The Levy Triennium and the move to the new insolvency risk model

Chris Collins, PPF &
Gareth Rumsey, Experian
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A history of the PPF levy

Pension Protection Fund

Before:

'Initial Risk-Based Levy'

Based on:
underfunding &
insolvency risk

2006/07 – 2011/12

Scaling factor set annually

Now:

'New Levy Framework' (First triennium)

Main changes:
investment risk
and smoothing

2012/13 – 2014/15

Fixed parameters including scaling factor

Future:

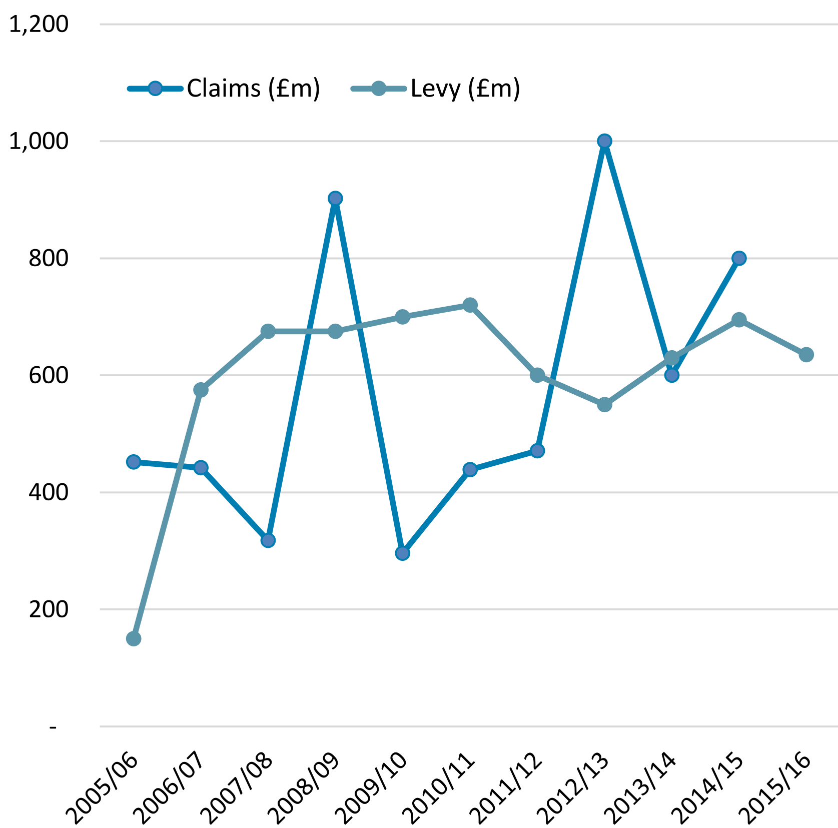
'New Levy Framework' (Second triennium)

Main changes:
new partner
(Experian)

2015/16 – 2017/18

Fixed parameters

How much we charge – the Levy Estimate



The 2015/16 Levy Estimate announced in Sept 14:

- £635 million
- 10% reduction on the 14/15 Estimate

2016/17 Estimate will be published next Sept:

- calculated using same scaling factor, data up to July, assumptions about changes to March 16

Wide range of "assumptions" needed for Levy Estimate

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None of the data we use for 16/17 invoices available

Assumptions needed:

- What will happen to yields?
- How much will our universe shrink?
- How will Employer's Experian scores change?
- How will Deficit Reduction contributions, Contingent Assets, affect levy?

