Annual Report and Accounts 2011/12

Pension
Protection
Fund

Protecting **People's** Futures

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Protection
Fund

Annual Report & Accounts 2011/12

Annual Report presented to Parliament pursuant to Section 119(5) of the Pensions Act 2004 and Accounts presented to Parliament pursuant to paragraph 22(6) (b) of Schedule 5 to the Pensions Act 2004.

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1 What we are here to do ...

> Tens of thousands of people now receive compensation from us and hundreds of thousands more will do so in the future.

Pension Protection Fund

We protect millions of people throughout the United Kingdom who belong to defined benefit pension schemes. If their employers go bust, and their pension schemes can't afford to pay what they promised, we will pay compensation for their lost pensions.

Tens of thousands of people now receive compensation from us and hundreds of thousands more will do so in the future.

Compensation, and the cost of running the PPF, are paid for through levies on eligible pension schemes. We also generate income from our own investments, taking on the assets of schemes that transfer to the PPF – and recovering money, and other assets, from insolvent employers of the schemes we take on.

We are a public corporation, set up by the Pensions Act 2004, and are run by an independent Board. We report to Parliament through the Secretary of State for Work and Pensions.

Fraud Compensation Fund

We also pay compensation to members of pension schemes of all types whose employers go bust and the schemes have lost out financially due to dishonesty.

This compensation is paid for through a separate levy on all pension schemes.

Financial Assistance Scheme

The Government handed over responsibility for the day-to-day running of the Financial Assistance Scheme (FAS) to the PPF in July 2009, although all FAS activities remain government-funded.

The FAS pays financial assistance to people who belonged to certain defined benefit pension schemes which are ineligible for compensation from the PPF.

2 Who we are ...

Chairman

Lady Judge CBE

Chief Executive

Alan Rubenstein

Executive Board Members

Martin Clarke

David Heslop

Non-executive Board Members

Dick Barfield

Ann Berresford

John Bevington

Sir Anthony Holland

Arnold Wagner OBE

Baroness Warwick of Undercliffe

Sharmila Nebhrajani (appointed 27 June 2012)

Directors

Clive Lewis-Jones

Sara Protheroe

David Taylor

Christopher Hughes
Left the Board in November 2011

Director of Finance, Graham Crowe
Left the organisation in March 2012

Director of Corporate Affairs, Paul Reynolds
Left the organisation in April 2012

Director of Strategy and Policy, Naomi L'Estrange
Left the organisation in August 2012

3 A statement from the Chairman

"… we now directly protect more than 360,000 people who might have otherwise lost their pensions."

I am very pleased to report that in 2011/12, my second year as Chairman of the PPF, we maintained the momentum of progress that we achieved in the last year which was always going to be a challenging task in light of the continuing difficult economic environment in which we have been operating.

I believe that our major achievement is that we now directly protect more than 360,000 people who might have otherwise lost their pensions through no fault of their own. As we have stated in our vision for 2015, we expect that figure to rise to more than half a million in the next few years – a responsibility which means that now, more than ever, it is vital that we put our customers first in everything we do.

We emphasised how serious we are about this objective when we, as a Board, started to look at making a step change in the customer experience for both PPF and FAS members. The first step of this journey was in March 2012 when we voted to bring the PPF's member administration services in-house, replacing our current supplier. This will be a very significant two year project which will enhance our ability to provide customers with exactly the services that they need, when they need them.

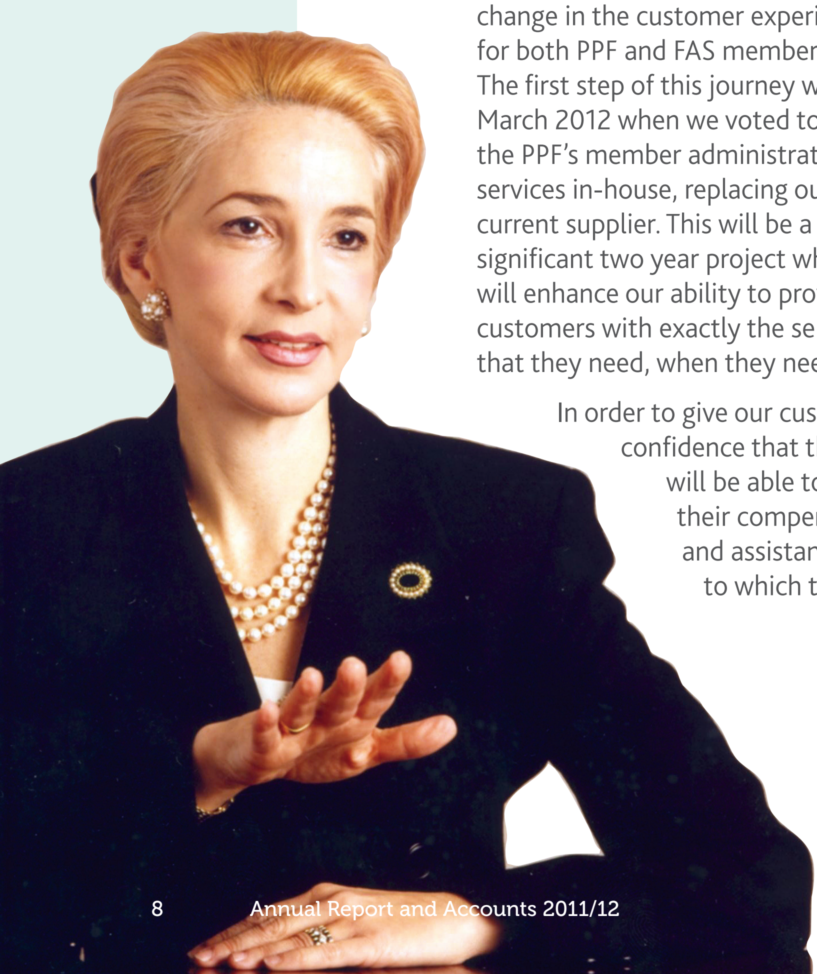
In order to give our customers confidence that the PPF will be able to pay their compensation and assistance to which they are entitled, I am determined that we do everything in our power to achieve our target of being financially self-sufficient by 2030.

To that end, I was again very encouraged by our investment performance which, combined with the income we receive from the collection of our levy, means that we are well on our way to meeting our funding target by 2030. We also have a healthy surplus, an asset portfolio of approximately £11 billion and a 106.9 per cent funding level.

In a public recognition of our investment achievements during the year when we achieved an overall return of 25.2 per cent – and following our being named Risk Magazine's Pension Fund Risk Manager of the Year in 2010/11 – our financial risk and investment teams received further plaudits in 2011/12.

They were awarded the Best Innovation Prize at the 2011 IPE European Pension Funds Awards in November for their use of 'repos' as part of our liability driven investments and, in April 2012, we were recognised by Financial News with its award for Best Investment Strategy (DB) and by Portfolio Institutional for Portfolio Construction. I would like to congratulate all those who contributed to these awards for their achievements.

We are not, however, in any way complacent. The country is still in recession, pension fund levels as recorded by our 7800 Index are at their lowest ever and we remain exposed to large claims now or in the future.



In addition, there are developments outside of our control which could have adverse effects on both the PPF and the pensions industry as a whole.

One such development that I have been watching closely are the plans by the European Commission to extend Solvency II insurance measures to cover all defined benefit pension schemes throughout Europe. Unfortunately, this could potentially have disastrous consequences, which is why one of my priorities during the year was to make sure that my concerns were raised with all the relevant parties and that our views were explained appropriately.

Applying principles that relate to insurance companies to pension schemes across Europe could, I believe, lead to improved funding being imposed too quickly, having the unintended consequence of leading to more scheme closures and failures. We will continue to work with the European Commission to make sure we, and they, understand the full impact of whatever proposals they eventually put forward.

Finally, I would again like to recognise the vital support we receive from our excellent Board members. During the year, we saw the retirement of Christopher Hughes, who had been a non-executive member since the PPF began in April 2005, and latterly became our senior independent director. Christopher has served the PPF very well and his advice and support have been welcomed by non-executive and executive members alike. He will be missed and we wish him well for the future.

I am delighted, however, that Arnold Wagner who joined the Board last year as a non-executive director has replaced Christopher as our senior independent director. His excellent advice, support and effort have proved extremely valuable since his appointment, and this new role will serve to enhance his contribution to important Board decisions in the future.

During the year, we also appointed Mike J O'Brien as an independent advisor to our investment committee. Mike has agreed to help to make sure that we have sufficient independent investment knowledge and experience on the committee to help me, and my Board colleagues, provide the right challenge and support when making investment decisions.

Finally, I would like to thank our entire executive team and all PPF staff for their tireless and excellent efforts throughout the year. I look forward to working with them to meet the challenges that no doubt will face us in the future.

Barbara Judge

Lady Judge CBE
Chairman

"We ... have a healthy surplus, an asset portfolio of approximately £11 billion and a 106.9 per cent funding level."

4 Chief Executive's review

" We anticipate that, by 2015, we will be directly protecting approximately 500,000 PPF and Financial Assistance Scheme (FAS) members – while our investment portfolio is forecast to rise to more than £17 billion."

I said in my review last year that, while our financial sustainability was not in doubt, we expected our capacity to deliver to be tested in the coming 12 months. And, as predicted, it has indeed been a testing time for the PPF in many ways – but also a time when we have seen a considerable number of successes.

By the end of 2011/12, about 128,000 people had transferred to the PPF, nearly double the number a year before, and we were managing £11.1 billion of assets, up almost £4.7 billion on the equivalent figure for 2010/11.

These numbers will only grow. We anticipate that, by 2015, we will be directly protecting approximately 500,000 PPF and Financial Assistance Scheme (FAS) members – while our investment portfolio is forecast to rise to more than £17 billion.

This growth is virtually unparalleled in the pensions industry and it is vital that we meet the numerous challenges that this will create, not only in ensuring that we get our money to work as quickly as possible, so protecting our financial position in turbulent markets, but also in ensuring we look after our members efficiently and effectively.

The PPF surplus at 31 March 2012 rose to almost £1.07 billion, an increase of about £390 million on the previous year. However, this figure should be seen in the context of our objective for the PPF to be financially self-sufficient by 2030, something we remain on course to achieve, and the more challenging environment for pension schemes as a whole (already in the current year, we have seen a number of high profile collapses, leading to claims on the PPF of £665 million).

But, overall, our performance should serve to give our members continued confidence in our commitment to provide their compensation and assistance for as long as they need them.

During the year, we again set ourselves three big challenges which help us focus our efforts and provide targets which are deliberately stretching and tough.

They were:

- maintain a level of 80 per cent confidence in achieving our 2030 funding objective
- secure 150,000 more members' futures, and
- inspire customer confidence.

By the end of the year, our long-term risk modelling showed that we could be 84 per cent confident of being fully-funded by 2030; we had secured the futures of 132,000 PPF and FAS members (slightly below our target as a consequence of one big scheme with 34,000 members remaining in the assessment period while under review); and, as measured by our customer confidence counter, which aggregates data on correct compensation payments, customer enquiry handling and complaints, we scored a 9/10 for inspiring confidence – which is a 'great' rating.

And talking of customers, we decided, as our Chairman has highlighted, that it was an appropriate time in our development to bring our PPF member administration services in-house, replacing Capita Hartshead when its contract expires in 2014 (although it will continue to provide administration services for FAS).

Our investment strategy continued to deliver encouraging returns despite the continuing financial upheaval while maintaining our low risk profile. Our overall return of 25.2 per cent, driven largely by the return on the sophisticated liability matching strategies we employ, clearly set us apart yet again.

The Assess & Pay programme, designed to help schemes complete our assessment process more quickly, also began to pay dividends during the year, culminating in the transfer of a scheme of 443 members in just over 10 months – the first scheme to be transferred in less than one year and, I am sure, by no means the last.

In May 2011, after an extended period of consultation with the pensions industry, we unveiled a new pension protection levy framework. Since then, we have committed significant time and resource to ensure that it will be successfully implemented in 2012/13. We not only confirmed the rules governing the framework and set them for three years, to deliver the predictability our levy payers had asked us for, but also worked hard to make sure levy payers were aware of the need to hit important deadlines for providing us with information and take actions that could reduce their levy bill.

Also, in anticipation of future levies that would automatically track the risks to which we are exposed, we set a levy estimate for 2012/13 of £550 million, compared with £600 million in 2011/12.

Since that time, of course, conditions for defined benefit pension schemes have deteriorated significantly. Yields on 30 year gilts, a proxy for the rates at which liabilities are discounted, have fallen sharply from 4.36 per cent at the end of March 2011 to 2.9 per cent at the time of writing. As a result, our 7800 Index, which tracks the s179 funding levels of the schemes we protect, dipped from an aggregate surplus of £36.9 billion at 31 March 2011 to a deficit of £283 billion at the end of July 2012.

Even though our new levy formula includes a smoothing element, which is intended to reduce levy volatility, the kind of market movements we have witnessed produced such a sharp deterioration in scheme funding levels (and consequent rise in our risk) that, without the Board's intervention, next year's levy estimate would have risen by the maximum permissible amount. However, the Board decided to strike a balance and set the 2013/14 estimate at the same amount that we will collect in 2012/13.

Photograph: ©Richard Pohle/"The Times"

Chief Executive's review continued ...

"I want to thank all the PPF's staff for their hard work...we live in testing and difficult times and it is a testimony to their dedication that we continue to deliver as an organisation."

Controls on public sector bodies imposed by central Government continued to create a difficult operating background. So, while I am able to report that we underspent our Strategic Plan, the fact that £1.1 million of this underspend was due to the continuing difficulties we have experienced in recruiting and retaining the right calibre of staff does give cause for concern.

To that end, during the year we began a review of our pay and reward structure with the aim of benchmarking all our roles against similar roles in the marketplace. Our ambition is to improve our chances of recruiting and retaining the skilled staff we need, so that we can continue to deliver the level of service our members are entitled to expect from us.

For the second year running we were named in the 'One to Watch' category of the Best Companies to Work for in the Public Sector list, a national award scheme which allows us to compare our performance with others in the public sector.

While we showed encouraging progress over the previous year, and this remains a good result, we will be working hard again this year at being the best we can to improve our ranking.

Following last year's Autumn Statement by Chancellor George Osborne – and a speech by the Prime Minister – regarding the need for more investment in UK infrastructure, we signed a memorandum of understanding with HM Treasury and the National Association of Pension Funds aimed at setting up a Pensions Infrastructure Platform (PIP) to encourage UK pensions funds to invest in infrastructure projects, something they have – for a number of reasons – been reluctant to do in the past.

In my discussions with pension funds and other interested parties, I have found that people are genuinely supportive of the idea that pension funds and infrastructure investment fit well together. Certain obstacles still have to be overcome but I remain optimistic that we will launch the PIP in early 2013. I believe PPF's involvement with this project demonstrates further our position as an innovative and influential part of the broader pension landscape.

Finally, as always, I want to thank all the PPF's staff for their hard work and commitment throughout the year. We live in testing and difficult times and it is a testimony to their dedication that we continue to deliver as an organisation, never resting on our laurels and always willing to embrace new ways of working.

So, a big thank you to all PPF staff as we look forward to what I believe will be one of our most exciting and challenging years yet.

Alan Rubenstein
Chief Executive

5 Our vision, mission and values

Our staff work to achieve our vision, mission and values – and strategic objectives – which have made a significant impact on our organisational culture since they were introduced two years ago.

Our vision will be realised as we fulfil our mission and, 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 we do.

Vision

Protecting people's futures – that is what the PPF is all about, providing a secure future for people of all ages.

Mission

Pay the right people the right amount at the right time – this goes to the heart of what the PPF has been set up to do.

Values: ICARE

Our values define the way we work. They are integral to our success in fulfilling our mission and realising our vision. In living up to these values, 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
- Meet our funding target through prudent and efficient management of our balance sheet
- Set and collect an appropriate levy and allocate it fairly
- Maintain our reputation by communicating clearly what we do and why
- Be an efficient and effective organisation where staff are recognised and valued
- Maintain effective risk management in all areas of PPF business.

"Our vision will be realised as we fulfil our mission and, to do this, we must also be successful in delivering our strategic objectives."

6 Financial and performance highlights

Financial highlights

- By 31 March 2012, we were **84 per cent** confident of meeting our target of being financially self-sufficent by 2030, and
- we had a funding level calculated on an actuarial basis of **106.9 per cent**, up from **105.1 per cent** as at 31 March 2011

Between 1 April 2011 and 31 March 2012,

- we generated total net income of **£370 million**
- we raised levies totalling **£605 million**, **£4 million** of which related to the Fraud Compensation Fund (FCF), in line with our published targets
- our operating costs were **£40 million**, which continue to be under budget
- we received new claims from schemes entering PPF assessment valued at **£471 million**, marginally lower than last year (**£490 million**) on a lower number of claims (**116** in 2011/12 against **149** in 2010/11) – this figure includes schemes that re-entered the assessment period after having previously left to seek buyout
- our investment strategy delivered an overall return of **25.2 per cent**, representing **£1,687 million** (the main contributor to this performance was the return on our hedging portfolio)
- we had investments valued at **£11,055 million**, up from **£6,356 million** on 2010/11
- we took on assets totalling **£2,469 million** from the **147 schemes** which completed the PPF assessment period and transferred during the year
- our actuarial liabilities for members who have transferred into the PPF increased from **£4,076 million** to **£8,373 million** (this included liabilities of **£3,585 million** from the **147 transferred schemes**)
- the value of these liabilities increased by **£915 million** (compared with an increase of **£139 million** in the previous year) due to changes in actuarial assumptions and how those assumptions played out – the main cause of this increase was falling gilt yields but our hedging programme protected us against the impact of this rise by working to increase the value of our investments by roughly the same amount
- we also paid out compensation to our members totalling **£203 million**
- we held provisions of **£1,709 million, £14 million** of which relates to the FCF, for probable future claims on the PPF and the FCF, less than the value at the end of 2010/11 of **£1,859 million**, again **£13 million** of which relates to the FCF.

Performance highlights

Strategic objective	Key Performance Target set out in 2011 Strategic Plan	Achievement delivered in 2011/12
Manage schemes through the assessment and wind-up processes in a timely and efficient manner	155 PPF schemes to complete assessment	180 schemes completed the assessment process
	300 FAS schemes to complete wind up	311 FAS schemes wound up and transferred £273 million worth of assets transferred to government
Meet our funding target through prudent and effective management of our balance sheet	Implement our programme of new investments	During the year, 10 new managers were funded with a total of £1.3 billion. We increased our exposure to alternative asset classes by £948 million
	Maximise recovery of assets from insolvent scheme employers	We secured recoveries of £284 million during the year, and we estimated that our restructuring activities added value totalling £135 million
	Monitor the long term funding position against the threshold 80 per cent likelihood of achieving our long term target	At 31 March 2012, our assessment of the likelihood of meeting our long term funding target was 84 per cent
Set and collect an appropriate levy and allocate it fairly	Invoice 90 per cent of 2011/12 schemes, and collect 90 per cent of uncontested 2011/12 levy, by 31 December 2011	97 per cent of uncontested Protection levies had been collected by year end
	Invoice and collect 90 per cent of the 2011/12 Fraud Compensation Levy by 31 March 2012	99 per cent of the Fraud Compensation Levy had been collected by year end
Maintain our reputation by communicating clearly what we do and why	At least 80 per cent of stakeholders agree that the PPF communicates effectively	71 per cent of stakeholders agreed that the PPF communicates effectively (compared with 67 per cent in 2010)
Be an efficient and effective organisation	Deliver agreed savings set out in 2011/12 budgets	By year end, we underspent our budget by £6 million
Maintain effective risk management in all areas of PPF business	Implement enhanced Financial Risk Management (FRM) systems by end March 2012	We implemented enhanced FRM systems, or robust plans were in place to complete implementation, by year end

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Putting our members first

Strategic objective: manage PPF and FAS schemes through the assessment and wind-up processes in a timely and efficient manner.

Highlights:

By 31 March 2012,

- **128,114** people were receiving PPF compensation, or will do in the future
- We paid out a total of **£463 million** in PPF compensation since 2005
- **72,154** people were receiving FAS assistance, or will do in the future
- We paid out a total of **£223 million** in FAS assistance since 2009.

The assessment process for PPF schemes and the wind-up process for FAS schemes lie at the heart of our operations – and managing these processes efficiently provides certainty to our members as soon as possible, while allowing us to control costs effectively.

That is why we committed significant resource during the year into building on the successful implementation of our Assess & Pay programme which we launched in 2010 to reduce the typical assessment period from 35 months to less than two years.

Assess & Pay progress

At the start of the year, we announced that we had transferred 50 schemes through the Assess & Pay programme and we began to work closely with trustees to see how we could start to roll this process out to other schemes in the PPF assessment period.

As part of this work, we set up a panel of five actuarial firms to carry out s143 valuations for schemes in assessment. We did this because the Assess & Pay pilot showed that a dedicated actuary with specific knowledge to carry out these valuations brings many benefits, in terms of expertise, time and cost.

The principles underpinning this decision led us to set up a second panel for firms, such as scheme administrators, which can provide specialist services to help schemes complete assessment more quickly and effectively. The successful firms were announced in August 2012 following a comprehensive tender process.

Much of this effort culminated in March 2012 when we transferred a scheme with 443 members in just over 10 months, the first to be transferred in less than one year. As the Assess & Pay process becomes more sophisticated, we believe that this scheme will be the first of many to transfer within such a short time period.

Customer experience

By 2014, we expect a combined total of about 365,000 members to have transferred to us. This is why during the year we started to look at enhancing the customer experience for both PPF and FAS members.

Currently, our member services are handled by business services firm, Capita Hartshead. Following extensive market testing during the year, we felt that by the time Capita Hartshead's contract comes to an end in 2014, we will be mature enough as an organisation to make bringing these services in-house a viable option.

In March 2012, the PPF Board accepted a recommendation to bring member services in-house by 2014.

By doing this, we can make sure we have greater control and flexibility over the services we provide. This means that we can fulfil our main aim to put customers at the heart of everything we do.

Capita Hartshead will continue to be an important strategic partner for the PPF and will continue to provide the member services for the FAS which we run on behalf of the Government.

End of year figures

PPF:

- During the year ended 31 March 2012, a total of 53,463 people transferred to the PPF, making a grand total of 128,114 people who have transferred since the PPF began.
- 81,253 people completed the PPF assessment period during the year (this was less than we anticipated because the Turner & Newall pension scheme, which has 34,000 members, remains under statutory review).
- Since 2005, we have paid out a total of £463 million in compensation, more than £200 million of that was paid out in 2011/12.
- At the end of the year, we were supporting 293 schemes in the assessment period with assets of £5,374 million and liabilities of £7,070 million.

FAS:

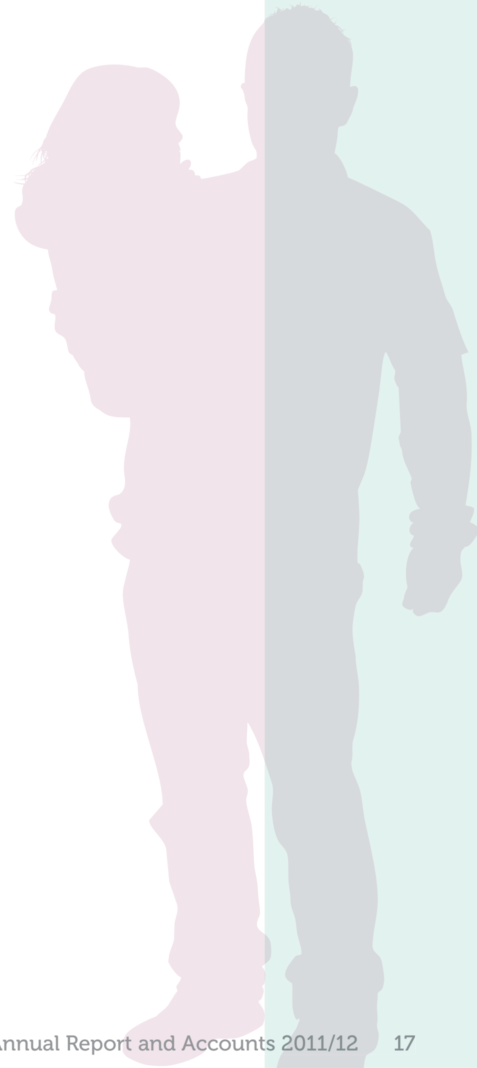
- By end of March 2012, we had transferred 598 FAS schemes and, as a result, more than £320 million of scheme assets had transferred to Government.
- During the year, the number of people receiving FAS assistance increased from 16,917 to 22,844 and the FAS paid out £74 million.
- We also transferred 311 schemes to our administrators, Capita Hartshead, beating the target we set ourselves at the beginning of 2011/12 of 300.
- This means that since the FAS started, a total of more than £210 million has been paid out and 1,288 schemes had looked to qualify for the FAS. By 31 March 2012, 1,037 of these schemes had qualified.

GMP equalisation

In November 2011, after a lengthy consultation, we confirmed how we propose to calculate compensation for men and women being assessed for entry into the PPF – or who are already PPF members – to ensure they are treated equally, as required by law.

At the same time, we undertook a six month pilot project with selected schemes so we could put this calculation method through it paces.

We are now considering the outcomes of this pilot.



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Funding for the future

Strategic objective: Meet our funding target through prudent and effective management of our balance sheet.

Highlights:

By 31 March 2012,

- the Pension Protection Fund was **£1,069 million** in surplus, an increase of **£391 million** from the previous year
- we were **84 per cent** confident of reaching our funding target for the Pension Protection Fund
- the PPF's investment portfolio rose from **£6,356 million** in 2010/11 to **£11,055 million**
- we had earned a return of **25.2 per cent** on the Fund's invested assets.

Our long-term funding target to be financially self-sufficient by 2030 is the backdrop against which we set our investment strategy and the amount of pension protection levy we charge.

Self-sufficiency means that we will be fully-funded with minimal exposure to interest rate, inflation and market risks and with protection against future claims and the risks of people living longer than we estimate.

Long-term funding update

Since we first published our funding strategy in August 2010, we have always stressed how important it is that we keep it under review to make sure that it reflects any new factors which may affect our chances of success.

We published the first formal review of the strategy in November 2011, alongside our 2010/11 Annual Report. We are publishing at the same time as this document the second such review which discusses various developments over the last year.

At the present time, we believe we are on course to meet our funding aims. Our latest assessment shows that while the probability of achieving self sufficiency, measured on our base case, fell from 87 per cent in March 2011 to 84 per cent in March 2012, the figure is still above the comfort level expressed by our Board in 2010.

But we have to be very aware about events which might reduce that probability even further. In our review, we consider two specific stress tests which assess the robustness of our strategy to alternative views of the future.

Our financial position

As at 31 March 2012, we reported a surplus of almost £1.07 billion, representing a funding position of 106.9 per cent. This compares with a surplus of £678 million at March 2011, representing a funding position of 105.1 per cent.

Our financial position improved mainly because the value of our investments was able to keep pace with the increasing value of our liabilities - and because income from the pension protection levy and our own investment returns (including the inflation and interest rate hedge) exceeded the value of claims on the PPF during the year.

Investment performance

Our invested assets, again, continued to grow substantially during the year, incorporating the transfer of assets from schemes entering the PPF (£2.5 billion), levy collections (£0.6 billion) and the investment returns on our assets (£1.7 billion).

Our major achievement during the year was to make sure that our extensive programme of interest rate and inflation hedging protected the PPF from the damaging effect that falling interest rates would otherwise have had on our funding position.

These hedging assets grew in value in 2011/12 to keep pace with the increasing value of our liabilities. This meant that, together, our return-seeking and hedging investments returned 25.2 per cent during the year (equivalent to £1.7 billion) to keep our overall funding level robust.

Our return seeking investments produced a return of 2.1 per cent in the year (equivalent to £337 million) ahead of our LIBOR benchmark of 0.9 per cent. But, while we have performed well during the year, we remain mindful of the long-term investment horizon over which we aim to achieve low volatility performance. Over the last three years, our benchmark (three month LIBOR) has been 0.9 per cent a year. During this period, we have achieved returns of 7.2 per cent (excluding our liability driven investment programme).

Also during the year, we put in place a portfolio of investments for the future, implementing our objective of 20 per cent strategic allocation to alternatives.

Our total asset portfolio is expected to have a long-term return potential of +1.8 per cent a year in excess of our liabilities.

Recoveries and transfer of scheme assets

Recoveries from insolvent employers continued to be an important income stream. We have now made – or expect to realise in the future - £1.3 billion in recoveries since we were first set up.

During the year, we collected £2.5 billion in cash and other assets from schemes which had entered the PPF. To transition these assets into the PPF's investment strategy economically and with minimum risk, we transition them in batches. As at the end of the year, we had assets totalling £1.4 billion awaiting transition, and this was completed early in the new financial year.

"During the year a total of £984 million was invested in alternative assets. We secured recoveries of £284 million in the year. At 31 March 2012, our assessment of the likelihood of meeting our long term funding target was 84 per cent."

8 Funding for the future continued …

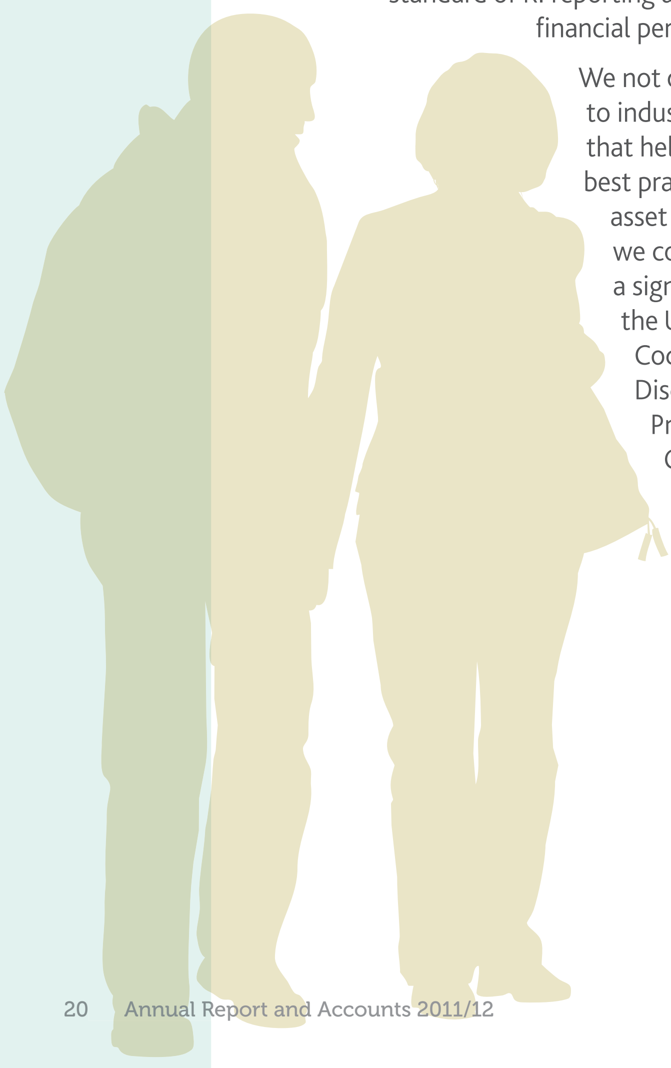
Responsible investment

We remain committed to being a responsible and vigilant asset owner which means we will exercise our rights, including voting rights, to safeguard sustainable returns in the long-term.

