Department for Work & Pensions

Departmental Review of the Pension Protection Fund (PPF)

May 2022

Contents

Glossary

AMNT	The Association of Member Nominated Trustees
CEO	Chief Executive Officer
CIO	Chief Investment Officer
CRO	Chief Risk Officer
DB	Defined Benefit
DWP	Department for Work and Pensions
ESG	Environmental, Social and Governance
FAS	Financial Assistance Scheme
FCA	Financial Conduct Authority
FCF	Fraud Compensation Fund
FCL	Fraud Compensation Levy
FReM	The Government Financial Reporting Manual
FSCS	Financial Services Compensation Scheme
IPE	Investment and Pensions Europe
ISG	Industry Steering Group
LDI	Liability Driven Investment
MaPS	The Money and Pensions Service
NEST	National Employment Savings Trust
PAG	Pensions Advisory Group
PLSA	Pensions and Lifetime Savings Association
PPF	Pension Protection Fund
PPFO	PPF Ombudsman
QAR	Quarterly Assurance Report
RAC	Risk and Audit Committee
RI	Responsible Investment
SAA	Strategic Asset Allocation
SIP	Statement of Investment Principles
SME	Small and Medium Size Enterprises
TCFD	Task Force on Climate-Related Financial Disclosures
TPO	The Pensions Ombudsman
TPR	The Pensions Regulator

Introduction

This report sets out the findings from a departmental review of the Pension Protection Fund (PPF), a public corporation[1] sponsored by the Department for Work and Pensions (DWP). The review was carried out in the first quarter of 2022 by a small team, led by Lesley Titcomb CBE as the independent lead reviewer.

The review's terms of reference, found in annex B, were based upon the Cabinet Office guidelines[2], setting out a need to consider efficacy, efficiency, accountability and governance. This was then agreed with the Minister for Pensions and Financial Inclusion and the Secretary of State for Work and Pensions

The review considered the 'form and function' of the PPF in terms of whether it is fulfilling the purpose and objectives for which it was established in 2005 and also whether it is still required. It examined:

- the PPF's governance and strategy, as guided by the governance standard and considered whether it offers value for money;
- the relationship between the PPF and the DWP;
- the purpose and operation of the various levies which fund PPF's activities;
- how it manages risk and its investments; and
- the administration of the Financial Assistance Scheme (FAS) and Fraud Compensation Fund (FCF);
- the state of PPF's relationship with a range of stakeholders.

The review team requested and reviewed written material from the PPF and the DWP and conducted a series of interviews with PPF executives, DWP officials and a range of external stakeholders with different perspectives on the PPF and its relationship with the DWP. A full list of those interviewed is at annex A. The independent lead reviewer also attended a Quarterly Accountability Review (QAR) meeting between the DWP and the PPF and observed part of a PPF Board meeting.

The last review of the PPF was the 2014 Triennial Review of Pensions Bodies, which made no recommendations for changes to the PPF. There have been no subsequent reviews of PPF carried out by the DWP.

[1] Cabinet Office, Classification of public bodies: information and guidance - GOV.UK (www.gov.uk), 2016
[2] Cabinet Office, Public Bodies Review Programme - GOV.UK (www.gov.uk), 2022

Lead Reviewer's Foreword

I am pleased to present the report from the DWP's departmental review of the Pension Protection Fund, for which I was appointed as the Lead Reviewer.

I would like to thank everyone who has assisted with and contributed to this review. It has benefited from very constructive engagement from the PPF itself and from officials in the DWP, all of whom responded to requests for interviews and to questions willingly and promptly.

The PPF provides a critical safety net for the many millions of people who save through defined benefit occupational pension schemes when something goes wrong with the sponsoring employer. It also carries out a number of other functions. I spoke to a wide range of stakeholders including representatives of those who are protected by the PPF and those who fund it. All of them speak highly of it and are very supportive of its role and the way it operates. I am very grateful to all those who agreed to be interviewed for the review and who gave me their insight and observations.

I would particularly like to thank the DWP team dedicated to supporting this review (David Bateman, Steve Barton, Katherine Bourgis and Chris Lenton) for all their hard work, help and guidance.

Subsequent to the completion of this report, in September 2022 the speed and magnitude of rises in gilt yields caused a significant liquidity squeeze for some defined benefit (DB) pensions schemes that use liability driven investments (LDI) to hedge against movements in interest rates and their LDI providers.

I understand that the PPF managed the collateral calls it faced over this period successfully.

The key recommendations in the report relate to the long-term direction of the PPF. These matters remain pertinent issues for PPF and their relevance is unchanged by what happened in the events related to LDI.

Lesley Titcomb, CBE

Summary of Findings

1. In conducting this review, I have found the PPF to be a well-run public body offering high standards of service and value for money to those who use it and pay for it. It has a good relationship with the DWP, with an appropriate balance between independence in its operations and necessary accountability. It is well-managed and well-governed and is highly regarded by the full range of its stakeholders.

2. My recommendations are therefore limited in number, focusing on areas where there is an opportunity to enhance rather than a need to rectify. In particular, there is an opportunity for the PPF to share its good practice in certain areas more widely and an opportunity for the DWP and the PPF to consider whether it and its expertise can be used in other ways for public benefit.

3. The success of the PPF's Funding Strategy is such that it has built up a level of reserves which provide a high degree of probability that it will be able to provide any compensation which might be required for the population of savers in DB schemes. Such schemes continue to reduce in number and improve in levels of scheme funding, with the resultant risk that the PPF may find itself with more money than it ultimately needs in future. However, there is never absolute certainty; a number of schemes, including some very large ones, remain open to new joiners and a number of other, generally smaller, schemes continue to operate at a level of funding which means they are unlikely to achieve buy-out and are not attractive to commercial consolidators. So, the PPF and the protection it provides will continue to be required for the foreseeable future, albeit the challenge of building up sufficient funding may have reduced.

4. The PPF has recently published its new 3-year strategy[3] and is now working on an associated funding strategy, which will in turn provide a decision-making framework for the Board when considering the future of the levy. These will be of considerable interest to stakeholders.

5. While the day to day working relationship between the DWP and the PPF is good, it is principally focused on either fairly low-level issues relating to matters set out in the accountability framework, or on dealing with specific policy issues. There are few opportunities to discuss long-term strategic issues relating to the future of the PPF or wider policy issues. The PPF Chair is also new in role and, inevitably, some regular meetings which used to take place at senior level have not happened because of the pandemic. **I therefore make the following recommendations:**

    - **That the DWP and the PPF work together to explore whether it is feasible for the PPF's skills and capabilities to be used in other ways for public benefit; for example, in managing investments for Government or acting**

[3] PPF, [Pension Protection Fund Strategic Plan 2022 (ppf.co.uk), 2022]

as a consolidator or provider of aggregated services for schemes which would benefit from this, but which are not attractive to commercial consolidators.

- **That the DWP and the PPF work together to understand the implications of the PPF's funding position in light of expected future developments in the population of Defined Benefit (DB) pension schemes and plan well ahead for any legislative changes that might be needed; for example, to address what happens to any funding which is surplus to requirements.**

- **That the DWP ensures that the new PPF Chair has the chance to build her relationships with key senior people in the DWP, including the Minister for Pensions, the Permanent Secretary and the Director of Private Pensions Policy; in particular, the PPF Chair and CEO should meet the Minister for Pensions together twice a year, with a focus on the strategic challenges, risks and opportunities facing the PPF.**

- **That more opportunities are found for the Executive Team at PPF to meet their counterparts at the DWP and spend time on future strategic challenges or emerging complex policy issues and how to address them effectively in partnership. The Quarterly Accountability Review (QAR) between DWP and PPF can then be the principal forum through which the day-to-day performance of the PPF is addressed.**

- **That DWP and PPF reassess how their working relationship operates so as to ensure emerging issues are handled quickly and collaboratively. This to include undertaking a lessons learnt exercise in relation to the Fraud Compensation Fund (FCF) project to determine how the use of a 'task and finish' Steering Group and other successful approaches can be replicated and the risk of any misalignment of interest in dealing with policy issues reduced.**

6. Governance and risk management within the PPF are generally good, with the Board and Committees operating well and a clear mission, purpose and values. **My recommendations here are quite low level:**

   - **That the PPF concludes its review of the responsibilities of the second line risk function as soon as possible, moves to appoint a permanent Chief Risk Officer (CRO) and then completes the build out of its second line investment risk capability as soon as possible.**

   - **The Risk and Audit Committee should occasionally have a meeting which is specifically focused on risk, rather than both audit and risk.**