Historic Examples

14/15: Used current yields (3 month average) – actual movements reduced collections 5%. Now use ESG

15/16: Experian scores – changes "worth" £65m

		Current Band									
		1	2	3	4	5	6	7	8	9	10
Expected band	1	100%									
	2	8%	92%								
	3	4%	8%	88%							
	4	3%	5%	8%	84%						
	5	2%	3%	6%	9%	80%					
	6	2%	2%	4%	7%	9%	76%				
	7	2%	2%	3%	5%	7%	9%	72%			
	8	2%	2%	2%	4%	5%	7%	10%	68%		
	9	2%	2%	2%	3%	4%	6%	7%	10%	64%	
	10	2%	2%	2%	3%	3%	4%	6%	8%	10%	60%

The second Triennium and the move to Experian

- Second Triennium began 2015/16, planning years earlier…
- Experian appointment announced in July 2013 – offered to develop a PPF-specific model
- Compared using ‘Success Criteria’ agreed by our Industry Steering Group

Predictiveness

Transparency

Stability

Coverage

Best practice

Manipulation

Appeals

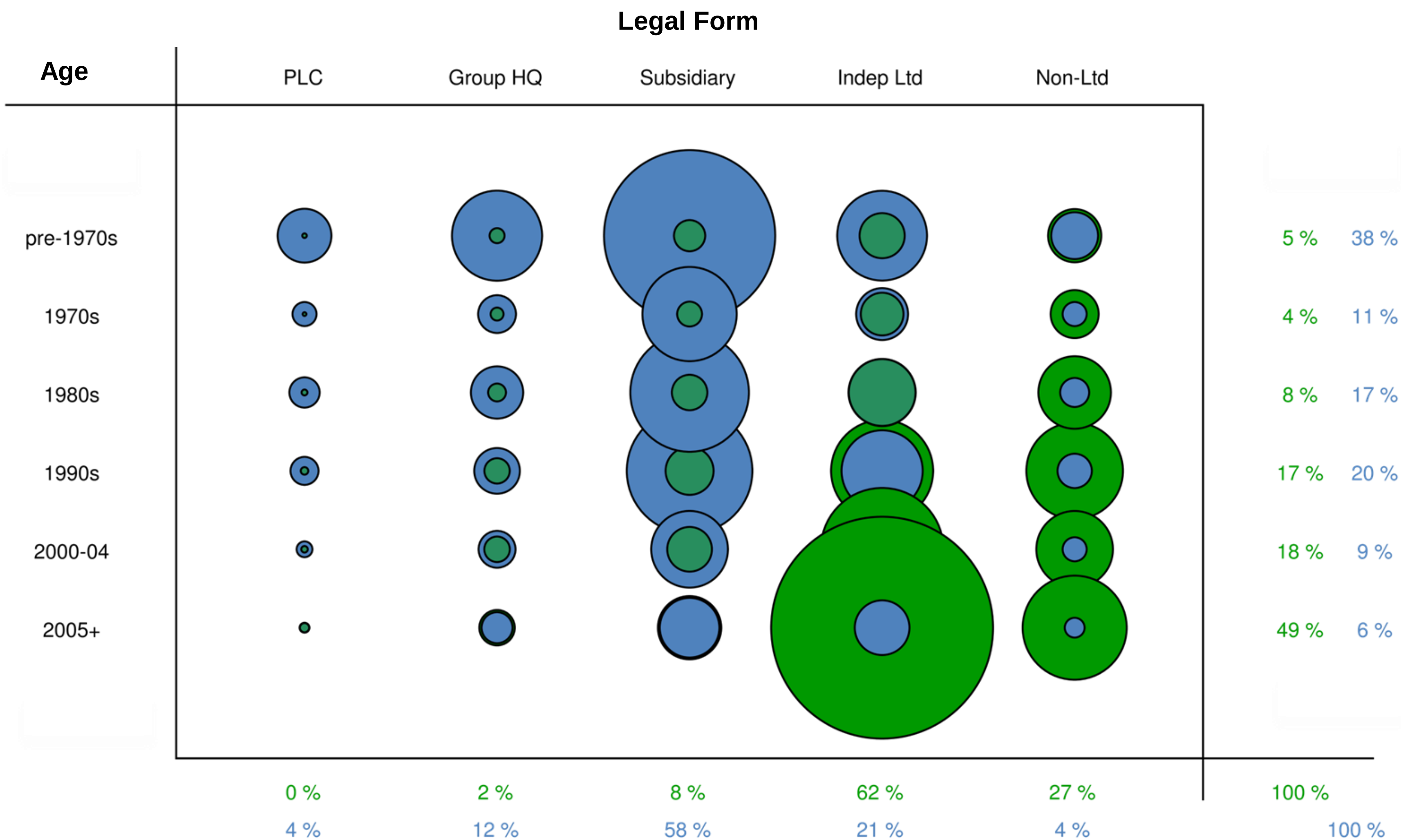
Costs

Transition

