Pricing Pension Insurance: The Proposed Levy Structure for the Pension Protection Fund

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The Pension Protection Fund (PPF) published its levy proposals today, 16 December 2005. Two financial experts who specialise in pensions, Anthony Neuberger (Warwick Business School, University of Warwick) and David McCarthy (Tanaka Business School, Imperial College) have responded with criticism to the levy proposals put out by the Pension Protection Fund (PPF). The proposals were contained in a Consultation Document in July 2005, setting out the structure of the levy. Their criticisms are detailed in a paper published in the current issue of Fiscal Studies.

Neuberger's and McCarthy's criticism is based on the following:

- the burden of the levy falls heavily on the weakest schemes. Calculations based on figures in the Consultation Document imply that a quarter of the levy will be raised from just 4% of schemes, while the strongest 50% of schemes will pay just 15% of the levy. The burden is not one the weakest schemes will be able to pay. The money to pay the levy will come out of assets that would otherwise reduce scheme deficits, and a large part of the cost will fall on the PPF itself when the schemes then fail.

- the levy as proposed will be volatile and unpredictable, particularly for schemes with weak sponsors. The historical evidence suggests that a quarter of weak sponsors are substantially downgraded each year; on the PPF's proposals, such a downgrading could lead to as much as a fourfold increase in the levy year-on-year.

- the proposal could also put in question the PPF's own solvency. The future level of claims is unpredictable. If claims are heavy (as has been the experience of the PPF's US counterpart, the PBGC), the PPF will need to raise its levy income substantially over the years. It envisages that any increase in the amount of the levy would be pro rata. But with the levy falling so heavily on the weakest schemes it is questionable whether the PPF would be able to raise the levy substantially without causing unacceptable damage to weaker schemes.

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2. Contact Emma Hyman or Bonnie Brimstone in the IFS press office on 020 7291 4800 for copies of the article.