During the year, our investment team received training on how to assign a responsible investment (RI) rating to each fund manager and, supported by our in-house RI specialist, encourage them to improve their RI practices.

This has been so successful that more than 50 per cent of our assets are now allocated to managers that we believe are working towards better RI practice, eg several have signed up to the Principles of Responsible Investment (PRI) and we have seen a much improved standard of RI reporting alongside financial performance.

We not only contribute to industry initiatives that help improve RI best practice across asset classes but we continue to be a signatory to PRI, the UK Stewardship Code, the Carbon Disclosure Project and the CDP Water Disclosure Project.



Fund managers

During the year, we recruited nine firms to our panel of transition managers which we set up to offer as much flexibility as possible when transitioning pension scheme assets to the PPF. We also set up a Liability Driven Investment (LDI) panel of four managers to increase our flexibility with our LDI strategy.

This strategy helps reduce our risk by more closely matching our assets to our liabilities.

Also during the year, we started the process of appointing a panel of specialist bond managers to complement our existing managers in this area. These will, again, give us greater flexibility to access a broader range of bond strategies.

Finally, we also sought to appoint a panel of farm and timberland managers to handle future investments which will be predominantly in land and the operations necessary to cultivate and market agricultural products, or to grow and sell timber.

Awards

Further to being named Risk Magazine's Pension Fund Risk Manager of the Year in 2010/11, we took home the Best Innovation Prize at the 2011 IPE European Pension Funds Awards in November 2011.

The award was for the PPF being in the vanguard of Liability Driven Investment and the use of repos in our LDI strategy in closing our swap spread risk.

In April 2012, we were also recognised by Financial News with its award for Best Investment Strategy (DB) and by Portfolio Institutional for Portfolio Construction.

9 Pension protection levy – present and future

Strategic objective: Set and collect an appropriate levy and allocate it fairly.

Income from the pension protection levy, which we charge all eligible pension schemes, remains essential to fund the compensation we pay. Our aim during the year was to put in place changes to make sure the levy we charge to individual schemes is both more predictable and stable – and more appropriately reflects the risk they pose to the PPF.

As ever, we need to balance security for our members with setting a levy that pension schemes can afford to pay.

New levy framework

We confirmed full details of the new levy framework in May 2011, following a previous early announcement in January 2011 designed to give levy payers enough notice to meet important deadlines for submitting all the information we need to calculate individual levy bills.

In September 2011, we began consulting on the rules which govern the new framework and they were confirmed in November. In a significant break from the past – when we changed the way the levy is calculated every year – these new rules are intended to be fixed for three years.

This means that levy bills will be more predictable than ever before and schemes can expect that if their risk falls over the three years, then so will their levy.

To provide further help to schemes, we issued further guidance in December 2011 on investment risk (used in the levy calculations for the first time), contingent asset and block transfers as well as levy practice guidance.

We have been working hard to make sure all the necessary processes are in place to successfully implement the new framework and we are firmly on track to begin invoicing under the new rules in autumn 2012.

Throughout the year, we have done all we can to make sure levy payers were aware of the need to hit important deadlines for providing us with information and to think carefully about the action they can take to reduce their levy bills, eg putting in place contingent assets.

Levy future

In September 2011, we announced that the pension protection levy estimate for 2012/13 will be £550 million.

However, under the new rules, the number of schemes putting in place, or re-certifying, contingent assets or deficit reduction contributions for the 2012/13 levy year fell, further increasing our risk which means we anticipate collecting more levy than the original estimate.

Highlights

- During 2011/12, we collected cash totalling **£649 million** relating to all levy years.
- We collected **94 per cent** of uncontested levies by 31 December 2011, beating our target of **90 per cent.**
- We set a levy estimate **£550 million** for 2012/13, compared with **£600 million** for 2011/12.
- We began to implement the new levy framework to come into effect in 2012/13.

9 Pension protection levy – present and future continued ...

"97 per cent of uncontested protection levies had been collected and 99 per cent of the Fraud Compensation Levy had been collected by year end."

Our levy framework is designed to respond automatically to changes in risk. Conditions for pension schemes have deteriorated significantly since 2011/12 and funding fell to record levels. As a result, claims on the PPF, especially since March 2012, were substantially higher. In fact, at the time of writing, they had equated to more than a year's levy income.

If this pattern continues, it will inevitably feed into future levy increases.

Levies for 2011/12

So we could provide excellent customer service in relation to queries as they arose, we staggered the issuing of invoices during September and October 2011 – and most schemes received their invoices by the end of October.

Schemes are aware that we now charge interest on late levy payments. This has helped improve the speed at which bills are paid. With most schemes paying their bills on time, we believe it is right that they are not asked to effectively subsidise those who choose not to.

Average days to pay were reduced to 29 (down from 34 in 2010/11).

During the year, we worked with our insolvency risk providers, Dun & Bradstreet (D&B), to streamline the process for employers to appeal their failure scores. Some stages in the process were combined so we now have a simpler three stage process which means that schemes can escalate their appeals more quickly to senior levels within D&B.

Data provision

To make sure we maintain a consistent annual invoicing cycle, we continued to seek improvements in the accuracy of data supplied to us for calculating individual levy bills. During the year, we reviewed and updated the validation rules on the Pensions Regulator's Exchange System which means we can have all the correct data we need, when we need it.

By having complete and accurate scheme information when we want it – which can be produced efficiently and with minimal manual intervention – we can make informed, accurate assumptions to support our levy calculations and collections.

Fraud Compensation Fund

We are responsible for providing compensation to occupational pension schemes where the sponsoring employer has gone bust and where the scheme has suffered a loss through fraud or dishonesty. This compensation is paid out from the Fraud Compensation Fund (FCF).

During the year, we announced that for the third year running we would raise a fraud compensation levy during 2012/13. This was necessary due to the expected cost of current claims. This levy is collected on our behalf by the Pensions Regulator.

The FCF remains in deficit by some £2.1 million. Raising a levy will clear some of this deficit but we may need to raise further levies in the future depending on the level of claims against the FCF.

10 Communicating is a two-way thing

Strategic objective: maintain our reputation by communicating clearly what we do and why.

We have always stressed the importance of communicating clearly with everyone who has an interest in what we do, listening carefully to their views and adapting our policies to take account of those views where appropriate.

During the year, we continued to deliver our messages and information through a variety of communications channels so that we can provide information that is trusted and respected, have a leadership team that is available to all, identify opportunities to work with industry to achieve the best results and demonstrate that we are open and transparent in everything that we do.

Feedback

During the year, we commissioned and completed our regular stakeholder perception survey which provides us with invaluable information about how well stakeholders such as members, pensions professionals and levy payers feel we are doing. We then use this information to further improve the way we communicate.

The latest survey found that:

- more than 70 per cent of all stakeholders felt that the PPF communicates effectively through all channels
- almost 90 per cent of stakeholders felt they were handled in a professional way when contacting the PPF
- 90 per cent of all stakeholders are aware of, and understand their main role in relation to, the PPF, and
- 80 per cent of our stakeholders believe that the PPF is able to meet its statutory objectives.

Some stakeholders were concerned about whether or not the PPF can sustain its performance in the long-term.

Providing reassurance to all our stakeholders, particularly our members, that we remain on track for self-sufficiency in 2030 is, therefore, a key communications goal.

Communications channels

Our website remains the first port of call for many professionals seeking information about the PPF. During the year, it had almost 180,000 unique visitors who made almost 300,000 visits in total, resulting in 1.4 million page views. Also, our separate PPF and FAS member websites received 48,000 hits in 2011/12.

As the PPF's membership grows, and we complete our planned move to bring member administration services in-house, we will be revamping the website to make it even more customer-focused in the future.

Highlights

- We issued **135** different publications for scheme members and industry.
- Our customer service teams handled more than **130,000** enquiries.
- We arranged for our Chairman and Chief Executive to speak at, or attend, more than **140** meetings and other events.
- More than **600** pension professionals watched our first ever PPFTV broadcast on YouTube.

10 Communicating is a two-way thing continued …

“71 per cent of stakeholders agreed that the PPF communicates effectively (compared with 67 per cent in 2010)”

We issued 42 alerts, press releases and information notices to almost 2,500 people who have registered their emails with us, as well as other interested parties such as professional organisations and the media. We issued four PPF update bulletins during the year to more than 25,000 people who were at that time registered on the Pensions Regulator’s Exchange database.

We also arranged for our Chairman and Chief Executive to speak at, or attend, more than 140 events during the year which we use as valuable opportunities to find out from people how well they think we are doing – and what we can do to improve.

During the year, we published 135 documents which included consultation, decision and guidance documents on issues such as the pension protection levy, contingent assets and revised actuarial factors.

We also published the sixth version of The Purple Book, in conjunction with the Pensions Regulator, which focuses on the risks faced by predominantly private sector defined benefit pension schemes throughout the UK. Data in The Purple Book is based on 6,432 schemes, representing about 12 million members. This accounts for 98 per cent of PPF-eligible schemes and 99.6 per cent of estimated eligible liabilities.

Each month, we publish the PPF 7800 Index which provides regular updates on scheme funding levels. This allows us to track funding and risk through time.

Member communications

As part of our continuing drive to put our customers at the heart of everything we do, we developed new welcome booklets during the year for both PPF and FAS members which provides all the information they need to understand what it means to be a PPF or FAS member.

We also produced a booklet which we encourage trustees to issue to their members when their schemes enter the PPF assessment period. This booklet explains what the PPF is, what members should expect to happen during the assessment period and an explanation about how PPF compensation is calculated.

All PPF members also received a copy of an annual review which summarised what we did during 2010/11. Independent research shows that this is hugely welcomed by members as a way of keeping them in touch with what the PPF is up to.

Customer services

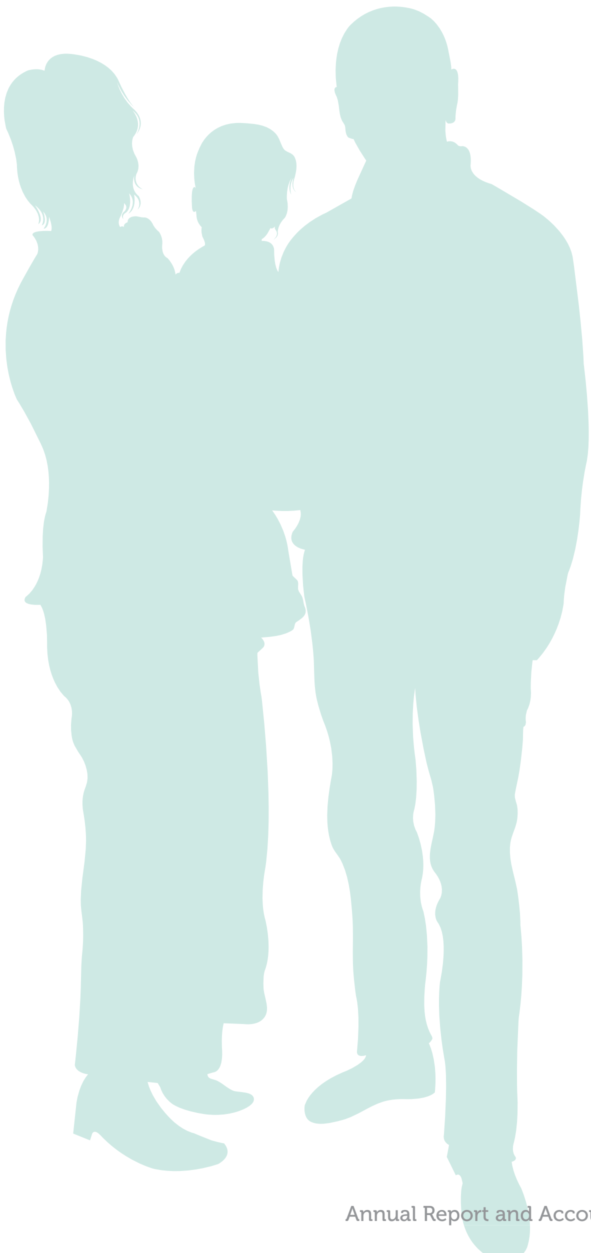
Our dedicated Stakeholder Support Team continued to provide the main point of contact for industry professionals and employers, among others. During the year, it handled 8,305 telephone calls and 3,072 letters and emails.

Our payments administration customer services team handled 65,699 written enquiries and 56,137 telephone enquiries for both PPF and FAS throughout 2011/12.

Webcasts

Last year, we began to use webinars and webcasting as a cost-effective alternative to getting across important messages to our stakeholders through events such as roadshows.

In January 2012, we launched our own PPF TV web channel on YouTube. The first broadcast was aimed at informing levy payers about the new levy framework and helping them prepare for the changes so that when their bills arrive, they will be accurate and what they expect. This has been watched by more than 600 people, so far. One viewer commented: 'Clear and concise communication. Well done.'



11 Our developing organisation

Strategic objective: be an efficient and effective organisation where staff are recognised and valued.

Highlights

- We spent **£40 million** running the organisation against a budget of **£46 million.**
- The average administration cost per PPF member fell from **£85** in 2010/11 to **£83** in 2011/12.
- We improved our position in the **One to Watch** category of the Best Companies to Work for in the public sector list.

Performance and development

During the year, we sought 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 continued to support strong leadership at all levels, identify potential and performance, develop our talent management programme and promote a culture of coaching, mentoring and development.

To that end, all senior managers in the organisation took part in a comprehensive training and development programme called 'Leading the PPF Way'. This programme is aimed at reinforcing the skills, knowledge and behaviours that our people managers need to become effective leaders within the organisation and continues into 2012/13.

Retention and recruitment

As a growing and changing organisation, we recognised the need during the year to review our pay and rewards structure to improve our chances of recruiting the best people – and retaining those that we already have.

That is why we undertook a comprehensive benchmarking of all salaries, comparing ourselves with similar organisations predominantly in the private sector, as that is where we want to attract people from – and where PPF staff are more likely to leave for.

This resulted in a new pay structure being rolled out in August 2012 which is aimed at rewarding people purely on their performance and development rather than a more traditional annual indexed pay increase across all staff.

Efficiencies

During the year, we spent £40 million, £6 million under budget.

An important measure of our efficiency is the average administration cost per PPF member, including all those in assessment and those that have transferred. This average cost fell marginally from £85 in 2010/11 to £83 in 2011/12.

The PPF's payment practice is to pay our UK suppliers in accordance with the terms of business agreed with them. As at 31 March 2012, the aggregate amount owed to suppliers, compared to the total amount billed by suppliers during the year, expressed as a number of days, was 18 (compared to 27 days as at 31 March 2011). We have excluded from this statistic supplier invoices which were under query or dispute with the suppliers at year end.

Survey and recognition

For the second year running, we were named in the 'One to Watch' category of the Best Companies to Work for in the Public Sector list, a national award scheme which allows us to compare our performance with others in the public sector.

Overall, we showed encouraging progress over the previous year, with a total score of 628, compared with 624 in 2010/11, and only 31 points away from achieving one star status (out of three). While this was an improvement, we hope that by continuing to strengthen our employee engagement, we will see further improvement next year.

Community involvement

We have a community responsibility policy which has long recognised that, as a responsible employer, we have a role to play in contributing to the local community and beyond.

During the year, we continued our membership of Croydon Commitment, a charitable business partnership which bridges the gap between the needs of the local community and businesses in the area.

Under its auspices, we took part in a charity abseil and decorated the new flat of a woman and her young son who were made homeless following the Croydon riots in August 2011. We also participated in two community days – serving Christmas dinner to members of a pensioners' drop-in centre and clearing a wildlife garden for a local primary school.

We also took part in a range of other fundraising events for a range of charities including Help for Heroes, Epilepsy Action, Macmillan Cancer Support and Walk to the Stars and we raised almost £4,000.

Statistics

By 31 March 2012, we had 224 employees. This figure was down on last year's figure of 291 primarily because of planned reductions in staff numbers and recruitment difficulties.

During the year, the number of days we lost to sickness averaged 5.5 per person (1.5 per cent). This included long-term absences of more than 28 days.

Excluding long-term absences, we only lost 3.8 days per person (1.3 per cent), which compares favourably with the Civil Service average of 8.5 days per person.

12

Managing our risks

Strategic objective: maintain effective risk management in all areas of PPF business.

Highlights

- We had implemented a programme of change to improve further our ability to mitigate financial risks.
- We had reviewed our risk appetite to make sure it remains fit-for-purpose.
- Rolled out non-financial risk training across the organisation.

Good risk management will allow us to have increased confidence in achieving our objectives, effectively constrain threats to acceptable levels and take informed decisions about exploiting opportunities.

This is not just about the risks we can control but also the risks we cannot. It's important that we fully understand the implications of these uncontrollable costs, such as pension scheme funding and the state of the economy, as the financial futures of hundreds of thousands of people can be threatened.

Our current approach to risk management has served us well and helped us successfully manage the risks facing us since we started in 2005.

But we have not rested on our laurels and, as our business grows, we continue to refine our processes to manage the risks the PPF faces.

Risk appetite and risk universe

In line with the general principles of effective risk management, we adopt the following cycle: our Board decides on its risk appetite, we identify and assess our main risks, agree how to mitigate and control those risks and establish comprehensive monitoring and reporting.

Central to our risk management is the PPF Board's risk appetite statement which we refresh each year. A copy of this statement can be found on our website.

We have set risk appetites for the seven key risks to our mission and our strategic objectives. These can be found in our governance statement in section 2 of this report.

Future risk management

We have developed risk management processes and frameworks at an operational level for both financial and non-financial risks.

In view of our developing investment portfolio, and following best practice governance, we have also established an independent financial risk function, in line with leading practice in major financial institutions.

Best practice

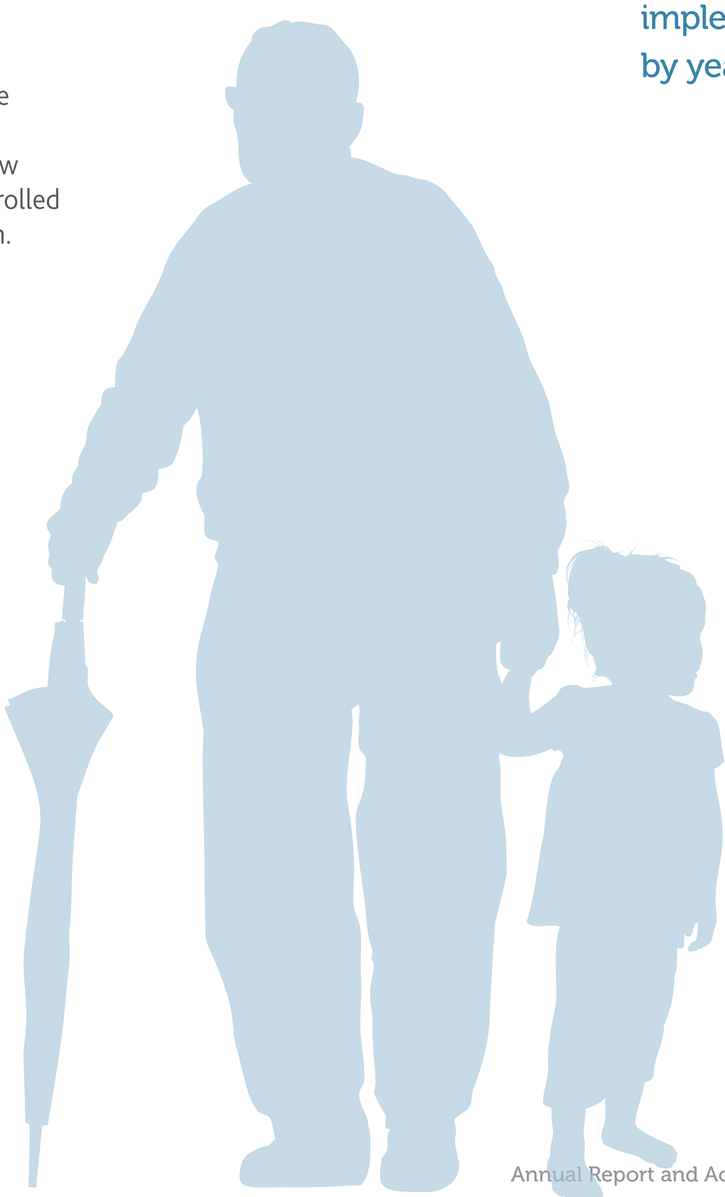
We look to best practice in the private and public sector to benchmark our approach and have engaged with the risk management profession both in this country and globally to test our approach.

A paper on Enterprise Risk Management at the PPF was awarded a prize by the Professional Risk Managers' International Association (PRMIA) and has been published both by that organisation and the Society of Actuaries (SoA) in the United States.

Risk training

To help embed our risk appetite and raise knowledge of risk management we developed new non-financial risk training and rolled this out across the organisation.

"We implemented enhanced systems, or robust plans were in place to complete implementation, by year end."



13 General information

During the year, we handled a number of appeals, complaints and requests for information.

Reviewable matters – 2011/12 levy year

We run a statutory appeals process in respect of ‘reviewable matters’ listed in the Pensions Act. The majority of appeals under this process relate to the levy.

During 2011/12, we issued 99 review decisions in response to levy appeals, compared with 171 the previous financial year. In 70 of these cases, the scheme was found to have been levied correctly. In the remaining 29 cases, we agreed with some or all of the scheme’s appeal. In 23 cases, the applicants further appealed the review decision to the Reconsideration Committee.

We also issued six review decisions in relation to other reviewable matters (primarily individuals’ compensation entitlements) during 2011/12.

Maladministration complaints

We dealt with four formal complaints of maladministration during 2011/12. In all of the cases, the Board found that no maladministration had occurred.

Freedom of Information (FoI) requests

During the year, we received 30 FoI requests and we disclosed fully the information requested in 13 cases, partially disclosed in six cases and did not hold the information asked for in two cases.

Other requests were declined because the information was restricted, commercially sensitive or too costly to disclose.

We do not charge for disclosing information. In this way we comply, as a public sector information holder, with the cost allocation and charging requirements set out in the relevant HM Treasury and Office of Public Sector Information Guidance.

General complaints

During the year, we received 49 PPF complaints, 48 of which were resolved at Stage One and one was escalated to Stage Two.

We logged 74 FAS complaint cases, of which 73 were resolved at Stage One and one case was escalated to Stage Two.

No PPF or FAS cases were referred to the next stage with the Independent Case Examiner (ICE).

For the PPF, the focus of complaints was around delays in responding to queries from members and difficulties in logging on to the member website. For FAS, complaints were mostly about delays in responding to queries, delays in receiving information about levels of assistance and/or changes in the level of assistance.

Guidance on how complaints and appeals are handled can be found on our website.

Part 2
Statutory Reports

Statement of Accounting Officer's responsibilities

Under the Pensions Act 2004, the Board of the PPF is required to prepare for each financial year a statement of accounts in the form and on the basis directed by the Secretary of State for Work and Pensions with the consent of the Treasury. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Board and of its income and expenditure, gains and losses and cash flows for the financial year.

In preparing the accounts, the Board is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by the Secretary of State, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis.

The Secretary of State for Work and Pensions has appointed the Chief Executive as the Accounting Officer for the Board. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the Board's assets, are set out in Managing Public Money published by HM Treasury.

Alan Rubenstein
Accounting Officer
15 October 2012

Governance statement

Governance framework

There are eight Non-Executive Members including the Chairman and including one new Member appointed after the end of the reporting period. There are three Executive Members, including the Chief Executive. All Non-Executive Members were independent at appointment having no current or previous material relationship with the organisation as an employee, officer or contractor.

The Board has established a number of committees to enable it to conduct its business in accordance with its Statement of Operating Principles.

The Board has also delegated to the Chief Executive a wide power to take decisions to ensure operational effectiveness with regular updates to the Board provided on performance, risks and strategic briefings. The Chief Executive has established a number of internal committees to oversee the operations.

Further details of the governance framework are provided in appendix 1.

Board performance

The Board conducted an evaluation of Board performance through a questionnaire, followed by individual meetings of members with the Chairman. The balance, skills, experience and diversity of the Board was felt to be broadly appropriate. It was thought that the addition of a Board level Chief Financial Officer would enhance the balance of the Board and this appointment is underway.

The Board met on eight occasions in the 2011/12 financial year, in addition to a Board training session.

Board member details, committee memberships and attendance at Board and committee meetings are set out in appendix 2.

Highlights of reports

The Board and its Committees considered a number of issues during the year which are described more fully in appendix 3, including:

- agreeing a new levy framework for 2012/13 and agreeing a target levy collection of £550 million for 2012/13 and the assumptions for setting the levy parameters
- approving the customer service strategy
- approving the risk appetite statement and risk universe
- approving the Strategic Plan 2012 (made up of the Management Plan 2012/13 - 2014/15 and Business Plan 2012/13)
- reviewing the Board's corporate governance arrangements (Audit Committee)
- undertaking yearly and half yearly performance reviews of Executive Directors and recommending bonus payments (Remuneration Committee)
- changes to the hedging strategy in order to reduce the swap spread risk (Investment Committee).

Account of corporate governance

The Board is committed to adhering to high standards of corporate governance and annually reviews its compliance against the UK Corporate Governance Code and the HM Treasury / Cabinet Office Corporate Governance Code for central government departments. Formal reporting of compliance with the HM Treasury / Cabinet Office code on a comply or explain basis is a requirement and is set out in this statement.

The latest review of compliance with the HM Treasury / Cabinet Office code was considered by the Chairman, the Senior Independent Director and the Audit Committee in February 2012. To adapt to changed provisions in the code the Board has included individual Board Member performance and assessment of training and development needs as part of the discussions between each Board Member and the Chairman following the annual Board performance evaluation. Changes to encourage Boardroom diversity have also been noted and factored into the Nomination Committee's appointment criteria. The Board meets the provisions of the code where they apply to the PPF.

Full details of the review can be found in appendix 4.

The risk and control environment

The PPF's approach to risk management follows the guidelines provided by HM Treasury in its document entitled 'Orange Book: Management of Risk – Principles and Concepts.'

The Board has determined that the following list represents the most significant sources of risk to the achievement of its objectives:

- business strategy
- cultural
- funding and investment
- investment operations
- legal
- operational, and
- reputational

The Board determines its risk appetite on an annual basis, which is then cascaded to risk owners within the PPF who report quarterly their adherence to this. The Board's risk appetite can be accessed by clicking on the following link: **http://www.pensionprotectionfund.org.uk/About-Us/Documents/Risk_Appetite_Statement.pdf**

Significant risks

We have identified the following risks, which we manage as part of the normal course of our business, that have the potential to impact on our ability to deliver our objectives and may pose a risk to the achievement of the three year business plan:

- Changes in the PPF's environment arising from adverse economic conditions and/or a failure of the regulatory system may mean we cannot achieve our funding objective by 2030
- Business disruption and increased risk caused by high staff turnover through being uncompetitive in labour markets
- Significant systemic or idiosyncratic risk materialises - eg large inherited deficit of £2bn, and
- PPF investment strategy is inappropriate to meet the long term objectives of the fund.

Further details of our risk and control environment can be found in appendix 5.

Board directions

No board directions have been issued.

Personal data related incidents

There are no material data incidents to disclose.

Review of effectiveness

As Accounting Officer, I also have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control has been informed by:

- the assurances I sought and received from other Board Members and senior staff of the PPF detailing the work undertaken to ensure risk management and control is addressed in their areas of responsibility
- the work of the Executive Directors and senior managers within the PPF who have responsibility for the development and maintenance of the internal control framework, and
- comments made by the external auditors in their management letter and other reports.

The opinion of the Head of Internal Audit on the overall adequacy and effectiveness of PPF's framework of governance, risk management and control states: "It is our opinion that, and on the assumption that Internal Audit recommendations are implemented, the Pension Protection Fund has a sound framework of control in the areas reviewed which we are satisfied should provide assurance regarding the effective and efficient achievement of the Pension Protection Fund's objectives."

I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Audit Committee, the Executive Committee, the Asset and Liability Committee and the Risk Management Committee.

Alan Rubenstein
Accounting Officer
15 October 2012

Appendix 1 - Governance framework

The Pensions Act 2004 requires that the Board has a majority of Non-Executive Members, including a Non-Executive Chairman. All Non-Executive Members were independent at appointment having no current or previous material relationship with the organisation as an employee, officer or contractor. There are eight Non-Executive Members including the Chairman and including one new Member appointed after the end of the reporting period.

The Board must appoint a Chief Executive and at least two further Executive Board Members. There are three Executive Members including the Chief Executive and the recruitment of a Chief Financial Officer to join the Board is underway.

The Board is required under the Pensions Act 2004 to have a Non-Executive Committee. The functions of the Non-Executive Committee are set out under section 112 of the Pensions Act 2004:

(a) the duty to keep under review the question whether the Board's internal financial controls secure the proper conduct of its financial affairs

(b) the duty to determine under sub-paragraph (5) (a) of paragraph 12 of Schedule 5, subject to the approval of the Secretary of State, the terms and conditions as to remuneration of any Chief Executive appointed under sub-paragraph (4) of that paragraph

(c) the duty to determine under paragraph 13(3)(a) of that Schedule, subject to the approval of the Secretary of State, the terms and conditions as to remuneration of any member of staff who is also to be an executive member of the Board

(d) the duty to determine under paragraph 13(3)(b) of that Schedule, the terms and conditions as to remuneration of any member of staff of a description prescribed for the purposes of that provision.