- **The PPF should consider how the Board could hear more directly about the member perspective to inform its deliberations.**

- **The DWP should regularly review the salaries of Executive Board Directors in the context of wider public sector pay policy, to ensure that they do not become a barrier to recruiting and retaining individuals of appropriate experience and calibre and to ensure that the differentials between Executive Director and other senior executive roles do not drift too far apart.**

7. The PPF manages investments totaling £38bn as at the end of 2020-2021 financial year[4], broadly split between assets which hedge its future liabilities and return-seeking assets. It manages over 50% of its assets in-house, including a significant amount of the liability driven investment, to have the control to drive performance of this critical aspect of the portfolio and to get value for money, and uses a range of external investment managers for the rest. Its recent performance against its investment benchmarks has been outstanding. **My recommendations here are:**

   - **The Board should consider commissioning an independent review of the Fund's investment strategy and the associated Statement of Investment Principles and Strategic Asset Allocation.**

   - **PPF should take a higher public profile and share more information on its approach to investment management, particularly in relation to its industry leading commitment to responsible investing. It should consider including more information in its Annual Report to provide insight into specific investment choices. It should also use its position as a public body to work with others to encourage the development of more UK-focused well-structured alternative investment opportunities.**

   - **The Board and Executive should consider whether it would be appropriate to seek Financial Conduct Authority (FCA) authorisation and regulation for either the PPF itself or a dedicated subsidiary, given the increased significance of the investment management function, and if so decided, then start discussions with the DWP on any legislative change that would be required.**

8. The PPF is highly respected by its stakeholders, but they observe that its profile within the pensions industry is not as high as it was, say, five to ten years ago. Smaller schemes and sponsoring employers are particularly appreciative of the efforts made to communicate with them individually and the PPF produces some excellent

[4] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk), Page 14

educational material for members. Relations with other key bodies, such as The Pensions Regulator, are generally good. **My recommendations in relation to stakeholders are:**

- **The PPF should take a higher public profile within the pensions industry and share more about its new strategy and funding strategy, the impact of levies, the implications of recent court cases, its engagement with the pensions dashboard etc, as well as its investment activities.**

- **The PPF should conduct an in-depth assessment including consulting with other interested parties, of the pros and cons of communicating the existence and shape of the compensation available to the members of Defined Benefit (DB) pension schemes and how this might be done in a simple and cost-efficient way.**

- **The PPF should seek to provide a levy calculator for schemes and their employers via its website, so that they can work out what their risk-based levy charge will be in pounds and pence. If it is not feasible to provide this, then it should explain clearly why this is the case.**

- **The PPF should continue to work closely with other relevant bodies such as The Pensions Regulator (TPR), The Financial Conduct Authority (FCA) and The Financial Services Compensation Scheme (FSCS) and, wherever possible, produce joint consultations with one or more of these bodies where they have overlapping or adjacent and related responsibilities.**

9. Levy payers agree that the risk-based levy is an effective contributor to the protection fund, which funds the compensation provided by the PPF as well as a limited element of PPF costs. It works well in their view and they were appreciative of the changes made to provide assistance during the pandemic, especially the small scheme adjustment. I received no specific comments on the scheme-based levy, which is paid by all schemes and based on size. However, the administration levy, which is collected separately by The Pensions Regulator alongside the general levy on pension schemes and then passed to the DWP, which in turn makes a grant to the PPF to cover a proportion of its administrative expenditure, is less transparent and appears to be an unnecessary complication for both the PPF and its stakeholders.

10. The PPF has flagged that the levies at present form a diminishing part of its funding, which is increasingly provided through investment returns. PPF also recognises that there is pressure from some stakeholders to reduce the amount of risk-based levy collected, given PPF's strong funding position. The PPF has been considering this as part of its new funding strategy. However, there are constraints in law on what the

PPF can do with the levy; it cannot be raised by more than 25% of the previous year's total. If the levy were reduced to nothing, then it would not be possible to raise a further levy if circumstances required it. **As regards the levies, I recommend that:**

- **The administration levy is abolished and, once the existing reserve is expended, the PPF is permitted to recover all its administrative costs via the levy which it collects itself.**

- **The DWP and the PPF should work together to ensure that any necessary changes are made to ensure that the PPF annual levy (both risk-based and scheme-based elements) can be reduced easily, if the PPF Board so decides, but that the PPF retains the freedom to reintroduce or raise the levy again should circumstances change.**

11. The past two years have proved challenging in respect of the FCF, which is administered by the PPF on behalf of the DWP. A High Court judgement has clarified the eligibility of schemes specifically established to perpetrate pension liberation fraud. This in turn has led to claims against the FCF being higher than has historically been the case, the Fraud Compensation Levy (FCL) being increased for future years and legislation being passed to permit the Government to make a loan to the PPF if required to meet FCF claims. Nine of the eleven bodies who responded to the government's consultation on the proposed levy rate increases wanted to see a comprehensive review of pension fraud compensation provision, arguing that the original legislative intent is being significantly exceeded. **I therefore recommend that:**

    - **When the DWP decides to undertake a review of the Fraud Compensation Fund (FCF) and the compensation it offers, it should seek operational input from the PPF in relation to working with it and through pensions schemes in determining the nature and level of compensation required. Such a review should cover the appropriate level of compensation, its interaction with other compensation or redress regimes e.g., The Financial Services Compensation Scheme (FSCS) and The Pensions Ombudsman (TPO), and how it is funded.**

Overview of the Pension Protection Fund

12. The PPF is both an organisation and a fund. The fund provides an important part of the framework for the protection of those who save for their retirement through Defined Benefit (DB) pension schemes sponsored by their employer, when an employer becomes insolvent and its pension scheme cannot afford to pay its promised pensions, the PPF provides compensation to scheme members for the pensions they have lost. The compensation is funded from the assets of schemes which transfer into the PPF, the management of the investments held by the PPF and from a levy raised on DB schemes and usually paid by the sponsoring employer. The PPF as an organisation also administers the FAS using funds provided from the public purse. The Scheme was set up to provide financial assistance to eligible scheme members whose employer collapsed prior to 2005. The FCF provides compensation where eligible schemes have lost out due to acts of dishonesty.

13. The PPF is a statutory public corporation, governed by a Board and employing approximately 470 people, accountable to Parliament through the Secretary of State for the DWP. It is based in Croydon, South London with an office housing the investment team at Cannon Street in the City of London.

14. When the sponsoring employer of an eligible DB pension scheme becomes insolvent, the scheme will usually enter what is called the PPF assessment period. A scheme will transfer to the PPF if the assessment shows that it is not funded well enough to buy at least PPF levels of compensation from an insurance company or an alternative sponsor. At the same time, the PPF will recover what it can from the insolvent employer, by acting as a creditor on behalf of the pension scheme.

15. The PPF's most recent 'Purple Book'[5] shows that in 2021 there were 5,520 schemes eligible for PPF cover, with 9.7m members. 52% of these schemes are still open to benefit accrual in some form, but only 11% are open to new members. Schemes with fewer than 1,000 members make up 80% of the total number of schemes, but only around 10% of total assets, liabilities and members.

16. The PPF currently pays compensation to over 288,000 people. This compensation is funded by means of a levy on all eligible DB pension schemes, with schemes paying proportionately more where they pose a greater level of risk due to their funding levels, likelihood of insolvency or the level of investment risk being run. Substantial funding is also generated through investment returns and through managing the assets of schemes that transfer into the PPF.

[5] PPF, The Purple Book | Pension Protection Fund (ppf.co.uk), 2021

17. The PPF managed assets totaling £38 billion as of 31 March 2021[6]. The PPF holds reserves that are over and above the amount needed to pay every current member and their dependents their full compensation for life. These extra reserves allow for uncertainties and variables such as future collapses of sponsoring employers and longevity risk. These reserves have increased from £5.1 billion in 2020 to £9.0 billion in 2021, largely due to impressive investment returns. The PPF also raises an annual levy on DB pension schemes which in 2020/21 totaled £630m.[7] In addition, an administration levy is raised each year by the DWP, which then makes a grant to the PPF to cover certain administration costs.

18. The key goal of the PPF's funding strategy over the past few years has been to be self-sufficient by their funding horizon, the funding horizon is defined as the point in which future claims on the PPF will be low and self-sufficiency is having sufficient assets to pay compensation in full, without reliance on investment performance or by charging a levy equal to expected claims. This is currently defined as 110% funded by 2030. However, as 2030 approaches, the PPF is reviewing its funding strategy and expects to publish an updated version in early July 2022. This will also provide a framework within which the Board will be able to take future decisions concerning the level of the risk-based levy[8].

