SLAUGHTER AND MAY

BRIEFING
1 OCTOBER 2015

PPF: Consultation on 2016/17 levy published

A. Overview

1. On 21st September, 2015, the PPF published its 2016/17 PPF levy consultation and accompanying documents, comprising:

    1.1 draft determination and accompanying appendices (asset-backed contributions, contingent assets, deficit reduction contributions, insolvency risk, investment risk, MFR conversion, transfers and transformation),

    1.2 draft guidance on asset-backed contributions,

    1.3 draft guidance on bespoke investment risk calculation,

    1.4 draft guidance on block transfers,

    1.5 draft guidance on contingent assets,

    1.6 draft deficit reduction contribution guidance, and

    1.7 draft guidance on exclusion of mortgages.

2. Comments are invited by 22nd October, 2015.

3. The levy estimate for 2016/17 is £615 million, £20 million less than last year, reflecting improvements in the insolvency risk scores of employers and guarantors.

4. Since the levy estimate is a 3% reduction on 2015/16, the PPF Board does not intend to adjust the levy scaling factor (0.65%), or levy multiplier (0.000021) from last year.

5. The PPF says its levy rules for 2016/17 are "very substantially the same" as for 2015/16, reflecting its desire to maintain stability of methodology for the 3 years of the second "triennium" (2015/16 to 2017/18).

6. The main changes are:

    6.1 a relaxation in the reporting requirements for re-certifying asset backed contribution arrangements ("**ABCs**") (see **D**. below), and

    6.2 some changes to insolvency risk measurement (see **C**. below).

7. The PPF also says it intends to re-invoice schemes that "incorrectly" classified themselves as Last Man Standing ("**LMS**") schemes prior to the PPF's "clarification" in the 2015/2016 levy determination (see **F**. below).

B. Insolvency risk measurement

1. 2015/16 saw the introduction of a new PPF-specific insolvency risk scoring methodology.

2. The PPF says it has seen a high level of take-up on the PPF/Experian web portal; over 90% of employer insolvency scores are apparently now being actively monitored.

3. The PPF notes that the introduction of Financial Reporting Standard FRS102 for accounting periods beginning on or after 1st January, 2015 may lead to new pension liabilities appearing on employers' balance sheets. The PPF is considering whether any action is necessary in relation to this.

C. Mortgage exclusions

1. Experian found that the existence of a recent mortgage was highly predictive of the risk of insolvency and so measures the most recent mortgage. The 2015/16 determination allowed exclusion (by certification) of some mortgages. See our December, 2014 client note on this topic for details.

2. For 2016/17, mortgage certificates provided for refinance, pension scheme and rent deposit mortgages for 2015/16 will automatically be recognised for 2016/17.

3. Mortgage exclusions for entities with investment grade credit ratings where the entity continues to meet the requirements for certification will be carried forward but Experian plans to monitor ratings so the exclusion can be disapplied if the entity's rating falls below investment grade.

4. "Immaterial mortgages" (i.e. where the amount secured is no more than 0.5% of the charger's total assets) must be re-certified, with certificates being submitted to Experian by 31st March, 2016, and including any charges previously certified for 2015/16.

5. The PPF says it is considering extending the credit rating exclusion to allow for private credit ratings to be used as a basis for certification. It is also proposing to broaden the definition of "refinance mortgage" to capture new mortgages that are a restatement or confirmation of existing lending, with no changes or extension to its terms, without the existing mortgage needing to be released. The PPF is also seeking views on whether charges over bank accounts should be eligible to be excluded as "Immaterial".

   Action point: If you are likely to benefit from these proposed relaxations, please respond to the PPF consultation.

D. Asset-backed contributions

1. The 2015/16 levy rules introduced a requirement to certify asset-backed contributions ("**ABCs**") if their value was to be recognised in the levy. 66 ABC certificates were submitted, all of which were approved. But the consultation document highlights areas which gave rise to issues and the PPF notes it may take a more rigorous approach in future years.

2. The draft ABC guidance sets out principles to follow on re-certification of ABC arrangements. The PPF says that, in most cases, there will be no need to produce further legal advice and, potentially, a lighter touch valuation will be accepted. Otherwise the PPF does not expect to make significant changes to the ABC regime.