Polar opposites - PPF Universe and general UK population
Age vs. Legal Form

Pension Protection Fund

Business Universe (3m) **PPF Employers (17k)**



Predictive attributes : Commercial Delphi Score versus the PPF specific score

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Delphi Weighting	Business Attributes	PPF-specific Model
10-15%	Historical payment behaviour, delinquency trends	0-10%
40-60%	Financial statement data	70-90%
10-40%	Directors personal data and directorship data	0%
5-20%	Company profile- size, age, industry sector,	0-5%
10-15%	Derogatory items – county court judgments, personal bankruptcy	0-%
5-10%	Previous search data	0%
0%	Corporate group strength	0-30%
0%	Secured borrowing	5-20%

Tailored delivery via PPF web portal, supported by dedicated customer service team

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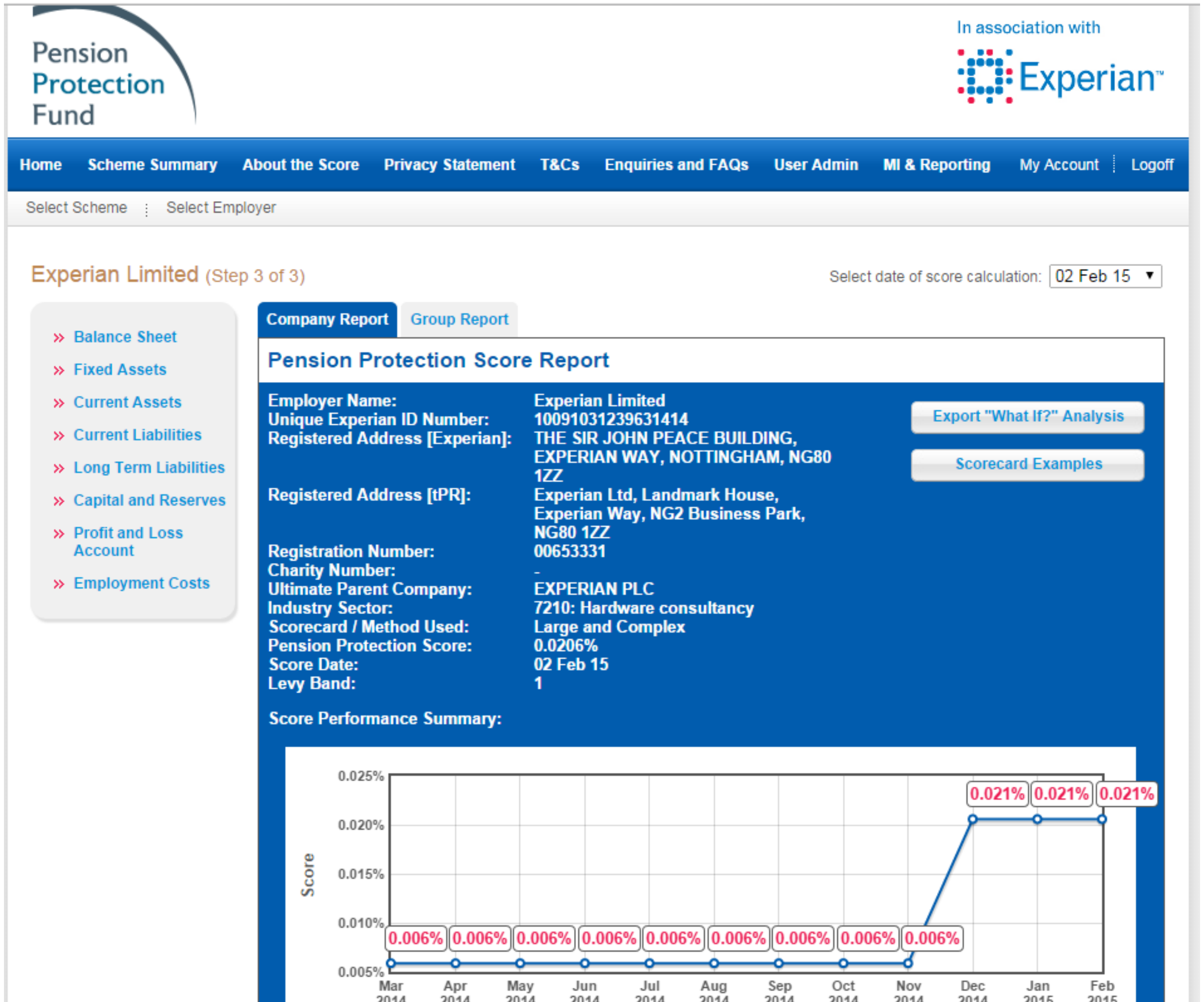