19. The last few years have seen several major legal cases affecting the levels of compensation provided by the PPF, culminating in the European Court Judgement in the Hampshire case and the European Court Judgment in the Bauer case. These Judgments set a minimum level of compensation. A Court of Appeal Judgment in the Hughes case found the PPF compensation cap to be unlawful on the grounds of age-discrimination. [9]

20. The DWP and the PPF continue to work in partnership through the ramifications of these decisions. The financial implications of the judgements are considered manageable, although the operational challenges they pose are significant.

[6] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk), Page 14
[7] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 14
[8] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 14
[9]PPF, Information for valuing benefits in respect of the Hampshire, Hughes and Bauer judgments in a section 143 valuation (ppf.co.uk), 2021

The Efficacy of the PPF

21. This review has considered whether the basic form and function of PPF is still appropriate and the need for the organisation still exists. The PPF's functions are set out in statute. Cabinet Office guidance[10] sets out three tests as part of the efficacy standard:

- Is this a technical function, which needs external expertise to deliver?
- Is this a function which needs to be, and be seen to be, delivered with absolute political impartiality?
- Is this a function that needs to be delivered independently of ministers to establish facts and/or figures with integrity?

22. With respect to all the functions set out in legislation, my view is that the PPF is fulfilling its remit well and there is no need for any major changes to either its structure or remit. There is clearly a need for an entity, not under the direct control of central government, that can manage funds and administer payments without any political interference. 5,520 schemes with 9.7m members remain eligible for PPF cover.

23. However, in my view there is now an opportunity to address questions relating to the future scope of the PPF, given that the number of DB schemes is likely to continue to decline and the PPF itself has built up significant reserves. There is also an opportunity to explore what else the PPF could do in future, to make use of the expertise that it has built up, for example, in relation to sovereign wealth management, consolidation or aggregated services for smaller schemes which are not attractive to commercial consolidators. (See also recommendation regarding strategic level interaction with DWP).

Recommendation 1: The DWP and the PPF should work together to explore whether it is feasible for the PPF skills and capabilities to be used in other ways for public benefit; for example, in managing investments for Government or acting as a consolidator or provider of aggregated services for schemes which would benefit from this, but which are not attractive to commercial consolidators.

Recommendation 2: The DWP and the PPF should work together to understand the implications of the PPF's funding position in light of expected future developments in the population of DB pension schemes and plan well ahead for any legislative changes that might be needed; for example, to address what happens to any funding which is surplus to requirements.

[10] Cabinet Office, Requirements for Reviews of Public Bodies - GOV.UK (www.gov.uk), 2022

Accountability: the PPF's relationship with the DWP

24. Should the DWP and PPF conclude that the PPF should take on other roles then this may influence the question of whether the PPF should seek FCA authorisation and regulation, which is discussed further in paragraph 94.

25. A framework document sets out clear arrangements for the working relationship between the DWP and the PPF. It defines both departmental and PPF responsibilities and provides a statement of principles to guide relations to ensure the effective discharge of responsibilities. The Framework Document clearly sets out the public body's purpose, describes the governance and accountability framework that applies between the roles of the body and DWP, reflecting the specific structures, roles and responsibilities in each case, and sets out how the day-to-day relationship works in practice, including in relation to financial matters.

26. PPF has a good working relationship with the DWP. The primary contact is managed through the DWP ALB Partnership Division, with frequent and regular engagement, with typically 4-5 touch points a week on a range of issues: for example, budgets, forecasts, people-related matters, and cybersecurity. There is also regular contact between the General Counsel and his team and DWP private pensions policy officials on a range of issues: for example, legislation, the impact of recent court decisions and the funding of fraud compensation.

27. PPF engages more formally with DWP through Quarterly Accountability Review (QAR) meetings. These meetings enable the DWP to hold the PPF to account and provide a forum for discussing operational delivery, budgets, forecasts, and some policy issues of mutual interest.

28. The Chief Executive meets regularly with the Minister for Pensions and officials in the DWP pensions policy teams, including attending the QAR meetings. The Chair is relatively new in her role and has recently has her first meeting with both the Minister for Pensions and the Director for Private Pensions and Arm's Length Bodies.

29. As a public corporation, PPF has a significant level of autonomy and understandably seeks to guard its independence from government. This is appropriate for the most part; however, officials at the DWP noted that on occasion it can impact the efficient and effective working relationship with DWP as sponsoring department. The examples of this relate to addressing policy issues when there have been questions about the respective responsibilities of PPF and DWP.

30. Otherwise, good working relationships are demonstrated with DWP, specifically with the PPF Partnership Team, although I noted a mismatch in the level of contact between PPF and DWP, with comparatively junior DWP staff having regular contact with more senior, often Board-level, PPF leads. This can mean that there is a tendency to focus on smaller issues with less discussion of where the strategic opportunities and risks lie.

Recommendation 3: The DWP should ensure that the new PPF Chair has the chance to build her relationships with key senior people in the DWP, including the Minister for Pensions, the Permanent Secretary and the Director of Private Pensions Policy; in particular, the PPF Chair and CEO should meet the Minister for Pensions (MfP) together twice a year, with a focus on the strategic challenges, risks and opportunities facing the PPF.

Recommendation 4: More opportunities should be found for the Executive Team at PPF to meet their counterparts at the DWP and spend time on future strategic challenges or emerging complex policy issues and how to address them effectively in partnership. The Quarterly Accountability Review (QAR) between the DWP and PPF can then be the principal forum through which the day-to-day performance of the PPF is addressed.

31. Evidence from a number of those interviewed during this review has shown that the relationship between DWP and PPF has evolved and matured during the programme of work to address the funding of the FCF which has resulted in the rapid passing of legislation enabling government to provide loans to the PPF to fund fraud compensation.

32. It would appear from comments made during interviews that there was initially some distance between the two organisations but that has been addressed through gaining a better understanding of the different perspectives and challenges the respective organisations faced in delivering the analytical, legal, operational and policy elements of the programme. Ensuring that communication occurs frequently and at the right level is key here and it is a credit to the teams involved on both sides that a complex problem has been progressed. There are clearly lessons to apply across the range of relationships PPF and DWP has, which also involves other Government departments such as HM Treasury.

33. On a policy level, both PPF and DWP representatives reported that the Steering Group on dealing with FCF worked well, with scope there to look at the lessons learnt and apply them to policy issues going forward. Getting the right representation is key, plus a willingness to share early thinking on both sides.

Recommendation 5: That DWP and PPF reassess how their working relationship operates so as to ensure emerging issues are handled quickly and collaboratively. This to include undertaking a lessons learnt exercise in relation to the Fraud Compensation Fund (FCF) project to determine how the use of a 'task and finish' Steering Group and other successful approaches can be replicated and the risk of any misalignment of interest in dealing with policy issues reduced.

34. These are relatively small issues, however. My overall impression is of a strong and open relationship existing between body and DWP, with a willingness on both sides to share information and develop solutions to problems in a collegiate and professional manner.

Governance

35. Governance arrangements are set out in the Framework Agreement, drawn up by the DWP in conjunction with the PPF Board. This document sets out the broad framework within which the PPF operate including powers and duties, also the roles and responsibilities of the Chief Executive (CEO), Chair and Board. Additionally, the document sets out DWP's requirements as the sponsor responsible to Parliament for PPF governance and finance. There is also an annual budget allocation letter that goes to the CEO and from 2022 there will be a letter to the Chair in line with the new sponsorship code, setting out Departmental priorities.

36. The last framework document was effective from August 2019 and remains fit for purpose. However, new guidance for public corporations, recently published by Cabinet Office, requires work to commence shortly on a new framework document with a view to completion by the end of the current financial year. [11]

Board composition

37. The Secretary of State for Work and Pensions appoints the Chair and the other Board members are appointed by the Board, as set out in the Pensions Act 2004. The Head of the DWP Partnership Division sat on the panel for the recent round of interviews for new Board members, which is a change to recent practice and should give the partnership team greater insight into the PPF's recruitment and appointments.

[11] PPF, PPF Framework Document 2019.docx (sharepoint.com) 2019

38. With regard to the current Board, the Chair, Kate Jones, has been in post since July 2021. She had previously been a non-executive director for five years, including a period as Chair of the Investment Committee and replaced Arnold Wagner; the chair for the previous five-year period. During 2020/21 the Board had eight non-executive members at any one point in time including the Chair, also three executive members: the Chief Executive, the Chief Customer Officer and the General Counsel.