The Board is also required to have a Reconsideration Committee to reconsider reviewable matters cases and maladministration complaints.

In addition, the Board has established an Audit Committee and Remuneration Committee as the sub-committees of the Non-Executive Committee and Investment, Nomination and Decision Committees as Committees of the Board. Each Committee has a majority of Non-Executive Members. The terms of reference for these Committees can be accessed at **http://www.pensionprotectionfund.org.uk/About-Us/TheBoard/Pages/TheBoard.aspx** and their activities during the 2011/12 financial year are reported below.

Board procedures are governed by its Statement of Operating Principles and its decision making role by the Schedule of Delegations and matters reserved to the Board. The Board has delegated to the Chief Executive a wide power to take decisions to ensure operational effectiveness. The Executive reports to the Board through monthly reports on performance against strategic objectives, the Chief Executive's report and other briefings, as required. The data included in these reports is reviewed by the Executive Committee prior to circulation. Papers are circulated a week in advance of meetings and feedback on the quality and timeliness of the information provided is sought in the Board effectiveness evaluation.

The Chief Executive has established a number of internal committees and their roles and those of individual postholders are set out in guidelines entitled, 'Authorisations from the Chief Executive'.

Appendix 2 - Board's performance

The Board met on eight occasions in the 2011/12 financial year in addition to a Board training session.

The Board is chaired by Lady Judge CBE.

Board member details, committee memberships and attendance at Board and Committee meetings are set out below.

Chairman
Lady Judge CBE

Chief Executive
Alan Rubenstein

Executive Members
Martin Clarke
David Heslop

Non-Executive Members
Dick Barfield
Ann Berresford
John Bevington
Sir Anthony Holland
Christopher Hughes *(also Senior Independent Director of the Pension Protection Fund until December 2011)*
Arnold Wagner OBE *(also Senior Independent Director of the Pension Protection Fund from December 2011)*
Baroness Warwick of Undercliffe

All biographies are on the PPF website **www.pensionprotectionfund.org.uk/About-Us/TheBoard/Pages/BoardMembers.aspx**

The following Board member stood down during the year:
Christopher Hughes.

The following Board member was appointed in June 2012:
Sharmila Nebhrajani.

Attendance at Board and Committee meetings during 2011/12

	Board	Remuneration Committee	Audit Committee	Investment Committee	Reconsideration Committee	Nomination Committee	Decision Committee
Lady Judge CBE	8 of 8	2 of 3°	1 of 4°	n/a	n/a	2 of 2	1 of 1°
Dick Barfield	6 of 8	n/a	4 of 4	5 of 5	n/ a	n/a	n/a
Ann Berresford	7 of 8	n/a	4 of 4	3 of 5°	n/a	n/a	n/a
John Bevington	6 of 8	3 of 3	n/a	5 of 5	n/a	n/a	1 of 1
Martin Clarke	7 of 8	n/a	3 of 4°	5 of 5	n/a	n/a	n/a
David Heslop	7 of 8	n/a	3 of 4°	n/a	n/a	n/a	n/a
Sir Anthony Holland	7 of 8	3 of 3	n /a	n/a	12 of 12	n/a	n/a
Christopher Hughes *	4 of 5	n/a	3 of 3	n/a	8 of 12	n/a	n/a
Alan Rubenstein	8 of 8	3 of 3°	3 of 4°	4 of 5	n/a	n/a	1 of 1
Arnold Wagner OBE	7 of 8	3 of 3	n/a	n/a	n/a	2 of 2	1 of 1
Baroness Warwick of Undercliffe **	6 of 8	n/a	1 of 1	n/a	9 of 12	n/a	n/a

* Stepped down from Board December 2011

** Became a member of the Reconsideration Committee May 2011 and the Audit Committee December 2011

° Attended meetings as an observer

Andrew Carruthers and Christopher Hughes are co-opted members of the Reconsideration Committee and were invited to attend three and six meetings during the financial year respectively. Mike O'Brien is a co-opted Member of the Investment Committee and has attended three (out of a possible three) meetings during the financial year.

Board decisions

The Board approved a new levy framework for 2012/13 which aims to make the levy more predictable and stable for levy payers and introduces investment risk as a measure for the first time.

Board Members considered the longer-term needs of members as the number of members entering the PPF and those receiving FAS payments grows. The Board agreed a customer service strategy that focuses on a high standard of service and will incorporate an increased range of services and information that can be accessed on-line, where the member wishes to do so.

Board Members also approved the risk appetite statement and risk universe and consideration was given to the implications of the move from the Retail Prices Index to the Consumer Prices Index as the index against which PPF compensation is being increased and revalued.

In addition, a number of decisions that fall within the Board's normal cycle of work were taken, such as approving the Strategic Plan for 2012, (made up of the Management Plan 2012/13 – 2014/15 and Business Plan 2012/13), the Annual Report and Accounts 2010/11 and updated modelling assumptions for the Long-Term Risk Model. The Board also agreed a target levy collection of £550 million for 2012/13, the assumptions for setting the levy parameters and in December 2011, after consultation, the final levy Determination for 2012/13. Proposals for the assumptions to be used for the PPF valuation for 2012 were also approved.

The Board conducted an evaluation of Board performance through a questionnaire, followed by individual meetings of members with the Chairman. The balance, skills, experience and diversity of the Board was felt to be broadly appropriate. It was thought that the addition of a Board level Chief Financial Officer would enhance the balance of the Board and this appointment is underway.

Appendix 3 - Highlights of reports

Audit Committee

The Audit Committee is chaired by Ann Berresford. The Committee met on four occasions during the year. The agenda continued to be busy, including monitoring compliance with the Board's risk appetite and trialling a new approach to internal audit which incorporated two 'deep dive' internal audit reports on investment risks and compensation. 'Management deep dives' were presented on operational risks and controls in transition and levy invoicing.

As part of its normal cycle of work, the Committee reviewed the risk management policy, the whistleblowing policy and the Board's corporate governance arrangements. The Committee also approved the Annual Report and Accounts 2010/11, including the actuarial valuation, for recommendation to the Board.

The contract with BDO LLP, the PPF's internal auditors, was extended by a year.

Training was received on revisions to the statement on internal control and its replacement by a governance statement. Committee Members met separately with the internal and external auditors on three occasions.

Remuneration Committee

The Remuneration Committee is chaired by Arnold Wagner OBE[1]. The Committee met on three occasions during the year and

- was briefed on the staff pay remit for 2011/12
- agreed objectives for Executive Directors in 2011/12
- undertook yearly and half yearly performance reviews of Executive Directors and recommended bonus payments; and agreed contract renewal arrangements for the Chief Executive and Chief Operating Officer for recommendation to the Secretary of State.

Investment Committee

The Investment Committee is chaired by Dick Barfield. The Committee met on five occasions during the year and the Committee agreed a number of key proposals including further stages to the hedging strategy in order to reduce the swap spread risk. The Committee also agreed to set currency hedge ratios for each of the PPF's alternative asset classes and to increase the upper limit in Global Tactical Asset Allocation to allow greater flexibility in asset allocation.

The Committee approved the investment in direct real estate and senior loans using special purpose vehicles. Furthermore, the proposal to expand the range of alternative investments to include farmland and timberland was agreed.

The proposal to extend the permissible assets within the Statement of Investment Principles to include emerging market debt was also approved by the Committee.

As part of its normal cycle of work, the Committee:

- approved the continuation of the existing Fraud Compensation Fund investment strategy
- approved the continuation of the current framework for approving and overseeing fund managers
- considered four investment update reports
- considered four reports from the Investment Advisor
- received four reports summarising the activity of the Asset and Liability Committee
- reviewed four 'deep dive' reports, including transition risk, demographic risk, fund manager risk and systemic risk
- received two presentations on markets and strategy review
- received a report on responsible investment.

The Board approved Mike O'Brien as a co-opted member to the Investment Committee for a period of three years to ensure sufficient independent investment knowledge and experience on the Committee.

[1] Taking over from John Bevington as Chairman in June 2011

Decision Committee

The Decision Committee is chaired by John Bevington. The Committee met once during the year.

The Decision Committee takes decisions on matters which are normally delegated to the Chief Executive which he elects to refer back to the Committee as well as any specific cases assigned to it by the Board. This may be due to the particular circumstance of the issue where additional Board Member input is thought valuable or where it is judged necessary in the light of the possibility of future review or complaint.

Reconsideration Committee

The Reconsideration Committee is chaired by Sir Anthony Holland. The Committee met on 12 occasions during the year and considered, and issued decisions relating to, 27 cases where levy payers challenged their levy. The Committee found that the levy had been calculated incorrectly in eight of these cases.

The Committee also considered four non levy review cases relating to compensation payments and maladministration complaints.

Nomination Committee

The Nomination Committee met twice during the year. These meetings were chaired by Lady Judge CBE. The Nomination Committee recommended the appointment of Sharmila Nebdhrajani to the Board as a Non-Executive Member and she joined the Board on 27 June 2012.

Board appointments

The Secretary of State for Work and Pensions is responsible for appointing the Chairman of the PPF and as a ministerial appointment this is governed by the guidance set by the Office for the Commissioner of Public Appointments. All other Board appointments are made by the Board on the recommendation of the Nomination Committee; however the Secretary of State must approve the remuneration and terms and conditions for the Chief Executive and the remuneration for other Executive Board Members. The Secretary of State also determines the fee for Non-Executive Members.

The appointment of 'ordinary' members to the Board is governed by regulations under which the Board must include an independent member as part of its appointment panel.

Appendix 4 - Account of corporate governance

The Board is committed to adhering to high standards of corporate governance and annually reviews its compliance against the UK Corporate Governance Code and the HM Treasury / Cabinet Office Corporate Governance Code for central government departments. Formal reporting of compliance with the HM Treasury / Cabinet Office code on a comply or explain basis is a requirement and is set out in this statement.

The latest review of compliance with the HM Treasury / Cabinet Office code was considered by the Chairman, the Senior Independent Director and the Audit Committee in February 2012. To adapt to changed provisions in the code, the Board has included individual Board Member performance and assessment of training and development needs as part of the discussions between each Board Member and the Chairman following the annual Board performance evaluation. Changes to encourage Boardroom diversity have also been noted and factored into the Nomination Committee's appointment criteria. The Board meets the provisions of the code where they apply to the PPF.

The principal areas of compliance are met as follows:

Accountability

The Chairman and Chief Executive meet regularly with Ministers and Senior Officials from the Department of Work and Pensions in addition to quarterly accountability review meetings. The Department approves the Board's Strategic Plan and the Board delivers its Annual Report and Accounts to parliament through the Secretary of State.

The Chief Executive of the PPF is also its Accounting Officer. Compliance with Accounting Officer responsibilities are supported through the Board's risk management procedures and through a shared objective for senior management to support the Accounting Officer in fulfilling his responsibilities.

The Board and Board composition

The structure of the Board is underpinned by the framework set out in the Pensions Act 2004 as well as developing governance and operational requirements. Committees have been established to serve these needs. The composition of the Board is determined by the skills, experience and diversity needed to deliver the PPF's statutory functions and is supported by its members' financial, investment, legal, risk management, operational and member representation knowledge.

The Board focuses on strategic issues, supporting the PPF's performance against its strategic objectives, risk management and ensuring that these all support the long-term success of the organisation.

The Board recognises that effective behaviours and culture support organisational delivery and risk management. The Board operates in accordance with its Board Manual which identifies how meetings should be conducted and individual members also adhere to the code of conduct, guidance on dealing with potential conflicts of interest and expenses and hospitality.

Board effectiveness

The Board has an operational framework in place and has determined its behavioural values. The actual operation of this framework and these values as well as Board balance is reviewed through annual Board effectiveness evaluations. These evaluations are conducted internally with periodic facilitation by external consultants.

The Board has regulations in place for the appointment of 'ordinary' Board Members and both the Board and its Nomination Committee consider the current and future needs of the Board to focus the Board appointment process. New Board Members receive induction training and ongoing briefings are provided to support Non-Executive Members' understanding of the organisation's operations and key risks. Board and Committee papers are dispatched a week in advance and the Board is supported by a dedicated secretariat.

Risk management

The Board has set its risk appetite which it reviews at least annually. The Board is supported in its risk management role by its Audit Committee, its internal and external auditors and its Investment Committee. Regular reports are received from the Executive which has established a Risk Management Committee and an Asset and Liability Committee to ensure effective day-to-day oversight of organisational and financial risks. The Board maintains a gifts and hospitality register. Information on risks and risk management processes is provided in Appendix 5.

Appendix 5 – The risk and control environment

Our system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives. It can, therefore, only provide reasonable, and not absolute, assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Board of the PPF's policies, aims and objectives. This process is also designed to evaluate the likelihood of those risks being realised and their impact, should they be realised, and to manage them efficiently, effectively and economically.

The system of internal control has been in place in the Board of the PPF for the year ending 31 March 2012 and up to the date of signing of these accounts and accords with Treasury guidance.

Internal audit services are provided on an outsourced basis by BDO in accordance with Government Internal Audit Standards. Audits are undertaken in accordance with an internal audit plan approved by the Audit Committee.

The risk and control environment

The PPF's approach to risk management follows the guidelines provided by HM Treasury in their document entitled 'Orange Book: Management of Risk – Principles and Concepts.'

The Board has determined that the following list represents the most significant sources of risk to the achievement of its objectives:

- business strategy
- cultural
- funding and investment
- investment operations
- legal
- operational, and
- reputational.

The Board determines its risk appetite on an annual basis, which is then cascaded to risk owners within the PPF who report quarterly their adherence to this. The Board's risk appetite can be accessed by clicking on the following link:
http://www.pensionprotectionfund.org.uk/About-Us/Documents/Risk_Appetite_Statement.pdf

This is complemented by risk reviews at both a team and process level with identified risks and controls captured in risk registers and monitored regularly.

Risk processes are embedded throughout the organisation and individuals' responsibilities are communicated annually.

During 2011/12, a programme of change designed to enhance the capacity of the PPF to handle financial risks associated with the management of a growing and complex balance sheet was initiated. This has delivered a number of improvements including:

- A comprehensive set of financial risk policies which provide a full coverage of the financial risks of the PPF.
- Provision of daily risk / position data to the Investment team based on interim risk metrics.
- A reinforced financial risk management capability with the establishment of a risk practice function which will provide independent performance and risk measurement.
- A benchmarking exercise of the PPF financial risk management practices against industry best practice.
- An independent report on investment and risk monitoring data requirements.

We undertake 'deep dives' of particular risk types with risk owners at Board and Executive Committees to ensure that we are managing all the risks we face and that the controls we have in place are appropriate.

As an organisation that deals with a lot of data we take this very seriously and operate in accordance with the Security Policy Framework (SPF) and related Data Security guidance issued by HMG. To help achieve this, we have gained certification in the ISO27001 Information Security standard and implemented ongoing six monthly ISO27001 audits to make sure we maintain compliance with the standard.

Remuneration report

Remuneration and bonuses

Executive directors receive a fixed salary which is reviewed annually by the Remuneration Committee. Their contracts allow for the payment of an annual performance related bonus of up to 20 per cent of their base salary.

The Chairman was paid a fixed fee and was contracted to work for the PPF for two days a week. All other non-executive directors received a fixed fee, based on working 26 days a year. This salary was not performance-related and there was no provision for compensation if a contract was terminated.

Contracts

Executive directors are employed on a fixed term contract and non-executive directors are appointed for a fixed term of office.

Name	Contract type	Start date	End date
Lady Judge CBE	Term of office (first)	01 July 2010	30 June 2013
Alan Rubenstein	Fixed Term Contract (second)	01 July 2012	30 June 2015
Martin Clarke	Fixed Term Contract (second)	17 May 2010	16 May 2013
David Heslop	Fixed Term Contract (second)	01 July 2012	30 June 2015
John Bevington	Term of office (second)	19 October 2012	18 October 2015
Christopher Hughes	Term of office (second, extended by one year)	01 December 2007	30 November 2011
Dick Barfield	Term of office (second)	01 October 2012	30 September 2015
Ann Berresford	Term of office (second)	01 August 2010	31 July 2013
Sir Anthony Holland	Term of office (second)	01 August 2010	31 July 2013
Arnold Wagner OBE	Term of office (first)	04 January 2011	03 January 2014
Baroness Warwick of Undercliffe	Term of office (first)	07 March 2011	06 March 2014
Sharmila Nebhrajani	Term of office (first)	27 June 2012	26 June 2015

Notice periods

The Chief Executive, Executive Director of Financial Risk and the Chief Operating Officer have notice periods of six months. Non-executive directors' appointments can be terminated with one month's notice by either the Board or the individual member. The Chairman's appointment is subject to a six month notice period by either the Secretary of State for Work and Pensions or by the postholder. This can be waived by either party and the postholder can accept payment in lieu of notice.

Executive directors – outside appointments

We recognise the benefits to the individual, and to the organisation, of executive directors of the PPF serving as non-executive directors of other organisations and companies. These roles are undertaken outside of PPF working hours through a combination of paid and unpaid leave. Fees, where applicable, are retained by the executive director for current appointments. External non-executive appointments held by executive directors during the year were:
Martin Clarke, Congregational & General Insurance plc and the UK Sustainable Investment & Finance Association.

Pensions

Pension benefits are provided through the Civil Service pension arrangements. Further details can be found on the Civil Service website **http://www.civilservice.gov.uk/pensions/**.

Cash equivalent transfer values

This is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme.

CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

Salary and pension entitlements (subject to audit - see auditor's report pages 48 – 49)

	Salary (in bands of £5,000)				Pensions				
	Year ended 31 March 2012		Year ended 31 March 2011		Real increase in pension and related lump sum	Total accrued pension at pension age at 31/3/12	Cash Equivalent Transfer Value at 31/3/12	Cash Equivalent Transfer Value at 31/3/11	Real increase in CETV
	Salary £'000	Bonus £'000	Salary £'000	Bonus £'000	£'000	£'000	£'000	£'000	£'000
Lady Judge CBE Chairman	55-60	N/A	40-45	N/A	N/A[1]	N/A	N/A	N/A	N/A
Alan Rubenstein Chief Executive	195-200	40-45[2]	195-200	5-10[2]	2.5-5	10-15	146	94	44
Martin Clarke Director of Financial Risk	165-170	25-30[2]	165-170	5-10[2]	N/A[1]	N/A	N/A	N/A	N/A
David Heslop Chief Operating Officer	135-140	20-25[2]	135-140	5-10[2]	2.5-5	5-10	83	55	20
John Bevington Non-Executive member	15-20	N/A	15-20	N/A	N/A	N/A	N/A	N/A	N/A
Christopher Hughes Non-Executive member (until 30 November 2011)	10-15 (Full year equivalent: 15-20)	N/A	15-20	N/A	N/A	N/A	N/A	N/A	N/A
Dick Barfield Non-Executive member	15-20	N/A	15-20	N/A	N/A	N/A	N/A	N/A	N/A
Ann Berresford Non-Executive member	15-20	N/A	15-20	N/A	N/A	N/A	N/A	N/A	N/A
Sir Anthony Holland Non-Executive member	15-20	N/A	15-20	N/A	N/A	N/A	N/A	N/A	N/A
Arnold Wagner OBE Non-Executive member	15-20	N/A	0-5	N/A	N/A	N/A	N/A	N/A	N/A
Baroness Warwick of Undercliffe Non-Executive member	15-20	N/A	0-5	N/A	N/A	N/A	N/A	N/A	N/A

[1] Neither Lady Judge nor Martin Clarke were members of any employer sponsored pension arrangement during the year.
[2] The bonus values disclosed here relate to the Executive Directors' performance in the 2010/11 year (paid in 2011/12).

As at the date of publication of this report, no decision had been made on the award of bonuses based on 2011/12 performance.

In these circumstances, Cabinet Office guidance requires the disclosure of prior year awards. For consistency of comparison, the bonus values disclosed in the year ended 31 March 2011 relate where applicable to the Executive Directors' performance in 2009/10 (paid in 2010/11).

* Based on latest actuarial valuation

No directors received any non-cash benefits during the year.

Salary multiples

Reporting bodies are required to disclose the relationship between the remuneration of the highest-paid director in their organisation and the median remuneration of the organisation's workforce.

	2011-12	2010-11
Band of highest paid director's total remuneration	£240-245k	£210-215k
Median total remuneration	£44k	£42k
Ratio	**5.4**	**5.1**

The banded remuneration of the highest paid director in the organisation in the financial year 2011-12 was £240-245k (2010-11: £210-215k). This was 5.4 times (2010-11: 5.1 times) the median remuneration of the workforce, which was £44k (2010-11: £42k). The increase in the ratio is attributable to the bonus paid in 2011-12 relating to the 2010/11 year compared to that paid in 2010/11 relating to the 2009/10 year.

In 2011-12 and 2010-11 no employees received remuneration in excess of the highest paid director. Remuneration ranged from £17k to £240-245k (2010-11: £16k to £210-215k).

Alan Rubenstein
Accounting Officer
15 October 2012

Statement on going concern

In order to comply with the Government Financial Reporting Manual when preparing this annual report and accounts, we have to explain why we have adopted a 'going concern' basis for the organisation. An organisation deems itself a going concern if its management believe that the organisation will continue to operate and there is no intention, nor need, to close down its functions. After reviewing the three funds which we operate, cash flow forecasts and our powers to raise levies and control outgoings, we decided to adopt a going concern basis for the PPF as a whole because we believe we have enough resources to continue operating for the foreseeable future.

Pension Protection Fund

For the PPF, we considered the following factors when making this decision:

- our cash flow forecasts, which indicate that cash and other asset inflows will significantly exceed outflows for the foreseeable future, supported by:
- our levy raising powers – see (**http://www.pensionprotectionfund.org.uk/levy/aboutlevy/Pages/AbouttheLevy.aspx**) and
- our reserve powers on compensation levels – see (**http://www.pensionprotectionfund.org.uk/Pages/Compensation.aspx**)

Fraud Compensation Fund (FCF)

The volume of claims on the FCF remains at relatively low levels so we do not have enough statistics to forecast the level of future claims accurately. We therefore remain vulnerable to an unexpected rise in the volume of claims or unusually large or urgent claims.

However we have reviewed our powers and obligations and decided that the going concern basis remains appropriate for the FCF for the following reasons:

- none of the claims which the FCF has received and which it will probably have to pay out on are from schemes that have immediate cash flow requirements
- claims take some time to investigate and validate, which gives us time to plan how we will settle them
- in addition, we have powers to settle claims in instalments in order to ease any strain on the Fund's cash flow
- during the year, the Board maintained its funding strategy for the FCF which is to build up a small surplus in the Fund over a number of years by raising a fair and proportionate levy.

Administration Fund

In considering the going concern status of the Administration Fund, we took into account the status of the Board as an independent statutory corporation, while also recognising that the Board receives funding from its sponsor department, the Department for Work and Pensions (DWP), in the form of grant-in-aid, to cover all of its expenditure on its functions as FAS scheme manager, and its expenditure on certain PPF administration functions. We also considered the regulations under which DWP finances its payments to the Board on grant-in-aid for PPF administration functions by raising a PPF Administration Levy from eligible pension schemes.

We decided that the going concern basis for the Administration Fund remains appropriate because of the robust financial procedures governing:

- The setting of operating budgets, including administration budgets which inform the setting by DWP of the rates of the PPF Administration Levy
- In-year reviews and forecasts of administration expenditure
- Controls over applying for grant-in-aid from DWP, and
- The segregation of levy payer-funded PPF activities and government-funded FAS-related activities.

Audit disclosures

I confirm that I have taken all appropriate steps to make myself aware of any relevant audit information and made sure that the Board's auditors are aware of that information. As far as I am aware, there is no information that the Board's auditors are unaware of. I also confirm that no remuneration for any work other than the statutory audit has been paid to the auditors.

Alan Rubenstein
Accounting Officer
15 October 2012

The certificate and report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the Board of the Pension Protection Fund for the year ended 31 March 2012 under the Pensions Act 2004. These financial statements comprise the Consolidated Statements of Comprehensive Net Income, Financial Position, Cash Flows, Changes in Reserves and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Board of the Pension Protection Fund, the Chief Executive and Auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities the Board of the Pension Protection Fund and the Chief Executive, as the Accounting Officer, are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Pensions Act 2004. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Board of the Pension Protection Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Board of the Pension Protection Fund; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Board of the Pension Protection Fund's affairs as at 31 March 2012 and of the group's net income for the year then ended; and
- the financial statements have been properly prepared in accordance with the Pensions Act 2004 and the Secretary of State's directions issued thereunder.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Secretary of State's directions issued under the Pensions Act 2004; and
- the information given in the 'Who we are' and the 'Financial and performance highlights' sections of the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception:

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the remuneration report to be audited are not in agreement with the accounting records or returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1 9SP

17 October 2012

CONSOLIDATED STATEMENT OF COMPREHENSIVE NET INCOME

For the year ended 31 March 2012

	Notes	2012 £m	2011 £m Reclassified
Operating income			
Income from levies	1	604.8	690.6
Total operating income		**604.8**	**690.6**
Operating expenses	2		
Staff costs		(16.8)	(17.2)
Other costs		(23.0)	(42.1)
Total operating expenses		**(39.8)**	**(59.3)**
Net operating surplus		**565.0**	**631.3**
Investment activities			
Investment income	3	283.9	146.3
Change in fair value of investments	4	1,456.3	258.6
Investment expenses	5	(53.3)	(25.9)
Net investment return		**1,686.9**	**379.0**
Claims activities			
Losses on actuarial liabilities	6	(914.8)	(138.9)
Current year claims for compensation	7	(471.0)	(489.7)
Revaluation of prior year claims for compensation	8	(496.2)	(127.0)
Net cost of claims		**(1,882.0)**	**(755.6)**
Comprehensive net income for the year		**369.9**	**254.7**

The Board has no comprehensive income or expenditure other than the comprehensive net income disclosed above.

The accounting policies and notes on pages 54 - 87 form part of these financial statements.

The components of the net cost of claims in 2010/11 have been reclassified to reflect the revised presentation of movements in the provisions for the cost of equalising compensation – see accounting policies.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 March 2012

	Notes	2012 £m	2011 £m Reclassified
Assets			
Operational cash		42.6	107.8
Investment assets	9	17,135.9	8,884.1
Levy receivables		42.7	88.9
Transfer-in receivables		29.9	66.5
Other current assets		19.1	2.7
Property, plant and equipment	10	0.7	1.1
Intangible assets	10	0.1	0.5
Total assets		**17,271.0**	**9,151.6**
Liabilities			
Investment liabilities	9	(6,080.9)	(2,528.1)
Other current liabilities		(43.0)	(16.3)
Actuarial liabilities	11	(8,373.3)	(4,076.1)
Claims provisions	12	(1,709.2)	(1,859.2)
Total liabilities		**(16,206.4)**	**(8,479.7)**
Total assets less total liabilities		**1,064.6**	**671.9**
Represented by			
Total tax payer funds	21	(1.0)	(0.5)
Total levy payer funds	21	1,065.6	672.4
Total levy and tax payer funds		**1,064.6**	**671.9**

The Statement of Financial Position has been changed to present assets and liabilities in liquidity order, and to reclassify assets and liabilities related to repurchase agreements. The provisions for the cost of equalising compensation have also been reclassified between actuarial liabilities and claims provisions to reflect the revised presentation of the provisions for the cost of equalising compensation – see accounting policies.

The accounting policies and notes on pages 54 - 87 form part of these financial statements.

The Board of the Pension Protection Fund approved these accounts on 24 September 2012 and authorised the Accounting Officer to sign this Consolidated Statement of Financial Position.

Alan Rubenstein
Accounting Officer
15 October 2012

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 March 2012

	2012 £m	2011 £m Reclassified
Cash flows from operating activities		
Operating surplus	565.0	631.3
Compensation payments	(203.1)	(119.5)
Assets from schemes transferring into the PPF receivable as cash	321.8	288.3
Items reported in "Investment return" but settled through operating bank accounts	(21.5)	(10.8)
Purchase of intangible assets	-	(0.3)
Purchase of property, plant and equipment	(0.3)	(0.2)
Depreciation and impairment charges	1.0	1.3
Movement in current liabilities	26.7	5.9
Movement in receivables	66.4	(2.5)
Net cash inflow from operating activities	**756.0**	**793.5**
Cash flows to investing activities		
Cash transfers to investment managers	(1,471.8)	(993.1)
Cash transfers from investment managers	627.8	171.8
Net cash outflow to investing activities	**(844.0)**	**(821.3)**
Cash flows from financing activities		
Financing from DWP for PPF activities (levy payer funded)	15.3	22.7
Financing from DWP for FAS activities (tax payer funded)	7.5	10.8
Net cash inflow from financing activities	**22.8**	**33.5**
Net increase/(decrease) in cash and cash equivalents in the year	**(65.2)**	**5.7**
Cash and cash equivalents at beginning of the year	**107.8**	**102.1**
Cash and cash equivalents at end of the year	**42.6**	**107.8**

The Statement of Cash Flows for the prior year has been reclassified to reflect only those cash flows under the Board's direct operational control, and to exclude cash flows managed by the Board's appointed investment managers.