Transparency through what-if calculator and scorecard analysis tool

Pension Protection Fund

Employer / guarantor ID	10091031239631414		
Employer / guarantor name	Experian Limited		
Registered Address (source: Experian)	EXPERIAN LIMITED, THE SIR JOHN PEACE BUILDING, EXPERIAN WAY, NOTTINGHAM, NG80 1ZZ		
Registered Address (source: tPR)	Experian Limited, Experian Ltd, Landmark House, Experian Way, NG2 Business Park, NG80 1ZZ		
Registration Number	00653331		
Charity Number	#N/A		
Ultimate Parent Company	EXPERIAN PLC		
Industry Sector	7210: Hardware consultancy		
Scorecard / method used	**Large and Complex**	**Original:**	**Large and Complex**
Pension Protection Score	**0.0206% Current**	0.0206% **Change**	0.0000%
Score date	02 Feb 15		
Levy Band	**1**		

Scorecard Figures and Ratios	**Year N**	**Year N-1**	**Year N-2**	**Year N-3**	**Change**
Consolidated Accounts	**No**	**No**	**No**	**No**	**No**
Accounting Period (Weeks)	**52**	**52**	**52**	**52**	
Turnover	**536,200,000**	421,300,000	399,200,000	375,800,000	42.68%
Total Assets	**738,600,000**	748,100,000	634,600,000	1,642,200,000	-55.02%
Shareholders Funds	67,700,000	163,700,000	184,900,000	166,300,000	-59.29%
Fixed Assets	496,100,000	493,200,000	396,300,000	352,400,000	40.78%
Employee Remuneration	220,700,000	192,700,000	183,000,000	164,800,000	33.92%
Net Worth	**-126,200,000**	***-69,800,000***	***54,700,000***	**59,500,000**	-312.10%
Stock + WIP	**0**	0	0	300,000	N/A
Total Net Assets	67,700,000	163,700,000	184,900,000	166,300,000	-59.29%
Capital Employed	**83,800,000**				
Current Assets	242,500,000				
Current Liabilities	654,800,000				
Retained Earnings	50,000,000				
Pre-tax Profit	**66,500,000**				
Trade Creditors	20,100,000				
Employment	**3,340**				
Cash	1,100,000				
Age of Most Recent Mortgage/Charge	**0.00**				

Current Lender (most recent mortgage or charge)

N/A

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Large and Complex

Average scorecard insolvency rate	**1.15%**	**Universe insolvency rate**	**0.92%**

