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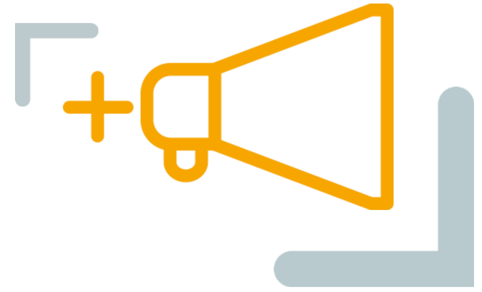

News Alert 2017/09

29 September 2017

PPF drops total levy take by 10% - but the largest companies could still see significant levy increases

At a glance

The Pension Protection Fund (PPF) has published its Levy Policy Statement for the next three years combined with the draft Determination for the 2018/19 levy season. Most of the proposals from the March consultation (see News Alert 2017/06) have been confirmed in the new policy.

Whilst the headline estimated total levy is falling by just over 10% to £550 million for the 2018/19 levy season, which will result in levy reductions for many, some of the biggest companies sponsoring pension schemes will see significant increases in their levy. The PPF is also consulting on its latest levy proposals that could take away the levy savings employers remaining in the top Levy Band, Band 1, were expecting to see.

Key Actions

Sponsoring employers

- Check how insolvency risk will be assessed for you under the new policy, and consider the effect of any changes in Levy Band on the expected levy. The changes could be most material for:
    - larger companies that find themselves on the new "Non-subsidiaries £30m+ turnover/large subsidiaries" scorecard;
    - companies with a public credit rating; or
    - regulated financial institutions without a credit rating whose insolvency score will be calculated using the new industry-specific scorecard.
- Consider whether changes to both insolvency scores and the treatment of parental guarantees in the levy calculation make a new parental guarantee worth implementing. New guarantees will have to be on the updated standard PPF form once published.
- Consider whether to respond to the PPF's latest consultation, particularly if in insolvency risk Levy Bands 1, 2 or 3 where the latest proposals could reduce anticipated levy savings or even see levy increases.

Trustees

- Confirm the effect of any sponsor insolvency risk changes on the scheme levy.
- Consider whether any further professional advice is needed for parental guarantees that save £100,000 of PPF levy or more.
- Consider whether to certify Deficit-Reduction Contributions. New rules make the process simpler and potentially more cost-effective, especially for small schemes closed to accrual and with liabilities less than £10m.

The Detail

On 27 September, the PPF published a combined Policy Statement and Consultation Document confirming its policy for the next triennium, which covers the 2018/19 to 2020/21 levy seasons, and setting out its proposals for the 2018/19 levies. At the same time the PPF published its 2018/19 draft Determination along with related technical documents.

The Policy Statement is very much as proposed in March (see News Alert 2017/06), with the major changes centred on the measurement of insolvency risk (developing Experian's PPF-specific models and introducing alternative methodologies for certain employers) and a welcome simplification to the Deficit-Reduction Contribution regime.

Most companies are expected to see their assessed insolvency risks either increase or stay the same as a result of the Experian model changes. However, to offset this, and also to reflect the PPF's intention to collect less levy this season (£550m in total compared to £615m), the risk-based levy scaling factor sees a significant drop from 0.65 to 0.48.

The PPF's impact assessment shows that nearly two-thirds of schemes would have seen reduced levies had the new policy applied in the 2017/18 levy season, with smaller and medium-sized employers in particular expected to benefit from the changes. However, larger companies without a credit rating are likely to see significant increases in levy as they are expected to foot a higher share of the bill.

The biggest changes are to Experian scores, with some of the largest employers likely to see big increases in their levies…

Companies facing the highest relative risk-based levies will be pleased to see a reduction in the risk-based levy cap, from 0.75% of smoothed liabilities to 0.5%.

There is also additional consultation on certain elements of the PPF levy calculation rules for 2018/19, including proposals to narrow the range of levy rates used for the "best" levy bands. Under these proposals companies in Levy Bands 1, 2 and 3 would see increases in their assessed insolvency risk, with the impact greatest for Levy Band 1 which would see nearly a 65% increase in levy rate. This consultation closes on 1 November and final details of the 2018/19 PPF levy calculation are expected to be confirmed in December.

…and under new PPF proposals for 2018/19 companies in Levy Band 1 could be paying a lot more than they expected too.

Our viewpoint

The PPF is targeting larger companies without a credit rating in the belief they have, in theory, been undercharged PPF levies in previous years. However, the changes to insolvency risk calculations will result in various winners and losers across the spectrum of sponsoring employers, depending on the specific circumstances of each employer. If the PPF's proposals go ahead as planned, even companies that remain in Levy Band 1 following the changes could see a significant increase in their levies.