The accounting policies and notes on pages 54 - 87 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESERVES

For the year ended 31 March 2012

	General reserves £m	Other reserve £m	Total reserves £m
Balance at 31 March 2010	**380.8**	**2.9**	**383.7**
consisting of:			
Tax payer funds	(1.3)	-	(1.3)
Levy payer funds	382.1	2.9	385.0
Result for 2010-11			
Tax payer funds	(10.0)	-	(10.0)
Levy payer funds	264.7	-	264.7
Total recognised net income	**254.7**	**-**	**254.7**
FAS grant in aid received in the year	10.8	-	10.8
PPF grant in aid received in the year	22.7	-	22.7
Balance at 31 March 2011	**669.0**	**2.9**	**671.9**
consisting of:			
Tax payer funds	(0.5)	-	(0.5)
Levy payer funds	669.5	2.9	672.4
Result for 2011-12			
Tax payer funds	(8.0)	-	(8.0)
Levy payer funds	377.9	-	377.9
Total recognised net income	**369.9**	**-**	**369.9**
FAS grant in aid received in the year	7.5	-	7.5
PPF grant in aid received in the year	15.3	-	15.3
Balance at 31 March 2012	**1,061.7**	**2.9**	**1,064.6**
consisting of:			
Tax payer funds	(1.0)	-	(1.0)
Levy payer funds	1,062.7	2.9	1,065.6

The 'other reserve' figure of £2.9m in the Fraud Compensation Fund represents the net assets of the Pensions Compensation Board, the predecessor body to the Fraud Compensation Fund. The Pensions Compensation Board was dissolved under the Pensions Act 2004, and its residual assets, valued at fair value as at 5 April 2005, have been brought into the Fraud Compensation Fund under the operation of merger accounting.

The accounting policies and notes on pages 54 - 87 form part of these financial statements.

Statement of accounting policies

The Board of the Pension Protection Fund (the Board) is a statutory corporation incorporated on 6 April 2005 under the Pensions Act 2004. The Act requires the Board to hold and apply statutory funds which constitute the three broad streams in which the financial activities of the Board are accounted for:

- the Pension Protection Fund itself
- the Fraud Compensation Fund
- the Administration Funds

The Pension Protection Fund holds substantially all the Board's assets and liabilities, receives protection levy income, and incurs much of the Board's costs. Its assets arise from levy income collected, the investment return and assets transferred from schemes for which the Pension Protection Fund has assumed responsibility. The Pension Protection Fund's principal reported liabilities are the liabilities to pension scheme members for whom it has assumed responsibility and a provision for the total estimated value of the deficits of schemes where eventual entry to the Pension Protection Fund is judged probable.

The Fraud Compensation Fund receives fraud compensation levies and holds a fund to compensate schemes which have suffered loss due to acts of dishonesty.

The Administration Funds record most of the Board's administrative expense and the related funding, including those associated with the Board's functions as Manager of the Financial Assistance Scheme.

1) Basis of preparation

These Accounts have been prepared in accordance with the Accounts Direction dated 18 February 2010 given to the Board by the Secretary of State for the Department for Work and Pensions, with the approval of the Treasury, in accordance with the Pensions Act 2004 (Schedule 5, Part 4, Paragraph 22 (2) (b)). It requires the Board to prepare accounts in accordance with the 2011-12 Government Financial Reporting Manual (FReM). The FReM requires accounts to follow, as far as appropriate, private sector practice based on International Financial Reporting Standards (IFRS).

It is not expected that adoption of Standards (including Interpretations of Standards) which are in issue but not yet effective will have a material impact on the Board's financial statements, with the exception of IFRS 9 *Financial Instruments: Classification and Measurement*, due to become effective 1 January 2013. IFRS 9 replaces the current classifications of financial assets currently within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (see Accounting Policy Note 11) with two categories, namely those measured at fair value and those measured at amortised cost.

Following a review of its financial statements as described in paragraph 41 of IAS1 *Presentation of Financial Statements,* and in line with the practice of many financial institutions and central government funds, the Board has presented its Statement of Financial Position on a liquidity basis, rather than categorising assets and liabilities into 'current' and 'non-current'. Assets sold under repurchase agreements and the related financial liabilities have been reclassified as part of this process.

These Accounts have been prepared on a going concern basis and income and expenditure are accounted for on an accruals basis.

The principal accounting policies adopted by the Board are summarised below.

2) Consolidated and separate financial statements

The Board manages exposure within its investment portfolio to certain alternative asset classes by creating special purpose entities. As at 31 March 2012, the Board had created one such special purpose entity, and in compliance with IAS 27 *Separate Financial Statements*, the Board treats this entity as a subsidiary company. It is the Board's policy that this entity be stated in the Board's statement of financial position at fair value, based on the values of the investments held by the entity. In the consolidated statement of financial position the investments owned by the entity are included in financial assets carried at fair value through profit and loss. Gains, income and expenses related to the investments held within this entity are consolidated on a line-by-line basis in the consolidated statement of comprehensive net income. The notes to the financial statements include a statement of financial position on a non-consolidated basis, treating the value of this entity as an investment in a subsidiary company.

3) Segmental reporting

The Board was created by the Pensions Act 2004 and this Act specifies that the Board must hold, manage and apply two ring fenced funds. Additionally, as a statutory corporate body, the board is responsible for the management and control of its administration functions funded by grant in aid from DWP. To comply with IFRS 8 *Operating Segments* notes to the accounts show the financial transactions and balances of the following three separate streams of activity:

- Pension Protection Fund
- Fraud Compensation Fund, and
- Administration Funds.

4) Income recognition

Income from levies

Protection levy and fraud compensation levy income is recognised on an accruals basis.

The Board adopts IAS 18 *Revenue Recognition* in recognising levy income, based on its assessment of the eligibility of individual schemes to qualify for protection or compensation, and their consequent obligation to pay the relevant levy.

Investment return

Investment return is defined as the net total of:

- Investment income earned on invested assets, including interest and dividends;
- Net gains from financial assets designated at fair value;
- Investment related expenses such as direct fund management fees, custody charges and trading expenses.

Investment income is accounted for on an accruals basis, that is:

- Interest income arising from cash deposits, fixed interest securities and similar investments is accounted for using the effective interest rate
- Dividends and distributions are accounted for when the dividend or distribution is declared.

Net gains from financial assets designated at fair value include:

- gains and losses realised on the disposal of investments;
- unrealised gains and losses on investments held at the accounting date, that is, the difference between acquisition cost and current fair value;
- gains and losses arising on the translation of investments (including cash, payables and receivables) denominated in foreign currencies into sterling.

Investment related expenses are accounted for on an accruals basis. The Pension Protection Fund (Prescribed Payments and Investment Costs – Amendment) Regulations 2011 (SI 2011/671) define the investment related expenses which the Board is permitted to charge to the Protection Fund.

5) Grant-in-aid

Grant-in-aid from the Department for Work and Pensions is used to finance the administration activities of the Board. These receipts are not treated as income, but as required by the FReM, are treated as financing and credited to the General Reserve because they are regarded as contributions from a controlling party.

6) Leases

The Board's policy is to treat the Memoranda of Terms of Occupancy (MOTOs) with DWP, under which it occupies the premises used by the Board and its staff, as operating leases as defined in IAS 17 *Leases*. Payments under these MOTOs are charged to the Statement of Comprehensive Net Income on the basis of amounts payable in the year.

The Board has no other operating leases and no finance leases.

7) Property, plant and equipment

In accordance with IAS 16 *Property, Plant and Equipment,* the Board recognises the following assets:

- Information technology hardware
- Plant and machinery
- Furniture and fittings

These items are capitalised if the cost of purchase either as a single item or as a group of related items bought for a common purpose exceeds £1,000. Items below this value are written off in the year of purchase.

8) Intangible assets

In accordance with IAS 38 *Intangible Assets,* the Board capitalises the following as intangible assets:

- The costs of purchasing major software licences
- The costs of major software and software development and enhancement are capitalised as intangible assets, where it is considered that the resulting software has an extended useful life. Ongoing software maintenance costs are written off in the year they occurred.

9) Depreciation

Depreciation is provided on property, plant and equipment and all intangible assets at rates calculated to write down the cost or valuation (less any estimated residual value) of each asset evenly over its expected useful life as follows:

- Information technology equipment 3 years
- Major software licences 3 years
- Software & software development 3 years
- Leasehold improvements 5 years

The Board also holds assets as Payments on Account and Assets under Construction, representing payments made and assets purchased as part of larger capital projects. Depreciation is charged on these assets only when the project is complete and the assets brought fully into use.

10) Impairment

The Board reviews levy receivables throughout the year and where the Board considers that to pursue outstanding unpaid pension protection levy amounts is no longer possible or cost effective, the levy debt is written off. At the year end, the Board reviews levy receivables outstanding, and sets up provisions for amounts it considers may be written off. In accordance with IAS 18 *Revenue Recognition*, the movement on this provision is disclosed as an expense.

The Board also reviews levy receivables at the year end in the context of the Board's experience of levy payers lodging appeals requesting corrections and waivers of their levy invoice. The Board sets up provisions for amounts it considers may be credited, in full or in part, following resolution of levy payers' appeals. It is the Board's policy that these provisions are accounted for as adjustments to levy income.

11) Financial Instruments

Recognition and derecognition

Financial assets and liabilities are recognised when the Board becomes party to the contracts that give rise to them, for example, on the trade date for investment purchases.

Financial assets are derecognised when the right to receive cash flows has expired or the Board has transferred substantially all the risks and rewards of ownership or control of the asset. Financial liabilities are derecognised when the obligation to deliver cash or another financial asset is discharged, cancelled or expires.

Repurchase agreements and similar arrangements

Securities sold subject to repurchase agreements remain on the Statement of Financial Position and a liability is recorded for the consideration received. Securities lent remain on the Statement of Financial Position.

Classification

Financial instruments are classified under the following categories which are determined at initial recognition:

- Financial assets/liabilities at fair value through profit or loss, separated by:
  (a) those designated at fair value through profit or loss upon initial recognition and
  (b) those classified as held for trading
- Loans and receivables
- Held-to-maturity investments
- Available-for-sale financial assets, and
- Financial liabilities measured at amortised cost.

The Board does not currently hold any financial instruments classified as 'held to maturity investments' or 'available for sale financial assets'.

Derivative instruments, which mainly relate to the operation of the Board's liability driven investment policy, are classified as held for trading in accordance with IAS 39. Derivative contracts mainly comprise interest rate swaps, inflation rate swaps, options, credit default swaps and forward foreign exchange contracts.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, principally cash and loans to banks.

Valuation

Financial instruments are valued by the Board at fair value, which is defined as follows:

- Quoted securities and other exchange-traded assets, including derivative contracts, are valued at closing prices at the end of the reporting period, which may be defined as bid price or last traded price depending on the convention of the stock exchange or other market on which they are quoted
- Derivative contracts which are not exchange-traded (often referred to as over-the counter contracts) are valued at prices calculated by the fund managers, using valuation methodologies based on market sources as described in note 18
- Pooled investment vehicles are valued at closing bid prices or, if single-priced, at the closing single price
- All other assets for which a recognised investment exchange does not exist are valued at a fair value estimated by the appointed custodian, fund manager or other appropriately qualified professional adviser, and approved by the Board.

12) Foreign currency translation

Transactions denominated in foreign currency are recorded at the exchange rates prevailing on the dates of the transactions. All assets and liabilities denominated in foreign currencies are translated into sterling at the rates prevailing at the year end. Exchange differences arising on settlement and on retranslation are recognised in change in fair value. Forward foreign exchange contracts are valued at rates prevailing at the year end.

13) Tax

By virtue of the Pension Protection Fund (Tax) Regulations 2006, SI 2006/575, the Board is treated in the same way as UK registered pension schemes. Income from which recoverable withholding tax has been deducted is recorded gross, and the tax recoverable is included in receivables. Where tax withheld cannot be recovered, income is recorded net. The Board does not have to pay tax on its surplus or gains.

Value added tax is normally irrecoverable and is recognised as part of the expenditure to which it relates.

14) Actuarial liabilities

The Board recognises the full value of the liabilities of the Pension Protection Fund disclosed in the annual actuarial valuation of the Pension Protection Fund. This represents the present value, as at the end of the reporting period, of the liability to pay compensation to the members, both deferred and retired, of all pension schemes for which the Board has assumed responsibility, valued on the assumptions set out in the actuary's report. It also includes an allowance for all categories of operating expenses permitted by various regulations to be charged against the Protection Fund.

It also includes a provision for the cost of equalising compensation that is unequal on account of inequalities in Guaranteed Minimum Pensions (GMPs) accrued between 17 May1990 and 5 April 1997 on the liabilities of schemes that have transferred to the PPF. The inclusion of the provision for the cost of equalising compensation on the liabilities of schemes that have transferred to the PPF represents a change of presentation from prior years, as this provision was previously included as a component of claims provisions.

The value is impacted by changes in actuarial assumptions, discount rates and other relevant factors, including the payment of benefits during the period.

15) Claims provisions and contingent liabilities for claims

For the Pension Protection Fund, in complying with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* the Board considers all eligible pension schemes whose sponsoring employers have experienced a qualifying insolvency event before the end of the accounting period. Where eventual entry of the scheme into the Protection Fund is judged probable, the Board recognises a provision; and where eventual entry into the Protection Fund is judged possible, the Board discloses a contingent liability.

In all cases, the provision or contingent liability is valued at the net deficit impacting the Protection Fund, that is:

- scheme liabilities valued at protected benefit levels, including an allowance for all categories of operating expenses permitted by various regulations to be charged against the Protection Fund, and including a provision for the cost of equalising compensation that is unequal on account of inequalities in Guaranteed Minimum Pensions (GMPs) accrued between 17 May1990 and 5 April 1997 on the liabilities of schemes forming the provisions or contingent liabilities
- net of assets under the trustees' control, including asset recoveries from insolvent employers.

Within the Fraud Compensation Fund, the Board recognises provisions for claims where it judges that it is probable that the claim will be validated, that is, that an eligible pension scheme has suffered a loss due to an act of dishonesty. Where the Board judges that validation of the claim is possible (ie that the likelihood is greater than remote but lower than probable) a contingent liability will be disclosed.

16) Impact of the Board assuming responsibility for schemes

Schemes may exit the PPF Assessment process through the Board issuing a Transfer Notice under section 160 of the Pensions Act 2004. This Notice has the effect of the Board assuming responsibility for the scheme, so that all the property, rights and liabilities of the scheme are transferred to the Board. The following accounting policies apply to this transfer of assets and liabilities:

- The scheme's net financial assets are transferred to the Board at fair value as at the effective date of the Transfer Notice.
- Actuarial liabilities are transferred to the Board as at the effective date of the Transfer Notice and are valued using the same policies set out in Accounting Policy Note 14 which apply to the Board's existing actuarial liabilities.
- Where the net deficit of a transferring-in scheme has been provided for at the end of the previous reporting period, changes in the value of the deficit due to changes in the value of the scheme's assets and liabilities from the previous accounting date up to the effective date of the Transfer Notice are accounted for as 'revaluation of prior year claims'.

17) Significant estimates and judgements

The preparation of financial statements requires management to make estimates and assumptions. Actual results could differ from estimates. Information about these judgements and estimates is contained in the relevant accounting policies and notes to the accounts, and the key areas of estimation uncertainty are highlighted below:

Cost of claims, claims provisions and contingent liabilities: the calculation of the costs of claims on both the Protection Fund and the Fraud Compensation Fund relies on the use of actuarial assumptions for the valuation of scheme liabilities. It also relies on techniques such as rolling forward asset values as at a prior date to the Board's accounting date using investment indices. For the Protection Fund, these estimation techniques are described in detail in the Actuary's Supplementary Report included in this Annual Report and Accounts. These assumptions and techniques introduce estimation uncertainty in that the actual value of scheme assets and liabilities at the Board's accounting date may differ from the values estimated and used to calculate provisions and contingent liabilities.

Actuarial liabilities, and gains or losses on actuarial liabilities: the calculation of the actuarial liabilities of the Protection Fund relies on the use of actuarial assumptions about a number of financial and demographic factors. These assumptions are set out in Annex M2 of the Actuarial Valuation included in this Annual Report and Accounts. These assumptions introduce estimation uncertainty in that the Fund's actual experience of these financial and demographic factors may differ from the assumptions used to calculate the actuarial liabilities.

Techniques for valuing financial instruments for which there is not an active market: the Board holds financial instruments for which markets are not active, and for which the fair value is determined using valuation techniques. The choice of valuation technique appropriate to the type of financial instrument, and the choice of inputs to the valuation methodology (whether based on observable market data or not) are both matters of judgment and involve the use of estimates. In general these financial instruments are valued by the Board's appointed fund managers or other appropriately qualified professional adviser, and where possible, the resulting valuations are verified by the Board's custodian. The Board recognises that the actual experience of values eventually realised from these financial instruments may differ from the estimated values disclosed in these accounts.

Note 1 Income from levies

Protection levies are chargeable to eligible pension schemes incorporating risk-based factors (principally scheme underfunding and employer insolvency risks) and scheme-based factors (principally the value of scheme liabilities).

		2012 £m	2011 £m
Risk-based levies in respect of the current year		489.0	540.8
Scheme-based levies in respect of the current year		118.3	141.8
Total protection levies in respect of the current year		**607.3**	**682.6**
Risk-based levies in respect of prior years		(9.0)	4.0
Scheme-based levies in respect of prior years		2.8	0.5
Total protection levies in respect of prior years	i	**(6.2)**	**4.5**
Income from protection levies		**601.1**	**687.1**
Income from fraud compensation levy	ii	**3.7**	**3.5**
Total income from levies		**604.8**	**690.6**

i) Income from protection levies in respect of prior years includes the value of credit notes issued during in 2011/12 following the conclusion of appeals by levy payers resulting in reductions in their protection levy bills. It also includes the movement in provisions for possible future credit notes where invoices outstanding at year end are subject to appeals by levy payers.

ii) The Board raised a Fraud Compensation Levy again in 2011/12, at the rate of 25p per eligible pension scheme member. The levy is collected by the Pensions Regulator on the Board's behalf.

Note 2 Operating expenses

The Pension Protection Fund (Prescribed Payments and Investment Costs – Amendment) Regulations 2011 came into force on 1 April 2011. These Regulations require the Board to charge to the Pension Protection Fund all sums required to meet investment costs, costs in relation to insolvency and costs which are supplementary to the Board's investment and insolvency functions.

Existing regulations, The Pension Protection Fund (Prescribed Payments) Regulations 2008 (SI 2008/664), require the Board to charge to the Protection Fund any sums required to meet the costs of creating and maintaining records of members entitled to PPF compensation, running payrolls to pay compensation and verifying data for the purposes of creating and maintaining data and running payrolls.

The 2011 regulations extend to the 2008 regulations the requirement to charge to the Protection Fund all costs which are supplementary to the main function of member data management and running compensation payrolls.

The notes in this section show, in relation to both employee benefits and other operating expenses, the impact of complying with these regulations and charging the specified types of expense to the Protection Fund in 2011/12, compared with charging those costs to the PPF Administration Fund in 2010/11.

All operating expenses which do not fall into the categories required by these regulations to be charged to the Pension Protection Fund are charged, as appropriate, to the PPF Administration Fund or the FAS Administration Fund.

Staff costs

	Pension Protection Fund £m	PPF Administration Fund £m	FAS Administration Fund £m	2012 £m
Wages and salaries	2.2	6.6	2.2	11.0
Social security costs	0.2	0.6	0.2	1.0
Other pension costs	0.5	1.3	0.4	2.2
Contractors and secondees	0.1	1.9	0.6	2.6
Total staff costs	**3.0**	**10.4**	**3.4**	**16.8**

	Pension Protection Fund £m	PPF Administration Fund £m	FAS Administration Fund £m	2011 £m
Wages and salaries	-	8.6	2.2	10.8
Social security costs	-	0.8	0.2	1.0
Other pension costs	-	1.5	0.4	1.9
Contractors and secondees	-	1.6	1.8	3.4
Termination benefits	-	0.1	-	0.1
Total staff costs	**-**	**12.6**	**4.6**	**17.2**

Included in wages and salaries above is the movement in the accrual for compensated absences.

Details of the remuneration of members of the Board of the Pension Protection Fund are given in the Remuneration Report. The employee benefits reported include the costs of all Board members.

The average number of staff employed, including secondment and temporary staff, was:

	2012 £m	2011 £m
Permanent employees	194	219
Short term contract, seconded and temporary staff	49	20
FAS Operating Unit staff	13	52
Total	**256**	**291**

The average number of staff employed includes FAS Operating Unit staff employed by DWP and seconded to the Board from July 2009. This arrangement with DWP ended in July 2011, and the 4 months' secondment of an average of 39 staff has been averaged across the whole year.

Reporting of Civil Service and other compensation schemes - exit packages

Comparative data is shown (in brackets) for 2010-11

Exit package cost band	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band
£25,000-£50,000	1 (0)	-	1 (0)
£50,000-£100,000	0 (1)	-	0 (1)
Total number of exit packages	1 (1)	-	1 (1)
Total cost/£	**£29,087** (£85,549)	**-**	**£29,087** (£85,549)

Pensions

Employees of the Board of the Pension Protection Fund are eligible for membership of the Principal Civil Service Pension Scheme (PCSPS) and can opt to join the defined benefit section, or to contribute to a stakeholder (defined contribution) arrangement. The PCSPS is an unfunded multi-employer defined benefit salary related scheme but the Board is unable to identify its share of the underlying assets and liabilities. Defined benefit contributions are therefore accounted for by the Board as if they were contributions to a defined contribution scheme. A full actuarial valuation of PCSPS was carried out as at 31 March 2010 and details can be found in the Cabinet Office: Civil Superannuation Resource Accounts **(www.civilservice-pensions.gov.uk).**

During the year to 31 March 2012, employer contributions of £2.1 million (year to 31 March 2011: £1.9 million) were payable to the defined benefit section of the PCSPS at one of four rates in the range 17.1 per cent to 25.5 per cent (year to 31 March 2011: same range). The scheme's actuary reviews employer contributions every four years following a full scheme valuation. These contribution rates reflect the benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees of the Board can opt to open a partnership pension account, which is a stakeholder pension with an employer contribution. Employer contributions of £0.1 million (year to 31 March 2011: £0.1 million) were paid to one or more of a panel of three appointed stakeholder pension providers. Employer contributions were age-related and range from three per cent to 12.5 per cent of pensionable pay, and employers also match employee contributions up to three per cent of pensionable pay.

In addition, employer contributions were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

At 31 March 2012, pension contributions in respect of the month of March 2012 totalling £169,000 were outstanding, and were paid over to PCSPS in April 2012 in accordance with legislative requirements.

Other operating expenses

		Pension Protection Fund £m	PPF Administration Fund £m	FAS Administration Fund £m	2012 £m
Member administration costs		1.2	-	1.5	2.7
Movement in provision for levy waivers and appeals	i	4.5	-	-	4.5
Write off of receivables	i	0.3	-	-	0.3
Staff related and recruitment		0.1	0.8	0.1	1.0
Advisory and other professional services		5.8	2.0	1.6	9.4
Statutory audit costs	ii	-	0.1	-	0.1
Accommodation and general office		-	1.3	0.7	2.0
IT and telephony		0.4	1.1	0.4	1.9
Depreciation and amortisation charges		-	0.8	0.3	1.1
Total other operating expenses		**12.3**	**6.1**	**4.6**	**23.0**

		Pension Protection Fund £m	Fraud Compensation Fund £m	PPF Administration Fund £m	FAS Administration Fund £m	2011 £m Reclassified
Member administration costs		2.3	-	-	0.8	3.1
Movement in provision for levy waivers and appeals	i	22.7	-	-	-	22.7
Write off of receivables	i	2.4	0.5	-	-	2.9
Staff related and recruitment		-	-	0.8	0.2	1.0
Advisory and other professional services		-	-	4.0	2.2	6.2
Statutory audit costs	ii	-	-	0.1	-	0.1
Accommodation and general office		0.1	-	1.5	1.1	2.7
IT and telephony		-	-	1.4	0.7	2.1
Depreciation and amortisation charges		-	-	0.9	0.4	1.3
Total other operating expenses		**27.5**	**0.5**	**8.7**	**5.4**	**42.1**

Other operating expenses have been reclassified to allow analysis of member administration costs.

i) The write-off costs disclosed here represent the value of levy receivables where the Board considers pursuing unpaid protection levy amounts is no longer possible or cost effective. It also includes the movement on the provision set up the Board against levy debtors outstanding at year end where the Board considers it likely that debts will be written off in future.

ii) Statutory audit costs totalled £130,000 for 2011/12 (£130,000 for 2010/11).

Note 3 Net investment income

	2012 £m	2011 £m Reclassified
Financial assets designated at fair value through profit and loss		
Debt instruments	294.1	128.7
Equity	12.1	11.4
Property	15.5	13.0
Income from annuity policies	12.0	8.3
Total	**333.7**	**161.4**
Financial assets not designated at fair value through profit and loss		
Deposit interest	0.6	0.3
Other investment expense	(50.4)	(15.4)
Total	**(49.8)**	**(15.1)**
Total investment income	**283.9**	**146.3**

Other investment expense includes both interest receipts and interest payments arising from derivative transactions.

Note 4 Change in fair value of investments

	2012 £m	2011 £m Reclassified
Financial assets designated at fair value through profit and loss		
Debt instruments	994.8	(82.9)
Equity	35.0	46.1
Managed funds	37.4	37.4
Insurance policies	8.1	(1.5)
Property	18.2	20.0
Private equity	31.1	52.9
Infrastructure	0.3	-
Foreign exchange contracts	67.0	31.2
Net gain from financial assets designated at fair value through profit and loss	**1,191.9**	**103.2**
Held for trading Derivative financial instruments	**258.2**	**51.3**
Loans and receivables Other investment assets	**6.2**	**104.1**
Total change in fair value of investments	**1,456.3**	**258.6**

Note 5 Investment expenses

Investment expenses consist of fund management fees, custody charges and transaction costs charged to the Protection Fund, as permitted by the Pension Protection Fund (Prescribed Payments and Investment Costs - Amendment) Regulations 2011.

	2012 £m	2011 £m
Fund management fees	47.8	19.5
Custody charges	0.7	0.6
Transaction costs	4.8	5.8
Total investment expenses	**53.3**	**25.9**

Fund management fees include, where required under investment management agreements, performance related fees where fund managers are awarded bonuses for producing investment returns in excess of agreed thresholds.

Note 6 Loss on actuarial liabilities

The loss on actuarial liabilities in the Pension Protection Fund represents the increase in value of those liabilities over the reporting period.

A detailed analysis attributing this change in value to a variety of financial and demographic factors can be found in Annex M2 to the accompanying Actuarial Valuation report.

Note 7 Current year claims for compensation

Pension Protection Fund

The claims value recognised consists of the aggregate value as at 31 March 2012 of provisions for 100 new schemes (or individual sections of schemes) (2011: 142 schemes) where eventual entry into the Protection Fund is considered probable, and where reliable estimates can be made of the impact on the Protection Fund. Also included are claims in respect of a further 16 schemes (2011: 7 schemes) which, although already in assessment in the prior year, were not provided for at 31 March 2011 because the schemes were then estimated to be in surplus at their assessment dates. Based on further information received during the year, the Board now estimates that these schemes cannot meet their protected liabilities and so includes the values of these schemes' deficits as current year costs of claims.

The claims in respect of the total of 116 schemes (2011: 149 schemes) are detailed below.

	2012 £m	2011 £m Reclassified
Scheme assets including recoveries	1,442.6	1,680.2
Protected liabilities	(1,913.6)	(2,169.9)
New claims recognised	**(471.0)**	**(489.7)**

Protected liabilities include provisions for equalisation of guaranteed minimum pension (GMP) and expenses.

Readers should refer to the Actuary's Supplementary Report as at 31 March 2012, in particular Annexes S6 and S7, for further detailed information on the calculation of these provisions.

Fraud Compensation Fund

There were three new claims on the Fraud Compensation Fund during the year. One claim was settled during the year. The Board has created provisions for two of the claims. The value of all three claims is trivial.

Note 8 Revaluation of prior year claims

The total revaluation of prior claims charged to the Statement of Comprehensive Net Income can be analysed as follows:

		PPF 2012 £m	FCF 2012 £m	Total 2012 £m
Release of provisions for schemes no longer considered probable for entry		(72.1)	-	(72.1)
Revaluation of provisions brought forward from previous year end	i	483.6	0.7	484.3
Changes in provisions for schemes transferring into the Protection Fund during the year	ii	84.0	-	84.0
Total revaluation of prior year claims		**495.5**	**0.7**	**496.2**

		PPF 2011 £m Reclassified	FCF 2011 £m	Total 2011 £m Reclassified
Release of provisions for schemes no longer considered probable for entry		(33.5)	-	(33.5)
Revaluation of provisions brought forward from previous year end	i	196.7	0.6	197.3
Changes in provisions for schemes transferring into the Protection Fund during the year	ii	(36.8)	-	(36.8)
Total revaluation of prior year claims		**126.4**	**0.6**	**127.0**

i) Revaluation of provisions brought forward from the previous year end

In the Protection Fund, of the 322 schemes for which provisions were made as at 31 March 2011:

- 131 schemes were transferred into the Protection Fund during the year
- 35 schemes' provisions have been released because the Board no longer considers it probable that the schemes will eventually transfer to the PPF.

The Board considers that the remaining 156 schemes (or scheme sections) will probably enter the Protection Fund in the future and has therefore retained the associated provisions, and revalued them to 31 March 2012.

ii) Changes in provisions for schemes transferring into the Protection Fund

During the year 147 schemes transferred into the Protection Fund. Provisions had been created as at 31 March 2011 in respect of 131 of these schemes. A further 16 schemes completed the assessment process during the year and transferred into the Protection Fund in respect of which no provision had been created as at 31 March 2011, including 5 which entered Assessment during 2011/12.

The components of total revaluation of prior year claims for 2010/11 have been reclassified to reflect the revised presentation of provisions for the cost of equalising compensation.

Note 9 Financial assets

The 'Funding for the future' section of the Annual Report includes an investment performance commentary, covering the investment activities undertaken in respect of the Protection Fund.