39. There were eight full Board meetings, held remotely over the year because of the pandemic, with full attendance by all Board members. There was also ad hoc contact between Non-Executive Board members and the Executive as required. Board procedures are governed by its Statement of Operating Principles document.[3]

40. The Board has oversight of PPF's strategy, funding and business plan, policies and services, whilst monitoring the performance and quality of service. Additionally, it is responsible for creating and supporting the organisational values, whilst ensuring the PPF conducts business to high ethical standards that it also complies with all laws, rules, and regulations applicable.

41. The Board is responsible for PPF's compliance with the requirements of the Pensions Act 2004 and for compliance with the UK Corporate Governance Code and HM Treasury and Cabinet Office's "Corporate governance in central government departments: Code of good practice".[12]

42. An internal effectiveness evaluation is conducted by the Board for each of two years out of every three, in addition to a triennial effectiveness review conducted by an external consultant[13]. The 2021 Board effectiveness evaluation was positive with a few minor suggestions for further engagement by Board members with the development of the PPF strategy and the strengthening of relationships between Non-Executive and Executive Directors. These are being addressed.

43. Members operate in accordance with the Board Manual[14], which provides guidance on the conduct of meetings. Individual board members abide by the code of conduct, the guidelines for handling potential conflicts of interest, and guidance on expenses/hospitality[15]. A formal training programme was also introduced in 2021 for Board members.

44. A review of agenda, minutes and recent Board effectiveness reviews, my discussions with board members and my observation of a Board meeting show that the Board is

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[12] HMT, Corporate governance in central government departments: code of good practice (publishing.service.gov.uk), 2017
[13] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 56
[14] PPF, Statement of Operating Principles and Delegations (ppf.co.uk), 2021

[15] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 56

well established and mature, with a clear structure and responsibilities. It is well balanced with regards to gender but lacks ethnic diversity. It does not have a member who is actively receiving PPF compensation.

My one observation on the Board's agenda is that, in common with many similar bodies, the Board rarely hears collectively directly from members who are receiving PPF compensation, albeit that the Chief Customer Officer is on the Board, customer satisfaction levels are regularly reported and individual Board members can listen to calls with members.

Recommendation 6: That the PPF should consider how the Board could hear more directly about the member perspective to inform its deliberations.

45. I also note that the Executive Board members have been in post for a while now and the salary paid to them has to be approved by DWP Ministers (unlike those for Executives who are not on the Board), as is usual for a public body. Should it be necessary to replace them it is possible that the PPF would struggle to recruit individuals of similar experience and calibre to fill these posts without offering an increase in salary and significant differentials could open up between Executive Board Directors and other senior Executives.

Recommendation 7: That the DWP regularly reviews the salaries of Executive Board Directors in the context of wider public sector pay policy, to ensure that they do not become a barrier to recruiting and retaining individuals of appropriate experience and calibre and to ensure that the differentials between Executive Director and other senior executive roles do not drift too far apart.

The Board and the Executive

46. The executive committee is led by the CEO and is responsible for the running of the PPF. The Board has assigned the CEO powers in order to take decisions to ensure operational effectiveness and to provide regular updates to the Board regarding risks, strategy and performance[16].

47. The CEO, Oliver Morley, has been in post since 2018 and clearly has a strong skillset for the role, with experience centred around value for money and digital. He has instigated improvements to IT and cyber capabilities, including bringing much of it in-house. Oliver is well regarded by the Board and is viewed as having made substantial

[16] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk), Page 41

progress in delivering the objectives set him by the Board as well as having empowered his team significantly.

48. My discussions with the Chair, CEO and other Board members show a good working relationship between the Chair and CEO with regular communication through formal and informal channels. Given that I have observed this I make no further recommendations in relation to this area.

Board Committees[17]

49. The Board has established a number of committees with each having a majority of non-executive members, namely:

- remuneration committee
- non-executive committee
- risk and audit committee (RAC)
- reconsideration committee
- investment committee
- decision committee
- nomination committee

50. I spoke to the Chairs of two of the Committees (Investment and RAC), in addition to the Chair and the CEO. I specifically asked about the decision to maintain one committee responsible for Risk and Audit, when many organisations have taken the decision to split these between two separate Committees. The PPF told me that it keeps this under review but feels that agendas are manageable for an organisation of its size, particularly as the Investment Committee also has a significant focus on investment risk. However, the RAC may benefit from ensuring that it has the time to do further deep dives into particular areas of risk by careful agenda ordering or an occasional meeting devoted entirely to risk.

Recommendation 8: The Risk and Audit Committee (RAC) should occasionally have a meeting which is specifically focused on risk, rather than both audit and risk.

51. The Investment Committee has a particularly important role to play in exercising oversight over PPF's investment management activities under the Chief Investment Officer (CIO). It contains several investment specialists who can challenge the team effectively. A number of matters concerning investments are rightly reserved to the full

[17] PPF, Board members | Pension Protection Fund (ppf.co.uk)

Board, including the approval of the Statement of Investment Principles. Some further observations in relation to the PPF's approach to investment management are included from paragraph 78 onwards.

Risk Management

52. The PPF has developed a robust Risk Management Framework and the overall management of risk within the PPF is thorough, with a proportionate framework in place. The Risk Management Framework is aligned to the nature of the organisation as a public body and is based on the Three Lines of Defence model, in conjunction with a Risk Appetite Statement.

53. The Interim Chief Risk Officer is carrying out a review of the scope and organisation of the second line risk team. The CRO, CIO and Chair of the Investment Committee all told us that developing an effective second line specialist investment risk capability has proved challenging and is still work in progress.

54. This was one of two points that I noted relating to risk management from the most recent Board Effectiveness review, the other being the need to be more prepared for when things go wrong, or indeed for when an unforeseen opportunity presents. If not already in place, that might point to the need for a specific annual scenario planning exercise.

55. PPF's assurance framework provides assurance that the organisation has in place effective risk management procedures, robust and comprehensive controls plus a positive culture with regards to compliance.

56. Within the frameworks, there are clear lines of accountability up to the Senior Leadership Team, Board, and the RAC. In defining the responsibilities at each level, PPF is aligned and adhering to HM Treasury Orange Book principles.[8]

57. Finally, and without wishing to restrict or reduce PPF's independence as a public corporation, I observe there is scope for it to be more open with the DWP Partnership Division both as regards the early sharing of information on emerging strategic risks and issues and in linking to the network of risk management professionals in DWP and its other bodies. These strategic risks and issues should be the focus of the regular meetings for the Chair and CEO with the Minister and senior officials I have previously proposed.

Recommendation 9: PPF concludes its review of the responsibilities of the second line risk function as soon as possible, moves to appoint a permanent

Chief Risk Officer (CRO) and then completes the build out of its second line investment risk capability as soon as possible.

Diversity and Inclusion

58. The Board has a strong focus on diversity and inclusion within PPF itself and links this to its Environmental, Social and Governance (ESG) responsibility as a public body and as an investment manager (see paragraphs 78-93) with a broader outlook beyond carbon-related metrics. In particular, PPF has set stretching targets in relation to ethnicity and voluntarily publishes ethnicity pay gap information.

59. The Diversity Pay Gap Report reported that PPF's median gender pay gap stood at 15.86% in 2021, which is slightly worse than the 15.7% reported in 2020.The median bonus pay gap between men and women reduced from 31% in 2020 to 16.2% in 2021, With 82% of males employed and 81% of females employed now receiving bonus pay.[18].

60. The PPF is a signatory of the Women in Finance Charter and has set a new target for female representation at senior management level at 45% by 2023. This new target was set after the PPF achieved its previous target of 40% two years ahead of schedule in October 2019.

61. On 31 March 2020, the PPF's median ethnicity pay gap stood at 23% and the bonus pay gap at 11%. This is a result of the majority of senior leaders being white. The hourly pay gap has improved significantly in 2021 to 15.6%, However, the bonus pay gap has worsened to 36.92% as ethnic minorities are currently underrepresented in areas that command higher pay and bonuses such as investment, risk, and IT. The overall improvement in pay is due to an increase in the proportion of employees who are from an ethnic minority. 23.7% of employees and 14.1% of senior managers are from an ethnic minority as of December 2021. [19]

62. As a step towards closing its ethnicity pay gap, the PPF has set targets for representation of ethnic minority employees across the organisation and within senior manager roles. In December 2019, the PPF signed the Race at Work Charter and the organisation also runs a reverse mentoring programme to provide senior leaders with insight into the barriers faced by ethnic minorities.

