Sackers

Consultation on the third PPF levy triennium

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Introduction

The PPF is consulting on how it intends to develop the PPF levy for the next three year period, or triennium, which starts in 2018/19.

Key points

- The PPF proposes several changes to its scorecards with the aim of "a more accurate assessment of insolvency risk". These changes are expected to lead to a decrease in levy for around two-thirds of schemes. However, some schemes, particularly those with very large employers, are likely to see an increase.
- An alternative approach to assessing a scheme's insolvency risk is proposed for schemes with types of sponsor for whom the PPF does not consider the current methodology appropriate.
- For the levy year 2018/19, trustees certifying / recertifying a Type A contingent asset with a realisable recovery of at or over £100 million will be required to obtain a guarantor strength report, prepared by a professional adviser, prior to certification.
- The consultation also seeks views on the possibility of a levy discount for good governance and reducing the administrative burden for smaller schemes.

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.

Indications are that the model is performing well so the PPF only proposes to refine its methodology by:

- introducing two new scorecards to which employers will be allocated according to their size (using a threshold of £30m annual turnover). This is intended to ensure that SMEs will pay a levy appropriate to their risk
- rebuilding the two "small accounts" scorecards and the not-for-profit scorecard to deliver a higher level of predictiveness

- using credit ratings, where available, to generate insolvency risk scores and, for un-rated entities regulated by the FCA, to use industry specific scorecards supplied by a credit rating agency.

As these new scorecards should be even more stable, the PPF is also consulting on whether to continue to calculate the levy by averaging monthly scores, or to move to using scores as at 31 March each year (31 March 2018 for the 2018/19 levy) instead. The monthly averaging approach was originally introduced to deal with the far greater variability of the preceding Dun & Bradstreet failure score.

If the PPF decides to retain monthly averaging it will use scores on the new basis from October 2017 at the earliest.

Alternative approaches to assessing insolvency risk

The PPF proposes using a different approach for calculating the levy for the following:

- schemes sponsored by entities established by statute or wholly or directly owned by the Crown, central government or a statutory authority (for example, the FCA) ("State Entities")

- schemes without substantive sponsors ("SWOSS")

to ensure their schemes pay an appropriate levy.

State Entities

The PPF considers that State Entities cannot be assessed appropriately using the Experian model and should be automatically placed in Levy Band 1. Such an approach is in line with that used by Credit Ratings Agencies for entities of this type.

SWOSS

In February 2017, the PPF published a consultation on a new levy rule for 2017/18 for SWOSS, based on a model for pricing put options (see our Alert). Broadly, this new rule (which was included in the PPF's final determination for the 2017/18 levy year) applies to a scheme which, on or after 1 January 2017 and before 1 April 2018 (or such later date as the PPF in its discretion may decide):

- has entered into an Ongoing Governance Arrangement

- in relation to which the PPF is satisfied that TPR has agreed that an Ongoing Governance Arrangement will be entered into at a future date.

An "Ongoing Governance Arrangement" is defined as "an agreement (or agreements) and/or other documentation the purpose of which, in the opinion of the Board, is to set out the terms on which the Scheme is permitted to operate without a substantive sponsor".

This new levy rule will be consulted on again for the levy year 2018/19. However, in advance of that, the PPF is "keen for stakeholders to provide further comment and views on this new area".

Small schemes

Evidence suggests that the smallest schemes lack the resources to obtain more than the legal minimum of actuarial support. This means that such schemes receive no advice on levy issues and may be taking steps to reduce risk but not reporting such measures to the PPF.

As the PPF cannot remove or adapt the levy for small schemes unless the risk such schemes pose to it merits such treatment, it is considering introducing measures in relation to deficit-reduction contributions ("DRCs") which would relieve the administrative burden for all schemes. Broadly, the PPF proposes:

- simplifying the existing calculation methodology (for example, ignoring investment expenses)
- allowing schemes to certify the contributions paid under a scheme's recovery plan as the corresponding DRC to be certified for levy reduction purposes.

The two options are not necessarily mutually exclusive.

The PPF welcomes views on these potential changes and asks for suggestions of improvements and simplifications in other areas that would particularly help smaller schemes.

Type A contingent assets – guarantor strength

For a Type A contingent asset (parental guarantee) to be recognised by the PPF, the trustees must certify that, broadly, the guarantors would be able to meet the amount guaranteed ("the realisable recovery") in an insolvency situation (see our Alert). This aims to ensure that the reduction in risk provided by the contingent asset justifies the corresponding reduction in the PPF levy.

However, the PPF continues "to see cases where the guarantor's position appears to only seriously be considered once selected for review through the PPF's assessment process, rather than prior to certification".

As a result, the PPF is proposing to introduce a new requirement for guarantees where the realisable recovery is certified (or recertified) at £100 million or higher. In such circumstances, the PPF will require the trustees to obtain a guarantor strength report (which would address points such as scheme structure and details of group debt facilities), prepared by a professional adviser, prior to certification. The report would specify a realisable recovery that could be appropriately certified.

While the PPF acknowledges that this will increase costs for some schemes, the PPF believes this is justified in terms of making the regime more risk reflective. It will also provide trustees with increased certainty of what is expected of them when assessing the guarantor's position.

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

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

The PPF warns that it will scrutinise assets certified just below the £100 million threshold in the first year to ensure that schemes are not deliberately certifying questionable guarantees at just below the reporting trigger.

Trustees may voluntarily obtain a report for consideration by the PPF in respect of contingent assets which fall outside the reporting threshold.

Other changes for contingent assets

The PPF is also proposing:

- changes to its methodology to make it easier for "guarantor-employers" to have a guarantee taken into account and to simplify certification for multiple guarantors

- to conduct a full review of the wording of contingent asset agreements.

Levy discount for good governance

The Work and Pensions Select Committee recommended that the PPF “re-examine how the levy framework could incentivise schemes to improve scheme governance”.

This idea was first considered by the PPF in 2011, but it “concluded that there were practical barriers at that time”. In this consultation, the PPF is seeking views from stakeholders on whether there is now a case for a good governance discount. It is also requesting evidence of how good governance reduces risks to the PPF and views on how it could be measured for levy purposes.

Next steps

The consultation closes at 5pm on 15 May 2017. The PPF intends to present its conclusions in a second consultation alongside other areas for consideration later in 2017. That consultation will also set out its views on the appropriate level of levy to collect, moving into the next triennium.

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