

# PPF Levy 2012/13: Consultation

October 2011

Importance ★★★★★

The PPF has given details of how it proposes to take account of investment risk and of its new approach to insolvency risk. The levy estimate for 2012/13 is £550 million, the lowest target yet.

In May the PPF confirmed it would introduce its “new framework” from next April with a view to making levy bills more scheme-specific and less volatile.

The main changes to the risk-based levy outlined in the consultation paper are:

- to reduce the influence of temporary market movements, funding will be smoothed by applying the daily average of appropriate indices and rates over five years,
- investment risk will be recognised for the first time,
- insolvency risk will be measured by putting employers into one of ten risk bands based on their average D&B failure score over twelve months and
- new requirements are likely to mean that the PPF will reject some existing contingent asset guarantees.

An important aim of the new framework is to allow the levy estimate and rules to remain fixed for three years at a time instead of being revised significantly every year.

A scheme’s risk-based levy depends on the underfunding risk it poses – which will now include investment risk – and the employer’s risk of insolvency.

## Underfunding risk

The PPF will no longer assess underfunding risk by taking asset and liability values at a single date. Instead, it will roll forward assets and liabilities using daily averages of indices and yields taken over the five years to 30 March 2012. This will produce a smoothed deficit figure.

To gauge investment risk, the PPF will calculate a stressed deficit by applying notional changes to asset and liability values. Each asset class has its own stress factor, the biggest being to UK equities (a reduction of 22%). On the liability side the PPF will apply an interest rate stress and, for index-linked liabilities, an inflation stress. The proposed stress factors are in the consultation document.

The measure of underfunding risk will be the greater of the smoothed and stressed deficits.

## Actions to consider in the light of the new framework

- update D&B more frequently now that a failure score is a twelve month average,
- avoid classifying assets as “insurance funds” or “other” in a scheme return where a more precise category is available,
- on new and existing contingent asset guarantees, check ahead of time that the guarantor is likely to be good for the full liability at the time of (re)certification,
- where an entity that is “associated” under the new, wider definition is to put up a contingent asset, gather evidence that it satisfies the definition in good time and
- note the deadlines for various actions and allow adequate lead time to meet them.

The PPF will base its stress tests on the information about assets and liabilities reported in scheme returns. It urges schemes to make sure this information is correct. The guidance on Exchange (the Regulator’s electronic reporting system) is being updated to help them.

The PPF draws particular attention to the asset categories “insurance funds” and “other”. Unless there is information to the contrary, it will treat “other” assets as equities and apply the heaviest stress factor. It will also treat assets categorised as “insurance funds” as equities and so encourages schemes to report the different components of such funds separately under other headings where they can.

Large schemes (PPF liabilities over £1.5bn) will be required to carry out their own, bespoke stress testing according to criteria the PPF will set.

## Insolvency risk

To measure insolvency risk, employers will be put into one of ten bands, each with its own levy rate. An employer’s band will depend on its average D&B failure score on the last business day of the twelve months to the end of March 2012.

Where a new employer begins to participate in a scheme, the average failure score over twelve months will be taken even though the employer might have begun to participate part way through the year.

The levy rate in a multi-employer scheme will be the average of all the employers' levy rates, weighted by numbers. In last-man-standing schemes for associated employers, a factor of 0.9 will continue to be applied. For last-man-standing schemes for non-associated employers, a new factor has been developed. Employers with such schemes should look up the appropriate part of the consultation document.

Foreign employers will continue to have their foreign failure score converted to the UK scale.

Employers are likely to want to update D&B frequently. Information filed in one month will be reflected in the failure score at the end of the following month. Monthly scores will be available free of charge to trustees, employers and their advisers.

The PPF warns that D&B are likely to adjust the methods they use to generate failure scores some time during the three year period. It does not yet know what the impact might be but will work with D&B to ensure the levy remains stable.

## Contingent assets and deficit reduction contributions

Most of the rules on risk reduction measures will remain the same but there are some changes.