		2011 £m Reclassified	Asset transfers £m	Purchases £m	Sales £m	Gain / (Loss) £m	2012 £m
Debt instruments	i, ii	5,840.4		12,914.3	(9,031.9)	974.9	10,697.7
Equity		777.0		9,552.7	(8,787.7)	(11.6)	1,530.4
Managed funds	iii	174.3	2,083.3	723.3	(1,116.9)	(272.5)	1,591.5
Insurance policies	iii	119.7	63.6		(0.1)	12.2	195.4
Property		394.3		197.7	(63.3)	18.1	546.8
Private equity		180.0		132.1	(79.7)	(5.3)	227.1
Infrastructure		-		33.4	-	-	33.4
Other financial assets		3.4		1.0	-	-	4.4
		7,489.1	**2,146.9**	**23,554.5**	**(19,079.6)**	**715.8**	**14,826.7**
Foreign exchange contracts		(42.3)					80.2
Derivative financial instruments	iv	646.1					1,890.2
Investment income receivable		43.4					82.9
Amounts receivable from investments sold		473.4					245.9
Cash at fund managers		274.4					10.0
Total investment assets		**8,884.1**					**17,135.9**
Investment liabilities							
Repurchase agreements		(2,036.0)					(3,753.8)
Amounts payable for investments purchased		(150.8)					(517.7)
Derivative financial instruments		(341.3)					(1,809.4)
Total investment liabilities		**(2,528.1)**					**(6,080.9)**
Total investment portfolio		**6,356.0**					**11,055.0**

i) During the year, the Board completed its implementation of a securities lending programme. At 31 March 2012 the Board held £106.9 million non-cash collateral against £103.0 million of securities lent. The collateral held consisted entirely of debt instruments issued by, or guaranteed by, governments.

ii) Debt instruments include £3,753.8 million (2011 - £2,036 million) of UK Government securities sold under agreements to repurchase.

iii) Asset transfers represent the fair value of assets transferred in specie from schemes transferring into the Protection Fund as a result of the issue of Transfer Notices.

iv) The Board's derivative financial instruments are designated as held for trading as they are part of a general investment strategy to manage interest rate and inflation risk.

The financial assets table has been reclassified to aggregate the investment assets and liabilities managed by the Board's appointed investment managers in accordance with the Board's Statement of Investment Principles.

Note 10 Property, plant and equipment and intangible assets

	Information technology £m	Furniture & fittings £m	Payments on account & assets under construction £m	Total property plant and equipment £m	Intangible assets £m
Cost					
At 1 April 2011	4.5	1.0	0.1	5.6	3.4
Additions in the year	-	-	0.3	0.3	-
Disposals in the year	(0.1)	-	-	(0.1)	-
Assets brought into use	0.1	-	(0.1)	-	-
At 31 March 2012	4.5	1.0	0.3	5.8	3.4
Depreciation					
At 1 April 2011	(4.0)	(0.6)	-	(4.6)	(2.9)
Depreciation charged in the year	(0.4)	(0.2)	-	(0.6)	(0.4)
Disposals in the year	0.1	-	-	0.1	-
At 31 March 2012	(4.3)	(0.8)	-	(5.1)	(3.3)
Net book value at 31 March 2012	**0.2**	**0.2**	**0.3**	**0.7**	**0.1**

	Information technology £m	Furniture & fittings £m	Payments on account & assets under construction £m	Total property plant and equipment £m	Intangible assets £m
Cost					
At 1 April 2010	4.1	1.0	0.4	5.5	3.0
Additions in the year	-	-	0.5	0.5	-
Disposals in the year	-	-	-	-	-
Assets brought into use	0.4	-	(0.8)	(0.4)	0.4
At 31 March 2011	4.5	1.0	0.1	5.6	3.4
Depreciation					
At 1 April 2010	(3.2)	(0.4)	-	(3.6)	(2.5)
Depreciation charged in the year	(0.8)	(0.1)	-	(0.9)	(0.4)
Disposals in the year	-	-	-	-	-
At 31 March 2011	(4.0)	(0.5)	-	(4.5)	(2.9)
Net book value at 31 March 2011	**0.5**	**0.5**	**0.1**	**1.1**	**0.5**

Note 11 Actuarial liabilities in the Pension Protection Fund

The value of actuarial liabilities disclosed here is the aggregate value of the actuarial liabilities for all current beneficiaries of the Protection Fund, revalued to 31 March 2012. It can be analysed as follows:

	2012 £m	2011 £m Reclassified
Opening value of actuarial liabilities	4,076.1	2,520.1
Actuarial liabilities at dates of transfer	3,585.5	1,536.6
Actuarial losses	914.8	138.9
Benefits paid since transfer	(203.1)	(119.5)
Total actuarial liabilities	**8,373.3**	**4,076.1**

The value of actuarial liabilities disclosed for 2010/11 has been reclassified to reflect the revised presentation of provisions for the cost of equalising compensation.

Note 12 Provisions for claims

The total value of provisions for claims on the Board breaks down into:

	2012 £m	2011 £m
Claims on the Pension Protection Fund	1,695.7	1,846.4
Claims on the Fraud Compensation Fund	13.5	12.8
Total provisions for claims	**1,709.2**	**1,859.2**

Further analysis of the provisions is provided in the notes below.

Provisions for claims on the Pension Protection Fund

As at 31 March 2012, the Pension Protection Fund recognises provisions in respect of 256 pension schemes (2011: 322 schemes). The aggregate value of provisions can be analysed as follows:

	2012		2011	
	Number of schemes	£m	Number of schemes	£m Reclassified
Scheme specific claims				
Provisions at start of year	322	1,846.4	323	1,743.7
New claims arising in the year	116	471.0	149	489.7
Provisions no longer required	(35)	(72.1)	(24)	(33.5)
Revaluation of prior year claims	-	567.6	-	159.9
Release of provisions for schemes transferring to the PPF	(147)	(1,117.2)	(126)	(513.4)
Provisions at end of year	**256**	**1,695.7**	**322**	**1,846.4**

The value of claims provisions disclosed for 2010/11 has been reclassified to reflect the revised presentation of provisions for the cost of equalising compensation.

Provisions for claims on the Fraud Compensation Fund

As at 31 March 2012, the Fraud Compensation Fund recognises provisions in respect of eight pension schemes (2011: six schemes). The aggregate value of provisions can be analysed as follows:

	2012		2011	
	Number of schemes	Value £m	Number of schemes	Value £m
Claims at start of year	6	12.8	6	12.2
Revaluation of claims	-	0.7	-	0.6
New claims	3	-	1	-
Claims paid	(1)	-	(1)	-
Claims at end of year	**8**	**13.5**	**6**	**12.8**

Note 13 Contingent liabilities

Pension Protection Fund

Claims

The Board discloses contingent liabilities for claims on the Pension Protection Fund of £1,968.9 million (2011: £1,361.2 million), representing possible future claims on the Fund, including for schemes where the insolvency of the sponsoring employer occurred after 31 March 2012, and for schemes where, although no insolvency event has yet occurred, the Board judges it likely that such an event may occur in the future.

The Actuary's Supplementary Report as at 31 March 2012 included in the Annual Report and Accounts classifies these contingent liabilities into four types and readers should refer to the Supplementary Report, in particular Annex S2, for definitions and further detail of these contingent liabilities types.

Write off of Protection Levy

A number of pension schemes are pursuing legal actions to determine whether those schemes are eligible for pension protection and therefore liable to pay the protection levy. The Board considers it probable that these proceedings will determine that the schemes are eligible, and so has accounted for the levies in respect of those schemes as levy income. However, the Board judges that it remains possible that the legal actions to determine eligibility will conclude that they are ineligible and not liable to pay protection levies. Therefore the Board discloses the contingent liability to write off (where debts are outstanding) or to refund (where debts have been settled) a total of £52.0 million in protection levy income, should the legal actions result in a determination that the schemes are ineligible to enter the PPF and therefore not liable to pay protection levies.

Fraud Compensation Fund

The Board discloses as at 31 March 2012 contingent liabilities of £2.1 million relating to three schemes (as at 31 March 2011: £2.0 million relating to four schemes) which may be eligible to claim on the Fraud Compensation Fund, on the basis that the Board thinks it less than probable that the schemes are eligible to claim compensation, or that the Board thinks it less than probable that any scheme losses can be attributed to acts of dishonesty.

Note 14 Pension Protection Fund financial instruments – risk disclosures

IFRS 7 *Financial Instruments: Disclosures* requires disclosures which enable users of financial statements to evaluate the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Protection Fund's Statement of Investment Principles (SIP) is available by following this link
http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/SIP_November_2010.pdf

The SIP describes the Board's primary objective as to have sufficient funds to pay compensation to members of eligible pension schemes. It goes on to describe the Board's funding objective which is designed to mitigate the risks of failing to meet this primary objective. The Board's intention in setting this funding objective, and in managing the financial risks associated with it, is to achieve a balance between protecting and securing the compensation payments for current and potential members of schemes that come into the Protection Fund while setting a fair and proportionate levy, reflecting its duty to consider the interests of parties affected by the rate of the levies.

The Board's funding objective is described in more detail in this document:
http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/Funding_Strategy_Factsheet.pdf

The SIP describes the governance arrangements for the Fund, and sets out the roles and responsibilities of the Board, the Investment Committee and the Asset and Liability Committee. It sets out the arrangements for managing the risks associated with the financial instruments the Board holds, specifically the investment of:

- Accumulated levy contributions paid into the Fund, and
- Assets transferred by pension schemes entering the Fund.

The Board adopts low risk investment strategies in line with its duty of prudent management of its financial affairs. Its intention is to match current estimates of the Board's liabilities and provide some outperformance over the estimated liabilities. Any outperformance should contribute to the long-term sustainability of the Fund and reduce the burden on levy payers. The management of the investment portfolio, and its liability-matching and return-seeking components, is described in the 'Funding for the future' section of the annual report, together with a commentary on the implementation of this strategy and the investment performance achieved during the year. The report describes the role played by derivatives and financial instruments of other asset classes (equities, bonds, property funds and currency funds) in the Protection Fund's investment strategy.

The nature and extent of risks arising from financial instruments to which the Protection Fund is exposed at the end of the reporting period and the methods used to measure and manage the associated risks are discussed below.

Note 15 - Pension Protection Fund - valuation risk

The Protection Fund's portfolio of financial instruments includes instruments which are quoted in active markets and for which the fair value can be derived directly or indirectly from prices quoted in those markets. The Board also holds financial instruments for which markets are not active, and for which the fair value is determined using valuation techniques. The policies and methodologies used to value the Fund's financial instruments introduce valuation risk, in that the actual experience of values eventually realised from these financial instruments may differ from the estimated values disclosed in these accounts.

The following table analyses the Fund's financial instruments over the hierarchy of fair valuation methodology set out in IFRS7, reflecting the significance of inputs used in making the valuation.

Level 1 assets are those valued by reference to quoted prices in active markets for identical assets. For the Fund, level 1 assets include debt instruments and equities which are quoted in open and active markets.

Level 2 assets are those assets valued using inputs other than quoted prices and where those inputs are observable either directly (ie as prices) or indirectly (ie derived from prices). Level 2 assets consist mainly of sovereign and corporate debt instruments which are valued in the main using prices provided by price aggregation services. These services source prices from brokers and dealers authorised to trade in those debt instruments. The debt instruments are readily realisable and the Board considers that the prices provided by the aggregation services are robust and reliable. Also included in level 2 assets are certain pooled vehicles such as property and GTAA funds where valuations are based on observable inputs and where units can be readily redeemed.

Level 3 assets are those valued using inputs which are not based on observable market data. Included under level 3 are private equity funds and other funds, where the Fund gains exposure to those asset classes through unitised vehicles. The units in these funds are not traded in active markets and are valued mainly on a 'share of net asset value' basis. The assets underlying these unitised funds may consist of assets which themselves fall into any of the three IFRS7 levels.

Where the underlying assets fall into level 3, such as property and private equity, they are typically valued using industry-standard valuation methodologies. These methodologies carry the inherent risk that the valuations will differ from the actual experience of values eventually realised. The Fund also holds insurance policy assets valued using actuarial models.

Financial instruments measured at fair value

	Level 1 £m	Level 2 £m	Level 3 £m	as at 31 March 2012 £m
Financial instruments measured at fair value				
Debt instruments	622.4	10,047.4	27.9	10,697.7
Equity	1,530.4	-	-	1,530.4
Managed funds	-	1,591.5	-	1,591.5
Insurance policies	-	-	195.4	195.4
Property	-	546.8	-	546.8
Private equity	-	-	227.1	227.1
Infrastructure	-	-	33.4	33.4
Foreign exchange contracts	80.2	-	-	80.2
Other financial assets	-	-	4.4	4.4
Derivative financial assets	-	1,890.2	-	1,890.2
Investment income receivable	82.9	-	-	82.9
Amounts receivable from investments sold	245.9	-	-	245.9
Cash at fund managers	10.0	-	-	10.0
Repurchase agreements	-	(3,753.8)	-	(3,753.8)
Amounts payable for investments purchased	(517.7)	-	-	(517.7)
Derivative financial liabilities	-	(1,809.4)	-	(1,809.4)
Total	**2,054.1**	**8,512.7**	**488.2**	**11,055.0**

	Level 1 £m	Level 2 £m	Level 3 £m	as at 31 March 2011 £m Reclassified
Financial instruments measured at fair value				
Debt instruments	358.0	5,444.6	37.8	5,840.4
Equity	777.0	-	-	777.0
Managed funds	-	57.6	116.7	174.3
Insurance policies	-	-	119.7	119.7
Property	-	-	394.3	394.3
Private equity	-	-	180.0	180.0
Infrastructure	-	-	-	-
Foreign exchange contracts	-	(42.3)	-	(42.3)
Other financial assets	-	-	3.4	3.4
Derivative financial assets	-	646.1	-	646.1
Investment income receivable	43.4	-	-	43.4
Amounts receivable from investments sold	473.4	-	-	473.4
Cash at fund managers	274.4	-	-	274.4
Repurchase agreements	-	(2,036.0)	-	(2,036.0)
Amounts payable for investments purchased	(150.8)	-	-	(150.8)
Derivative financial liabilities	-	(341.3)	-	(341.3)
Total	**1,775.4**	**3,728.7**	**851.9**	**6,356.0**

Financial instruments measured at fair value based on significant unobservable inputs (level 3)

	2012 £m	2011 £m Reclassified
Financial assets		
Balance as at 31 March 2011	**851.9**	**465.6**
Gains or losses in the statement of comprehensive net income	5.3	(40.0)
Purchases	253.8	2,903.9
Sales	(111.8)	(2,477.6)
Transfers out of Level 3	(511.0)	-
Balance as at 31 March 2012	**488.2**	**851.9**

Note 16 Pension Protection Fund – market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices, and includes price risk, interest rate risk and currency risk.

Price Risk

Price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting similar financial instruments traded in the market. The Protection Fund's financial instruments are carried at fair value and fair value changes are recognised in the Statement of Comprehensive Net Income, therefore all changes in market conditions will directly affect total investment return.

The Board manages price risk by diversifying its investments across a range of asset types, both within the UK and globally, and sets asset allocation guidelines for the fund managers as per the table below.

Asset class	2012 £m	Actual %	Tolerance range
Global bonds	3,962.9	-	-
UK bonds and cash	2,665.0	-	-
Cash and bonds	**6,627.9**	**72.0%**	**65%-85%**
Public equity	1,103.0	12.0%	5%-20%
Alternatives (including property)	1,467.9	16.0%	10%-25%
Total assets allocated per SIP	**9,198.8**	**100%**	**-**

Alongside the strategic allocation, the SIP permits us to take tactical investment views, either to enhance return, or to control risk, but always within the overall risk appetite set by the Board. The actual investment values disclosed above incorporate tactical positions held at the year end but excludes assets and liabilities held solely for hedging purposes.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Protection Fund is exposed to interest rate risk in that the valuation of its current and potential future liabilities is sensitive to interest rates, as well as to a range of other financial and demographic factors described in more detail in the Protection Fund's Statement of Investment Principles. This interest rate sensitivity is explicitly taken into account by the Board when setting the strategic asset allocation for the Protection Fund's investments. The Board mitigates interest rate risk by applying a portfolio of derivatives to closely match the liability sensitivities to nominal and real interest rates. At the reporting date, the Protection Fund's financial instruments exposed to interest rate risk amounted to the following:

	Fixed rate financial assets	Variable rate financial assets	Non interest bearing financial assets	
	2012 £m	**2012 £m**	**2012 £m**	**2012 £m**
Debt instruments	10,697.7	-	-	10,697.7
Equity	-	-	1,530.4	1,530.4
Managed funds	1,246.3	345.2	-	1,591.5
Insurance policies	-	-	195.4	195.4
Property	-	-	546.8	546.8
Private equity	-	-	227.1	227.1
Infrastructure	-	-	33.4	33.4
Foreign exchange contracts	-	-	80.2	80.2
Other financial assets	4.4	-	-	4.4
Derivative financial assets	-	1,890.2	-	1,890.2
Investment income receivable	-	-	82.9	82.9
Amounts receivable from investments sold	-	-	245.9	245.9
Cash at fund managers	-	10.0	-	10.0
Repurchase agreements	(3,753.8)	-	-	(3,753.8)
Amounts payable for investments purchased	-	-	(517.7)	(517.7)
Derivative financial liabilities	-	(1,809.4)	-	(1,809.4)
Total	**8,194.6**	**436.0**	**2,424.4**	**11,055.0**

	Fixed rate financial assets	Variable rate financial assets	Non interest bearing financial assets	
	2011 £m	**2011 £m**	**2011 £m**	**2011 £m Reclassified**
Debt instruments	5,840.4	-	-	5,840.4
Equity	-	-	777.0	777.0
Managed funds	57.7	116.6	-	174.3
Insurance policies	-	-	119.7	119.7
Property	-	-	394.3	394.3
Private equity	-	-	180.0	180.0
Infrastructure	-	-	-	-
Foreign exchange contracts	-	-	(42.3)	(42.3)
Other financial assets	3.4	-	-	3.4
Derivative financial assets	-	646.1	-	646.1
Investment income receivable	-	-	43.4	43.4
Amounts receivable from investments sold	-	-	473.4	473.4
Cash at fund managers	-	274.4	-	274.4
Repurchase agreements	(2,036.0)	-	-	(2,036.0)
Amounts payable for investments purchased	-	-	(150.8)	(150.8)
Derivative financial liabilities	-	(341.3)	-	(341.3)
Total	**3,865.5**	**695.8**	**1,794.7**	**6,356.0**

The interest rate risk table has been reclassified to capture all PPF assets. Interest rate risk also impacts the management of the Fund's actuarial liabilities. As described in the Actuarial Valuation, the Fund's future liabilities are discounted using the higher of the zero-coupon interest rate swaps yield less 15 basis points and the gilts strip yield. The swaps used to hedge interest rate risk do not therefore fully close the mismatch with the 'higher of gilts and swaps' rate used in the Valuation. A programme using gilt repurchase agreements ('repos') to increase the exposure to gilts is in place to manage this 'swap spread risk' and eliminate much of this mismatch.

The main risk in the repo programme is roll risk, ie that we cannot enter into new repo contracts when the existing contracts expire. This will lead to the Fund being exposed to interest rate risk until we reinstitute the interest rate hedge in the swap market. Roll risk is mitigated in a number of ways, including diversification of maturities, limits on exposure to individual counterparties, and a limit on the total size of the programme relative to total outstanding commercial repo exposure.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Protection Fund's liabilities are entirely designated in sterling and therefore it is the Board's strategy, within its risk appetite, to hedge assets back to sterling.

For certain asset classes such as private equity and GTAA assets, the Board's current risk appetite leads to a strategy of applying an optimal currency hedging ratio based on the characteristics of the asset class.

At the reporting date the residual un-hedged foreign currency exposure is as follows:

	2012 £m	2012 %	2011 £m	2011 %
Euro	141.6	11.3%	83.8	21.3%
US Dollar	897.6	71.3%	210.1	53.4%
Other currencies	219.2	17.4%	99.7	25.3%
Total	**1,258.4**	**100%**	**393.6**	**100%**

Currency sensitivity analysis

The analysis below shows the impact on the above values of a 10 per cent increase and decrease in rates relative to sterling.

	Increase/(Decrease) in value of Financial Instruments £m
10% increase	(114.4)
10% decrease	139.8

Value at risk sensitivity analysis

In order to estimate the sensitivity of the Fund's financial position to adverse changes in financial markets, the Board applies the methodology set out in the Guidance for the Bespoke Investment Risk Calculation: **http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/investment_risk_consultation_May11.pdf**

This scenario has been calibrated to represent a 'one-standard deviation event' and will be applied by defined benefit pension schemes to provide a measure of their investment risk, which will be used in 2012/13 as an input to the formula of the Risk-Based Levy.

Applying this scenario as at 31 March 2012 results in an increase in assets of £1.7 billion and an increase in liabilities of £2.4 billion, thereby leading to a negative impact on the Statement of Financial Position of £0.7 billion.

Annex S5 of the Actuary's Supplementary Report models the sensitivity of the values of the Fund's assets and liabilities to changes in the rates of a wide variety of financial and non-financial factors. The scenarios modelled in this analysis cover changes in interest rates, changes in inflation rates (including where CPI rates diverge from RPI), changes in gilt yields and changes in mortality assumptions and other demographic factors.

Note 17 – Pension Protection Fund - credit risk

Credit risk is the risk that a counterparty to a financial instrument will cause a financial loss for the Protection Fund by failing to discharge an obligation.

The main exposure to credit risk in the Protection Fund's financial instruments arises from investments in sovereign, corporate and specialist credit strategies. The Protection Fund is also exposed to counterparty credit risk on derivatives, cash and cash equivalents, amounts due from brokers and transfer-in receivables. The Board is satisfied that the credit quality of all the financial instruments exposed to credit risk is in accordance with the risk appetite described in our SIP, as the instruments consist of investments in sovereign, corporate and specialist credit; derivative and other contracts with counterparties whose credit rating meets the Board's criteria; and debtors with levy payers, pension schemes and others where recovery of the debt is probable. At the reporting date, the Protection Fund's financial assets exposed to credit risk amounted to the following:

	2012 £m	2011 £m Reclassified
Debt instruments	10,697.7	5,840.4
Insurance policies	195.4	119.7
Derivative financial assets	1,890.2	646.1
Amounts receivable from investments sold	245.9	473.4
Investment income receivable	82.9	43.4
Cash at fund managers	10.0	274.4
Operational cash	30.7	97.7
Levy receivables	42.7	88.9
Transfer-in receivables	29.9	66.5
Other receivables	1.5	2.3
Total	**13,226.9**	**7,652.8**

The Board also recognises that the collection of the protection levy represents a credit risk, in that levy payers have the right to appeal the amount of protection levy billed to them and to request reviews of the data used to assess their eligibility for protection, and the data used to calculate their protection levy; and that levies may not be collectible for other reasons. The Board mitigates the risk that the amount of protection levy initially billed to levy payers may not be fully recoverable by setting up provisions, based on the experience of the outcome of successful appeals, and the experience of write-offs for other reasons, to impair the value of levy debtors at the reporting date.

The impairment of financial assets represented by levy debtors is illustrated below: 'past due' in this table is defined as older than 28 days, which is the time allowed to levy payers either to pay or to request a review of their levy invoice, after which activities to recover debts will commence.

Levy debtors impaired and past due	**Not past due 2012 £m**	**0-3 months past due 2012 £m**	**3-6 months past due 2012 £m**	**Over 6 months past due 2012 £m**
Financial assets past due not impaired	-	-	**2.3**	**28.1**
Financial assets before impairment	-	-	8.7	10.6
Impairment	-	-	(3.4)	(5.3)
Impaired financial assets	-	-	**5.3**	**5.3**
Total financial assets past due and impaired	-	-	**7.6**	**33.4**
	2011 £m	**2011 £m**	**2011 £m**	**2011 £m**
Financial assets past due not impaired	-	**6.4**	**6.4**	**16.1**
Financial assets before impairment	2.4	24.8	19.0	9.4
Impairment	(0.6)	(10.3)	(8.1)	(5.0)
Impaired financial assets	**1.8**	**14.5**	**10.9**	**4.4**
Total financial assets past due and impaired	**1.8**	**20.9**	**17.3**	**20.5**

Note 18 – Pension Protection Fund – liquidity risk

The Board mitigates the risk of a shortfall of liquid assets relative to immediate liabilities through processes of cash flow forecasting, comparing cash inflows from protection levy collections and scheme asset transfers with immediate liabilities. These liabilities include:

- liabilities to pay compensation to members
- liabilities to pay fees and expenses to service providers
- liabilities to maintain levels of collateral in the Board's hedging programmes, and
- liabilities to meet commitments to fund managers, for example, capital calls on private equity and infrastructure investments.

The Board also considers that significant proportions of its portfolio of financial instruments can be easily liquidated should the need arise, as they are, for example, traded on active investment exchanges. 87 per cent of the portfolio of financial instruments is considered easy to liquidate.

Current levels of compensation payments and fees and expenses payments are disclosed elsewhere in these financial statements.

The Board estimates that a 100bps rise in interest rates would require the Board to fund the collateral requirements of its hedging programmes by a further £1,048 million.

Future commitments to pay capital calls to fund managers as at 31 March 2012 consisted of:

Denominated in US Dollars	**$855.0m**
Denominated in Euros	**€112.0m**

The following table shows a liquidity ageing analysis for financial liabilities:

Financial liabilities due:	**within 1 year 2012 £m**	**1-5 years 2012 £m**	**5-10 years 2012 £m**	**Over 10 years 2012 £m**	**Total 2012 £m**
Financial liabilities including derivatives settled net					
Derivative financial instruments	222.0	75.0	46.4	1,466.0	1,809.4
Amounts payable for investments purchased	517.7	-	-	-	517.7
Repurchase agreements	3,753.8	-	-	-	3,753.8
Money purchase benefits payable	1.5	-	-	-	1.5
Compensation payments due	0.1	-	-	-	0.1
Accruals and other payables	37.4	-	-	-	37.4
Total financial liabilities	**4,532.5**	**75.0**	**46.4**	**1,466.0**	**6,119.9**

Financial liabilities due:	within 1 year 2011 £m	1-5 years 2011 £m	5-10 years 2011 £m	Over 10 years 2011 £m	Total 2011 £m Reclassified
Financial liabilities including derivatives settled net					
Derivative financial instruments	23.6	28.8	15.8	273.1	341.3
Repurchase agreements	2,036.0	-	-	-	2,036.0
Amounts payable for investments purchased	150.8	-	-	-	150.8
Money purchase benefits payable	2.0	-	-	-	2.0
Compensation payments due	0.1	-	-	-	0.1
Accruals and other payables	9.2	-	-	-	9.2
Total financial liabilities	**2,221.7**	**28.8**	**15.8**	**273.1**	**2,539.4**

Derivative financial instruments

As described in the Protection Fund's SIP, the Board uses hedging strategies to mitigate the risk of a fall in the value of assets against the liabilities. The Protection Fund has entered into a combination of interest rate and inflation swap agreements to adjust the cash flow profile from assets to match the liability cash flow profile. This is primarily to mitigate interest rate and inflation risk.

The SIP also permits, within the overall risk appetite set by the Board, tactical investment views to be taken, either to enhance return or to control risk. These tactical views are frequently implemented through the use of options and other derivative instruments.

The value of the portfolio of derivative financial instruments at the reporting date is as follows:

	Assets 2012 £m	Liabilities 2012 £m	Total 2012 £m
Derivatives due to settle within 1 year			
Interest rate swaps	194.0	(33.4)	160.6
Inflation rate swaps	3.4	(1.7)	1.7
Options	205.6	(186.7)	18.9
Credit default swaps	-	(0.1)	(0.1)
	403.0	**(221.9)**	**181.1**
Derivatives due to settle after more than 1 year			
Interest rate swaps	1,257.1	(1,353.5)	(96.4)
Inflation rate swaps	148.6	(190.6)	(42.0)
Options	75.4	(37.2)	38.2
Credit default swaps	6.1	(6.2)	(0.1)
	1,487.2	**(1,587.5)**	**(100.3)**
Total value of derivative portfolio	**1,890.2**	**(1,809.4)**	**80.8**

	Assets 2011 £m	Liabilities 2011 £m	Total 2011 £m
Derivatives due to settle within 1 year			
Interest rate swaps	16.6	(23.5)	(6.9)
Inflation rate swaps	0.2	(0.1)	0.1
Options	8.1	-	8.1
Credit default swaps	0.1	-	0.1
	25.0	**(23.6)**	**1.4**
Derivatives due to settle after more than 1 year			
Interest rate swaps	475.3	(216.2)	259.1
Inflation rate swaps	138.6	(99.9)	38.7
Options	5.4	-	5.4
Credit default swaps	1.8	(1.6)	0.2
	621.1	**(317.7)**	**303.4**
Total value of derivative portfolio	**646.1**	**(341.3)**	**304.8**

Swap valuation methodologies

Interest rate swaps are valued using an interest rate swap pricing model, a time series of historic LIBOR rates and a zero coupon interest rate swap curve generated by the fund manager using models based on market sources. Zero coupon interest rate swaps are used for the Protection Fund as their purpose is to match the sensitivity of asset values to the sensitivity of liability values to changes in interest rates. The curve is used in the pricing model to ascertain the future LIBOR rates to be applied in calculating the floating leg cash flows and to calculate the present value of future fixed and floating leg cash flows.

Inflation rate swaps are valued using an inflation swap pricing model, a time series of historic UK inflation rates, a zero coupon swap inflation expectation curve, an inflation seasonality model and the zero coupon interest rate swap curve used in the valuation of interest rate swaps.

The value of paired long and short credit default swaps is derived from calculating the estimated net cash flow between the paired credit default swaps based on the fund manager's pricing models, broker appraisal and third party information, and from calculating a price for the long and short credit default swaps using one of the approved methods for pricing credit default swaps.

Note 19 Fraud Compensation Fund – financial risks

Because of the non-trading nature of the Fraud Compensation Fund's activities and the way it is financed, the Fraud Compensation Fund is not exposed in this area to the same financial risks faced by business entities.

Funding risk – The Board reviewed its funding strategy for the Fraud Compensation Fund during the year and considered the risks posed to the Fund by the unpredictability of claims, both in size and frequency, the ceiling on the levy that the Board can raise, and the mitigation provided by the Board's powers to agree with the trustees of claimant schemes that settlements be made in instalments. The Board considered its duties to secure the compensation payments to current and potential claimant schemes, balanced with its duty to set a fair and proportionate levy.

The Board concluded that it could best manage the funding risk by aiming to build up a small surplus in the Fund by raising levies over a number of years. This strategy will be reviewed if the observed pattern of claims is seen to change. The Fund remains at risk of large and urgent claims, but the Board does not consider it proportionate to build up a large surplus at the expense of levy payers.

Liquidity risk – The Fraud Compensation Fund is not exposed to significant liquidity risks as the Board is of the opinion that

- the assets of the Fraud Compensation Fund, including its investment assets, are highly liquid and readily realisable; and
- the time required to investigate claims and decide whether payment (including any instalment settlements) should be made is adequate to raise any levy income required over and above the funds already under the Board's control.

