Milestone
Performance Development Process evolved, with people understanding their performance in terms of objectives and competencies	1. Performance Reviews completed by June 2011.
Staff recognition scheme rewards performance against our values and new ways of working.	2. Monthly awards to identify staff making exceptional contributions to promotion of PPF values.[18]
Modular Leadership course rolled out to support new ways of working i.e. Leaders taking responsibility for efficiency and ensuring people are valued and recognised.	3. All line managers identified for the course to attend by March 2012.
Be an efficient organisation and operate within the budgets outlined in this plan, delivering the savings set out.	4. Deliver agreed savings.

5.6 Maintain effective risk management in all areas of PPF business.

Activity / Action	KPI / Milestone
Enhancement of the Financial Risk Management Framework	1. Approve enhanced Financial Risk Management policy and practices by end of June 2011. 2. Implement enhanced Financial Risk Management systems by end of March 2012.
Maintain effective financial risk management	3. Review investment operational risks quarterly. 4. Monitor financial risks including investment and funding risks monthly.
Maintain effective operational risk management	5. Monitor all the risks facing the PPF monthly at Risk Management Committee. 6. Maintain ISO 27001 accreditation to ensure effective management of information security risks.

[18] See page 6 of this document

6. Updated financial plan and budget

6.1 Governance and Funding

The executive management of the PPF regularly reviews the cost of delivering our objectives, and the impact of current developments on future years' expenditure.

The majority of our operating and capital expenditures are funded by grant in aid drawn down from DWP. Grant in aid is in turn financed by the PPF administration levy raised by DWP on eligible pension schemes.

Where the PPF performs functions in relation to the Financial Assistance Scheme, costs are recovered on a fully absorbed cost basis from DWP. All FAS costs are borne by Government rather than PPF levy payers.

Regulations require certain costs to be charged to the Protection Fund. Recent amendments under The Pension Protection Fund (Prescribed Payments and Investment Amendment) Regulations 2011 transfer costs which had previously been paid out of the Administration Fund to the Protection Fund. These include investment fees, insolvency fees, balance sheet risk management fees, member data management fees and all associated staff costs. The Protection Fund is financed by the protection levy, the transfer of assets from schemes completing the PPF assessment process, and investment returns on the Fund.

These regulations are being introduced because both the Board and DWP agree that it is more appropriate in the long-term for the Protection Fund to bear the costs arising from its investment and financial risk management functions, its insolvency function and its member data management activities since it is the Protection Fund that benefits directly from these activities. Raising funds to cover these costs through the pension protection levy will mean that schemes that are more likely to enter the PPF proportionally pay more of the costs.

Including these costs in the administration levy risks giving an inaccurate view of the costs of running these functions of the Board that are unique — by making this change the legislation will allow closer scrutiny of the Board's running costs in the administration budget.

6.2 Financial Plan

In respect of its Government-funded FAS functions, the Board of the PPF has participated, with the support of DWP, in the Government's Spending Review 2010 programme. Even in respect of its administration levy funded PPF functions, the Board has incorporated into its budgeting process the programme's principles of reducing wasteful spending and improving the transparency, efficiency and accountability of public services.

The table below gives our view of the resource requirement for the period to 2013/14, the first 3 years of the Government's 4 year Spending Review programme. This shows an overall reduction in costs funded by Government and administration levy payers of 34 per cent compared to the 2010/11 budget. This reflects the operational efficiencies we are working towards with the implementation of the target operating model for PPF assessment process, together with the wind up of the majority of the FAS schemes. It also reflects the change of funding for certain cost categories which will in future be charged directly to the Protection Fund. The costs for the PPF administration levy payers reduce by 29 per cent over this period, while in respect of the Board's FAS functions, the reduction is 47 per cent.

The consolidated PPF and FAS 2010/11 forecast expenditure of £31,580k is expected to be 9per cent lower than budget. PPF still managed to deliver the majority of our short term objectives and delivered savings through internal efficiency improvements and close cooperation with our outsourcing providers. The spending restrictions and recruitment freezes which were introduced to all public bodies during the year also contributed to this saving.

We have developed budgetary controls and management review activities to manage costs within funding limits. Our costs are driven in a number of areas by events that are difficult to forecast and control, such as insolvencies and legal claims. That is why we have designed the planning process to deliver a "most-likely" case financial forecast, derived largely from the volume assumptions set out in section 4.3.

All Figures £'000	**Forecast 2010/11**	**Budget 2010/11**	**Budget 2011/12**	**Plan 2012/13**	**Plan 2013/14**
Salary and Related Costs *	17,340	19,550	17,560	16,600	15,200
Training and Recruitment	780	670	880	500	500
Travel and Meetings	220	505	310	300	200
Accommodation and General Office	2,490	2,665	2,300	2,200	1,700
Communication and Publications	110	315	90	200	100
IT & Telecoms *	2,130	2,050	2,100	1,500	1,600
Investment Advisory *	750	840	0	0	0
General Legal Services *	1,270	1,300	960	1,200	1,200
Insolvency Professional Fees *	730	1,000	0	0	0
Other Professional Services *	420	737	520	500	600
Scheme Wind Up Services	1,180	597	1,810	900	1,000
Member Payroll Services	2,140	2,061	2,250	2,400	2,500
Other Outsourced Services	740	850	740	800	800
Depreciation	1,280	1,515	1,370	1,600	1,000
Total Resource Requirement	**31,580**	**34,655**	**30,890**	**28,700**	**26,400**
Capital Expenditure	600	1,500	1,200	900	900

* Costs from 2011/12 onwards transferred to the Protection Fund in whole or in part

The split of the total estimated overhead resource requirement between PPF Administration, FAS Administration and the Protection Fund is set out below.