### ■ Type A contingent assets: guarantees

The insolvency risk of entities putting up new or existing PPF compliant guarantees will be assessed in the same way as for employers except that if fewer than twelve months' failure scores are available, the single score at the end of March 2012 will be used.

In a single employer scheme, the effect of a guarantee will be to substitute the insolvency risk of the guarantor for that of the employer. In a multi-employer scheme, the insolvency risk of the guarantor will only substitute for those of employers with a higher insolvency risk. This will help where scheme employers range in insolvency risk and where the guarantor is not the strongest group company.

The PPF has concerns that the cut in levy that a guarantee achieves is not always matched by a reduced risk that the scheme will need PPF protection. To address this there will be a new certification requirement that the guarantor – whether new or an existing one – would be able to meet its full obligation under the guarantee on the date of the certificate.

The PPF will take steps to check the value of a guarantee and to call for additional evidence to substantiate it where appropriate. For a guarantee to be recognised, the PPF would need to be satisfied with the evidence before the deadline for (re)certifying it at the end of March. This could impose a substantially increased lead time for certifying some new and old guarantees.

These tougher requirements are likely to mean that the PPF will be rejecting some guarantees that it has accepted in previous years.

### ■ Type B(ii) security over real estate

The certified value of charges over real estate will be subject to a stress test (minus 6%) but there will be no separate smoothing.

### ■ Type B(iii) security over securities

The certified value will be subject to smoothing and stressing (as equities).

### ■ Guarantors and chargors

To date the PPF has required them to be "associates" of a scheme employer in a strict statutory sense. In future it will be sufficient that they already have a strong commercial or legal relationship with one of the employers and that they are providing a contingent asset because of that relationship. A statement to this effect, backed by evidence, will need to be included when the asset is certified by the end of March.

### ■ Deficit reduction contributions

The PPF has no plans to change the rules on deficit reduction contributions. They will not be subject to smoothing or stressing.

## Levy parameters

The intention is for the levy parameters to remain the same for three years.

The scaling factor is applied to each scheme's risk-based levy to bring the total (taken with the scheme-based levy) as near as may be to the estimate. This will be 0.89. In the past this factor has fluctuated widely from year to year.

The risk-based levy cap limits the levy a scheme can be asked to pay. It is designed to make the levy affordable for the least well funded 10% or so of schemes and will be 0.75% of smoothed liabilities.

Under the new framework, the scheme-based levy has the job of meeting the cost of the cross-subsidy that results from the levy cap. It will be 0.000085 of smoothed scheme liabilities and will raise about 11% of the total levy (half its current share).

There are certain circumstances in which the PPF would need to adjust these parameters during the three years e.g. if, contrary to the legislation, the risk-based element would otherwise account for less than 80% of the total levy.

## Procedural changes

In relation to scheme returns, the PPF reminds trustees that they have a statutory obligation to provide complete and accurate information.

The return will have a limited number of new data fields as a result of the new levy framework. The PPF will be taking steps to bring these to trustees' attention.

It will no longer be possible to report partial block transfers.

## Final rules

The consultation closes on 5 November. The final rules for the 2012/13 levy will be available by the end of the year and probably in mid December.

If you would like more information, please contact the person in our pensions team with whom you normally deal or **Marcus Hellyer** at [marcus.hellyer@burges-salmon.com](mailto:marcus.hellyer@burges-salmon.com).

Finally, here are the key dates.

Key dates	
End of each month April 2011 – March 2012	Monthly D&B failure scores
By 5pm, 30 March 2012 Exchange opens for filing in November 2011	Update scheme return via Exchange
5 years to 30 March 2012	Reference period over which funding is smoothed
By 5pm, 30 March 2012	(Re)certify contingent assets
By 5pm, 10 April 2012	Certify deficit reduction contributions up to 31 March 2012
By 5pm, 29 June 2012	Certify full block transfers made up to 31 March 2012
Autumn 2012	Invoicing starts

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