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UK pensions speedbrief - Will your PPF levy increase from April 2015?

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The Pension Protection Fund has issued a **consultation paper** setting out its proposed levy framework for the three levy years from April 2015 onwards. This could result in your scheme's PPF levy changing significantly.

The biggest change is the use of Experian to assess insolvency risk instead of Dun & Bradstreet. Experian's model is significantly different to that of Dun & Bradstreet: it will be important to understand the likely effect of this change for your scheme. There are also changes around asset-backed contributions, unsecured guarantees (Type A contingent assets) and last-man standing schemes.

To allow trustees and employers time to assess the implications of the new model for the sponsor's individual scores, only scores from October 2014 onwards will feed into next year's levy figures.

The consultation closes on **9 July 2014**.

So, how will the PPF's assessment of insolvency risk change?

The driver behind the new risk model is the realisation that employers which sponsor defined benefit ('DB') pension schemes eligible for entry to the PPF are not typical of the average UK business. Employers with DB schemes:

- are generally larger than the majority of UK employers
- have been established for much longer than most UK employers
- are much more likely to be part of a corporate group.

These factors influence the employer's insolvency risk. Experian has therefore worked to develop a model based on data relating to (and in particular, the actual insolvency experience of) those UK employers which have sponsored a DB scheme since the PPF was set up in 2005.

Some key points to note about the new model are:

- It focuses on **financial information**. In contrast, the generic model previously used by Dun & Bradstreet placed significant weight also on non-financial factors, such as geographical location or the number of directors;
- It allocates each employer into one of eight sub-groups, based on the type and size of business, its corporate structure (stand-alone or part of the group), and the nature of the accounting information which it publishes. Each sub-group is assessed using a specially tailored **"scorecard"**, including one for not-for-profit entities; and

In response to stakeholder feedback, it places greater weight on the strength of the employer's wider **corporate group** (the Dun & Bradstreet generic model recognised weakness within the employer group but did not give significant credit for the existence of a strong corporate group).

One area which is still open to discussion, and where the PPF is particularly inviting comments, is whether there should be an override for entities with a credit rating from Moody's, Standard & Poor's or Fitch. If introduced, the use of an available credit rating would be mandatory, not optional.

The consultation paper also proposes changes to service delivery, again responding to calls from stakeholders. Access to individual scores and to the underlying data used by Experian in arriving at those scores will be provided using a web portal, and it will be possible to set up an automatic email alert to notify changes in the insolvency risk score.

Access to the portal is currently restricted to trustees and approved scheme representatives, though the PPF is considering how direct access could be granted to employers.

How will the PPF give credit for asset-backed contribution (ABC) structures?

The PPF is concerned that the asset used to back the contributions in ABC structures in the event of insolvency may be worth less than the value attributed to the income stream in the scheme's accounts, resulting in an undeserved levy reduction.

To tackle this, the PPF plans to strip out the value of the ABC income stream from the s.179 values when the levy is calculated. To have the benefit of the ABC taken into account for levy purposes, annual certification will instead be required (as for contingent assets).

If the ABC is certified, credit will be given for the underlying asset value or the value of the income stream, whichever is lower. The income stream value must be reassessed each year, but the underlying asset will only need to be revalued every three years.

Two important points to note:

- Only ABCs backed by assets of the same kind as would currently be acceptable as Type B contingent assets will be accepted by the PPF. In practice, this means that only ABCs based on UK property assets will be recognised for levy purposes.
- Where schemes have already submitted a deficit reduction certificate in respect of an existing ABC, that certificate will be disapplied in its entirety. So if the certificate also covered other contributions (eg. recovery plan payments), schemes will need to recertify those contributions.

Is anything else changing?

The Consultation also addresses two other material potential changes.

First, **Type A contingent assets** (unsecured parent / group company guarantees) are changing so that:

- In future, trustees will have to certify a fixed amount which they consider the guarantor will be able to meet in the event of employer insolvency: the option to certify more

generally that the guarantor can meet its obligations will be removed. Credit will only be given for the fixed amount when the levy is calculated; and

- The guarantor's insolvency risk rating will be adjusted to take account of the fact that it has given the guarantee. (If the guarantor participates in the scheme itself, this change would apply only to its risk score as guarantor, not as employer.)

Secondly, a couple of changes are proposed in relation to **last-man standing schemes**:

- Following several cases where the PPF has found that schemes have been wrongly categorised (and so wrongly taken advantage of the current 10% reduction in the risk-based levy for last-man standing schemes), trustees will need to confirm that they have legal advice that the scheme is a last-man standing arrangement; and
- The scheme-structure factor applied to a last-man standing scheme for associated employers is to change, with the insolvency risk for each employer being weighted according to the number of members attributable to that employer.

How would this affect your scheme?

These proposals could affect your PPF levy very significantly.

The PPF acknowledges that the new insolvency risk scoring model will produce winners and losers, since it results in a significant (though more even) redistribution of schemes across the ten levy bands. Some schemes may fall by 5 levy bands or more; equally, a lucky few will jump from band 10 to band 1.

Of those schemes seeing a material change to their levy, the PPF believes roughly 60% will see an improvement and 40% will experience a deterioration. Since the overall levy amount remains the same, the average increase for those schemes who fare worse under the new model will be rather larger than the average drop in levy for the 'winners'. On the PPF's estimates, the average increase is around 150%, but the average decrease is only 40%.

The consultation paper (plus **annexes**) contains a detailed impact assessment. However, employers (and trustees in relation to their sponsors) will want to obtain their indicative Experian scores and data and assess the likely impact on their own levy invoice. We expect that employers will contact their scheme's trustees as a matter of urgency to ensure they get access to this information as soon as it is available.

In the challenge of getting to grips with the new model ahead of October 2014, employers and trustees also should not overlook the likely impact of the PPF's other proposals. In particular, existing ABCs or Type A contingent assets may cease to be recognised in full or at all, which could have a serious knock-on effect on the size of PPF levies.

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