E. Contingent assets

1. The PPF has incorporated key elements from its Guarantor Strength factsheet (published in January, 2015 (Pensions Bulletin 15/03) into its Contingent Asset Guidance for 2016/17 (Section **5.1.18** onwards). The factsheet sets out the factors that trustees should consider when assessing the impact of employer insolvency on the guarantor. The Contingent Asset Guidance also includes a table setting out examples of key issues arising during the PPF's assessment of contingent assets submitted for 2014/2015.

   Comment (1): The requirements for guarantor strength were tightened in the 2015/2016 levy determination: discussions we had with the PPF revealed that, although the policy intent (that the guarantor's insolvency risk score should be substituted for the employer's only to the extent that the guarantor had available assets, excluding shares or inter-company loans or receivables from the employer) was clear, that intent was not supported by the wording in the levy determination and Contingent Asset Guidance. Inclusion of the additional wording on guarantor strength supporting the PPF's policy intent is helpful.

   Comment (2): An example of the PPF's hard-line approach to the issue of guarantor strength can be found in relation to the Land Rover Pension Scheme (Pensions Bulletin 15/14). To avoid finding themselves in the same position as the Land Rover Scheme, schemes should ensure that they operate within the ambit of the Contingent Asset Guidance on guarantor strength.

2. The PPF is offering a series of interactive seminars during September and October which it strongly encourages trustees and advisers (particularly where their contingent asset has not been called in for review this year) to attend.

F. Last man standing schemes

1. For 2015/16, schemes were only able to benefit from the reduction for last man standing ("**LMS**") schemes where they confirmed to the PPF they had received legal advice confirming their LMS status by 29th May, 2015. The reduction (previously a flat rate of 10%) was replaced by a sliding scale of between 0% and 10% depending on the concentration of membership across participating employers.

2. Around half of the schemes contacted responded by the deadline.

3. For 2016/17, the Regulator has included the confirmation of legal advice on the scheme return so it will no longer have to contact schemes separately. But only those indicating they have legal advice supporting their LMS status will receive the reduction.

4. A number of schemes responded to the effect they had legal advice that they were not in fact LMS in structure although they had reported as such in previous years. This apparently includes very large schemes for which levy reductions have been substantial.

5. The PPF says it intends to re-invoice such schemes for prior years and will contact the schemes concerned.

   Comment: It is important to distinguish here between schemes that incorrectly categorised themselves as LMS and schemes that took legal advice on the correct categorisation prior to the PPF's statement on the subject in its response to its consultation on the 2015/2016 levy.

   For some schemes (including those on Slaughter and May's model documentation) it was not immediately clear into which of the 3 categories in the scheme return they fell. The Pensions Regulator confirmed that they fell into the LMS category but the PPF then expressed a different view in relation to the 2015/2016 levy.

   Leaving to one side the question of whether the new test is correct, a number of schemes subsequently amended their rules to ensure they benefit from the LMS discount.

6. For those schemes that chose not to take legal advice or that did not respond to the request for information, the PPF will give them the opportunity to report in this year's scheme return before contacting them.

G. Key dates

The PPF will continue to use information from the annual scheme return to calculate levies. The deadline for submission is midnight at the end of Thursday, 31st March, 2016, except as detailed overleaf.

Item	Key Dates
Monthly Experian Scores to be used in 2016/17 Levy	Between 30th April, 2015 and 31st March, 2016
Deadline for providing updated information (to Experian) to impact on Monthly Experian Scores	One calendar month prior to the Score Measurement Date
Submit scheme returns on Exchange	By midnight 31st March, 2016
Reference period over which funding smoothed	5-year period to 31st March, 2016
Certification of contingent assets	By midnight 31st March, 2016
Certification of asset backed contributions	By midnight 31st March, 2016
Certification of mortgages (emailed to Experian)	By midnight 31st March, 2016
Certification of deficit-reduction contributions	By 5pm, 30th April, 2016
Certification of full block transfers	By 5pm, 30th June, 2016
Invoicing starts	Autumn 2016.

The consultation documents are on the PPF website

H. Action points

1. In order to keep their risk-based levies to a minimum, schemes should:

    1.1 check the risk scores of their participating employers on the web portal,

    1.2 start thinking about whether to re-certify existing contingent assets/previously-recognised ABC arrangements, and

    1.3 where applicable, re-check their LMS status to see whether they still qualify for the discount. It may be possible to amend scheme rules to achieve this.

2. For further information, please get in touch with your usual pensions contact at Slaughter and May.

Slaughter and May (PFJB/RFH) October, 2015