63. The PPF has succeeded in retaining valued members of staff living with disabilities or health conditions and achieved Disability Confident leader status in October 2020.[10]

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[18] PPF, PPF_Diversity_Pay_Gap_Report_2021.pdf Page 5 to 10

[19] PPF, PPF_Diversity_Pay_Gap_Report_2021.pdf page 5 to 10

64. I applaud the PPF's focus and leadership in this area and would note that there is an opportunity for it to showcase its success as part of an increased public profile and increased transparency on its responsible investment approach.

Organisational Culture and Behaviours

65. The Board regularly discusses organisational behaviour and culture, alongside considering the results from the staff engagement survey. A range of stakeholders commented on PPF's values-led culture, effective leadership and strong management all of which had been particularly demonstrated during the period of the COVID pandemic, albeit that this difficult period had inevitably sapped staff's energy.

66. I note that the PPF's positive organisational culture and its focus on responsible investment and the needs of its customers will stand it in good stead were it to seek FCA authorisation and regulation as discussed later.

Efficiency

Financial Management

67. The DWP/PPF Framework Document provides guidance on the financial accounting responsibilities of both the DWP and PPF; the DWP Permanent Secretary being the Principal Accounting Officer and the PPF Chief Executive taking personal responsibility for running the organisation in accordance with the principles of regularity, propriety, value for money and feasibility as the Accounting Officer. The standards for both roles in terms of governance, financial management and decision making are laid out in Managing Public Money, published by HM Treasury[20].

68. The Board is required to prepare and publish a statement of accounts for each financial year, providing its main activities and performance prepared on a going concern basis, in a form directed by the Secretary of State for Work and Pensions, with the consent of HM Treasury. A summary of forward plans should also be included in the report.

69. The accounts must align with the requirements of the Government Financial Reporting Manual (FreM) and HM Treasury's "Managing Public Money"[21]. The financial

[20] HMT, MPM Spring 21 with annexes 040322 1 .pdf (publishing.service.gov.uk) Page 4
[21] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 66

statements and accountability report are audited both internally, and externally by the Comptroller and Auditor General, and laid before Parliament annually.

70. Although operating expenses reduced by 6% in 2019/20 financial year, there was an increase of approximately 9% from £66m in 2020/21 to £72m in 2021/22, due to staff cost increases comprising a higher staff headcount (increase from 433 to 446 staff), bonuses and pay rises, also advisory cost increases from investment and project spend, including IT transformation and corporate case management system and IT operational costs[22]. The PPF explained that the increase in staff was mainly due to bringing IT in-house and to deal with Hampshire (see annex C) and FCF cases.

Value for Money

71. The Chief Executive is responsible for safeguarding the public funds for which the Board has charge, including the financial efficiency in the handling of the funds whilst ensuring value for money principles are adhered to.

72. PPF consciously chooses to focus on providing an excellent service for the members, which has cost attached, but the Board also monitors cost per member closely. With the recent and planned future investments in technology, such as improved IT systems and communication methods for members, the PPF aims to be able to support more members without additional headcount, while maintaining service levels and customer satisfaction.

73. A value for money review was completed in 2020, which examined the previous 18 months expenditure and a coming year forward look. This included checking that competition was encouraged from suppliers regarding procurement, prices were benchmarked and value for money initiatives were being implemented[23].

74. There are now plans in place for all contracts to include benchmarking and open competition, including the setting of and tracking of budgets, efficiency measures for operations and cost analyses for projects closely monitored. The Investment Committee has also conducted a deep dive to check the appropriateness of the fees paid to external asset managers. The PPF prefers to pay external investment managers performance-related fees rather than fixed fees wherever possible, believing that it aligns with its goals and incentivises strong investment performance.

75. The move of the investment team to a central London base has a substantial cost associated with it, but the CEO and CIO demonstrated to me the cultural and other

[22] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 22
[23] PPF, 2020, Value for Money, Unpublished.

positives: the importance of having those visible and personal links with the wider investment management industry as well as being better able to recruit and retain the calibre of staff required. They also noted the extremely good investment returns that are being achieved.

76. Overall, I concluded that financial management is strong and there is an appropriate focus on value for money which balances the interests of levy payers in controlling costs whilst providing excellent service to those entitled to compensation through the PPF. The PPF is in a position to continue to invest in developments to its digital journeys to enable it to serve increasing numbers of customers without increasing headcount or the cost per member.

Impact of Covid

77. The Covid pandemic was a period of challenge for the PPF, with staff assigned to working from home with all the adjustments that this entailed. However, this period has been deemed successful, with no significant operational risk incidents and no reduction in operational KPIs. Customer satisfaction remained high throughout.

78. In addition, PPF worked closely with The Pensions Regulator, and the Minister for Pensions and DWP officials during the pandemic and introduced several measures to mitigate the impact, particularly on smaller schemes and their employers. These included a reduction in the levy cap, the introduction of a limit on increases to bills and the ability to pay by instalments over a longer period.

Effectiveness

Investment Management

79. The PPF has assets under management of £38bn. It manages these assets in accordance with a Statement of Investment Principles (SIP)[24] which is published on its website and approved annually by the Board. PPF's management of investments supports its primary objective of having sufficient funds to pay compensation to the members of eligible defined benefit occupational pension schemes which have transferred to the PPF.

80. The SIP states that the PPF seeks to achieve its funding target by adopting a suitable low-risk investment strategy; setting a levy on eligible schemes; prudent management

[24] PPF, Statement of Investment Principles 2021 (ppf.co.uk)

of the PPF's assets, achieving a balance between protecting and securing the compensation payments for current members of the Fund and of schemes undergoing an assessment period and setting a fair and proportionate levy for eligible schemes that are not part of the PPF. The IPE, a leading European publication for institutional investors, describes PPF's approach as 'low-risk active management designed to limit downside in difficult market conditions and enhance its risk/return ratio'[25].

81. The SIP is then translated into a Strategic Asset Allocation (SAA), which as of September 2021 was:

- Liability Hedging Assets 40%
- Return Seeking Assets 41.5%
- Hybrid Assets 12.5%
- Cash 6%

82. The Board is required to seek written advice on the SIP from investment advisers and modify it if necessary. It approves any material changes proposed by the Investment Committee and sets a strategic investment risk appetite within the overall risk framework. The Chair of the Board is an experienced investment management professional and used to chair the Investment Committee.

83. The Investment Committee comprises Non-Executive Directors with relevant experience, including a co-opted member and an ESG specialist, and is responsible for the general oversight of the investment performance of the Fund and a number of specific things, including the development and review of the SIP, the development of the Responsible Investment principles for the Fund and the determination of the overall approach to risk management of investments and asset liability matching. This includes the assumptions which underpin the target return percentage[26] (for assets to grow at cash +1.4% annualised over the long term, over and above what is needed to cover claims on the fund and pay known benefits) and the flexibility around which any risk budget may be expressed. The Investment Committee is supported by an external specialist adviser.

84. The Asset and Liability Committee is the executive Committee responsible for the day-to-day monitoring of the implementation of the investment strategy and the SIP and a number of other specific responsibilities.

85. For the management of the portfolios, the PPF employs the services of investment experts as its external and internal fund managers and has specified investment guidelines and instructions concerning various types or categories of investment

[25] PPF: Redeveloped long-term risk model will enable 'step-change' | News | IPE
[26] PPF, [Strategic plan & business plan | Pension Protection Fund (ppf.co.uk)]

decisions. The fund managers make their trading decisions independently of the PPF.

86. Over recent years, the PPF has moved a significant part of its investment management in-house under the CIO. The CIO felt that the liability driven investment (LDI) management could be done more efficiently and effectively in-house. The PPF investment team has built up significant experience and expertise and has achieved very strong returns, directly and through its selection and monitoring of external fund managers. For example, in 2021 a 17.6% return on the non-hedging assets was achieved.[27] Approximately 50% of the investments are now managed in-house[28] and the PPF told us that it expects to bring in more.

87. Investment-related fees (both performance and management) form the largest element of PPF's administration costs - £241.1m in 2021[29].

88. The PPF reports that in-housing the liability driven investments has saved £60m over 5 years[30]. The PPF seeks to achieve value for money through careful selection and monitoring of external fund managers. It prefers to pay performance fees over fixed fees, thus paying more only when strong performance is achieved.

89. The PPF works with specialist external managers to find attractive investment opportunities for its return-seeking asset portfolio, with almost half the return seeking assets in so-called 'alternatives' including private equity, infrastructure development and 'real' assets such as property and timber. Assets received into the Fund when schemes enter the PPF are merged into the SAA over time.

