ASSOCIATION OF CONSULTING ACTUARIES

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15 May 2017

Chris Collins
Chief Policy Adviser
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon, Surrey
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Dear Chris

The third PPF levy triennium – 2018/19 to 2020/21

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation issued on 23 March 2017.

Our comments on the specific questions raised in the consultation are set out in the Appendix.

Overall we appreciate the logic you have employed to reach the proposals in the consultation. However, we note that the expected increase in the levy for larger companies will be difficult to manage, particularly as these companies are already paying a substantial proportion of the total levy. These employers are essentially financing a reduction in levy for all other employers.

We hope that you find these of assistance and would be happy to discuss them further if that is helpful. Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague Jan Claisse who prepared this response on 020 7985 7886 (jan_claisse@jltgroup.com).

Yours sincerely

David Everett
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

Sent by e-mail to: consultation@ppf.gsi.gov.uk

APPENDIX

The third PPF levy triennium – 2018/19 to 2020/21

1. Do you agree with the areas of the levy selected for review in the third triennium?

Yes. We are pleased that the framework is working well overall and appreciate that significant changes are not being made.

2. Do you agree with the scope of our review of the PPF specific model – that led to us rebuild five scorecards and propose recalibration of the three group scorecards?

Yes.

3. Do you agree with our conclusion that the re-built scorecards present sufficient benefits that they should replace the existing scorecards?

Yes, based on the evidence in your consultation document, although we note that there is a material impact on some large companies. We particularly welcome the proposal to remove mortgage age from the re-built scorecards as this has caused particular issues in the past. We would welcome this being removed from the other scorecards in due course.

We are aware of certain features of the new scorecards that do not appear to represent the true insolvency risk of certain types of company. For instance, companies with an in-house treasury function can look like they have no cash and be scored badly on that variable, when in fact they have access to a considerable amount of cash within the group. We suggest an adjustment is made to the Experian scorecard to allow for the cash available within the group structure.

Similarly, certain companies score badly because they have no trade creditors, when a trade creditor of £1 would give them a perfect score on that variable. We suggest companies should be able to provide audited evidence they have no trade creditors to receive a more reflective score on that variable.

4. Do you agree with our proposal to use public credit ratings in preference to the PPF-specific model?

Given that ratings agencies have their own tested models which are suitable predictors of insolvency then this is a sensible proposal.

We have encountered some practical difficulties with implementing the proposals as currently drafted:

- Only issuer credit ratings (where the company itself is rated) are reflected in the insolvency risk scoring, not issue credit ratings (where the specific debt issue is rated). Certain companies have issue credit ratings, but not issuer credit ratings as their structure means that the issuer rating would make little sense. Whilst we understand that issue ratings depend on a number of factors (such as security, other levels of debt), we believe they could still be used to give a more accurate risk of insolvency than the Experian model. We encourage you to explore the ways issue credit ratings could be used where an issuer credit rating is not available.

- Often groups are structured so the debt is issued by a specialist company in the group that may not employ the pension scheme members. As such, the sponsoring employer would appear not to have a credit rating when there is a clearly relevant credit rating in the group. We appreciate you may not want to take credit ratings for a large ultimate parent when the sponsoring employer is much lower down the group, but there are specific circumstances where a credit rating of another group entity would be relevant, including:
    - Where a subsidiary of the sponsoring employer is credit rated; and
    - Where a parent company is credit rated, and the total number of employers in the group from the parent down is not significantly greater than the number of employees from the sponsoring employer down (to catch holding/finance companies).

We are also aware that in a minority of cases certain companies have noticed that putting cash in up front into their pension scheme has caused their credit rating to worsen. This is unfortunate, but we are not sure there is a simple adjustment to reflect this (apart from via the certification of deficit reduction contributions).

5. Do you agree with our proposal to use industry scorecards for regulated financial institutions that are not themselves rated, in preference to the PPF specific model?

We do not have strong views on this proposal.

6. Do you agree with our proposed basis of scoring where public credit ratings or industry scorecards are used?

Yes.

7. Do you agree that we should seek an alternative approach for employers that cannot be assessed by reference to financial information alone? Do you have any comments on our draft rule?

Yes we believe that an alternative approach for such employers should be adopted. Allocating these employers to levy band 1 would be a pragmatic approach.

We note that there are other classes of employer who cannot be assessed by reference to financial information alone. For example, utilities regulated by Ofgem will have their DB pension scheme deficits ("Established Deficits") in respect of service up to certain cut-off dates essentially paid for by consumers via a pass-through mechanism. That will not be fully recognised in their accounting figures, but is surely as strong a covenant as some of the other examples the PPF is considering. We therefore suggest that the PPF extends the definition of quasi-governmental entities to include companies such as utilities where deficit contributions are particularly secure e.g. funded by the consumers of gas or electricity.

8. Do you think that we should move to a single point calculation of insolvency risk at 31 March? If not do you consider that a change should be made to the number of insolvency risk scores that are averaged?