Experian scores – more methods but scorecards simplified

The Policy Statement develops the Experian model for calculating insolvency risk scores and introduces more ways that a company's insolvency risk can be assessed, with insolvency scores for the 2018/19 season to be averaged over the period from the end of October 2017 to the end of March 2018. The rebuilt Experian scorecards and additional scoring methods have been developed to better represent the insolvency risks sponsoring employers actually pose to the PPF. The calculation methods include:

1. If your company has a credit rating with Moody's, Fitch or Standard & Poor's

Those credit ratings will be used to determine the company's insolvency score. If all three of the credit rating agencies allocate a credit rating to your company, the middle rating is taken. If only two agencies rate your company the worst rating is taken and if only one agency rates your company, that rating is taken.

Credit ratings will be used to calculate insolvency risk where available

The following table shows how Fitch and Standard & Poor's credit ratings transform to PPF levy bands:

Credit Rating	Levy Band	Credit Rating	Levy Band
AAA to A-	1	BB	6
BBB+	2	BB- to B+	7
BBB	3	B	8
BBB-	4	B-	9
BB+	5	CCC+ to D	10

2. If your company is a PRA-regulated bank, building society or insurance company on the appropriate list

An industry specific scorecard will be used for companies on either the Banks and Building Societies or Insurers PRA lists without a credit rating. These figures will be available on the PPF portal at some stage during October.

Certain PRA-regulated entities will have an industry-specific insolvency risk scorecard

3. If your company has neither a credit rating nor is PRA-regulated, it will be scored on an Experian scorecard

The Experian scorecards have been revamped as proposed in March, with five of the eight scorecards being rebuilt and in some cases rebranded.

Some Experian insolvency risk scorecards are changing

Many of the companies that find themselves on the new "Non-subsidiaries £30m+ turnover/large subsidiaries" scorecard will face considerably higher levies. However, companies on other scorecards will, on average, be better off, with smaller and medium-sized employers likely to see reductions in levy.

Whilst the Experian portal has shown scores under the proposed Experian scorecards since April, we will have to wait until sometime in October for the portal to fully reflect the Policy Statement, including credit ratings and industry-specific scores where these apply. All scores and credit ratings will be averaged over the 6-month period between 31 October 2017 and 31 March 2018 for the 2018/19 levy season, before reverting to a 12 month averaging period for 2019/20 and 2020/21.

Certain quasi-governmental organisations can apply to be put into Levy Band 1

Certain quasi-governmental organisations are being given the opportunity to certify that they are established by legislation/international treaty (or the employer is classed as central government, foreign government or the Crown) to automatically receive a Levy Band 1 insolvency risk assessment.

Our viewpoint

On the whole the new scorecards are expected to be tougher than their predecessors, but a considerably lower levy scaling factor will help to offset a higher insolvency risk score for many companies. Schemes that have just a single band deterioration in their levy score are expected to still generally see a reduced PPF levy for the 2018/19 levy season, but where the movement is greater this is likely to lead to increased levies.

Simplified Deficit-Reduction Contribution certification

Deficit-Reduction Contribution certification is being simplified

The PPF offered two possible simplifications to the Actuarial Certificate of Deficit-Reduction Contributions (ACDRC) in its consultation earlier this year. It has decided to adopt both of them in the Policy Statement:

- A simplified version of the current ACDRC regime open to all schemes, where the more complicated elements of the ACDRC calculation (such as investment expenses) are now ignored and any qualified actuary with appropriate experience (not just the Scheme Actuary) can perform the certification.
- A calculation based on the Deficit-Reduction Contributions outlined in the scheme's recovery plan, available to schemes with less than £10 million in liabilities that are closed to future accrual throughout the certification period, and have a recovery plan in

place at some point during the period. Trustees or a sponsoring employer can certify without an actuary if the amount certified is less than £1 million and relates only to contributions documented in the recovery plan.

Our viewpoint

These genuine simplifications to the ACDRC calculation are welcome. They should lead to it being economically viable for more schemes to certify their Deficit-Reduction Contributions.

Contingent Asset regime improved

A new requirement is that the PPF will require trustees to obtain a guarantor strength report, prepared by a professional adviser, before certifying parental guarantees that are expected to save £100,000 of PPF levy or more. The report will specify a Realisable Recovery that it would be appropriate to certify, demonstrating how funds within the guarantor's group would be available to support this amount in the event of the employer's insolvency. A new or updated guarantor strength report is required at each recertification, with the PPF expecting to review a significant proportion of these.