90. For the review of the SIP, the SAA and the assumptions underpinning the return targets, the CIO seeks advice and challenge from an investment bank and the Investment Committee also takes the view of its specialist external adviser. Given that the PPF is about to agree and then publish a new funding strategy the next review of the SIP and the SAA will be particularly significant. This could represent a good opportunity for the Board to commission an independent review of the investment approach which will, of course, be a significant contributor to delivering the required funding. This would provide strong, independent assurance to the Board and other stakeholders from a fresh pair of eyes that the investment approach is the right one going forward to support the revised funding objective(s) and that the strategic asset allocation reflects this. This is not an area where the DWP has the specialist expertise to challenge the PPF, nor is it its role to do so.

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[27] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) page 16
[28] PPF, Asset allocation chart | Pension Protection Fund (ppf.co.uk)
[29] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) page 17
[30] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) page 17

Recommendation 10: The Board should consider commissioning an independent review of the Fund's investment strategy and the associated Statement of Investment Principles and Strategic Asset Allocation.

91. The PPF is engaged in leading edge work in relation to ESG and responsible investment, for example, in the development of low carbon benchmarks. PPF supports the task force on climate-related financial disclosures (TCFD) and provides details of climate-related governance, strategy, risk management and metrics in a Responsible Investment (RI) report, including monthly dashboards provided to the CIO and quarterly dashboards to the Investment Committee. PPF reports on additional carbon footprint metrics for listed equities and credit holdings, with the equity portfolio reducing its carbon footprint by 16% in 2021[31]. It has aligned its ESG focus as an investment manager with its organisational aim to be carbon net zero.

92. PPF also has a visible track record in achieving strong investment performance. In December 2021 it was named 'European Pension Fund of the Year' at the IPE awards. It is keen to find further investment opportunities in, for example, UK infrastructure projects, but suitably structured opportunities are few in number and in great demand. As noted in the stakeholder management and communication section of this report, the PPF does not have a particularly high public profile. It is also not particularly transparent about what it is actually investing in at any point (for example, the Annual Report and Accounts contains very little on investments below the level of the Strategic Asset Allocation classes.)

93. I consider that as a highly successful, well-run public body PPF could do more to share its successes, learning and good practice more widely, as for example, National Employment Savings Trust (NEST) does. It could also seek to play a greater leadership role in the UK investment industry by working with others to encourage the development of appropriately structured alternative investment opportunities in, for example, UK infrastructure. However, given the PPF's claims risks are UK-based, best practice in the diversification of investments will always limit the proportion of assets that should be allocated to the UK.

Recommendation 11: The PPF should take a higher public profile and share more information on its approach to investment management, particularly in relation to its industry leading commitment to responsible investing. It should consider including more information in its Annual Report to provide insight into specific investment choices. It should also use its position as a public body to

[31] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) page 16

work with others to encourage the development of more UK-focused well-structured alternative investment opportunities.

94. When the PPF was established, it was not felt necessary for it to be authorised and regulated by the relevant financial regulator (then the Financial Services Authority) or the Pensions Regulator. However, with investment management now constituting a significant part of the PPF's activities it could be argued that it is carrying out activities which in other organisations are deemed to fall within the scope of financial services regulation. It is also possible that if consideration were to be given to the PPF taking on other responsibilities, then the question of whether it should be subject to financial regulation may arise again.

Those interviewed held differing views on this. Some felt that it would be advantageous for the PPF to be subject to authorisation and regulation by the Financial Conduct Authority as it would bring formal independent assessment against the standards that the PPF is striving to achieve. Some also felt that it would add to the attractiveness of the PPF as an employer, especially in the investment team, in that employees would be gaining experience in an FCA-regulated environment.

Others felt that it would be a great deal of extra work, perhaps directly relevant to only a limited part of the PPF's business and that the PPF is capable of setting high standards and holding itself to these, as it has done since 2005.

It is clear that the PPF needs to resolve its position on this point within the near future.

Recommendation 12: The Board and Executive should consider whether it would be appropriate to seek Financial Conduct Authority (FCA) authorisation and regulation for either the PPF itself or a dedicated subsidiary, given the increased significance of the investment management function, and if so decided, then start discussions with the DWP on any legislative change that would be required.

Stakeholder management and communication

95. A wide range of stakeholders told me of their high regard for the PPF and its Board and Executive team. Several of them noted that over the past 4-5 years, the PPF has become increasingly focused on providing excellent member services, achieving very high levels of customer satisfaction, albeit that this means that it's cost per member is not as low as it could be. It is offering more digital journeys to its customers, such as the new entirely digital route to retirement and has further to go in this regard. This is reflected in the 'transforming the way we work' strand in its recently published strategy

for 2022-25, albeit FAS stakeholders noted that the customers here are aging and may not be comfortable with more digital interaction. The PPF intends to maintain its traditional methods of communication alongside the new innovations

96. PPF offers some very good member education material; the member forum and newsletter are praised as effective channels of communication with PPF members. Its willingness to engage openly with member groups such as the Pensions Action Group (PAG)[32] on FAS is greatly appreciated, even though the groups' concerns are usually with the legislation and constraints on the level of compensation that can be offered, rather than the PPF's own operations.

97. The PPF has a limited social media presence at present and it may wish to consider how it could build this up. It can be particularly useful if the PPF needs to communicate widely and quickly in a challenging situation.

98. The PPF has robust complaints handling procedures with very few cases being referred on to the PPF Ombudsman (PPFO). Recent referrals to the PPFO have not been upheld, suggesting the PPF has done a thorough job of investigating and resolving the matter complained of. The PPFO told us that the working relationship between his team and the PPF is very good.

99. I heard from levy payers and their advisers/representatives that the PPF has increased its interaction with them over the last few years. Most of this contact concerns the proposed level of the PPF's risk-based levy, how this is calculated and what the latest proposals mean for individual schemes.

100. Small and Medium sized Enterprises (SMEs) and their advisers and trade bodies particularly welcome the SME forum, which was set up in response to a recommendation from the Work and Pensions Select Committee.[33] Participants felt it has increased their understanding of the burden that the PPF levy can represent for relationships where their views are valued. It was expressed that members feel their views are listened to, with adjustments made to the way the levy is run due to their input. However, the forum's success also relies on those who are willing to participate actively in it; there was some concern among those I spoke to about the very small, perhaps underfunded, schemes who don't have the time or capability to engage.

101. Advisers supporting smaller schemes told the review that dealing with the PPF during complex corporate transactions and insolvencies can be difficult for those schemes. The schemes can find the speed of decision-making and the pressure of negotiations quite intimidating and rely heavily on their advisers in these

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[32] PAG, Pensions Action Group - Campaigning for Pensions Justice (pensionstheft.org) 2022

[33] Gov.uk, Protecting pension savers – five years on from the Pension Freedoms: Accessing pension savings (parliament.uk) 2021-22

circumstances. The advisers felt that the trustees of such schemes might struggle to represent the interests of their members without the support that they provide and that perhaps the PPF could do more to educate trustees about what happens in such situations and what may be needed and expected of them.

102. Larger levy payers, both schemes and employers, also speak positively about the organisation, whilst most levy payers and their representatives feel the PPF is responsive to enquiries about issues such as the calculation of the levy, invoices, payments.

103. Levy payers (especially employers) and their advisers told me that they would welcome as much forward guidance on the level of the levy as possible to assist with business planning and budgeting. They would also welcome a levy calculator that enabled them to calculate their levy in pounds and pence, not just which band they will fall into. Currently, most schemes turn to their advisers for the detailed calculation.

Recommendation 13: The PPF should seek to provide a levy calculator for schemes and their employers via its website, so that they can work out what their risk-based levy charge will be in pounds and pence. If it is not feasible to provide this, then it should explain clearly why this is the case.

Public profile

104. Several stakeholders noted that PPF has had a reduced public profile over recent years compared, for example, to National Employment Savings Trust (NEST)[34], or to its own profile in the earlier years of its existence. A number of those interviewed felt it could take a higher profile and be more transparent about, for example: how it is funded (including who pays the levy); its approach to investment management; the FCF; the impact of the Bauer Judgment, Hampshire Judgment and Hughes judgement; and its decision-making on schemes in the assessment period (See annex C).

105. The publication of the PPF's new strategy for 2022-25 and development of the associated funding strategy which will enable the PPF Board to make decisions on the appropriate level of levy to raise may provide a good opportunity to increase its profile and level of transparency.

