Regis House, First Floor (126/7), 45 King William Street, London EC4R 9AN
Tel: +44(0)20 31026761 E-mail: acahelp@aca.org.uk
Web: www.aca.org.uk

Treatment of Type A Contingent Asset Guarantors in the 2013/14 PPF Levy

You may be aware that on 22 February the Pension Protection Fund (PPF) published a note regarding observations on guarantor strength. On 1 March the ACA wrote to the PPF to query the proposed treatment in this note of "last man standing" schemes (see **letter below**).

We are pleased to inform you that the PPF replied on 15 March (**separately posted on the website**). In response to our representations it has made adjustments to its note and taken certain other actions. The exchange of letters is published here for your interest.

1 March 2013

Paul Hannick
Policy Officer, Levy
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon, Surrey
CR0 6SR

DearPaul

TREATMENT OF TYPE A CONTINGENT ASSET GUARANTORS

I am writing on behalf of the Pension Schemes Committee of the Association of Consulting Actuaries (ACA)as we are concerned that the treatment of Type A contingent asset guarantors outlined in the PPF'snote published on 22 February 2013 regarding observations on guarantor strength will lead to some very inequitable PPF levies being charged. We urge you to reconsider the proposed treatment of guarantors that participate in "last man standing" schemes.

1. The issue – assuming a participating guarantor becomes insolvent

Paragraphs 2 to 4 of the PPF's "Observations on the PPF's assessment of guarantor strength for selected Type A contingent assets certified/re-certified in 2012/13" document refer to last man standing schemes. In particular:

- paragraph 3 refers to a guarantee from a sponsoring employer not providing significant additional support to the pension scheme in many cases; and
- paragraph 4 notes that a guarantor that also participates in the pension scheme should be assumed to be insolvent when performing the assessment of its strength for Type A contingent asset purposes.

We accept that in many cases a Type A contingent asset provided by a sponsoring employer in a last man standing scheme does not by itself significantly reduce the risk that the scheme represents to the PPF. But we believe that in many cases it does indicate that the risk to the PPF posed by the scheme is less, potentially significantly less, than you are proposing to give it credit for. As such, the test that "the reduction in levy achieved by acceptance of the contingent asset is commensurate with the reduction in risk to the PPF" could be seen to be met.

2. Risk-based levy inequity – an example

Consider an employer A with a failure score of 100. Employer A guarantees (in a PPF-compliant fashion and with sufficient assets to do so) the liabilities of three other employers, B, C and D, who each have a failure score of 10 and participate in the last man standing Scheme X. Consider the following two cases, each of which poses a similar risk to the PPF.

2.1. Case 1 – Employer A does not participate in Scheme X

When considered in a solvent state, but taking into account the failure of B, C and D, Employer A has sufficient assets to cover the total deficit of Scheme X on a 105% of section 179 basis and so the trustees of Scheme X can certify the guarantee. Therefore its insolvency risk of 0.0018 will replace the combined sponsoring employers' insolvency risks in the risk-based levy calculation.

2.2. Case 2 – Employer A participates in Scheme X

If considered to be in an insolvent state (as appears to be required by paragraph 4 of the observations note), Employer A would not have sufficient assets to cover the total deficit of Scheme X on a 105% of section 179 basis and so the trustees are no longer able to certify the guarantee. The insolvency risk for the scheme, assuming A, B, C and D have equal membership, is:

$$\text{Insolvency Risk} = 0.9 \times (0.25 \times 0.0018 + 0.75 \times 0.04) = 0.027405$$

This leads to a risk-based levy more than FIFTEEN times higher than Case 1, when in fact the schemes represent similar risks to the PPF.

3. Conclusion

A guarantee from a participating employer in a last man standing scheme does not significantly reduce the risk of that scheme to the PPF. But it is, and has always been, a useful mechanism for reflecting the true insolvency risk of a scheme to the PPF. Certifying a Type A guarantee in respect of one of the stronger employers in a scheme shows that it has the financial strength to support that scheme on its own if it has to. As such, it is a nonsense for the insolvency risk for that scheme to be increased because a number of weaker employers also participate.

We would be very grateful if you could confirm whether it is intended for last man standing schemes to be penalised in this way, or whether it is acceptable to certify a guarantee from a participating employer starting from a position thatit is solvent.

In passing, when we responded to the levy consultation on 26 October 2012 we noted, amongst other things, that the experience last year, where the PPF's initial guidance on Type A contingent assets was clarified close to the certification deadline, was not helpful and needed to be avoided for this levy season. So we are disappointed to have to raise this specific issue at this late stage.

I look forward to your early reply in order that we can bring this matter to the attention of our members. Please contact me on 020 7432 6635 (david.everett@lcp.uk.com)if you wish to discuss the matter.

Yours sincerely

David Everett
Chairman
ACA Pension Schemes Committee