ASSOCIATION OF CONSULTING ACTUARIES

Response to 2024/25 Consultation on the Levy Rules

Reponses to consultation questions

1) Do you agree that our approach to charging a minimum levy is appropriate given the legislative framework?

Yes, we agree, but only for the short-term and provided the PPF is satisfied that there is no further flexibility within current legislative constraints. If this is the case, we believe the current legislative framework is not fit for purpose and should be updated as soon as possible to remove the current restrictions, particularly the need to increase the total levy by no more than 25% year-on-year.

The PPF should not need to set a minimum levy in order to respond to 'shocks'. Reliance on the PPF is lower in the current environment and, while this may not always be the case, the levy should reflect the risk to the PPF and therefore permit zero levy in years when it is not required. If the PPF wants to collect a minimum levy, for example in order to fund in advance for the 1 on 20 scenario, we believe that the PPF should be able to collect a levy they consider reasonable and reflecting risks, subject to consultation, but without the existing legislative constraints effectively imposing a minimum below which the levy cannot fall.

The need for stability in levy amount is reasonable when significant levies are required, targeting a long-term funding position; however, based on the current gilt yield environment and general improvement in funding, it is arguable that the PPF is now beyond this stage.

2) Do you agree with our approach to introducing simplifications to the levy over time?

Yes. We agree with introducing simplifications when the total levy being collected is relatively small. However, if the PPF were to collect a more significant levy, for example if significant funding deficits were to emerge again, this would need to be revisited. Removing the legislative constraints would enable lower levies and more simplifications.

However, we consider that it is important to avoid situations where schemes in very different situations and representing materially different risks to the PPF are paying similar amounts of levy, where possible; for example, if the levy made no allowance for material differences in the schemes' funding positions.

If the levy calculation is to be simplified, we would like to see this go 'hand in hand' with simplification of the data collated as part of the annual scheme return.

3) Do you consider there are any areas where simplification should be considered more urgently?

Yes. We believe that the levy could be simplified as part of the 2024/25 levy determination in the follow areas:

- For schemes with insured liabilities (liabilities where an insurance product has been purchased to cover them, including where the assets and liabilities still remain with the trustees; that is, a buy-in), we suggest that a nil risk-based levy is charged to the insured liabilities, as they clearly pose no (or negligible) risk to the PPF. Ideally, following a full scheme buy-in transaction, we would prefer a change to the waiver system, which removes the requirement for a scheme to pay a PPF levy (ideally both scheme and risk-based). The number of schemes with buy-ins will increase substantially over the next few years.

- For smaller schemes, we would suggest charging a fixed levy on a sliding scale based on (for example) the value of liabilities, perhaps in ranges similar to the approach adopted by the PPF initially. For example, schemes with latest s179 liabilities under £1m, pay £x a year; between £1m-£5m pay £y p.a. etc. Such schemes have limited access to professional advice compared with larger schemes. Further, this would bring a level of stability and predictability for these schemes and their levy payments. Clearly care would need to be taken in ensuring consistency between the two approaches at the crossover points.

- For schemes paying deficit reduction contributions (DRCs), we welcomed the changes introduced a number of years ago. However, we believe that the DRC Certification process should be simplified further, as the current process is too onerous in light of the potential cost versus benefit; for example, whereby schemes notify the PPF of the DRCs paid and the PPF adjust this to allow for prudence. The impact of expenses paid is minimal for the majority of schemes. Further, the underfunding risk is reduced by DRCs and fewer employers are paying DRCs, so a simplified approach should be possible.
- We would like to see more pragmatic rules and guidance around Exempt Transfers to enable a wider range of circumstances to be certified. In particular, it should be made clear that open scheme/sections are not excluded from meeting the Exempt Transfer requirements and that the actuarial confirmation should be as at the date of transfer.

4) Do you agree with our proposal to minimise changes (delaying the introduction of A11, and the updating of asset and liability stress factors) to limit adjustments to the levy scaling factor (LSF) for 2024/25?

No.

We presume that the PPF considers it more accurate to base the liabilities, on which we determine the levy, on the more recent market conditions and the latest set of assumptions; that is, A11 for 2024/25. To date, it has been the approach of the PPF to adopt the latest set of assumptions each year and, therefore, we do not consider that having to change the LSF is necessarily a sufficiently strong reason to maintain use of the A10 assumptions. Changing the LSF from 0.37 to 0.5 is an option that should be considered, instead of not adopting A11; we do not believe adjustments to the LSF need to be limited.