All Figures £'000	Forecast 2010/11	Budget 2010/11	Budget 2011/12	Plan 2012/13	Plan 2013/14
Staff and Related Costs	12,750	14,165	11,160	10,800	9,900
Other Overheads & Services	9,440	9,830	7,270	7,400	7,200
PPF resource requirement	**22,190**	**23,995**	**18,430**	**18,200**	**17,100**
Capital expenditure	585	1,250	1,200	900	900
Staff and Related Costs	4,590	5,385	3,690	3,000	2,400
Other Overheads & Services	4,800	5,275	5,270	3,900	3,200
FAS resource requirement	**9,390**	**10,660**	**8,960**	**6,900**	**5,600**
Capital expenditure	15	250	0	0	0
Staff and Related Costs	0	0	2,710	2,800	2,900
Other Overheads & Services	0	0	790	800	800
Protection Fund requirement	**0**	**0**	**3,500**	**3,600**	**3,700**
Capital expenditure	0	0	0	0	0

6.3 2011/12 Budget

The £30,890k budget for 2011/12 reflects the resources required to deliver 155 schemes completing the assessment process, £600m levy collection and 220 FAS scheme wind ups and the continued successful implementation of our Statement of Investment Principles.

The budget also reflects the efficiencies which have been introduced and demonstrates how the PPF are delivering value for money. While delivering these objectives the 2011/12 budget has decreased by an overall 11 per cent from the 2010/11 budget total of £34,655k, contributing to a 10 per cent reduction in pay and 12 per cent reduction in non-pay expenditure.

Budgeted capital expenditure for 2011/12 is £1,200k compared with a forecast of £600k for 2010/11. The increase in expenditure is in part due to the deferral of projects originally scheduled for 2010/11. Expenditure in 2011/12 will focus on continued IT systems upgrades and the implementation of a casework system to help improve how we manage schemes through our assessment process.

The salary costs in 2011/12 increase from the forecast for 2010/11 as existing vacancies are filled. This leads on an annualised basis to higher staff costs which are offset by the closure of the FAS Operating Unit as described below. Following delays in recruitment in 2010/11, costs increase for 2011/12 in order to recruit back up to the required levels of staff. Investment in training is planned for in 2011/12 for new and existing staff members as part of the continuous improvement program.

Scheme wind up service costs cover the external costs of our outsourced provider who manages relationships with scheme trustees and advisors though the assessment period in PPF together with FAS costs to wind up schemes and transfer them to our payroll provider. In 2011/12 the increase reflects costs associated with work required to finish the majority of FAS 1 scheme wind up and transfers.

The FAS program will continue to deliver the winding up of schemes and transfer them to Capita, our payroll provider in order to pay the FAS pensioners the correct amount of assistance. From July 2011 the FAS Operational Unit in York will no longer operate and PPF will carry out any residual work; this will result in lower staffing costs in 2011/12. There will also be lower accommodation and IT costs as a result. The scheme wind up costs will diminish over this period as more FAS schemes are delivered to Capita; however, this transfer of member records leads to an increase in member payroll services costs.

6.4 Expenditure Estimate for the Protection Fund

For periods up to and including 2010/11, the costs payable directly out of the Protection Fund have been restricted to investment management fees, custodian fees, costs associated with creating and verification of member records and running a member payroll.

As noted in 6.1 above, recent changes to the regulations will enable certain other costs, which were previously paid out of the Administration Fund, to be paid out of the Protection Fund from April 2011.

The table below shows the Board’s estimate for 2010/11 for the Protection Fund and estimates of expenditure from 2011/12 onwards.

Estimates in £'000s	**2010/11**	**2011/12**	**2012/13**	**2013/14**
Protection Fund Admin Recharge	0	3,500	3,600	3,700
Fund Manager and Custodian Fees	19,700	41,300	63,700	86,000
Professional Fees	0	12,200	4,300	4,500
Member Payroll and Admin Fees	1,800	2,500	3,200	3,700
Total Estimate	**21,500**	**59,500**	**74,800**	**97,900**

The Fund Manager and Custodian Fees are largely based on assumed values of assets under management displayed in 4.3 whilst the professional fees are driven by advisory projects and activities necessary for the appointment of additional fund managers.

The large estimate for Professional Fees in 2011/12 relates to the costs of enforcing contribution notices for a small number of very large schemes currently in PPF assessment.

Member Payroll Services are largely driven by the volumes of members administered by our outsourced provider. Relevant contracts ensure that unit costs per member decrease as the volume of members increase. Member volumes are also displayed in section 4.3.

Further Reading

For further detail on the PPF and aspects of our strategy, please visit the following pages:

The Pension Protection Fund website
http://www.pensionprotectionfund.org.uk

The Purple Book 2010
http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx

PPF Long-Term Funding Strategy
http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/PPF_Funding_Strategy_Document.pdf

Pension Protection Fund Annual Report & Accounts 2009/10
http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/ARA_0910.pdf

PPF 7800 Index
http://www.pensionprotectionfund.org.uk/Pages/PPF7800Index.aspx

Risk Appetite Statement
http://www.pensionprotectionfund.org.uk/About-Us/Documents/Risk_Appetite_Statement.pdf

The Pensions Regulator website
http://www.thepensionsregulator.gov.uk/