Interest rate risk – Dependent on the date of the insolvency of the sponsoring employer of the claimant scheme, claims on the Fund may fall to be considered under the Occupational Pension Scheme (Pensions Compensation Provisions) Regulations 1997, which is the regime operated by the Fund's predecessor body, the Pension Compensation Board. Under this regime, claimants are entitled to interest based on the value of the validated loss, to be calculated at a rate of two per cent above base rate, for the period between the effective date of loss and the date of payment of compensation. The Fraud Compensation Fund therefore faces the risk that the return on its investments will be inadequate to cover the interest payments due to claimants whose claims are dealt with under this regime. The Fraud Compensation Fund's Statement of Investment Principles recognises this risk and describes the investment strategy designed to mitigate it.

Other claims on the Fund may fall to be considered under the Occupational Pension Schemes (Fraud Compensation Payments and Miscellaneous Amendments) Regulations 2005, which make no provision for the payment of interest, as claimants are entitled to receive only the value of the net loss suffered.

Foreign currency risk – The Fraud Compensation Fund has no significant exposure to foreign currency in respect of its compensation activities as all of its income, costs, assets and liabilities are denominated in sterling.

Credit risk – The Fraud Compensation Fund's loans and receivables are exposed to credit risk. Cash and cash equivalents are held in the form of units in liquidity funds managed by external fund managers.

Note 20 Administration Fund – financial risks

Because of the non-trading nature of the Board of the Pension Protection Fund's administration activities and the way it is financed, the Board is not exposed in this area to the degree of financial risk faced by business entities. Financial assets and liabilities are generated by the Board's routine operational activities, and are not held to change the risks facing the Board in carrying out its administration functions.

Liquidity risk – Both the Board's resource and capital requirements are funded by grant-in-aid from its sponsor department, DWP. The Board works closely with the DWP on budgeting and forecasting of expenditures, particularly on forecasting grant-in-aid requirements, to ensure that the Board is not exposed to significant liquidity risks.

Interest rate risk – The Board has no power to borrow to fund administration activities and therefore is not exposed to any interest rate risk. Any surplus funds on its Administration account are held in interest-bearing accounts.

Foreign currency risk – The Board has no significant exposure to foreign currency in respect of its administration activities.

Credit risk – The Board has very low exposure to credit risk. Staff travel loans are repaid over a defined period and repaid in full if employment is terminated. Cash and cash equivalents consists entirely of cash held in the Administration Fund's current bank account.

Note 21 Segmental Reporting

The following tables re-present the Board's Consolidated Statement of Comprehensive Net Income, Consolidated Statement of Financial Position and Consolidated Statement of Changes in Reserves to disclose the financial transactions and balances for which the Board is responsible in accordance with the 3 segregated funds managed by the Board.

Segmented consolidated statement of comprehensive income

	Pension Protection Fund £m	Fraud Compensation Fund £m	Administration Fund £m	2012 £m
Operating income				
Income from levies	601.1	3.7	-	604.8
Total operating income	**601.1**	**3.7**	**-**	**604.8**
Operating expenses				
Staff costs	(3.0)	-	(13.8)	(16.8)
Other costs	(12.3)	-	(10.7)	(23.0)
Total operating expenses	**(15.3)**	**-**	**(24.5)**	**(39.8)**
Net operating surplus / (deficit)	**585.8**	**3.7**	**(24.5)**	**565.0**
Investment activities				
Investment income	283.8	0.1	-	283.9
Change in fair value of investments	1,456.3	-	-	1,456.3
Investment expenses	(53.3)	-	-	(53.3)
Net investment return	**1,686.8**	**0.1**	-	**1,686.9**
Claims activities				
Losses on actuarial liabilities	(914.8)	-	-	(914.8)
Current year claims for compensation	(471.0)	-	-	(471.0)
Revaluation of prior year claims	(495.5)	(0.7)	-	(496.2)
Net cost of claims	**(1,881.3)**	**(0.7)**	-	**(1,882.0)**
Net comprehensive income	**391.3**	**3.1**	**(24.5)**	**369.9**

Segmented consolidated statement of comprehensive income continued

	Pension Protection Fund £m	Fraud Compensation Fund £m	Administration Fund £m	2011 £m
Operating income				
Income from levies	687.1	3.5	-	690.6
Total operating income	**687.1**	**3.5**	**-**	**690.6**
Operating expenses				
Staff costs	-	-	(17.2)	(17.2)
Other costs	(27.5)	(0.5)	(14.1)	(42.1)
Total operating expenses	**(27.5)**	**(0.5)**	**(31.3)**	**(59.3)**
Net operating surplus / (deficit)	**659.6**	**3.0**	**(31.3)**	**631.3**
Investment activities				
Investment income	146.3	-	-	146.3
Change in fair value of investments	258.6	-	-	258.6
Investment expenses	(25.9)	-	-	(25.9)
Net investment return	**379.0**	**-**	**-**	**379.0**
Claims activities				
Losses on actuarial liabilities	(138.9)	-	-	(138.9)
Current year claims for compensation	(489.7)	-	-	(489.7)
Revaluation of prior year claims	(126.4)	(0.6)	-	(127.0)
Net cost of claims	**(755.0)**	**(0.6)**	**-**	**(755.6)**
Net comprehensive income	**283.6**	**2.4**	**(31.3)**	**254.7**

Segmented consolidated statement of financial position

	Pension Protection Fund £m	Fraud Compensation Fund £m	Administration Fund £m	2012 £m
Assets				
Operational cash	30.7	11.4	0.5	42.6
Investment assets	17,135.9	-	-	17,135.9
Levy receivables	42.7	-	-	42.7
Transfer-in receivables	29.9	-	-	29.9
Other current assets	18.6	-	0.5	19.1
Property, plant and equipment	-	-	0.7	0.7
Intangible assets	-	-	0.1	0.1
Total assets	**17,257.8**	**11.4**	**1.8**	**17,271.0**
Liabilities				
Investment liabilities	(6,080.9)	-	-	(6,080.9)
Other current liabilities	(39.0)	-	(4.0)	(43.0)
Actuarial liabilities	(8,373.3)	-	-	(8,373.3)
Claims provisions	(1,695.7)	(13.5)	-	(1,709.2)
Total liabilities	**(16,188.9)**	**(13.5)**	**(4.0)**	**(16,206.4)**
Total assets less total liabilities	**1,068.9**	**(2.1)**	**(2.2)**	**1,064.6**
Represented by				
Total tax payer funds	-	-	(1.0)	(1.0)
Total levy payer funds	1,068.9	(2.1)	(1.2)	1,065.6
Total levy and tax payers' funds	**1,068.9**	**(2.1)**	**(2.2)**	**1,064.6**

Segmented consolidated statement of financial position continued

	Pension Protection Fund £m	Fraud Compensation Fund £m	Administration Fund £m	2011 £m
Assets				
Operational cash	97.7	7.6	2.5	107.8
Financial assets	8,884.1	-	-	8,884.1
Levy receivables	88.9	-	-	88.9
Transfer-in receivables	66.5	-	-	66.5
Other current assets	2.3	-	0.4	2.7
Property, plant and equipment	-	-	1.1	1.1
Intangible assets	-	-	0.5	0.5
Total assets	**9,139.5**	**7.6**	**4.5**	**9,151.6**
Liabilities				
Financial liabilities	(2,528.1)	-	-	(2,528.1)
Other current liabilities	(11.3)	-	(5.0)	(16.3)
Actuarial liabilities	(4,076.1)	-	-	(4,076.1)
Claims provisions	(1,846.4)	(12.8)	-	(1,859.2)
Total liabilities	**(8,461.9)**	**(12.8)**	**(5.0)**	**(8,479.7)**
Total assets less total liabilities	**677.6**	**(5.2)**	**(0.5)**	**671.9**
Represented by				
Total tax payer funds	-	-	(0.5)	(0.5)
Total levy payer funds	677.6	(5.2)	-	672.4
Total levy and tax payers' funds	**677.6**	**(5.2)**	**(0.5)**	**671.9**

Segmented consolidated statement of changes in reserves

The Board is required under the Pensions Act 2004 and associated legislation and regulations to use the reserves only for the purposes of managing the segregated funds specified in the legislation. The reserves associated with each of these funds are set out below.

	Pension Protection Fund		Fraud Compensation Fund			Administration Fund		Total Funds
	General reserves £m	Total fund £m	Other reserve £m	General reserves £m	Total fund £m	General reserves £m	Total fund £m	Reserves £m
Balance at 31 March 2010	**394.0**	**394.0**	**2.9**	**(10.5)**	**(7.6)**	**(2.7)**	**(2.7)**	**383.7**
consisting of:								
Tax payer funds	-	-	-		-	(1.3)	(1.3)	(1.3)
Levy payer funds	394.0	394.0	2.9	(10.5)	(7.6)	(1.4)	(1.4)	385.0
Result for 2010-11								
Tax payer funds	-	-	-	-	-	(10.0)	(10.0)	(10.0)
Levy payer funds	283.6	283.6	-	2.4	2.4	(21.3)	(21.3)	264.7
Total recognised net income / (expenditure)	**283.6**	**283.6**	**-**	**2.4**	**2.4**	**(31.3)**	**(31.3)**	**254.7**
FAS grant in aid received in the year	-	-	-	-	-	10.8	10.8	10.8
PPF grant in aid received in the year	-	-	-	-	-	22.7	22.7	22.7
Balance at 31 March 2011	**677.6**	**677.6**	**2.9**	**(8.1)**	**(5.2)**	**(0.5)**	**(0.5)**	**671.9**
consisting of:								
Tax payer funds	-	-	-	-	-	(0.5)	(0.5)	(0.5)
Levy payer funds	677.6	677.6	2.9	(8.1)	(5.2)	-	-	672.4
Result for 2011-12								
Tax payer funds	-	-	-	-	-	(8.0)	(8.0)	(8.0)
Levy payer funds	391.3	391.3	-	3.1	3.1	(16.5)	(16.5)	377.9
Total recognised net income / (expenditure)	**391.3**	**391.3**	**-**	**3.1**	**3.1**	**(24.5)**	**(24.5)**	**369.9**
FAS grant in aid received in the year	-	-	-	-	-	7.5	7.5	7.5
PPF grant in aid received in the year	-	-	-	-	-	15.3	15.3	15.3
Balance at 31 March 2012	**1,068.9**	**1,068.9**	**2.9**	**(5.0)**	**(2.1)**	**(2.2)**	**(2.2)**	**1,064.6**
consisting of:								
Tax payer funds	-	-	-	-	-	(1.0)	(1.0)	(1.0)
Levy payer funds	1,068.9	1,068.9	2.9	(5.0)	(2.1)	(1.2)	(1.2)	1,065.6

The 'other reserve' figure of £2.9 million in the Fraud Compensation Fund represents the net assets of the Pensions Compensation Board, the predecessor body to the Fraud Compensation Fund. The Pensions Compensation Board was dissolved under the Pensions Act 2004, and its residual assets, valued at fair value as at 5 April 2005, have been brought into the Fraud Compensation Fund under the operation of merger accounting.

Note 22 Consolidated and separate financial statements

In accordance with its accounting policy on consolidated and separate financial statements, the Board's non-consolidated Statement of Financial Position, treating the value of its special purpose investment entity as an investment in a subsidiary company, is disclosed below.

Consolidated statement of financial position

	Group		Parent	
	2012 £m	2011 £m Reclassified	2012 £m	2011 £m Reclassified
Assets				
Operational cash	42.6	107.8	42.6	107.8
Investment assets	17,135.9	8,884.1	17,054.3	8,804.2
Levy receivables	42.7	88.9	42.7	88.9
Transfer-in receivables	29.9	66.5	29.9	66.5
Other current assets	19.1	2.7	19.1	2.7
Property, plant and equipment	0.7	1.1	0.7	1.1
Intangible assets	0.1	0.5	0.1	0.5
Shares in subsidiary undertakings	-	-	81.6	79.9
Total assets	**17,271.0**	**9,151.6**	**17,271.0**	**9,151.6**
Liabilities				
Investment liabilities	(6,080.9)	(2,528.1)	(6,080.9)	(2,528.1)
Other current liabilities	(43.0)	(16.3)	(43.0)	(16.3)
Actuarial liabilities	(8,373.3)	(4,076.1)	(8,373.3)	(4,076.1)
Claims provisions	(1,709.2)	(1,859.2)	(1,709.2)	(1,859.2)
Total liabilities	**(16,206.4)**	**(8,479.7)**	**(16,206.4)**	**(8,479.7)**
Total assets less total liabilities	**1,064.6**	**671.9**	**1,064.6**	**671.9**
Represented by				
Total tax payer funds	(1.0)	(0.5)	(1.0)	(0.5)
Total levy payer funds	1,065.6	672.4	1,065.6	672.4
Total levy and tax payer funds	**1,064.6**	**671.9**	**1,064.6**	**671.9**

At 31 March 2012, the Board had one subsidiary company. It owned 100 per cent of the participating share capital ('A' class shares) of Crown Secondary Placements plc, a special purpose vehicle registered in the Republic of Ireland, set up to invest in certain private equity funds. The issued participating share capital in this company is at all times equal to the net asset value of the company. The reported comprehensive profit for the company for the 12 months to 31 March 2012 was €4.8 million.

Note 23 Operating lease commitments

The Board occupies premises under a number of Memoranda of Terms of Occupancy (MOTOs) with DWP, under which a bundled facilities price, comprising rent, rates and property service charges, is payable to DWP Estates. The total future minimum payments under these arrangements are given below, analysed according to the period in which the payments fall due.

	2012 £m	2011 £m
Land and buildings		
Not later than one year	1.3	1.3
Later than one year and not later than five years	4.7	5.2
Later than five years	-	0.8
Total	**6.0**	**7.3**

Note 24 Related party transactions

Of the accommodation costs disclosed in Note 2b, £1.6 million (year to 31 March 2011: £2.0 million) was payable to the Estates Division of DWP under the arrangements described in Note 23, Operating lease commitments.

There are no other related party transactions to disclose.

Note 25 Events after the reporting period

The accounts were authorised for issue on 17 October 2012, the date the Comptroller & Auditor General certified the accounts. The financial accounts do not reflect events after this date.

Actuarial valuation of the Pension Protection Fund

To: The Board of the Pension Protection Fund

From: Stephen Rice, Appointed Actuary

The actuarial valuation of the Pension Protection Fund as at 31 March 2012

1. Introduction

The Board of the Pension Protection Fund ('the Board') is required by paragraph 22 of schedule 5 to the Pensions Act 2004 to prepare a statement of accounts in respect of each financial year. Each statement of accounts must contain an actuarial valuation of the assets and liabilities of the Pension Protection Fund prepared and signed by the Appointed Actuary.

This is the seventh actuarial valuation of the Pension Protection Fund. The effective date of this valuation is 31 March 2012. The previous actuarial valuation was as at 31 March 2011, and the report on that valuation was dated 25 October 2011.

At its meeting on 26 April 2006 the Board appointed me to prepare the annual actuarial valuation of the assets and liabilities of the Pension Protection Fund. I intend my report to assist the Board with the preparation of the annual report and accounts as at 31 March 2012 and so I see the Board as the user of this report. As required by paragraph 22(5) of schedule 5 to the Pensions Act 2004, the Board will be sending a copy of this report, as part of the statement of accounts, to the Secretary of State and also to the Comptroller and Auditor General. No party, apart from the Board, the Secretary of State and the Comptroller and Auditor General, should rely on any part of this report.

This report does not contain advice on the funding of compensation payable from the Pension Protection Fund. In particular, the results of this valuation are not used in the determination of the levy. All the results in this report are outcomes of a valuation exercise involving the quantification of amounts for recording in the annual report and accounts.

In my view, while the Actuaries Code issued by the Actuarial Profession applies to the preparation of this report, there are no professional practice standards which directly apply. I have, however, prepared this report having regard to the principles in three Technical Actuarial Standards, namely TAS R (Reporting Actuarial Information), TAS D (Data) and TAS M (Modelling). This report should be considered alongside my supplementary report dated 3 October 2012. As my reports are prepared solely for the purpose of the Annual Report & Accounts of the Pension Protection Fund, I have not produced any projections of future accounting positions in either this or my supplementary report because the Board does not require them for its accounting disclosures.

2. Data

Individual member data was obtained from Capita (the administrators) in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012. I have carried out some overall checks on this data for general reasonableness and to ensure that it is consistent with that used in the actuarial valuation at 31 March 2011. A summary of the data as at 31 March 2012 is as follows (figures in brackets are as at 31 March 2011):

Deferred pensioners

Sex	Number	Average age	Total Accrued Pension revalued to 31 March 2012 (uncapped) (£000s pa)
Male	48,115 (31,395)	49.5 (49.4)	184,233 (116,863)
Female	22,493 (10,668)	47.8 (47.6)	46,082 (21,749)
Total	**70,608 (42,063)**	**49.0 (48.9)**	**230,315 (138,612)**

Pensioners

Status	Sex	Number	Average age	**Total Compensation at 31 March 2012** (capped where applicable) (£000s pa)
Members	Male	35,493 (22,003)	68.4 (67.8)	181,512 (103,466)
	Female	13,633 (6,100)	67.8 (68.4)	28,887 (12,621)
Dependants (excluding children)	Male	746 (361)	69.9 (70.3)	1,144 (529)
	Female	7,493 (4,520)	74.0 (73.3)	20,394 (11,846)
Children	Male	71 (40)	15.6 (15.6)	111 (78)
	Female	70 (45)	16.4 (16.1)	166 (82)
Total		**57,506 (33,069)**	**68.9 (68.6)**	**232,214 (128,622)**

Individuals who are in receipt of one tranche of compensation as well as being entitled to a further tranche of compensation beginning after 31 March 2012 are included in both tables.

In respect of the one scheme for which the individual membership data was not complete, a loading of 50 per cent was added to the calculated liabilities of the incomplete membership of that scheme. The loading was derived from an analysis of the grouped member data and liabilities provided in conjunction with the scheme's s143 valuation.

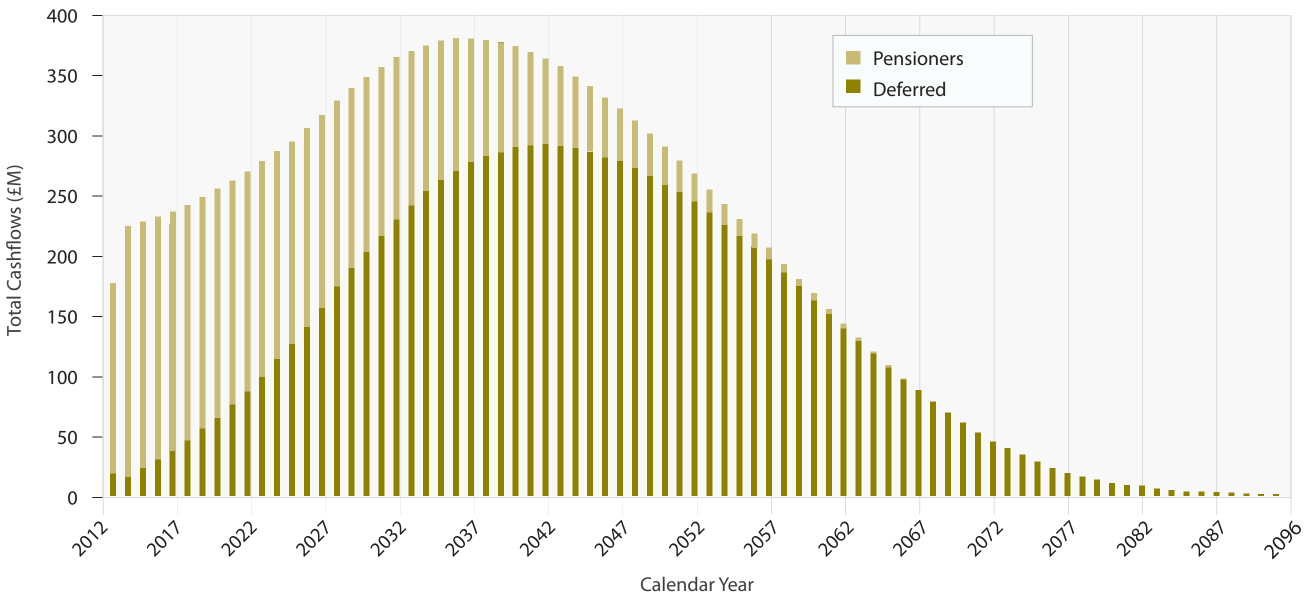
3. Compensation

The compensation in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012 has been determined in accordance with the provisions of Schedule 7 to the Pensions Act 2004 and consequent regulations. A summary of the compensation provisions is shown in Annex M1.

4. Method

In respect of each former member of schemes for which the Board assumed responsibility on or before 31 March 2012, the expected compensation cash flows for each future year are estimated. In estimating each yearly compensation cash flow for each former member, account is taken of the initial amount of compensation or accrued pension, mortality, the Normal Pension Age (NPA) for deferred members, compensation increases and the probability of survivors' compensation being paid. The expected cash flows are shown in the chart below (ignoring early retirement and commutation of annual compensation for a lump sum). Note that this cash flow projection takes no account of schemes for which the Board assumes responsibility after 31 March 2012.

Total Cashflows



The resulting yearly compensation cash flows are discounted back to a present value at the valuation date, 31 March 2012, and summed to obtain the actuarial present value of each former member's liability.

The financial and demographic assumptions employed are described briefly in the next section of this report and set out more fully in Annex M2.

A provision has been included for the cost of equalising former members' compensation that is unequal on account of inequalities in Guaranteed Minimum Pensions (GMPs) accrued between 17 May 1990 and 5 April 1997. In respect of the year to 31 March 2011, this provision for the cost of equalising former members' compensation was reported in my supplementary report dated 25 October 2011.

Based on the Board's proposed method for equalising compensation, loadings have been calculated to apply to compensation payable from Normal Pension Age 60 to 65 inclusive for men and women separately in respect of transferred schemes. These calculations use assumptions that I believe to be appropriate for schemes that have transferred into the PPF allowing for the Board's methodology. In addition, a loading was calculated for transferred schemes equal to the expected arrears of compensation due to these inequalities in GMPs.

The sum of all former members' liabilities plus the provision for the cost of equalising compensation for GMPs is the estimated sum required, based on the financial and demographic assumptions employed, to meet liabilities that have been transferred to the Board's responsibility.

5. Assumptions

In order to estimate future compensation cash flows, I have needed, in respect of the former members of schemes for which the Board assumed responsibility on or before 31 March 2012, to make assumptions about:

- annual increases in payment to that element of their compensation which accrued after 5 April 1997
- revaluation of compensation in deferment for those whose compensation does not begin to be paid until after the valuation date, 31 March 2012
- their future mortality and other demographic features, and
- whether the Secretary of State exercises his / her power under paragraph 30 of Schedule 7 of the Pensions Act 2004 to vary the 100 per cent level of compensation for those members in category 1 of Annex M1 and the 90 per centlevel of compensation for those members in category 2 of Annex M1.

In order to determine the present value of the liabilities, I have needed to discount the compensation cash flows, estimated as described above, back to the valuation date, 31 March 2012.

The Appointed Actuary has responsibility for the assumptions used in the statutory valuation of the assets of the PPF and the transferred liabilities, which are the subject of this report. The Board has responsibility for the assumptions used to value the provisions for schemes forming the provisions, as well as contingent liabilities, which are the subject of my supplementary report. Since there is a large overlap in the two sets of assumptions, past practice has been to adopt the same assumptions, as far as possible, for both purposes, which are agreed by the Board.

In proposing the assumptions for the 2012 actuarial valuation, I have taken account of the Accounts Direction which is given by the Secretary of State for Work and Pensions with the approval of HM Treasury in accordance with Schedule 5, Part 4 of the Pensions Act 2004.

Under this direction, the Board is required to prepare accounts in compliance with:

- the accounting principles and disclosure requirements of the current edition of the Government Financial Reporting Manual (the 'FReM') issued by HM Treasury which is in force for the financial year for which the accounts are being prepared
- other guidance issued by HM Treasury in respect of accounts which are required to give a true and fair view, and
- the Framework document agreed with the Board of the Pension Protection Fund.

The existing accounts direction also states that the discount rate used to discount future cash flows and liabilities should be that advised by the PPF's actuary (in accordance with Schedule 5 Part 4 section 22(4)(b) of the Pensions Act 2004 and the PPF valuation regulations 2005 and 2006).

None of the above provides direction on the choice of assumptions made for the valuation. However, in taking account of these documents and the accounts direction, the Board is required to place a value on the provisions which is best estimate (ie is equally likely to overstate as to understate the actual value). This follows from IAS 37, which the Board is required to take into account in accordance with the FReM. As the same choices of assumptions are made as far as possible for this report as for valuing the provisions, the value placed on liabilities of the PPF is also best estimate. I have chosen to do this using market pricing where possible.

A full description of the assumptions made can be found in Annex M2.

I have also carried out a sensitivity analysis in which the effect on the assets and liabilities is shown by changes in certain key assumptions. The results of this analysis may be seen in the supplementary report which I have prepared concerning the provisions of the Pension Protection Fund as at 31 March 2012.

6. Value of assets

The value of the Pension Protection Fund assets is determined in accordance with regulations 2, 4 and 5 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 (SI 2006 / 597).

I have adopted the value of the assets of the Fund as stated in the relevant accounts prepared by the Board for the financial period ending on 31 March 2012. I have not adopted either of the adjustments made available by regulations 4 and 5 as I considered that it was not appropriate to do so.

Accordingly I have taken the value of the assets of the Pension Protection Fund as at 31 March 2012 as £11,139,360,000. This includes £1,499,000 in respect of AVC assets that match AVC liabilities yet to be discharged.

This compares with £6,602,136,000 as at 31 March 2011.

An analysis of the change in the value of the assets of the Fund between 31 March 2011 and 31 March 2012 is as follows:

	£000s
Assets	
Value of assets at the start of the year (31 March 2011)	6,602,136
Assets for schemes entering the PPF during the year to 31 March 2012 (measured at their transfer dates)	2,468,287
Income from Pension Protection Levies	601,100
Compensation paid	(203,266)
Change in current assets (AVCs to be discharged)	(500)
Change in value of interest rate swaps and inflation swaps	987,580
Change in value of repurchase agreements	230,067
Change in value of invested assets on account of changes in bond yields	177,726
Change in value of invested assets on account of other changes (excluding bond yields, interest rate swaps, inflation swaps and repurchase agreements) net of investment management expenses.	312,233
Miscellaneous	(36,003)
Value of assets at the end of the year (31 March 2012)	**11,139,360**

7. Value of liabilities

The value of the Pension Protection Fund liabilities is determined in accordance with regulation 3 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 (SI 2006 / 597). This requires that:

(a) the liabilities of the Pension Protection Fund shall be any sums or properties falling to be paid or transferred out of the Fund required to meet liabilities listed in section 173(3) of the Pensions Act 2004; and

(b) the value of a liability shall be the present value of that liability at the valuation date.

The provision for the cost of equalising former members' compensation that is unequal on account of inequalities in GMPs is 1.6% of the actuarial liabilities. This is a weakening of the provision compared to that allowed for in my supplementary report to the actuarial valuation as at 31 March 2011 (2.4%) which takes account of the latest information available.

The actuarial liabilities in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012, on the assumptions described in section 5 and Annex M2, are summarised in the table below:

	£000s
Type of member	
Deferred pensioners	4,260,381
Pensioners	3,788,510
Provision for the cost of equalising compensation for GMPs	128,782
Administration expenses to be met from the Fund	195,588
Current liabilities (AVCs to be discharged)	1,499
Total	**8,374,760**

Accordingly I have taken the value of the liabilities of the Pension Protection Fund as at 31 March 2012 as £8,374,760,000.

This compares with £4,078,100,000 as at 31 March 2011[1].

An analysis of the change in the actuarial liabilities between 31 March 2011 and 31 March 2012 is as follows:

	£000s
Liabilities	
Actuarial liabilities at the start of the year (31 March 2011)	4,078,100
Liabilities for schemes entering the PPF during the year to 31 March 2012 (measured at 31 March 2012)	3,668,620
Effect of passage of time on discounting	71,496
Actuarial (gain) / loss due to change in financial assumptions	797,695
Actuarial (gain) / loss due to changes in mortality assumptions	(10,053)
Actuarial (gain) / loss due to experience being different from what was assumed	(4,033)
Change in GMP equalisation allowance	(64,391)
Change in expense allowance*	41,092
Compensation paid	(203,266)
Change in current liabilities (AVCs to be discharged)	(500)
Actuarial liabilities at the end of the year (31 March 2012)	**8,374,760**

* See section vii) of Annex M2 for a description of the changes incorporated for expenses

[1] This figure has been restated due to the change in presentation of the provision for the cost of equalising compensation for GMPs. The value of the liabilities quoted in my original report dated 25 October 2011 was £3,984,324,000.

8. Conclusion

The balance sheet in respect of the assets and liabilities of the Pension Protection Fund determined in accordance with the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 (SI 2006 / 597) is as follows:

	£000s
Assets	
The value of the Pension Protection Fund assets determined in accordance with the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006	11,139,360
Total assets	**11,139,360**
Liabilities	
The actuarial liabilities in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012	8,048,891
Provision for the cost of equalising compensation for GMPs	128,782
Allowance for certain expenses that are met from the Pension Protection Fund	195,588
The remaining liabilities under Regulation 3 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006	1,499
Total liabilities	**8,374,760**
Excess of assets over liabilities – before provisions	**2,764,600**
Funding ratio (Assets / Liabilities) – before provisions	**133%**

In respect of the Pension Protection Fund as at 31 March 2012, the value of the assets was £ 11,139,360, 000 and the value of the liabilities (including those in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012) was £8,374,760,000.

The excess of assets over liabilities of £2,764,600,000 in the Pension Protection Fund as at 31 March 2012 needs to be understood in the context of additional pension schemes that had entered into an assessment period, as defined in section 132 of the Pensions Act 2004, with effect from a date on or before 31 March 2012. Therefore, in addition to this formal report on the assets and liabilities, I have estimated provisions in respect of the assets, potential recoveries and liabilities of those schemes which, in the Board's judgement, are likely to be transferred into the Pension Protection Fund. These provisions are shown in my supplementary report to the Board dated 3 October 2012 and will be shown in the statement of accounts being prepared by the Board for the financial period ending on 31 March 2012.

