Sackers

Consultation on the third PPF levy triennium

Alert | 09 October 2017

Introduction

The PPF has confirmed that it will implement the majority of the proposals it consulted on earlier this year for third levy triennium (see our Alert) and is now seeking views on a small number of additional proposals as well as on the draft levy rules for 2018/19.

Key points

- The levy estimate for 2018/19 will be £550 million, 10% lower than the £615 million estimate for 2017/18.
- The PPF has decided to adopt alternative approaches for assessing a scheme's insolvency risk for certain types of employer to ensure they pay an appropriate levy.
- For the levy year 2018/19, trustees certifying / recertifying a Type A contingent asset which is likely to provide a levy reduction of £100,000 or more will be required to obtain a guarantor strength report, prepared by a professional adviser, prior to certification.
- Following a separate consultation in October 2017, the PPF will issue new standard agreements for contingent assets alongside the final levy rules in December. For the levy year 2018/19, any new contingent assets must be on these new forms, but existing agreements will not need to be re-executed.
- Proposals to design separate rules for smaller schemes and to introduce a levy discount for "good governance" have been shelved.

PPF-specific model

The PPF started using its bespoke insolvency risk model in the levy year 2015/16. The model is based solely on information about sponsors of DB pension schemes and, as such, is focused on those variables that are considered to be the most predictive of insolvency for this particular group of entities.

In the March consultation, the PPF set out evidence to support its view that the model is generally working well, but that there is a case for developing it further for the third triennium. Following responses to its proposals, the PPF has made some, limited, revisions and now intends to rebuild five scorecards and recalibrate the other three with the aim of improving "predictiveness".

The PPF acknowledges that many sponsors will see a change in levy band (following the introduction of new scorecard one) but expects that "following initial movement in scores on transition, the new scorecards will prove more stable".

Alternative approaches to assessing insolvency risk

The PPF proposed developing alternative methodologies to assess the insolvency risk of certain employers / schemes to ensure they pay an appropriate levy. It intends to adopt the following:

- where an employer (or ultimate parent of an employer) has a public credit rating this will be used as the basis for the assessment of insolvency risk. The PPF / Experian portal will display whether a rating is being used as the basis for a score and what the rating is

- for regulated financial service entities (that are not rated), the PPF will use a credit scoring model developed by Standard & Poor. It expects that scores calculated on this basis will become available on the PPF / Experian portal during the course of October

- where the PPF considers it appropriate, a group of entities close to government, which are judged to be of very low risk, will be allocated to levy band 1.

The PPF is satisfied that the use of different bases for assessing different sponsors is justified by the improvement in outcomes.

Deficit-Reduction Contributions ("DRCs")

Among other potential measures to ease the burden on smaller schemes, in the March consultation the PPF proposed changes to the process for certifying DRCs. Two options were put forward:

- simplify the existing calculation methodology, by removing the requirement for the certified DRC amount to incorporate a deduction in respect of investment management expenses met out of scheme assets (Option A)

- allow schemes to certify the contributions paid under a scheme's recovery plan, plus any "special contributions" which have served to amend the recovery plan or remove the need for one (Option B).

The PPF has decided to make Option A available to all schemes. "Smaller schemes" (defined as those with submitted s179 liabilities of less than £10 million) will, in certain circumstances, be able to use Option B.

Guarantor strength reports

For a Type A contingent asset (parent or group company guarantee) to be recognised by the PPF, the trustees must certify that, broadly, the guarantors would be able to meet the amount guaranteed in an insolvency situation (see our Alert). But, the PPF's experience is that it is still rejecting a significant number of Type A contingent assets on the basis of guarantor strength.

For the levy year 2018/19, the PPF has therefore decided to introduce a new requirement for trustees to certify that they have obtained a "guarantor strength report" (prepared by a covenant adviser, with input from other advisers as appropriate) prior to certification of an asset which will give rise to a levy reduction of £100,000 or more.

The PPF will review reports on a straight pass / fail basis, looking at whether the report:

- was prepared by the certification deadline
- addressed the required issues and gave the required duty of care.

Schemes with Type A assets which are below the threshold may choose to base certification on a report to benefit from certainty regarding the information the PPF will use to assess the guarantor's financial position.

The draft contingent asset guidance for the levy year 2018/19 provides details on, among other matters, the reporting threshold, timing, the contents of the report and the advisers' duty of care.

Contingent assets: standard form agreements

Now that the contingent asset regime has been in place for over ten years, the PPF has undertaken a comprehensive review of the contingent asset documentation.

As the review and an earlier, informal, consultation have given rise to several questions, the PPF intends to issue a separate consultation during October to cover all the issues. Following consideration of responses, the PPF will publish new forms alongside the final levy rules for 2018/19 this December.

Next steps

The consultation closes on 1 November 2017. As usual, the PPF intends to finalise the rules and publish the levy determination in December.

The PPF intends to use scores collected between 31 October 2017 and 31 March 2018 for the 2018/19 levy year. Trustees and employers should log on to the PPF / Experian portal to view and check their data and scores.

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