We believe that employers welcome the stability and predictability provided by the averaging of insolvency scores and we would therefore like to retain an aspect of this. If a change were to be made then we suggest a 6 month averaging period rather than 12 months.

9. Do you have suggestions of improvements and simplifications that would particularly help smaller schemes?

Given that there are a significant number of small schemes who contribute such a small proportion of the levy we could question whether it is worth charging a levy at all. However, we understand that this may not be desirable or possible within the existing regulatory framework. The most straightforward option would be that small schemes which are over a certain percentage funded do not get charged a risk based levy at all and the remainder get charged a fixed amount, so that the PPF aims to collect the same amount of levy overall from these schemes.

This would ensure that schemes are still incentivised to improve their funding position but that they do not need to spend time and money on getting detailed levy advice or engaging with Experian. However, this may not have a sufficient "risk based" focus.

Of the options proposed in your consultation, the first is the most straightforward whereas the second one would make strong employers feel as though they were being unfairly treated. The final one would result in additional complexity, and those schemes which had the resources to pay for advice would be able to take advantage of the opt-out, and those which do not would end up paying more.

10. Do you support our proposals to amend the approach for calculations of certified DRC amounts? If so, which factors do you consider should be used to allocate schemes between the two options (a) and (b) (which could include applying a single option to all schemes)?

Yes, this would be a welcome simplification for smaller schemes, a number of whom do not submit DRCs because the cost of the actuarial work outweighs any reduction in the levy. Option (b) would be the preferred approach for these schemes, as under this approach actuarial advice would not be needed and the scheme trustees or company FD could submit the DRC themselves.

We ask that these schemes retain the option to submit a DRC under the existing framework to take account of any non-recovery plan contributions paid, if applicable.

11. Do you have views on the proposed requirement for a guarantor strength report to be held by the trustees at the time of certification of Type A contingent assets? Do you have views on the proposed threshold of £100 million and are there any alternatives we should consider?

We believe that it is a sensible approach for scheme trustees to receive a guarantor strength report. The proposed threshold of £100m seems to be fairly arbitrary although we do not have access to the data to determine how many schemes would be affected by this. We would prefer to see a threshold based on potential levy saving rather than amount certified. Schemes who would be putting a guarantee in place of such an amount would already receive considerable levy management advice and therefore should know whether they would need to receive a report.

12. Do you have suggestions on updates to the contingent asset guidance you would expect from us to help meet the guarantor report requirements?

The guidance should set out clearly exactly what would be required in the guarantor report. We would expect that the report requirements could be fairly standardised to minimise the work from advisers in completing the work and from the PPF in extracting the relevant information. We would also welcome clarity on the intended "duty of care" that the PPF is expecting as this could be quite a subjective requirement.

13. Do you have views on the two proposed options where a guarantor is also a scheme employer?

We agree that the first proposed approach is the preferable one, although noting the additional complexity this will bring.

14. Do you support the proposal to allow trustees to certify different realisable recovery amounts for parental guarantees (Type A contingent assets) which have more than one guarantor?

Yes this is a very welcome amendment.

15. Do you have any suggestions on the drafting of the current standard form Contingent Asset documentation? Do you foresee any practical difficulties in re-executing agreements? Do you have views on issues to consider in setting a timeframe for re-execution?

Whilst we can understand the PPF's position on this, it will be a considerable administrative burden for all schemes to re-execute their contingent asset agreements on the new standard terms and could potentially open up negotiations between trustees and the guarantor. Therefore we would welcome a straightforward amendment process for schemes where there has been no material change to the contingent asset.

16. Do you have views on the options we set out on how we might better reflect the level of risk of the structure of loan note ABCs in the levy?

We assume that the scenario in the consultation whereby the value of the loan note ABC is greater than if it were a Type A Contingent Asset results from the loan note provider being independent from the employer or PPF guarantor and therefore it would be reasonable to place a different value on a loan note ABC than a Type A contingent asset in an insolvency situation.

The consultation suggests that schemes are using unsecured loan note ABCs to gain a significant levy reduction and the guidance on calculating the value of loan note ABCs is very subjective. We feel that the guidance is still appropriate as it stands.

17. Do you have views and/or evidence on the extent to which good governance leads to a reduction in risk, of one or more of the factors allowed for in legislation, to the PPF? If so are there particular aspects of governance that should be focused on for the purposes of awarding any levy discount?

We note that there is a considerable political drive to this question, but it is not clear to us that there is an objective way of measuring the relationship between governance by itself and risk reduction.   However, it may be worth further exploration as a discount could encourage appropriate behaviours.

Overall we believe that good governance leads to better funded schemes and appropriate investment strategies. The existing levy framework already reflects this.

18. Do you have proposals for the identification and measurement of good governance sufficiently linked to a reduction in risk for the PPF that meet the broad aims of avoiding a tick box approach, avoid administrative burdens and are not designed to be widely available? Do you have suggestions on who should administer such a process and how?

No, given our answer to the previous question.

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The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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