Variables Used	**Weighting**	**Low Score** — **High Score**
Capital Employed	**33%**	**79.5%**
Turnover	**17%**	**98.7%**
Turnover by Stock	**17%**	**42.1%**
Return on Assets	**12%**	**100.0%**
Sales by Employees	**5%**	**32.4%**
Change in Net Worth	**3%**	**0.0%**
Mortgage Age	**13%**	**100.0%**

Challenges raised and most frequently asked questions

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- Data accuracy – especially overseas employers
  - Self submission of accounts / time to capture
- Appropriateness of scorecards for certain entities
- Number / appropriateness of variables used in scorecards for certain sectors
- Lack of ability to manually override scores

Scorecards

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1	Large and Complex
2	Group Members – Full Accounts, >£50m turnover
3	Group Members – Full Accounts, £10m-£50m turnover
4	Group Members – Full Accounts, <£10m turnover
5	Group Members – Small Company Accounts
6	Independents – Full Accounts
7	Independents – Small Company Accounts
8	**Not-For-Profit organisations**

Large & Complex

- Capital Employed
- Turnover
- Stock Turnover
- Return on Assets
- Sales per Employee
- Change in Net Worth
- Mortgage Age

Independent Full

- Capital Employed
- Return on Shareholders Funds
- Turnover
- Creditor Days
- Change in Total Assets
- Mortgage Age