106. Interviewees felt that taking a higher profile would enable PPF to promote good practice and share its experience and expertise in areas such as ESG, investment in

[34] What is NEST, Workplace Pension Scheme | Nest Pensions

UK infrastructure, dashboard engagement, insourcing etc. It could also promote wider debate on PPF-related issues, e.g., whether PPF has a role to play as a consolidator for small, underfunded schemes which are not being picked up by the commercial consolidation vehicles.

Recommendation 14: The PPF should take higher public profile within the pensions industry and share more about its new strategy and funding strategy, the impact of levies, the implications of recent court cases, its engagement with the pensions dashboard etc, as well as its investment activities.

107. From our conversations with PPF executives and members of the Board, it is clear that some feel the PPF could promote its existence and the protection that it offers to the members of DB schemes more vigorously, with a view to allaying concerns about DB pensions in situations where employers are struggling or perhaps discouraging transfers out of DB schemes where this is not in the member's interest. Others are concerned that aspects of the protection, such as the levels of benefit available, are complex to explain and that members might rely on protection but then for some reason find that their scheme does not enter the PPF.

Recommendation 15: The PPF should conduct an in-depth assessment including consulting with other interested parties, of the pros and cons of communicating the existence and shape of the compensation available to the members of Defined Benefit (DB) pension schemes and how this might be done in a simple and cost-efficient way.

108. The PPF works closely with a number of other public bodies, notably The Pensions Regulator (TPR), The Money and Pensions Service (MaPS), The PPFO, The FCA and The FSCS. The level of interaction varies, but picks up in intensity when needed, for example in situations where there may be an increased likelihood of members of a DB scheme seeking to transfer out. The Pensions Regulator noted its particular interest in the PPF's thinking on the future of the risk-based levy, which it sees as a useful lever in influencing schemes to maintain a higher level of funding than they might otherwise do. Other stakeholders are keen that bodies such as the PPF and TPR publish joint consultations on areas of mutual interest and overlap.

Recommendation 16: The PPF should continue to work closely with other relevant bodies such as the Pensions Regulator (TPR), the Financial Conduct Authority (FCA) and the Financial Services Compensation Scheme (FSCS) and

wherever possible produce joint consultations with one or more of these bodies where they have overlapping or adjacent and related responsibilities.

The Levies

109. The PPF funds the compensation it pays to the members of DB schemes which have entered the fund and builds up reserves against future claims and uncertainties through managing the assets received from schemes entering the fund, managing investments and from raising a levy annually. It also pays some administration costs, such as third-party service providers and specialist advisors, from this levy. It receives grant-in-aid from the DWP to meet most, but not all, of its other administration costs. This is recovered from the PPF administration levy which is raised on all DB schemes eligible for PPF protection and collected by TPR alongside the General Levy on pension schemes.

110. The levy raised by the PPF itself is divided into two parts: the scheme-based levy which is paid by all eligible DB schemes according to size and the larger risk-based levy, which is calculated for each scheme and reflects the employer's insolvency risk, the scheme's underfunding risk and the scheme's investment risk. The PPF levy is often paid by the sponsoring employer, rather than by a scheme itself. Employers thus have a strong interest in the level of the levy and representatives of some smaller schemes told us that the PPF levy can be a significant figure in their profit and loss account.

111. I received no specific comments on the scheme-based levy, which is paid by all schemes regardless of size or how well funded they are.

112. Levy payers (including representatives of schemes and employers) told us that given they are required to contribute to the costs of providing compensation, they are supportive of the concept of a levy based on an assessment of the risks posed by each scheme, and that as operated by the PPF the current approach to this generally works well. They were appreciative of the changes made to provide assistance during the pandemic, especially the small scheme adjustment. As noted in the stakeholder section, they also appreciate the increased focus on communication with and service to levy payers but would like to see a levy calculator that would enable a scheme to see the specific amount that they are due to pay.

113. However, the administration levy is less transparent and appears to be an unnecessary complication for both the PPF and its stakeholders. The fund held by the DWP currently stands at approximately £30m, with the annual allocation to the PPF over the past few years averaging £14m (figures provided by DWP)[35].

[35] PPF, Annual Report and Accounts 2020/21 (ppf.co.uk) Page 34

114. It appears to me that the continued existence of the administration fund is an unnecessary complexity and creates an extra layer of accountability to the DWP which does not sit well with the PPF's status as a public corporation. The PPF has shown itself to be more than capable of managing its finances capably and of demonstrating its accountability to levy payers. It also has a strong focus on demonstrating value for money.

Recommendation 17: I recommend that the administration levy is abolished and, once the existing reserve is expended, the PPF is permitted to recover all its administrative costs via the levy which it collects itself.

115. PPF itself has noted that the PPF levy now forms a diminishing element of its funding (23.1% in financial year 2020/21), with the greater part coming from the assets from schemes transferred into the PPF and from investment returns. Given its strong funding position (127.3% by 31st March of 2021), the PPF is facing calls from some of its stakeholders for a reduction in the level of levy it collects each year, with some arguing that there is a case for reducing the levy to nil. Hitherto, the Board of the PPF has taken a risk-averse approach and continued to raise an annual levy (the levy estimate was £415m in 2022/23, £520m in 2021/22 and £620m in 2020/21, £567m). The PPF told us that it was considering this challenge as part of the review of its funding strategy and expects to say more on this later in the year.

116. However, the PPF also pointed out to us that there are constraints in law on what it can do with the level of the levy; in particular, it cannot be raised by more than 25% of the previous year's total. Thus, if the levy were reduced to nothing, then it would not be possible to raise a further levy if circumstances required it. Not surprisingly, the PPF Board is reluctant to give up, or reduce the effectiveness, of one of its key levers in ensuring that it can deliver compensation. It feels that this constraint on the levy should be removed, and I agree.

Recommendation 18: I recommend that the DWP and the PPF work together to ensure that any necessary changes are made so that the PPF annual levy (both risk-based and scheme-based elements) can be reduced easily, if the PPF Board so decides, but that the PPF retains the freedom to reintroduce or raise the levy again should circumstances change.

The Fraud Compensation Fund (FCF)

117. Alongside its role in providing compensation as a consequence of employer insolvency, the PPF also operates the FCF. The FCF provides compensation to eligible occupational pension schemes where there has been scheme asset reduction, attributable to an offence involving dishonesty, and where the employer has become insolvent or is unlikely to continue as a going concern. This includes both defined benefit and defined contribution pension schemes. The FCL recovers from eligible occupational pension schemes the costs of compensation paid from the FCF.

118. Since the establishment of the FCF in 2004 there has been a growth in pensions liberation fraud. Pension liberation fraud involves scheme members being persuaded to transfer their pension savings from legitimate schemes to fraudulent schemes with promises of high investment returns or access to a loan from their pension scheme before age 55 without incurring a tax charge. It is believed that the majority of such fraud occurred during the period 2010 to 2014. In November 2020, the High Court (in The Board of the PPF v Dalriada Trustees Ltd)[36] clarified that pension liberation schemes, if they satisfied specified criteria, were eligible to make a claim on the FCF.

119. There are insufficient assets within the FCF to meet claims arising from that judgment in the short term. The government therefore brought forward the Compensation (London Capital & Finance plc and Fraud Compensation Fund) Act 2021 which provides the Secretary of State with a power to make a loan to the Board of the PPF for the purposes of the FCF. The PPF will use the loan, along with any assets in the FCF, to meet these potential claims. The loan will be repaid via the FCL. DWP has also increased the ceiling on FCL rates via regulations.

120. The FCF is part of a wider policy picture relating to providing compensation to those who have suffered loss through dishonesty. The issue of pension scams, including pension liberation fraud, and how such activity should be addressed is outside the scope of this review. Nevertheless, the cause of the funding pressure on the FCF derived from the growth of pension liberation fraud and the eligibility of such schemes to access the FCF. This does not downplay the impact on individuals who have suffered loss through such schemes, but it does raise the question of what role, if any, the FCF should play in a wider compensation landscape in the future.

121. The Government has acknowledged this in its response to the FCL consultation and has stated that "it is not persuaded that an urgent review is required…. However, the Government will consider the possibility of a review over the medium term, alongside ongoing monitoring of the FCL ceiling." [37]

[36] TPO, Norton Motorcycles Determination | The Pensions Ombudsman (pensions-ombudsman.org.uk) 2020
[37] Gov.uk, Government response: review of the Fraud Compensation Levy ceiling 2021 - GOV.UK (www.gov.uk) 2021

122. Whilst it is up to Government to decide when to undertake such a review and how any consideration of the role of the FCF fits into a wider compensation regime, the PPF clearly has operational experience in running compensation schemes.