I have also estimated contingent liabilities as at 31 March 2012, including those in respect of other pension schemes which, in the Board's judgement, may possibly be transferred into the Pension Protection Fund in the near future. These contingent liabilities are shown in my supplementary report to the Board dated 3 October 2012 and will be disclosed in footnotes to the statement of accounts prepared by the Board for the financial period ending on 31 March 2012.

Signed: Stephen Rice

Date: 3 October 2012

Name: Stephen Rice, Appointed Actuary

Job Title: Chief Actuary

Qualification: Fellow of the Institute of Actuaries

Employer: The Board of the Pension Protection Fund

Annex M1 Summary of compensation provided by the Pension Protection Fund

Broadly speaking, the Pension Protection Fund provides two levels of compensation:

1. For individuals who have reached their scheme's normal pension age before the assessment date or, irrespective of age, are in receipt of either a survivor's pension or a pension on the grounds of ill health, the Board pays from the Pension Protection Fund **– 100 per cent level of compensation.**

In broad terms and in normal circumstances, this means a starting level of compensation that equates to 100 per cent of the pension in payment immediately before the start of the assessment period, as defined in section 132 of the Pensions Act 2004. This is subject to a review of the rules of the scheme by the Board.

The part of this compensation that is derived from pensionable service on or after 6 April 1997 increases each year on 1 January in line with the increase in the Consumer Prices Index (CPI) capped at 2.5 per cent and with a floor of 0 per cent. The increases granted on and before 1 January 2011 were linked to increases in the Retail Prices Index (RPI).

2. For the majority of people aged below their scheme's normal pension age the Board pays from the Pension Protection Fund **– 90 per cent level of compensation.**

In broad terms and in normal circumstances, this means 90 per cent of the pension an individual had accrued immediately before the assessment date (subject to a review of the rules of the scheme by the Board) plus revaluation in line with the increase in the RPI between the assessment date and March 2011, and the increase in the CPI between March 2011 and the commencement of compensation payments, subject to a floor of 0 per cent over the whole period, and to a maximum increase of 5 per cent per annum for the whole period (2.5 per cent per annum for pension accrued on or after 6 April 2009). Compensation is subject to an overall cap, which from April 2012 equates to £34,049.84 per annum at age 65 (the cap is adjusted according to the age at which compensation comes into payment).

Once compensation is in payment, the part that derives from pensionable service on or after 6 April 1997 is increased on 1 January each year in line with:

- for years 2011 and earlier, the increase in the RPI capped at 2.5 per cent and with a floor of 0 per cent, and
- for years 2012 and later, the increase in the CPI capped at 2.5 per cent and with a floor of 0 per cent.

In addition, after a member's death, compensation is paid to any children who are under 18 years old, or under 23 if they are in full-time education or have a disability. Generally, compensation will be paid to any legal spouse, civil partner or other relevant partner. However, individual circumstances may differ in this regard depending on the rules of the former pension scheme.

Under the Pensions Act 2004, the Board has a duty to pay compensation on a basis that is no more or less favourable to a woman (or man) than it would be to a comparable man (or woman) in respect of pensionable service on or after 17 May 1990. In meeting this requirement, the Board must take into account any differences in scheme benefits that have arisen owing to differences in the calculation of Guaranteed Minimum Pensions (GMPs) for males and females. The Board has received legal advice confirming the existence of its duty to pay compensation on this basis. The Board has now confirmed how it proposes to implement equalisation of compensation for members whose schemes have already entered the PPF. Before applying this method to all members a pilot project with selected schemes is currently being undertaken to identify any potential implementation issues. Based on this method, the probable costs of equalisation have been estimated. These events have led the Board to conclude that it should establish a provision within its financial statements for the cost of equalisation on both the schemes that have transferred to the PPF and those schemes forming the provisions. Additionally, a contingent liability is disclosed in respect of the cost of equalisation in respect of other contingent liabilities in the footnotes to the statement of accounts prepared by the Board for the financial period ending on 31 March 2012.

The Board has the power to alter the amount of the levy that it collects (up to the levy ceiling) to meet its liabilities. Additionally, under paragraphs 29 and 30 of Schedule 7 of the Pensions Act 2004, the Board;

- has the power to alter the rates of revaluation and indexation, and
- can recommend to the Secretary of State for Work & Pensions that the percentage of benefits paid as compensation is varied.

Annex M2 Assumptions

All assumptions will be either the same as, or derived in the same way as, those derived for the valuation as at 31 March 2011, unless stated otherwise

a) Compensation levels

As for previous valuations of the Pension Protection Fund, I have continued to assume that the Secretary of State will not exercise her / his power under paragraph 30 of Schedule 7 of the Pensions Act 2004 to vary the 100% level of compensation for those members in category 1 of Annex M1 and the 90% level of compensation for those members in category 2 of Annex M1.

b) Financial assumptions

For the liabilities in respect of transferred schemes I have applied the same rationale in setting the financial assumptions as I did in my report as at 31 March 2011. I consider that it is still appropriate for the financial assumptions to vary according to the term of the particular cash flow being estimated and discounted.

i) Discount rates

I consider that a notional portfolio of assets consisting of cash plus appropriate zero-coupon interest rate swaps contracts and inflation swaps contracts plus gilt strips (or notional gilt strips) provides the best match to the Pension Protection Fund liability cash flows. Calculating the liabilities in this way represents a low-risk approach to the setting of the financial assumptions, in the sense that there should be a low risk of the notional assets being inadequate to pay the PPF members as at the valuation date their full compensation.

Under the terms of a zero-coupon interest rate swap contract with notional principal P and tenor (=duration) N, the Fund would at time N pay interest on P to the counterparty of the London Interbank Offered Rate (LIBOR) while the counterparty would at the same time pay the Fund a fixed interest rate specified in the contract. Since around August 2008, zero coupon interest rate swap yields for longer tenors have been lower than the gilts strip (one with the individual cash flows stripped out of a gilt) yields at the same duration. It is therefore considered reasonable to construct a notional portfolio so that it contains gilts strips (or more often notional gilts strips) at longer durations and cash and swaps contracts at shorter durations.

Because it is difficult to earn close to LIBOR interest on cash, a deduction is made from the zero-coupon interest rate swap yields of 15 basis points at each term.

The discount rate for each term is therefore taken as the higher of the zero-coupon interest rate swaps yield less 15 basis points and the gilts strip yield. In practice this broadly leads to the use of swaps rate less 15 basis points for terms to 11 years and gilts strip yields thereafter.

A zero-coupon interest rate swaps yield curve as at 31 March 2012 was obtained from Insight Investment who constructed the curve by seeking indicative prices from investment banks.

A gilts strip yield curve as at 31 March 2012 was obtained from Insight Investment, which was derived from information available from the UK Debt Management Office. This curve shows gilt strips yields at terms from one year to 50 years inclusive. Yields at each of these terms are in respect of bonds with the closest nominal maturity to the indicated term. As the zero-coupon swaps curve and gilt strips curve both extend only as far as term 50, I have assumed that the discount rate applying in each year after year 50 is the same as that applying at year 50.

In my opinion, the Pension Protection Fund's Statement of Investment Principles is consistent with this discount rate derivation, albeit that the Board takes some extra investment risk in the expectation of outperformance.

ii) Revaluation rates

I have assumed that the Board of the Pension Protection Fund will not exercise its power under paragraph 29 of Schedule 7 of the Pensions Act 2004 to amend the maximum revaluation rate of five per cent p.a. (2.5 per cent p.a. in respect of compensation which derives from service after 5 April 2009).

As was the case last year, future revaluations of deferred compensation are linked to increases in the CPI rather than RPI. In considering what assumption would be appropriate for future CPI increases, I have noted that at present there is almost no market in CPI swaps or indeed any other instruments from which CPI prices can reasonably be inferred. Such limited current market pricing information as is available from insurance companies would suggest an assumption of CPI increases being 0.2 per cent p.a. less than RPI increases. I have therefore assumed, for this valuation, that future CPI increases will be 0.2 per cent p.a. less than future RPI increases. I have further assumed that the rate of future RPI increases, for the period from the valuation date to normal pension age, is determined from the RPI inflation swap curve (supplied as at 31 March 2012 by Insight Investment).

I am aware that there are other methods of deriving a CPI assumption and these include, for example, deducting a best estimate of the future gap between RPI and CPI from the market implied measure of RPI. I do not feel that this method is consistent with the setting of the other financial assumptions. Should a deeper market develop, I expect that the implied gap between RPI and CPI will further increase and I have shown the sensitivity of the balance sheet to there being a gap of 0.7 per cent. This may be seen in the supplementary report which I have prepared concerning the provisions of the PPF as at 31 March 2012.

The maximum revaluation rate of 5 per cent p.a. never applies, for any term, to compensation deriving from service before 6 April 2009. The maximum revaluation rate of 2.5 per cent p.a. would apply, for every term, to compensation deriving from service after 5 April 2009. For ease of calculation this upper limit of 2.5 per cent p.a.has been ignored. The consequent overstatement of liabilities is insignificant; a rough estimate of the overstatement is less than £1,500,000.

iii) Pension increase rates

I have assumed that the Board of the Pension Protection Fund will not exercise its power under paragraph 29 of Schedule 7 of the Pensions Act 2004 to amend the maximum annual increase rate of 2.5 per cent p.a., for compensation accrued after 5 April 1997.

For this compensation increase, therefore, I need an assumption, for each term, for the increase in the CPI capped at 2.5 per cent and with a floor of 0 per cent (call this CPI[0, 2.5 per cent]). If there was a market in CPI[0, 2.5 per cent] inflation swaps then a curve of prices for each term would be derivable directly. This market does not exist, but a market does exist for the equivalent swaps based on RPI. I have therefore decided to adjust the inflation swaps curve for RPI[0, 2.5 per cent] in order to derive assumptions for CPI[0, 2.5 per cent]. The adjustment was based on the ratio of a theoretical CPI[0, 2.5 per cent] curve (assuming CPI inflation is 0.2 per cent p.a. below RPI inflation) and a theoretical RPI [0, 2.5 per cent] curve. All of these curves, both actual and theoretical, were supplied by Insight Investment.

It has not been possible to obtain data for terms one to four years as at 31 March 2012 because Insight Investment did not receive quotes for trading the RPI[0, 2.5 per cent] inflation swap for these years on that day. Insight Investment was, however, able to generate notionally a curve for terms one to four years by assuming that the implied volatilities that can be derived from the more heavily traded RPI[0,3.0 per cent] inflation swap curve also applied to the RPI[0,2.5 per cent] curve. For each year beyond 50 years, I have assumed that the pension increase assumption applying is the same as that at term 50.

The table below shows the annualised average term-dependent rates of discount, inflation and increases to pensions in payment that I have assumed over the given term. Figures shown in brackets are as at 31 March 2011)

Term	Discount rate pa	CPI increase rate pa	Post 1997 pension increase rate pa
1	1.112% (1.216%)	3.070% (4.115%)	2.149% (2.307%)
2	1.079% (1.730%)	2.846% (3.894%)	2.044% (2.223%)
3	1.162% (2.194%)	2.816% (3.667%)	2.017% (2.183%)
4	1.303% (2.572%)	2.832% (3.498%)	2.017% (2.152%)
5	1.466% (2.882%)	2.858% (3.398%)	2.008% (2.123%)
10	2.375% (3.969%)	2.994% (3.471%)	2.050% (2.145%)
15	3.047% (4.413%)	3.155% (3.614%)	2.097% (2.186%)
20	3.508% (4.638%)	3.277% (3.671%)	2.133% (2.213%)
30	3.741% (4.560%)	3.401% (3.707%)	2.182% (2.237%)
40	3.693% (4.410%)	3.408% (3.683%)	2.205% (2.226%)
50	3.526% (4.286%)	3.425% (3.680%)	2.213% (2.224%)

Sources: Insight Investment

c) Demographic assumptions

i) Mortality

The assumption for mortality is in two parts. The first part is the assumption about baseline mortality. This reflects the rate at which people have been dying in the recent past. The second part of the assumption is an estimate of how mortality rates will change over time. Taken together, these assumptions reflect my best estimate of the mortality that will be experienced by members of the PPF (ie it is my view that the assumption is equally likely to overstate as to understate actual experience).

- **Baseline mortality**

For the valuation as at 31 March 2011, a mortality analyst, Club Vita, provided us with 149 different mortality curves to apply to individual members based on:

- member status (ie deferred pensioner, pensioner, or dependant)
- sex
- lifestyle (based on postcode)
- amount of compensation.

Club Vita has updated their experience dataset since the previous valuation and so has provided us with more up-to-date mortality curves to use this year. A total of 152 different mortality curves have been used for the valuation as at 31 March 2012.

These curves have been derived by analysing a large amount of data from its members (including the PPF). These curves are based on mortality experienced over the period 2007-2009.

- **Allowance for changes in mortality over time**

For the valuation as at 31 March 2011, I adopted the CMI-2010 mortality projection model. This model was adopted in its core form, without advanced parameterisation, with a long-term improvement rate of 1.5 per cent p.a. for both men and women.

I have seen no evidence to suggest that the long-term improvement rate should be changed from my assumption adopted last year. However, since the previous valuation, the CMI has updated the CMI-2010 model to take account of more up-to-date data.

For this valuation, I have therefore adopted the CMI-2011 mortality projection model in its core form, without advanced parameterisation, with a long term improvement rate of 1.5 per cent p.a. for both men and women for this valuation. In standard notation, my assumption for men is denoted CMI_2011_M [1.5 per cent] and for women is denoted CMI_2011_F [1.5 per cent].

It should be recognised that there is a substantial element of subjectivity about mortality assumptions and that different actuaries will come to different conclusions. The appropriate mortality assumption for future valuations will be kept under review and I have shown the sensitivity of the balance sheet to the assumed long term rate of improvement. This may be seen in the supplementary report which I have prepared concerning the provisions of the PPF as at 31 March 2012.

- **Life expectancies implied by the mortality assumptions**

The following table illustrates the range of cohort life expectancies of pensioners aged 65 on 31 March 2012 and, for non-pensioners aged 40 on 31 March 2012, the range of cohort life expectancies once they reach age 65 (based on the mortality assumptions being used for this valuation). Cohort life expectancies are based on the age-specific mortality rates allowing for projected changes in mortality. The figures in brackets show the cohort life expectancies based on the assumptions adopted in my valuation as at 31 March 2011. One source of the difference between the 2011 and 2012 expectations of life is due to an additional year's worth of mortality improvements in the 2012 figures.

Men

Membership group	Minimum life expectancy in years	Maximum life expectancy in years	Range of life expectancies, in years, within which 75% of all accrued compensation lies	Average life expectancy in years (weighted by annual compensation)
Pensioners:				
- Members	17.3 (17.2)	25.7 (25.9)	20.0-24.5 (20.1-24.3)	21.8 (21.5)
- Dependants	16.3 (16.0)	20.4 (20.9)	18.8-20.4 (19.5-20.9)	19.5 (19.5)
Male Non-pensioners:				
- Members	20.3 (20.4)	28.5 (28.8)	22.5-26.4 (23.1-26.1)	24.2 (24.4)
- Dependants	19.3 (19.1)	23.3 (24.0)	21.8-23.3 (22.6-24.0)	22.5 (22.6)

Women

Membership group	Minimum life expectancy in years	Maximum life expectancy in years	Range of life expectancies, in years, within which 75% of all accrued compensation lies	Average life expectancy in years (weighted by annual compensation)
Pensioners:				
- Members	20.4 (20.0)	27.5 (26.4)	22.6-25.6 (22.7-25.6)	23.8 (23.9)
- Dependants	18.9 (16.2)	27.7 (27.4)	21.8-25.6 (21.7-25.7)	23.2 (23.8)
Non-pensioners:				
- Members	23.6 (23.2)	30.5 (29.3)	25.7-28.5 (25.9-28.6)	27.0 (27.0)
- Dependants	22.5 (20.0)	30.2 (30.2)	25.1-27.4 (25.0-27.8)	25.8 (26.2)

ii) Commutation

No allowance is made for commutation of compensation. Even though estimated cash flows would be affected by making allowances, nonetheless these member options are roughly cost-neutral in that the value of the liabilities is roughly the same whether or not a member commutes pension for cash. The factors used to determine the amount of compensation given up for cash are assumed to change over time (being reviewed at least annually) in order to maintain this broadly cost-neutral position.

iii) Early retirement

No allowance is made for early retirement. Even though estimated cash flows would be affected by making allowances, nonetheless these member options are roughly cost-neutral in that the value of the liabilities is roughly the same whether or not a member retires early. The factors used to determine the reduction in compensation on early retirement are assumed to change over time (being reviewed at least annually) in order to maintain this broadly cost neutral position.

iv) Proportion married

For pensioners:

Where there is provision for survivor pensions for relevant partners an assumption consistent with 90 per cent (males) or 80 per cent (females) at normal pension age.

Where there is no provision for survivor pensions for relevant partners other than legal spouses an assumption consistent with 80 per cent (males) or 70 per cent (females) at normal pension age.

For deferred pensioners:

Where there is provision for survivor pensions for relevant partners an assumption, at the assumed date of retirement or earlier death, of 90 per cent (males) or 80 per cent (females).

Where there is no provision for survivor pensions for relevant partners other than legal spouses an assumption, at the assumed date of retirement or earlier death, of 80 per cent (males) or 70 per cent (females).

These are standard assumptions normally considered reasonable by actuaries measuring liabilities of UK pension funds.

v) Age difference between member and dependant

Females assumed to be three years younger than males.

This is a standard assumption normally considered reasonable by actuaries measuring liabilities of UK pension funds and is consistent with the recent experience of the fund.

vi) Children's pensions

No specific additional allowance is included for prospective children's pensions. Children's pensions already in payment are assumed to cease in accordance with the compensation entitlement with no allowance for mortality prior to cessation.

vii) Expenses

Since 1 April 2008 certain administration expenses are being met from the Pension Protection Fund rather than from the Administration Fund as happened before that date. Since 1 April 2011 certain other expenses are also being met from the Pension Protection Fund rather than the Administration Fund.

An allowance equal to 2.4 per cent of the value of the liabilities in respect of former members of schemes that have transferred into the Pension Protection Fund before 1 April 2012 has been made in respect of the future cost of expenses to be met from the Pension Protection Fund. This has been derived from a calculation of the present value of the expected future expenses that will be incurred in respect of these members. This calculation was based on the budgeted expenses to be incurred by the Pension Protection Fund in the three years following the valuation date. This compares to an allowance of 1.9 per cent in the previous year's valuation.

Actuary's supplementary report as at 31 March 2012

To: The Board of the Pension Protection Fund

From: Stephen Rice, Chief Actuary to the Board of the Pension Protection Fund

Actuarial liabilities, provisions and contingent liabilities of the Pension Protection Fund as at 31 March 2012

1. Introduction

The Board of the Pension Protection Fund (the Board) is required by paragraph 22 of schedule 5 to the Pensions Act 2004 to prepare a statement of accounts in respect of each financial year. Each statement of accounts must contain an actuarial valuation of the assets and liabilities of the Pension Protection Fund. This actuarial valuation is set out in my report to the Board dated 3 October 2012.

The statement of accounts also contains provisions and discloses contingent liabilities that require actuarial estimation. This supplementary report contains all these estimates except one. The exception is the provision for the cost of equalising GMPs in respect of members who had transferred to the PPF before 1 April 2012; this is disclosed in my actuarial valuation report dated 3 October 2012. This supplementary report also contains actuarial balance sheets for the Pension Protection Fund showing actuarial liabilities and provisions in comparison with the corresponding assets. The Board is responsible for the accounting policies, and this report has been prepared within the framework which it has determined. Although I have not been explicitly commissioned to provide this report, I have, nevertheless, prepared it for the Board and I intend my report to assist the Board with the preparation of the annual report and accounts as at 31 March 2012. I therefore see the Board as the user of this report and no other party should rely on any part of this report.

This report does not contain advice on the funding of compensation payable from the Pension Protection Fund. In particular, the results of this valuation are not used in the determination of the levy. All the results in this report are outcomes of a valuation exercise involving the quantification of amounts for recording in the annual report and accounts.

In my view, while the Actuaries Code issued by the Actuarial Profession applies to the preparation of this report, there are no professional practice standards which directly apply. I have, however, prepared this report having regard to the principles in three Technical Actuarial Standards, namely TAS R (Reporting Actuarial Information), TAS D (Data) and TAS M (Modelling). This report should be considered alongside my report to the Board dated 3 October 2012. As my reports are prepared solely for the purpose of the Annual Report & Accounts of the Pension Protection Fund, I have not produced any projections of future accounting positions in this report because the Board does not require them for its accounting disclosures.

2. Provisions

Under International Accounting Standard 37 (IAS 37) of the International Accounting Standards Board a provision should be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event,
- it is probable that a transfer of economic benefits will be required to settle the obligation, and
- a reliable estimate can be made of the amount of the obligation.

The application of this requirement in the accounting standard to the Board's statement of accounts as at 31 March 2012 is set out in Annex S1.

3. Contingent liabilities

Under IAS 37, a contingent liability is not recognised as a liability because it is either:

- a possible obligation (it has not yet been confirmed whether there is an obligation that could lead to a transfer of economic benefits), or
- a present obligation that does not meet the recognition criteria in IAS 37 (ie it is not probable that a transfer of economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

A contingent liability should, however, be disclosed if the possibility of an outflow of economic benefit to settle an obligation is more than remote. The application of this requirement in the accounting standard to the Board's statement of accounts for the financial period ending on 31 March 2012 is set out in Annex S2.

The definitions of contingent liabilities are specified by the Board and I have calculated the values accordingly. However, it should be noted that claims arising after 31 March 2012 could arise from sources other than those described in the definitions for the contingent liabilities. For the avoidance of doubt, the contingent liabilities are not meant to represent the expected claims in the coming year.

4. Data

The data used for this valuation is summarised in Annex S3.

5. Compensation provided by the Pension Protection Fund

The compensation provided by the Pension Protection Fund is summarised in Annex M1 of my report to the Board dated 3 October 2012.

6. Assumptions

The assumptions used to calculate the actuarial liabilities are set out in full in Annex M2 of my report to the Board dated 3 October 2012.

The set of assumptions used in order to calculate the provisions and contingent liabilities as at 31 March 2012 are in most respects the same as those used to calculate the actuarial liabilities. The differences are shown in Annex S4.

I have performed a sensitivity analysis by amending the valuation basis in key areas. The assumptions adopted for the sensitivity analysis are shown in Annex S5.

To determine whether a provision is required for a scheme, it is necessary to determine whether as at the insolvency date the value of the assets was less than the amount of Protected Liabilities (see Annex S1). The assumptions to determine this are derived from market conditions at the date of calculation following the published guidance on undertaking a valuation in accordance with section 179 of the Pensions Act 2004. This guidance is available on the Pension Protection Fund web-site;
http://www.pensionprotectionfund.org.uk/TechnicalGuidance/Pages/ValuationGuidance.aspx

7. Method to calculate the assets, actuarial liabilities, provisions and contingent liabilities

a) Actuarial liabilities

The method of calculating the actuarial liabilities is set out in my report to the Board dated 3 October 2012.

b) Provisions

The method of calculating the provisions varied according to the data that the Board was holding about the relevant schemes as at 31 March 2012.

1. Updated asset value information and recent membership data

This information was obtained from certain schemes classified as 'material schemes'. These are schemes which:

(i) satisfy the definition of a provision as set out in annex S1; and

(ii) are sufficiently large. (Starting with the largest scheme by liability, the Board had a target that at least 75 per cent of the total liabilities and provisions of the Pension Protection Fund should be made up of material schemes and schemes which have already transferred to the Pension Protection Fund); and

(iii) actually did provide membership data and updated asset information.

For the majority of the material schemes membership data and updated asset information was provided as at 31 December 2011 or later. For material schemes that provided data for the valuation as at 31 March 2011 but not for the valuation as at 31 March 2012 the data from the 2011 valuation was used instead.

For all material schemes, the asset value at 31 March 2012 was determined by rolling forward the updated asset value and making an adjustment for benefits paid between the 'as at' date of the assets and 31 March 2012. The liability was determined by generating future cash flows of PPF compensation for the members and discounting to 31 March 2012 using the assumptions set out in annex S4 of this report. No allowance was made for membership movements between the 'as at' date of the membership and 31 March 2012 as the majority of data was provided as at or close to 31 March 2012.

Material schemes and schemes which have already transferred to the PPF account for 90 per cent of the total liabilities and provisions, as compared with the target of at least 75 per cent.

2. A section 143 valuation or a section 179 valuation, but not updated assets and membership data

- A section 143 or 179 valuation was rolled forward to the insolvency date and used as a proxy for a section 143 valuation to determine whether the scheme was in deficit at the insolvency date and hence whether it should be included in the provisions.
- If the scheme was to be included in the provisions, the resulting section 143 or 179 valuation was then rolled forward to 31 March 2012 on the valuation basis.

The methodology used to roll the s143 / s179 valuation results forward to 31 March 2012, at the same time changing the valuation assumptions to those described in annex S4, is consistent with that applied for the calculation of levy in the financial year 1 April 2011 to 31 March 2012. . The 11/12 methodology is available in the Pension Protection Levy section of the Pension Protection Fund web-site at: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1112_determination_appendix_transformation.pdf

3. A Minimum Funding Requirement (MFR) valuation, but not updated assets and membership data, nor a section 143 valuation nor a section 179 valuation

The MFR valuation was initially transformed to a section 179 valuation (guidance version G3/A3) at the MFR valuation date using a methodology consistent with that available in the Pension Protection Levy section of the Pension Protection Fund website at: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1112_determination_appendix_mfrconversion.pdf

In practice very few schemes are assessed based on an MFR valuation and in all cases the section 179 has been used for the purpose of the calculations.

- The resulting section 179 valuation was rolled forward to the insolvency date and used as a proxy for a section 143 valuation to determine whether the scheme was in deficit at the insolvency date and hence whether it should be included in the provisions.
- If the scheme was to be included in the provisions, the resulting section 179 valuation was then rolled forward to 31 March 2012 on the valuation basis using the same methodology.

4. No updated assets and membership information, nor a section 143 valuation, nor a section 179 valuation, nor a MFR valuation

It was assumed that the scheme was in deficit at the insolvency date. The scheme's provision was estimated as the median provision for schemes where data was available.

For all non-material schemes, where information relating to income and outgo was forthcoming, this information was used to provide a more precise estimate of the scheme assets and liabilities as at 31 March 2012 than was available solely using the roll-forward methodology.

In addition to the above, a provision has been included for the cost of equalising compensation that is unequal on account of inequalities in Guaranteed Minimum Pensions (GMPs) accrued between 17 May 1990 and 5 April 1997. This provision is to cover the cost of equalisation both on the liabilities of schemes that have already transferred to the PPF and the liabilities of schemes which contribute to the provisions. Under the Pensions Act 2004, the Board has a duty to pay compensation on a basis that is no more or less favourable to a woman (or man) than it would be to a comparable man (or woman) in respect of pensionable service on or after 17 May 1990, and this includes equalisation for GMPs.

The Board has considered legal advice on how exactly compensation should be equalised to allow for the difference in the GMP formula for UK pension schemes. The Board has now confirmed how it proposes to implement equalisation of compensation for members impacted. Before applying this method to all members a pilot project with selected schemes is currently being undertaken to identify any potential implementation issues. Based on this method, loadings have been calculated to apply to compensation payable from Normal Pension Age 60 to 65 inclusive for men and women separately in respect of transferred schemes. These calculations use assumptions that I believe to be appropriate for schemes that have transferred into the PPF allowing for the Board's methodology. In addition, a loading was calculated for transferred schemes equal to the expected arrears of compensation due to these inequalities in GMPs.

A single loading was applied to the liabilities forming the provisions and contingent liabilities equal to the equivalent single loading that would give the total loading applied to transferred schemes. A separate provision has then been set up equal to the cost of equalising compensation for GMPs. Overall, the provision is 1.6% of the actuarial liabilities and liabilities of schemes forming the provisions. This is a weakening of the provision compared to that allowed for in my previous report (2.4%) which takes account of the latest information available. A number of assumptions have gone into the calculation of this provision and some sensitivities to the result have been carried out. By looking at a number of extreme scenarios, I conclude that the impact of equalising compensation for GMPs should be between 0.9% and 4.0% of liabilities and provisions.

c) Contingent liabilities

The method adopted for contingent liabilities was identical to that for provisions where the Board was in possession of a section 179 valuation. This was the same method as adopted last year. For one large scheme expected to enter assessment shortly after the valuation date membership data and updated asset information was obtained. For this scheme, the asset and liability values as at 31 March 2012 were determined using the same methodology as described for material schemes.

8. Results of the calculations

The results of the calculations of the actuarial liabilities, provisions and contingent liabilities are set out in Annex S6. I also show the results as at 31 March 2011 using the assumptions set out in the Report and Accounts as at 31 March 2011.

It is my opinion that the data collection processes and calculation methods described in section 7 have resulted in calculations that represent a reasonable estimate of provisions and contingent liabilities in aggregate for the Pension Protection Fund. I recognise that the use of summary data and roll-forward methodologies inevitably introduce approximations into the calculations, but I consider they remain appropriate for calculating aggregate provisions and contingent liabilities for the purposes of this supplementary report.

9. Actuarial Balance Sheets

Annex S7 sets out the actuarial balance sheets for the Pension Protection Fund as at 31 March 2012, including the liabilities of the schemes forming the provisions. For this purpose the liabilities are taken to be:

(a) the present value of the liabilities of the Pension Protection Fund to pay sums or transfer property, as required under section 173(3) of the Pensions Act 2004. This includes the liabilities in respect of compensation to members of schemes for which the Board has assumed responsibility and the cost of equalising compensation for GMPs on these liabilities. The total value is taken as £8,374,760,000, the same figure as was used in my actuarial valuation report of 3 October 2012; and

(b) my estimate of the present value of the liabilities of the schemes forming the provisions, as set out in Annex S6 of this report, which amounts to £6,959,290,000.