Further, we consider that updating the asset and liability stress factors would, in theory, make the model more risk-reflective and, therefore, spread the collection of levy more appropriately across all 'eligible schemes'. However, if doing so would concentrate the levy into a smaller number of levy payers and require knock-on changes elsewhere in 2024/25, then we agree delaying by a year could make sense and, in that, case it would be appropriate for the PPF to consult on those changes at that time.

We would strongly encourage the PPF (and TPR if necessary) to confirm any changes in the asset class guidance on Exchange well ahead of time, and significantly earlier than the 2023/24 changes were confirmed.

We would also ask PPF to delay any changes to the credit ratings agencies used until 2025/26 and provide notice of this before April 2025.

5) Do you agree that focusing the risk-based levy on a diminishing pool of risk-based levy payers is undesirable?

Yes, we agree. All 'eligible schemes' pose a risk to the PPF; therefore all such schemes could reasonably be expected to pay a risk-based levy. All 'eligible schemes' pay a scheme-based levy, regardless of the level of underfunding and this helps with the overall amount to be raised. A small risk-based levy, across most/all schemes, may therefore be of benefit.

That being said, having a smaller pool of schemes paying a materially higher levy, based on the risks they pose, is likely to provide an incentive to those schemes to identify and take risk mitigating actions. As a result, while this may reduce their risk to the PPF, it could in turn also reduce the total amount of levy raised.

These arrangements should be considered as a short-term fix. As noted above, we believe the current legislative framework is not fit for purpose and should be updated as soon as possible to remove the current restrictions, so that the levy need not be maintained at the £100 million level for artificial reasons.

6) Do you agree with our proposed criteria to assess the different options? If not, what do you consider the criteria should be?

Yes, we agree with your proposed criteria. The levy should take into consideration the level of risk to the PPF and this should be risk-based where possible; that is, to reflect the level of risk each scheme poses. It seems reasonable to enable the parameters to be adjusted each year in order to collect the required amount in levies. It is also consistent with TPR's long-term objective of having increased focus on scheme funding rather than insolvency risk.

Again, we note that these arrangements should be considered as a short-term fix pending legislative change.

7) Should we add an additional factor to the liabilities to limit the scale of increases in the levy scaling factor (LSF)? If so, do you have comments on how we should balance using the levy scaling factor and an adjustment factor for liabilities?

Yes, we believe this should be considered as this may be a helpful addition. However, the PPF should consider the potential impact on the volatility of individual scheme levies from year to year as part of the assessment – particularly where there is limited change in underlying risk.

8) Do you agree that it would be appropriate to align the levy methodology to the reason for charging the levy – to provide against highly adverse claims - by altering the asset and liability stresses?

Yes, we agree as mentioned above. The asset and liability stresses allow the PPF to more accurately reflect risk at a scheme level. In order to protect against extreme scenarios we believe this approach is more robust.

9) Do you agree that altering asset and liability stresses are more suited to a one-off adjustment rather than being adjusted every year to scale the overall levy up or down?

Yes, we agree. It seems sensible to keep the asset stresses updated to reflect recent experience, although this may not be needed every year.

10) Do you have any other ideas or suggestions to ensure a risk reflective approach to the levy in future years?

The levy reflects the risk that the PPF is called upon; that is, the risk of insolvency of the sponsoring employer and the risk the scheme is underfunded against the PPF level of benefits. We are aware that you already make an allowance for the risk of insolvency in your funding projections.

However, given the overall position of the DB market, a consideration could be to exclude the allowance for insolvency risk within the levy calculation (leaving only scheme and funding-risk elements). This would clearly simplify the process and materially reduce your fees of seeking an insolvency rating from an external rating agency.

11) Do you agree with our approach to simplify the process for special category employers?

Yes, we agree and welcome these simplifications.

To further simplify the process, in cases where an application has been successful, could the PPF consider removing the need to provide confirmation that Special Category Employers ('SCE') status continues applies each year? Perhaps it could continue to apply unless the PPF is advised otherwise by such levy payers, and this would be a condition of the initial application.

If confirmation continues to be required on an annual basis we would suggest the request is sent to a wider list of individuals, given the urgent timescale for the work, preferably including the levy contact. Based on our experience the email notification is sent to one individual and there have been occasions where that individual no longer works on the scheme and additionally the trustees often need to engage with individuals outside of the usual day-to-day employer contacts. Further, as part of this notification, the PPF provided an indication of the likely levy savings except for last year. Could this information be reintroduced from this year onwards, as it is of interest to levy payers?