A new guarantor strength report is required for guarantees that save over £100,000 of PPF levy

Where a participating company also guarantees the benefits of other companies participating in the scheme, the PPF has adjusted the formula for calculating the insolvency risk so that, for the purpose of the Realisable Recovery only the guarantor effectively no longer guarantees the liabilities attributed to itself as an employer. As a result many guarantees issued by employers participating in the scheme will have a more positive impact on the PPF levy.

There is also good news for schemes with multiple guarantors, for whom the restrictive requirement for "all guarantors to be able to guarantee the full Realisable Recovery" has fallen away.

Guarantors who have a credit rating or are one of the new quasi-governmental "Special Category Employers" will not see their insolvency risk affected because of the size of the guarantee (the "gearing" adjustment that applies to other guarantors).

After a review of its standard contingent asset agreements the PPF has decided that adjustments need to be made. New agreements should be made using the new standard forms that will be made available on the PPF's website from December 2017. Existing contingent assets do not have to be updated to the new format for this levy season – they have until the 2019/20 levy season to be re-executed.

Schemes will not have to re-execute existing contingent asset agreements for the 2018/19 levy season, but are expected to have to do so in time for 2019/20

Our viewpoint

Trustees of schemes with a guarantee that saves over £100,000 of PPF levy may face extra expense as a result of the new guarantor strength requirements.

Whilst schemes with employer-guarantors and multiple guarantors will want to check the effect of these changes on their position, the best news for many schemes here is the extra time they have before they need to re-execute existing contingent asset agreements. It could have made life administratively difficult if all existing contingent assets had to be re-executed over the next six months.

Other proposals

The PPF is exploring options to enhance the customer service experience for smaller schemes, but at this stage (other than the simplified Deficit-Reduction Contribution certificate) there are not going to be any "special rules" that will ease the administrative burden felt by the smallest schemes.

The consultation proposal that there be levy discounts for schemes with good governance has also been dropped for the time being, on the grounds that the risk reduction is difficult to practically assess.

The PPF has dropped the proposal for Asset-Backed Contribution (ABC) arrangements containing loan notes to be treated more like a parental guarantee, but it has offered trustees with an ABC arrangement containing real estate an alternative certification option.

We could see the first PPF levy charged on a "scheme without a substantive sponsor" that is newly arising as a result of a regulatory apportionment arrangement or insolvency. The PPF has also given itself the option to charge a levy to schemes that enter a PPF assessment period due to a restructuring with the expectation that a successor scheme will be established.

New matters for consultation

The PPF is now consulting on two specific aspects of the draft levy rules for 2018/19 ahead of the final Determination being issued in December. They are:

- Revised insolvency risks for schemes in Levy Bands 1, 2 and 3 – the PPF intends to increase the assessed insolvency risk for these levy bands because it feels there is currently too much of a gap between them, and that the actual insolvency risks of companies in these bands are not being properly reflected. Levy Band 1 would see the biggest increase in insolvency risk, up from 0.17% to 0.28%, which would more than offset the decrease in the levy scaling factor.

The PPF is proposing to increase the insolvency risk associated with Levy Bands 1, 2 and 3 – Levy Band 1 could see a 65% increase

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- Revised asset and risk stress factors – the PPF is proposing to update the stress factors it applies to both assets and liabilities. Most schemes will see an improved funding level for PPF levy purposes as a result of these changes.

The consultation also considers a simplification of the block transfer process in cases where the assets and liabilities of the scheme remain unchanged following segregation (a “self-segregation transfer”) or where a section/scheme transfers in its entirety to its own brand new section or scheme (a “1-1 transfer”).

Our viewpoint

A 65% increase in assessed insolvency risk for schemes remaining in Levy Band 1 feels very high – it more than offsets the proposed reduction in the risk-based levy scaling factor. Companies in this situation may wish to respond to the PPF with their thoughts on the proposal.

Timetable of events for the 2018/19 PPF levy season

The key dates from the 2018/19 draft levy Determination are as follows:

- 31 October 2017 to 31 March 2018 – month end dates used to average insolvency scores.
- 1 November 2017 – deadline for responses to the PPF’s latest consultation.
- December 2017 – the PPF will issue the final Determination and associated documents.
- Midnight on 29 March 2018 – deadline for submission of:
    - scheme returns (including any voluntary section 179 valuations);
    - certification of asset-backed contributions;
    - certification of quasi-governmental “Special Case Employer” details;
    - certification of mortgages (to Experian); and
    - certification or re-certification of contingent assets.
- 5pm on 30 April 2018 – deadline for certification of Deficit-Reduction Contributions.
- 5pm on 29 June 2018 – deadline for certification of full block transfers that have taken place before 1 April 2018.

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