(c) my estimate of the present value of the cost of equalising compensation that is unequal on account of inequalities in GMPs for the schemes forming the provisions, which amounts to £109,996,000.

Accordingly I have taken the liabilities of the Pension Protection Fund as at 31 March 2012 as £15,444,046,000.

In the actuarial balance sheets for the Pension Protection Fund as at 31 March 2012, the assets are:

(a) the value of the Pension Protection Fund assets determined in accordance with regulations 2, 4 and 5 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 (SI 2006/597); this value is taken as £11,139,360,000, the same figure as was used in my actuarial valuation report of 3 October 2012; and

(b) the sum of the estimated values of the assets in the schemes that generated the provisions described in section 2 of this report, plus any anticipated recoveries estimated on a prudent basis (£376,636,000); this figure amounts to £5,373,583,000.

Accordingly I have taken the value of the assets of the Pension Protection Fund as at 31 March 2012 as £16,512,943,000.

10. Reconciliation of the change in the funding position

Annex S8 shows a reconciliation of the opening and closing net funding position in the actuarial balance sheet for the Pension Protection Fund, including the schemes that generate the provisions.

Signed: Stephen Rice

Date: 3 October 2012

Name: Stephen Rice, Appointed Actuary

Job Title: Chief Actuary

Qualification: Fellow of the Institute of Actuaries

Employer: The Board of the Pension Protection Fund

Annex S1 Provisions in the Statement of Accounts for the financial period ending on 31 March 2012

The statement of accounts as at 31 March 2012 contains provisions in respect of eligible schemes as defined in section 126 of the Pensions Act 2004 in relation to which:

- an insolvency event notice under section 120 of the Pensions Act 2004 had been received by the Board from an insolvency practitioner on or before 31 March 2012,
- the Board had not stated on or before 31 March 2012 that the insolvency event was not a qualifying insolvency event,
- the insolvency date was on or before 31 March 2012,
- a withdrawal notice under section 122(2)(b) of the Pensions Act 2004 had not been received on or before 31 March 2012 (and, in the Board's judgement, is unlikely to be received) from the insolvency practitioner, and
- as at the insolvency date, the value of the assets was, in the Board's judgement (if the scheme had not yet transferred to the PPF), likely to have been less than the amount of the Protected Liabilities as defined in section 131 of the Pensions Act 2004 (determined on the section 179 basis as at the insolvency date).

Schemes which had, in the Board's judgement, a surplus of assets over the value of the Protected Liabilities at the insolvency date, but which may ultimately enter the PPF have been considered. A provision might be appropriate if there are a significant number of schemes in this position. Based on an analysis of our recent experience, I do not consider that this is so.

In addition, the position of schemes which, as a result of the valuation process set out in Annex S3, have a surplus of assets over the estimated value of the Protected Liabilities at the valuation date, and therefore contribute a negative amount to the provisions, has also been considered. It might be appropriate to offset some of this negative provision if there are a significant number of schemes in this position because some of these schemes may not ultimately enter the PPF. Again, I do not consider that this is so.

In addition to the above provisions I considered those schemes where an s143 valuation had been completed by the trustees and this showed an excess of assets over Protected Liabilities. These schemes did not, therefore, transfer into the PPF. There is a possibility that some of them will return to the PPF within six months of the s143 valuation being signed off (for instance if the trustees obtained a buy-out quote that showed a deficit of assets compared with the Protected Liabilities). Of these schemes, it was considered that it was probable four of these schemes would satisfy the requirements enabling them to transfer to the PPF. These schemes are expected to have a small surplus which is not material and have therefore been ignored.

Schemes which have completed the assessment period and have been operating as a closed fund have also been considered. There is a possibility that some of these schemes will return to the PPF (for instance if the trustees can demonstrate that there are now insufficient assets to provide PPF levels of compensation). Of these schemes, it was considered that it was probable seven of these schemes will ultimately transfer to the PPF and a provision has therefore been included for these cases. Information relating to them is limited and out of date; however my expectation is that all the schemes will be close to 100% funded. I have therefore set the liabilities (prior to adjustment for expenses and equalisation of GMPs) and assets for these schemes equal to the S143 asset value, or a later asset value if available. The total provision assets included for these schemes is £31,372,000 and this approximation is not therefore expected to have a material outcome on the result.

Additionally, an allowance for insolvency events that occurred on or before 31 March 2012 that have yet to be reported has also been made. This takes the form of an 'IBNR reserve' (Incurred But Not Reported reserve) which is determined by estimating the number of schemes where a claim has been incurred but not reported. This is calculated as a percentage addition to the number of schemes which have been reported and included as provisions. This percentage has been determined from an analysis of the average time lag between insolvency event occurrence and notification of such an event to the Board (via a section 120 notice) with consideration of the proportion of events resulting in a claim, as shown in the following table:

Number of months between insolvency event and Board receipt of S120 notice	Cumulative proportion of notifications received by each point in time
0	58%
1	89%
2	92%
3	95%
4	96%
5	97%
10	99%
16	100%

For this estimated number of schemes where a claim is yet to be reported, the provision is based on the median provision of schemes where a claim has been reported.

Additionally, we monitored the movement of the funding position in respect of schemes forming the provisions from 31 March 2012 to 3 October 2012 and our figures include the observed changes of sufficient materiality.

Annex S2 Contingent liabilities in the Statement of Accounts for the financial period ending on 31 March 2012

Four types of contingent liabilities are disclosed in footnotes to the statement of accounts. In previous years five categories have been disclosed. The category removed relates to schemes that had an insolvency date on or after 1 April 2012 and an insolvency event notice under section 120 of the Pensions Act 2004 had been received on or before 30 April 2012. The definitions of the four categories are given below.

1. Type 1 contingent liabilities are in respect of eligible schemes in relation to which:

- an insolvency event notice under section 120 of the Pensions Act 2004 was received by the Board from an insolvency practitioner on or before 31 March 2012,
- the Board had stated on or before 31 March 2012 that the insolvency event was NOT a qualifying insolvency event,
- in the Board's judgement, a subsequent insolvency event which will be a qualifying insolvency event is likely, and
- as at 31 March 2012, the value of the assets was, in the Board's judgement, likely to have been less than the amount of the Protected Liabilities, as defined in section 131 of the Pensions Act 2004.

2. Type 2 contingent liabilities are in respect of eligible schemes in relation to which:

- in the Board's judgement, as at 31 March 2012, no insolvency event has taken place, but the Board is nonetheless expecting to receive an insolvency event notice under section 120 of the Pensions Act 2004 from an insolvency practitioner in the future, and
- the Board has sufficient data about the scheme to be able to make an estimate of a contingent liability.

3. Type 3 contingent liabilities are in respect of schemes where:

- the Dun & Bradstreet failure scores are available to the Board and, based on the data available as at 28 February 2012, the score corresponding to the weighted insolvency probability of the scheme's participating employers was less than 10 (which means the probability of insolvency over the next year was greater than 4.68 per cent), and
- the Board in its view had sufficient information as at 31 March 2012 about the scheme to enable the funding level as at 31 March 2012 to be estimated, and
- as at 31 March 2012, the value of the assets was, in the Board's judgement, likely to have been less than the amount of the Protected Liabilities as defined in section 131 of the Pensions Act 2004.

Out of a population of around 6,500 schemes considered, 127 had a failure score of less than 10 associated with them. Of these 127 schemes, 112 were in deficit.

There is the potential to have a slight overlap with the IBNR reserve referred to in Annex S1. In the context of the total contingent liabilities I would expect the overlap to be trivial.

Type 3 contingent liabilities exclude any scheme already within the provisions or other categories of contingent liabilities.

It should be noted that in practice the schemes contributing to the type 3 contingent liabilities often change considerably from one year to the next.

4. Type 4 contingent liabilities are in respect of the cost of equalising compensation that is unequal on account of inequalities in Guaranteed Minimum Pensions (GMPs) accrued between 17 May 1990 and 5 April 1997.

Under the Pensions Act 2004, the Board has a duty to pay compensation on a basis that is no more or less favourable to a woman (or man) than it would be to a comparable man (or woman) in respect of pensionable service on or after 17 May 1990.

A contingent liability has therefore been established for the cost of equalising compensation in respect of contingent liability types 1 to 3 above.

Annex S3 Data

a) Data in respect of former members of schemes that were transferred to the Board on or before 31 March 2012

This data was shown in my report to the Board dated 3 October 2012.

b) Data in respect of provisions and contingent liabilities

There are 251 schemes which contribute to the provisions figure in the statement of accounts for the financial period ending on 31 March 2012 (and a further five schemes included via the IBNR estimate); liabilities in respect of another 49 schemes have not been recognised (ie not included in the provisions) because the value of their assets was, in the Board's judgement, likely to have exceeded the amount of the Protected Liabilities at their insolvency date. For Type 1, Type 2 and Type 3 contingent liabilities the recognition test assessment was undertaken at the valuation date since a qualifying insolvency event had not occurred.

A database is maintained for schemes forming the provisions. Data used to identify these schemes is obtained from information sent to the PPF on an employer's insolvency. This data is updated when new information arises. For instance, when a claim is rejected by the PPF, the database is updated to reflect this information and the scheme is no longer included in the provisions calculations.

In addition, the data used to place a value on the schemes forming the provisions is updated to allow for new information received by the PPF. We start off with data in relation to an s179 or MFR valuation which we already hold for the purposes of invoicing for levies, but as schemes near the end of their assessment period we will obtain an s143 valuation and the data from this will substitute any previous data held if:

- there is a material difference between the results of the s179 valuation (rolled forward to the insolvency date) and the s143 valuation,
- there is confidence in the results of the s143 valuation, and
- no material approximations have made in the s143 valuation.

In other cases, for instance material schemes, the PPF will actively seek additional information from Trustees so as to supplement or replace the data previously held on its database where it feels this will provide a more accurate valuation.

For contingent liabilities we make use of information that the PPF has gathered from sources such as Dun & Bradstreet, negotiations with companies and information submitted by The Pensions Regulator. The data used to place a value on these liabilities is taken from the information we hold for levy invoicing purposes. A database is not maintained over time for these schemes. A separate identification of contingent liabilities is made each year for the annual report and accounts and the latest data available is used in the valuation.

The numbers of schemes contributing to the various types of provisions and contingent liabilities are given in the table below. Figures in brackets relate to the total number of schemes considered for inclusion in the provision (ie it includes schemes where the value of their assets was, in the Board's judgement, likely to have exceeded the amount of the Protected Liabilities at their insolvency date). In all of the figures we have sought to recognise all segregated parts of schemes as separate schemes. This is the same treatment as was adopted at 31 March 2011.

Liability		Number of schemes recognised	Number of pensioners *	Number of deferred pensioners *
Provision	2012	251 (300 in total)	44,600	69,617
	2011	314 (369 in total	72,148	112,454
Provision - IBNR	2012	5 (5 in total)	n/a	n/a
	2011	8 (8 in total)	n/a	n/a
Type 1 contingent liability	2012	2 (2 in total)	52	137
	2011	2 (2 in total)	120	168
Type 2 contingent liability	2012	16 (16 in total)	52	137
	2011	10 (10 in total)	120	168
Type 3 contingent liability	2012	112 (127 in total)	11,590	24,991
	2011	103 (160 in total)	25,297	58,662

* Data in respect of recognised schemes only.

The valuation of the liabilities of material schemes forming the provisions and one large scheme included in the contingent liabilities which was expected to enter assessment shortly after 31 March 2012 has been undertaken using membership data, in some cases grouped by age and gender. The valuation of the liabilities of all other schemes forming the provisions and contingent liabilities has not been undertaken using member-by-member data as we do not hold this data. Instead the historic valuation results available for the schemes have been used and rolled forward on a global basis. As such the valuation will not be as accurate as one undertaken using individual membership data for each scheme. This approach, while perhaps inappropriate for valuation purposes for some schemes on an individual basis, in aggregate is, in my opinion, acceptable for estimating provisions and contingent liabilities. Generally there is no reason to doubt the quality of the information provided within a particular scheme's valuation report. It is important, however, to note that any errors contained within the original scheme valuation will carry through to this valuation.

Because of the lack of uniformity of data summaries in individual schemes' valuation reports, it has not been possible to provide any other summary data about schemes in the various liability categories.

As we do not hold member-by-member data for all the schemes forming the provisions, we have not been able to indicate the incidence of cash flows relating to the schemes forming the provisions. However, when collecting data for material schemes we obtained information relating to the pensions in payment and deferred pensions by age band and this indicated that the shape of the cash flows for schemes forming the provisions is not dissimilar to that for transferred schemes.

Annex S4 Assumptions

All assumptions will be either the same as, or derived in the same way as, those derived for the valuation as at 31 March 2011, unless stated otherwise.

a) Actuarial liabilities

The assumptions adopted were described in my report to the Board dated 3 October 2012.

b) Basis adopted for Provisions and Contingent liabilities

1. Discount, inflation and pension increase rates

For the provisions represented by material schemes we have used the term-dependent rates as described in Annex M2. For the provisions represented by non-material schemes and contingent liabilities it is not possible to use term-dependent rates as we do not have individual member data to be able to project cash flows. We have therefore made assumptions about the following:

- Discount rate in deferment (net of revaluation increases in deferment – see Annex M1 for a description of these increases),
- Discount rate in payment for non-increasing compensation for current pensioners,
- Discount rate in payment for non-increasing compensation for future pensioners,
- Discount rate in payment for increasing compensation for current pensioners (net of increases in payment – see Annex M1 for a description of these increases),
- Discount rate in payment for increasing compensation for future pensioners (net of increases in payment – see Annex M1 for a description of these increases).

These financial assumptions have been derived from the term-dependent rates shown in Annex M2. This has been done by assuming that cash flows for provisions will follow the same shape as cash flows for the Pension Protection Fund liabilities.

Single rates of discount, inflation and pension increases were determined so that the present values placed on each of the cash flows for pensioners and deferred pensioners was equal to the present value determined using term-dependent rates. These single rates of discount, inflation and pension increase were then used to determine the net discount rate as set out in the following table. The figures in brackets are those as at 31 March 2011.

Net discount rate	% pa
In deferment	0.4 (0.8)
In payment for non-increasing compensation for current pensioners	3.0 (4.1)
In payment for non-increasing compensation for deferred pensioners	3.5 (4.4)
In payment for increasing compensation for current pensioners	0.8 (1.9)
In payment for increasing compensation for deferred pensioners	1.3 (2.2)

2. Mortality

There is no evidence to suggest that my assumption for the base mortality or long term mortality improvement used in my previous report should change, other than to adopt the latest update to CMI 2011 model for mortality improvements. The mortality baseline in respect of a member is, therefore, S1PMA (men) and S1PFA (women) with future changes in line with CMI_2011_M [1.50 per cent] and CMI_2011_F[1.50 per cent] for men and women respectively. For the member's dependant, the baseline is S1DFA (female dependants) and S1PMA (male dependants) with future changes in line with CMI_2011_F [1.50 per cent] and CMI_2011_M [1.50 per cent] for female and male dependants respectively. These baseline tables and future projections have been issued by the CMI.

Because the liabilities of non-material schemes' provisions and contingent liabilities are calculated by rolling forward the results of an earlier valuation, it is not possible to use the chosen assumptions precisely. Instead, all members of non-material schemes are assumed to be male and their dependants assumed to be female. Ratios of annuity values using male mortality are therefore used in the transformation of the valuation result. This straightforward and tractable approach is fit for purpose since men comprise the majority of pension scheme liabilities.

The possibility of scheme-specific mortality was considered for large schemes satisfying the following definition:

- Liabilities at the section 179 (or section 143) valuation date were at least £200 million on the section 179 (or section 143) basis.

Scheme-specific mortality was adopted where the Board had evidence that future mortality for large schemes as defined above was likely to be significantly different from the assumptions set out in the first paragraph. In my opinion, there were no large schemes with evidence of significantly different mortality and so no adjustments for scheme-specific mortality have been made to the provisions or contingent liabilities.

3. Proportion Married

80 per cent of members are assumed to be married or to have a relevant partner. Again, because the liabilities are calculated by rolling forward the results of an earlier valuation it is not possible to use sex-specific proportions married.

4. Age difference between member and dependant

Females assumed to be three years younger than males.

5. Children's pensions

No specific allowance.

6. Expenses

Allowance has been made for expenses incurred by the trustees prior to transfer into the Pension Protection Fund. Allowance has also been made for certain expenses incurred after transfer to the Pension Protection Fund, in respect of schemes which are likely to transfer to the Pension Protection Fund (see Annex M2 of my report to the Board dated 3 October 2012 for an explanation of the additional expenses that are to be met from the Fund with effect from 1 April 2011). These allowances amount to 1.2 per cent of the total provisions over and above the standard expenses allowances under the section 179 valuation methodology. This compares to an allowance of 1.1 per cent in the previous year's valuation.

Annex S5 Sensitivity analysis

Results have been calculated on the basis described in annex S4. However, the future is never certain, and a wide range of factors could affect the future finances of the PPF. It is possible to capture some measure of how different possible outcomes for these factors affect the PPF by showing different valuation results using different values for the assumptions set out in annexes M2 and S4. For instance, if recipients of PPF compensation were to live longer than expected, the cash flows out of the PPF would rise, other things being equal. The risks that such a change pose to the PPF can be investigated by showing the results of the PPF valuation modified to reflect different assumptions about mortality rates and longevity. Conversely, if the values of (non-bond) assets held as investments by the PPF and schemes in assessment were to fall by 10 per cent, there would be less assets to meet liabilities, which, other things being equal, would be unchanged.

The scenarios considered are as follows:

Scenario 1: Assumptions based purely on the swaps curve at 31 March 2012 but with a deduction of 15 basis points at each term

Scenario 2: Assumptions based purely on the gilts curve at 31 March 2012

Under scenarios 1 and 2 the effect of the basis change is on the actuarial liabilities and on the liabilities forming the provisions.

Scenario 3: Assumes nominal yields increase by 0.5 per cent

Scenario 4: Assumes that inflation increases by 0.5 per cent at each term

In scenarios 3 and 4, we have looked at the effect on the invested assets and assets in respect of schemes forming the provisions as well as the effect on the liabilities. The result of a decrease in the above yields of the same magnitude has not been shown. This is because the PPF aims to adopt a fully hedged position with regards to interest and inflation. As a result, our funding position is relatively insensitive to changes in these rates. This is illustrated by the results of scenario 3 and 4 shown in Annex S7.

Scenario 5: Assumes that increases in the Consumer Prices Index will be 0.7 per cent lower than increases in the Retail Prices Index, (ie assuming that a market had developed in CPI and that it was priced at 0.7 per cent below RPI).

Scenario 6: Assumes that the probability of death in each year of age is 90 per cent of that used in the main basis.

Scenario 7: Assumes that the long term projection in mortality improvement is increased by 0.5 per cent to 2.0 per cent p.a.

Scenario 8: Assumes non-bond type assets decrease by 10 per cent at 31 March 2012. The asset value would be expected to change by a similar order of magnitude in the opposite direction if instead these assets are assumed to increase by 10 per cent.

Scenario 9: Assumptions based on s143 entry valuation basis (effective from 1 April 2011)

Historically, 2 additional scenarios have been included:

- Assume that the age difference between men and women decreases by one year so that men will be two years older than their spouse or partner.
- Assume that the proportion of married members increases by five per cent.

It has been estimated that the impact of each of these scenarios is small and will not impact funding by more than one per cent, and they have therefore been excluded.

A summary of the assumptions is shown below:

	Main Basis	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5	Scenario 6	Scenario 7	Scenario 8	Scenario 9
Discount rate in deferment	0.354%	0.021%	0.347%	0.831%	-0.130%	0.842%	0.354%	0.354%	0.354%	-0.300%
Discount rate in payment for non-increasing compensation for current pensioners	2.988%	2.773%	2.918%	3.456%	2.990%	2.985%	2.988%	2.988%	2.988%	3.140%
Discount rate in payment for non-increasing compensation for future pensioners	3.519%	3.179%	3.512%	4.007%	3.524%	3.514%	3.519%	3.519%	3.519%	3.140%
Discount rate in payment for increasing compensation for current pensioners	0.842%	0.630%	0.773%	1.303%	0.769%	0.928%	0.842%	0.842%	0.842%	0.640%
Discount rate in payment for increasing compensation for future pensioners	1.257%	0.923%	1.250%	1.736%	1.205%	1.320%	1.257%	1.257%	1.257%	0.640%
Non bond assets	Market value	Market value	Market value	Market value	Market value	Market value	Market value	Market value	Fall by 10%	Market value
Proportion married	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in s143 guidance (B5)
Mortality	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	As in Annexes S4 and M4	10% reduction in death rates	2.0% long term mortality improvement	As in Annexes S4 and M4	As in s143 guidance (B5)

Annex S6 Calculation results

a) Calculation of actuarial liabilities for members who have transferred into the Pension Protection Fund

The actuarial liabilities in respect of former members of schemes for which the Board assumed responsibility on or before 31 March 2012 plus the cost of equalising compensation for GMPs on those liabilities plus a sum required to meet the remaining liabilities under Regulation 3 of the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006 amount to £8,374,760 ,000.

b) Calculation of provisions

256 schemes were included in the provisions in the statement of accounts for the financial period ending on 31 March 2012, yielding the following estimated provisions (a comparison is shown with the equivalent figures from the 2011 Report & Accounts using the assumptions described in that report):

The table below shows the estimated assets held at 31 March 2012 in the 256 schemes forming the provisions. It also shows the outstanding anticipated recoveries, the resulting total assets and estimated funding position in respect of those 256 schemes.

	31 March 2012 (£000s)	31 March 2011 (£000s)
Assets excluding anticipated recoveries	4,996,947	7,041,550
Anticipated recoveries	376,636	399,447
Total assets	5,373,583	7,440,997
Provisions	7,069,286	9,287,440*
Excess of liabilities over assets	1,695,703	1,846,443*

* These figures have been restated due to the change in presentation of the provision for the cost of equalising compensation for GMPs. The value of the provisions quoted in my original report dated 25 October 2011 was £9,381,217,000 and the excess of liabilities over assets was £1,940,220,000.

The liabilities recognised as provisions are the present value of the liabilities calculated at each valuation date on the relevant basis.

The provision assets have decreased by £2,067,414,000 and this can be reconciled as follows:

	£m	£m
Assets as at 31 March 2011		**7,441**
Adjustment for schemes not considered probable in 2011 but which subsequently transferred to the PPF	352	
New schemes coming into assessment	1,026	
Schemes accepted into the PPF (assets as at the Transfer Date)	(2,468)	
Change in schemes' assets on account of known benefits paid out	(262)	
Claims no longer considered probable (exits or schemes estimated to be in surplus at their assessment date)	(1,493)*	
Claims now considered probable (schemes estimated to be in deficit at their assessment date)	65	
Change in schemes' assets on account of other changes (including updated valuation information, changes in recoveries and investment returns)	713	
Assets as at 31 March 2012		**5,374**

*Approximately £1.1 billion of this relates to one large scheme which was included as a provision last year but was subsequently confirmed as being in surplus at its assessment date.

The provision liabilities have decreased by £2,218,154,000 and this can be reconciled as follows:

	£m	£m
Provision liabilities at 31 March 2011		9,287
Adjustment for schemes not considered probable in 2011 but which subsequently transferred to the PPF	396	
New schemes coming into assessment	1,340	
Schemes accepted into the PPF (liabilities as at 31 March 2012)	(3,669)	
Claims no longer considered probable (exits or schemes estimated to be in surplus as at their assessment date)	(1,638)	
Claims now considered probable (schemes estimated to be in deficit as at their assessment date)	87	
Effect of passage of time on discounting	300	
Change in schemes' liabilities on account of change in financial assumptions	1,614	
Change in schemes' liabilities on account of change in mortality assumptions	(9)	
Change in schemes' liabilities on account of known benefits paid out	(262)	
Change in allowance for equalisation of GMPs*	(57)	
Change in schemes' liabilities on account of updated valuation information	(274)	
Change in allowance for future expenses**	5	
Miscellaneous	(51)	
Provision liabilities at 31 March 2012		**7,069**

* see section 7(b) of this supplementary report for an explanation of the change in allowance for equalisation of GMPs

** refer to 6. of annex S4 for an explanation of change in expenses

c) Calculation of contingent liabilities

The estimated amounts for the various types of contingent liabilities were as follows (a comparison is shown with the equivalent figures from the 2011 Report & Accounts under the Main Assumptions basis as described in that report):

Type of contingent liability	Estimated scheme funding positions / GMP equalisation costs (for type 4 contingent liabilities) as at 31 March 2012 (£000s)	Estimated scheme funding positions / GMP equalisation costs (for type 4 contingent liabilities) as at 31 March 2011 (£000s)
Additional category in 2011	N/A	4,388
1	2,266	5,937
2	1,125,206	227,578
3	744,335	982,161
4	97,139	141,147
Total	**1,968,946**	**1,361,211**

The liabilities recognised as contingent liabilities are the present value of the deficit calculated at each valuation date on the relevant basis.

Shown below are the total assets and total liabilities that correspond to the above deficits (contingent liabilities).
A comparison is shown with the equivalent figures from the 2011 Report & Accounts under the Main Assumptions basis.

Type of contingent liability *All amounts in £000s*	31 March 2012 Assets	31 March 2012 Liabilities	31 March 2011 Assets	31 March 2011 Liabilities
Additional category in 2011	N/A	N/A	25,643	30,031
1	10,209	12,475	10,517	16,454
2	1,596,164	2,721,370	810,819	1,038,397
3	2,666,468	3,410,803	3,814,081	4,796,242
4	N/A	97,139	N/A	141,147
Total	**4,272,841**	**6,241,787**	**4,661,060**	**6,022,271**

At this stage it is too early to assess whether any recovery is available for any type of contingent liability so none has been assumed.

Annex S7 Actuarial balance sheet

On the main 31 March 2012 basis the Pension Protection Fund actuarial balance sheet is as follows:

Assets	£000s
The value of the Pension Protection Fund assets determined in accordance with the Pension Protection Fund (Valuation of the Assets and Liabilities of the Pension Protection Fund) Regulations 2006	11,139,360*
The sum of the estimated values of the assets in the schemes that generated the provisions, plus any anticipated recoveries**	5,373,583***
Total assets	**16,512,943**

Liabilities	£000s
The present value of the liabilities of the Pension Protection Fund to pay sums or transfer property as required under section 173(3) of the Pensions Act 2004	8,374,760*
The present value of the liabilities of the schemes forming the provisions (inclusive of the cost of equalisation for GMP for both the Pension Protection Fund liabilities and the provision liabilities)**	7,069,286
Total liabilities	**15,444,046**
Excess of assets over liabilities	**1,068,897**
Funding Ratio (Assets / liabilities)	**106.9%**

* Inclusive of £1,499,000 in respect of AVC assets that match AVC liabilities yet to be discharged

** Inclusive of an allowance for IBNR (scheme assets of £19,559,000 and liabilities of £26,629,000)

*** Inclusive of anticipated recoveries of £376,636,000

I have also calculated the actuarial liabilities and the liabilities of the schemes forming the provisions using the bases set out in Annex S5.

The balance sheet on the various scenarios (as described in the section on sensitivity analysis in Annex S5) is as follows. None of these scenarios should be interpreted as upper or lower bounds of the range of reasonable estimates which might be made

amounts in £m	Main Basis	Scenario 1 2012 Swaps less 15 basis points	Scenario 2 2012 gilts	Scenario 3 Nominal plus 0.5%	Scenario 4 Inflation plus 0.5%	Scenario 5 CPI is 0.7% lower than RPI	Scenario 6 10% reduction in death rates[1]	Scenario 7 Long term mortality improve-ment plus 0.5%[2]	Scenario 8 Non bond type assets fall by 10%	Scenario 9 S143 Basis
Assets										
The value of the Pension Protection Fund assets	11,139	11,139	11,139	10,409	11,409	11,139	11,139	11,139	10,479	11,139
The values of the assets in the schemes that generated the provisions	5,374	5,374	5,374	4,914	5,664	5,374	5,374	5,374	5,204	5,374
Total assets	**16,513**	**16,513**	**16,513**	**15,323**	**17,073**	**16,513**	**16,513**	**16,513**	**15,683**	**16,513**
Liabilities										
The present value of the liabilities of the Pension Protection Fund	8,375	8,910	8,414	7,659	8,701	8,087	8,631	8,601	8,375	9,537
The present value of the liabilities of the schemes forming the provisions	7,069	7,479	7,100	6,429	7,264	6,758	7,193	7,169	7,069	7,677
Total liabilities	**15,444**	**16,389**	**15,514**	**14,088**	**15,965**	**14,845**	**15,824**	**15,770**	**15,444**	**17,214**
Excess of assets over liabilities	**1,069**	**124**	**999**	**1,235**	**1,108**	**1,668**	**689**	**743**	**239**	**(701)**
Funding Ratio (Assets / liabilities)	**107%**	**101%**	**106%**	**109%**	**107%**	**111%**	**104%**	**105%**	**102%**	**96%**

[1] Liabilities reduce by more proportionately if we assume a 10 per cent increase in death rates. Under this scenario the total liabilities would be £14,992 million and the funding level 110 per cent

[2] Liabilities reduce by more proportionately if we assume long term mortality improvements less 0.5 per cent. Under this scenario the total liabilities would be £15,020 million and the funding level 110 per cent

Annex S8 Comparison with the funding position as at 31 March 2011

Under IAS 37 a reconciliation is required of the opening and closing net funding position on the actuarial balance sheet, including schemes that generate the provisions. I show this as a table below:

Reconciling item	£m
Excess of assets over liabilities on the actuarial balance sheet at 31 March 2011	**678**
Change in actuarial liabilities (this is further broken down in section 7 of my report on the actuarial valuation of the Pension Protection Fund)	(4,297)
Change in liabilities for schemes forming the Provisions (this is further broken down in Annex S6)	2,218
Change in Pension Protection Fund assets (this is further broken down in section 6 of my report on the actuarial valuation of the Pension Protection Fund)	4,537
Change in assets for schemes forming the provisions (this is further broken down in Annex S6)	(2,067)
Excess of assets over liabilities on the actuarial balance sheet at 31 March 2012	**1,069**

The overall impact on the PPF liabilities and the provision liabilities as a result of the change in mortality assumptions for 2012 was a reduction in liability of £19 million.

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