Recommendation 19: When DWP decides to undertake a review of Fraud Compensation Fund (FCF) and the compensation offered, it should seek PPF operational input in relation to working with and through pension schemes in determining the nature and level of compensation required. Such a review should cover the appropriate level of compensation, its interaction with other compensation or redress regimes e.g., the Financial Services Compensation Scheme (FSCS) and The Pensions Ombudsman (TPO), and how it is funded.

123. I would further suggest that such a review should cover the appropriate level of such compensation and its interaction with other compensation regimes e.g., the Financial Services Compensation Scheme.

Next Steps

124. The review team have worked closely with PPF and DWP. [All the recommendations of this review have been accepted by PPF and DWP and been approved by the Minister for Pensions and Financial Inclusion and Secretary of State for Work and Pensions].

125. The DWP will work with PPF on delivery of the overall recommendations and the related steps-to-achieve. Progress will be reviewed in the Spring of 2023.

Annex A

People Interviewed

DWP Private Pensions and Arm's-Length Bodies Sponsorship Directorate (PPALB)

1. Pete Searle (Director)
2. Fiona Frobisher (Deputy Director – Defined Benefit Policy)
3. Jackie Oatway/Jenan Hasan (Deputy Director job share – ALB Partnership)
4. Alison Fryatt (Head of Pensions Bodies Partnership)
5. Russell Taylor (Pensions Bodies Partnership)

PPF Board

1. Oliver Morley (CEO)
2. Kate Jones (Chair of the Board)
3. Sara Protheroe (Chief Customer Officer)
4. David Taylor (General Council)
5. Lisa McCrory (Chief Finance Officer/Chief Actuary)
6. Barry Kenneth (Chief Investment Officer)
7. Katherine Easter (Chief People Officer)
8. Dana Grey (Chief Risk Officer)
9. Simon Liste (Chief Technology Officer)
10. Jayne Nickalls (Chair of the Renumeration Committee)
11. Chris Cheetham (Chair Risk Audit Chair)
12. Anna Troupe (Chair Investment Committee)

PPF Stakeholders

1. Julian Mund (CEO Pensions and Lifetime Savings Association [PLSA])
2. John Chilman (Chair Pensions and Lifetime Savings Association [PLSA])
3. Paul Rogers (Pensions Risk Director at [BT])
4. Jon Sharp (Small and Medium-Sized Enterprises [SME] director Western Pensions Solutions)
5. Paul Duffy (Independent Pensions Consultant)
6. Paul Foulds (CEO Middlesex Aerospace)
7. Caroline Sumner (CEO R3 Association of Business Recovery Professionals)
8. Charles Counsell (CEO TPR)
9. Maggie Rodger (Co-Chair Association of Member Nominated Trustees [AMNT])
10. Janice Turner (Co-Chair Association of Member Nominated Trustees [AMNT])
11. Peter Lapinskas (The Pensions Advisory Group [PAG])
12. Aled Edwards (Principal Consultant and Actuary at Quantum Advisory [SME])
13. Chris Ramsey (Senior Consultant Actuary at Barnett Waddingham [ISG])
14. Anthony Arter (Pensions Ombudsman and [PPFO])

Annex B

Terms of Reference for a Departmental Review of the Pension Protection Fund

Background

1. The Pension Protection Fund (PPF) was established by the Pensions Act 2004. The PPF pays compensation to members of defined benefit (DB) occupational pension schemes where the sponsoring employer became insolvent on or after 6 April 2005 and the scheme has insufficient assets to secure benefits of at least PPF compensation levels. As a public corporation the PPF is accountable to Parliament through the Secretary of State for Work and Pensions.
2. PPF manages the Financial Assistance Scheme, which provides assistance to members of schemes whose sponsoring employer has become insolvent prior to 6 April 2005, on DWP's behalf. In addition, the PPF also runs the Fraud Compensation Fund, providing compensation to occupational pension schemes that have lost out financially due to fraud, and whose employers have become insolvent.
3. The PPF is funded via remaining scheme assets, investment return, a levy on eligible DB schemes and recoveries from companies. The Board of the PPF has the power to charge individual DB schemes different levy amounts based on the risk they present to the PPF.
4. The PPF levy is made up of a scheme-based levy and a risk-based levy. The scheme-based levy is calculated on the level of the scheme's liabilities and the risk-based levy is calculated on scheme underfunding and the likelihood of the sponsoring employer's insolvency. The Board of the PPF must aim to collect at least 80 per cent of the overall pension protection levy through the risk-based levy.
5. Around 20% of the PPF's ongoing administrative costs are funded through the PPF Administration Levy on most DB schemes. It is calculated according to the number of scheme members and is set annually.

Purpose and scope

5. This review of PPF will be conducted on behalf of the Secretary of State for Work and Pensions.
6. The Review aims to provide a robust challenge to, and assurance of PPF. In doing so it will draw on the structure and approach of the Cabinet Office's emerging plan for future reviews, focusing on four key areas:

- Governance;
- Accountability;

- Efficacy;
- Efficiency.

7. Taking the above into account, the Review will consider (but not be limited to):

- How the PPF is currently performing and its ability to adapt and respond to future challenges and opportunities whilst meeting its obligations;
- The long term feasibility of the PPF and what policy changes would assist the PPF In the long term;
- The appropriateness of the financial arrangements underpinning the PPF and the extent to which its current funding model delivers value for money and an optimum return for its members and wider industry; and
- How the PPF is managing relationships with its key stakeholders and interacting with devolved administrations.

Governance

8. With reference to the governance framework set out in the Pensions Act and (as appropriate) the guidelines set out in the Cabinet Office's 'Partnerships with Arm's-Length Bodies: Code of Good Practice' this will consider governance within PPF and between PPF and DWP, including:

- The composition and effectiveness of the board;
- Effectiveness of corporate governance including staff management and the assessment of risk management;
- PPF's transparency and accountability, specifically with regard to data handling and performance.

Accountability

9. The review will consider the position and status of PPF as a DWP sponsored Public Corporation, focusing on:

- current partnership/stewardship arrangements with DWP;
- relevance of the current suite of performance metrics;
- PPF's interaction with DWP policy and other Government functions.

Efficacy

10. This will consider how PPF delivers its functions and how this is assessed, including:

- How far the functions performed by PPF contribute to DWP's goal to "ensure financial security for current and future pensioners";

- PPF delivery of its current statutory duties and responsibilities, any policy changes that would support its delivering its objectives and how effectively it responds to any changes and engages with DWP and HM Treasury.

Efficiency

11. This will consider how PPF manages its resources, including:

- How effective PPF is in managing public money in line with HM Treasury Guidance;
- How effective and efficient PPF has been in achieving its purposes and carrying out its functions;
- How effective PPF is in delivering value for money and how it plans to become more efficient, including through consideration of wider opportunities across the public sector;
- Where consistent with PPF's objectives, strategic alignment with wider government on accommodation, capital spend, recruitment and consideration of Shared Services.

Annex C

Court Judgements

The Hampshire Judgment

The Court of Justice of European Union of 6 September 2018 in the case of Grenville Hampshire v The Board of the Pension Protection Fund. ruled that, in the event of employer insolvency, every former employee should receive no less than 50% of the value of their accrued old age benefits (the minimum level) and that protection should never fall below the minimum level.[38]

The Bauer Judgment

The Court of Justice of the European Judgment of 19 December 2019 in the case of Pensions-Sicherungs-Verein VVaG v Günther Bauer (the Bauer Judgement) confirmed that Article 8 of the Insolvency Directive (2008/94/EC) does not require a full guarantee of a person's pensions rights, in the event of their employer's insolvency. It requires each former employee to receive, at least 50 per cent of the value of their accrued old-age pension benefits, and in addition, any reduction must not force the person to live below the Eurostat "at-risk-of poverty threshold".[39]

The Court of Appeal Judgment

The Court of Appeal Judgment of 19 July 2021 in the case of the Secretary of State for Work and Pensions, the Board of the Pension Protection Fund, Paul Hughes and Others found the Pension Protection Fund compensation cap to be unlawful on the grounds of age discrimination.[40]

[38] PPF, More Hampshire decisions confirmed | Pension Protection Fund (ppf.co.uk), 2021
[39] PPF, ECJ judgment in PSV v Bauer | Pension Protection Fund (ppf.co.uk), 2019
[40] PPF, Court of Appeal judgment on Hughes judicial review | Pension Protection Fund (ppf.co.uk), 2021