A buoy in the storm

Pension Protection Fund (PPF) CEO, Oliver Morley, and CFO, Lisa McCrory, sit down with Sophie Smith to discuss the lifeboat's latest annual accounts and funding position, and the steps it is taking to ensure members remain protected

Despite the impact of the pandemic, the PPF's *Annual Report and Accounts* revealed that the pension lifeboat's funding position has increased by 13.9 percentage points to 127.3 per cent. Its probability of success, which measures the PPF's progress towards achieving its funding objective of being 110 per cent funded at its funding horizon, currently set at 2030, also rose to its highest ever level of 95 per cent.

Could you tell us a bit about how the PPF was able to achieve these results amid the market volatility and uncertainty seen amid the pandemic?

PPF CFO, Lisa McCrory: The increase in our reserves from £5.1 billion to £9 billion was pretty much all down to the outstanding performance of our investments.

Our investment strategy is broadly in two parts. One, we hedge all of our interest and inflationary risk and we do this through our liability-driven investments. These investments make up 40 per cent of our investment portfolio, and I think that's been one of the success stories of the PPF for a long time, and it's protected our reserves when gilt yields have been volatile.

Secondly, the remainder of our investment portfolio is invested in growth assets, in the hope they will generate returns that will build our reserves over time. The past financial year has seen these assets return 17.6 per cent, which is a record for us. These outstanding returns have played a key role in increasing our reserves by £3.7 billion. This is a fantastic result and has really showed the value of some of the decisions we've made internally around our investment strategy and that have enabled us to react quite quickly to market changes and investment opportunities in what was a very fast-moving situation over the year.

PPF CEO, Oliver Morley: Our investment success over the past year has been a long time in the making and to an extent we're reaping the rewards of that.

While last year was not our best year in terms of our overall investment returns, as Lisa *[McCrory]* mentioned, our growth asset portfolio has seen its best year of returns to date. Our hedge has also done exactly what it should do and has protected us against changes in interest and inflation, which impact our liabilities. As gilt prices fell throughout the financial year, so did the value of our liabilities and this meant our overall returns dropped as our hedge mirrored the drop in gilt prices. It's been an exceptional year of investment performance for us, especially given the wider economic situation, and what we're seeing now is the benefit of our long-term investment strategy.

Considering this long-term investment view, what consideration of the climate, and broader environmental, social and governance (ESG) issues, is the PPF making in terms of investments?

Morley: We are focused on making sure that we're transparent and that our funds are also transparent to us so that we really understand that climate impacts and just general ESG impact of our investments.

We are driving a lot of our climate approach more generally around that transparency and that means that our board has set some high expectations in terms of ESG. I would say that is probably the main change in approach over time.

So, we've been building towards having those close relationships with managers, having that understanding and that ability to do stewardship well under those circumstances. We are proactively looking to make sure that we are on the front foot in this area, and I think it's working.

The PPF paid out £1 billion in member compensation for the first time ever in 2020/21, according to its *Annual Report and Accounts*. Can you tell us a bit about whether you expect greater levels of annual compensation going forward?

McCrory: The increase in compensation is driven by two factors. Firstly, our population is getting older. This means more current members are reaching their retirement age and are able to start to receive their PPF benefits. So even if we didn't get any other claims, we would still expect the amount of compensation we pay each year to increase.

But then, on top of that, the amount of compensation we pay to members each year will also increase as more members transfer into the PPF over time. Clearly claims are one of the big unknowns for us and we don't know, although we do project, how compensation might change as a result of that.

And does the PPF have any concerns around these potentially much larger future claims, particularly in light of the impact of the pandemic?

Morley: In terms of pandemic, I think we've weathered it really well. This is in part due to insolvencies being much lower than expected. Like many across the pension sector, we expected to see more claims as a result of the pandemic and it's been a positive surprise that this hasn't happened. Certainly some of the evidence is that the government furlough scheme and other support methods have worked really well to tide people and businesses over during what was a very difficult time.

We're still worried though. It's our responsibility to not be complacent and to be prepared for future claims. This is why we have our reserves. We need to ensure we're in a robust position so we can continue to protect our current and future members against potential claims which could have a material impact on our funding position.

We want to provide reassurance to our current and future members that we're in a strong financial position to be able to protect them for long as they need us.

McCrory: The risk of claims is one of the biggest risks we face and obviously one we take seriously and prepare for. We'll be paying compensation to our current and future members for a long time to come, and during this time we would expect periods where claims will be both higher and lower, and that's exactly what our reserves are there for.

Whilst the PPF levy was reduced this year, some industry organisations have queried whether continued levy payments are needed at all in light of the lifeboat's strong funding position. Could you explain why the levy is still needed?

Morley: The PPF levy continues to be a vital source of funding and plays a key role in allowing us to protect our current and future members. In order to continue to protect the 10 million members in the schemes that pay our levy, we need to remain financially resilient so we can withstand economic shocks, despite the risk of large claims. While our funding position has improved, there are a large number of schemes under our protection that would have, if they were to claim, a material impact on our balance sheet.

Despite this ongoing risk, our levy has reduced by more than £200 million over the past two years and we would like to see this trend continue over time as we progress towards achieving our funding target. However, where schemes have risk, they will need to continue to pay our levy to protect us from the risk they pose on us and our ability to protect our current and future members.

Written by Sophie Smith