

A hand with a ring on the ring finger points towards the left on a reddish-brown track with white and yellow lines. The word 'BUCK' is faintly visible in the background.

**Response by Buck Consultants
Limited to PPF consultation on
the possible inclusion of
investment risk as a risk factor in
the risk based levy**

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Response by Buck Consultants Limited to PPF consultation on the possible inclusion of investment risk as a risk factor in the risk based levy

We are pleased to have the opportunity to respond to the consultation on this important subject.

We note the impressive amount of research that underpins the consultation document and the conclusions drawn from it. However, we consider that the issue is essentially a straightforward one: Is it desirable in principle that schemes should generally match their assets more closely to their liabilities?

If the answer is “yes” then it seems sensible for the policies of potentially affected bodies such as The Pensions Regulator and The Pension Protection Fund to encourage that. The principal justification for the proposal in the consultation document not to differentiate between schemes with different investment strategies in terms of the levy amount seems to be that the difference between schemes at the moment is generally small, and where it does exist to any significant extent, it occurs only in respect of a relatively small number of schemes. Consequently, the administrative cost of reflecting such a difference in individual schemes’ levy amounts is said to outweigh the advantage to the PPF of introducing it.

However, the logic here appears to be flawed. We are certainly no supporters of unjustified administration requirements and their associated costs; however, if it is the belief of the PPF and the Regulator that it is in the interest of members of DB occupational schemes generally that assets should match liabilities to a much greater extent than they do in most schemes at the moment, then logic dictates that the emphasis should be on *encouraging* the majority of schemes to move their position. One obvious means of doing this is by requiring them to pay an increased share of the risk-based levy if they believe their investment strategy is the correct one for them to follow. If the levy amount reflected this decision, its higher cost would become a factor that those trustees would take into account in reaching their decision as to the desirability of pursuing their current strategy.

Is it true that closer matching of investment strategy to liabilities is generally desirable in most cases?

We believe that the Trustees’ asset allocation policy has a meaningful effect on both the likelihood and severity of claims on the PPF. Consequently, we are concerned that the proposed treatment of investment risk contrasts with the generally equitable arrangements introduced by the PPF Board.

For a pension scheme with “typical” membership profile and a sponsoring employer of average financial strength, even a large change in asset allocation towards bonds is unlikely to increase cash contributions to a degree that would cause insolvency of the employer. If bond yields are used when assessing the value of liabilities (eg for accounting purposes) the immediate impact of a change in asset allocation would be lower. In any case, we may assume that the change in investment strategy and increase in contributions would not be implemented if these changes would threaten insolvency of the sponsoring employer.

The impact of adverse equity market conditions or falling real interest rates, for a scheme with high equity market exposure may, however, be significant. This may realistically, result in levels of pension costs both on cash and accounting bases that cause uncontrolled and unexpected difficulty for the sponsoring employer. Crucially, in such circumstances, the severity of the call upon the PPF would also be much higher.

A low risk investment strategy is not appropriate for all schemes and does result in higher expected pension costs for the employer. But, when an employer is both able and willing to accept such costs to reduce risk, why should their PPF levy continue to subsidise those of other schemes with higher levels of investment risk?

Consequently we would recommend that the PPF Board reconsider their current proposal not to reflect investment strategy on an individual scheme basis when setting the risk-based levy.



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