Levy Band distribution by scorecard and associated annual insolvency rates

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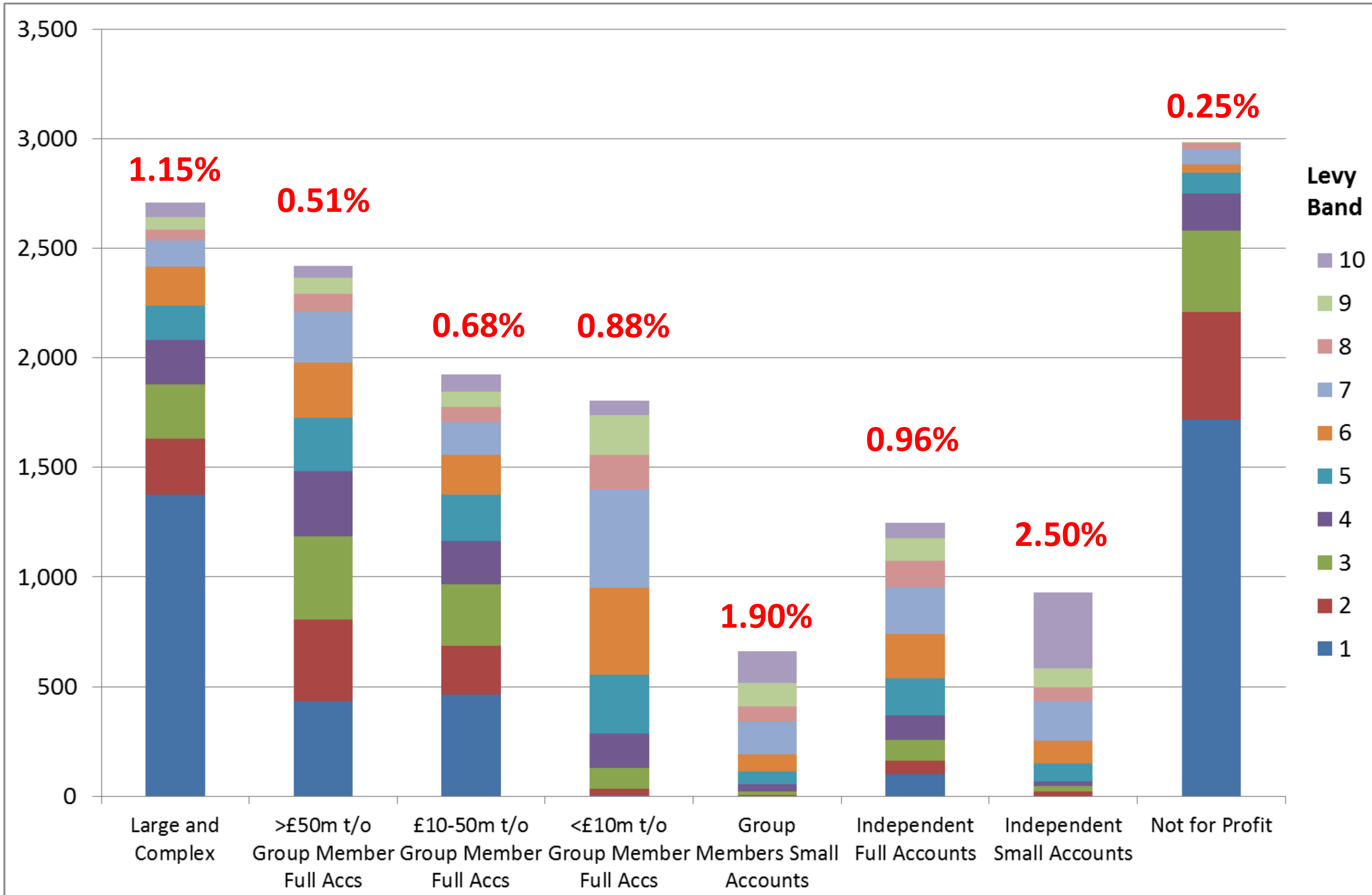
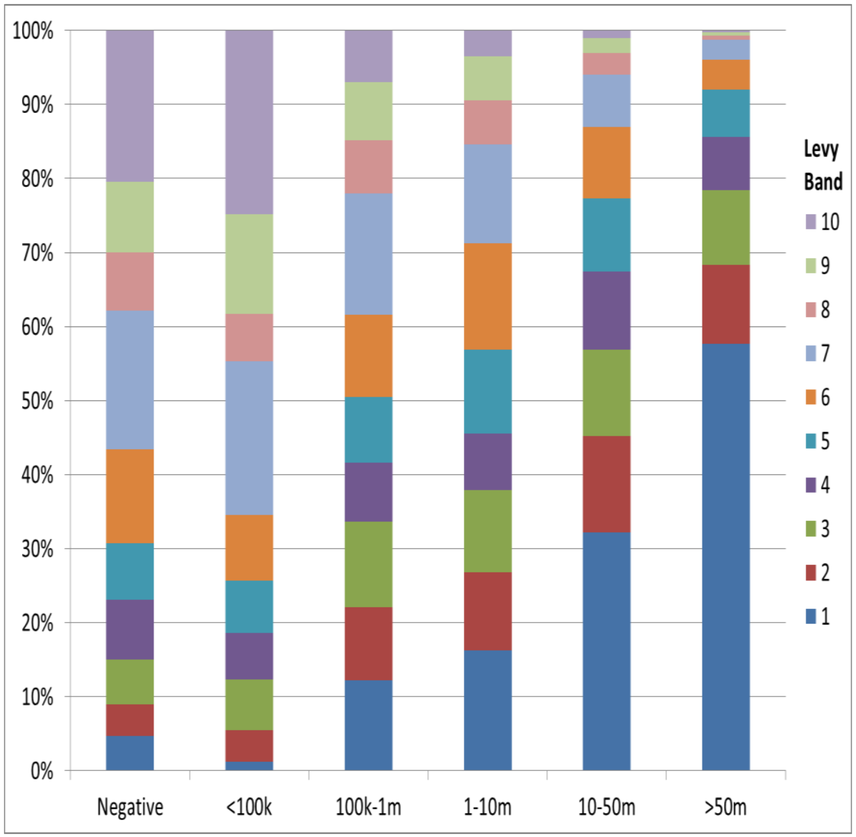
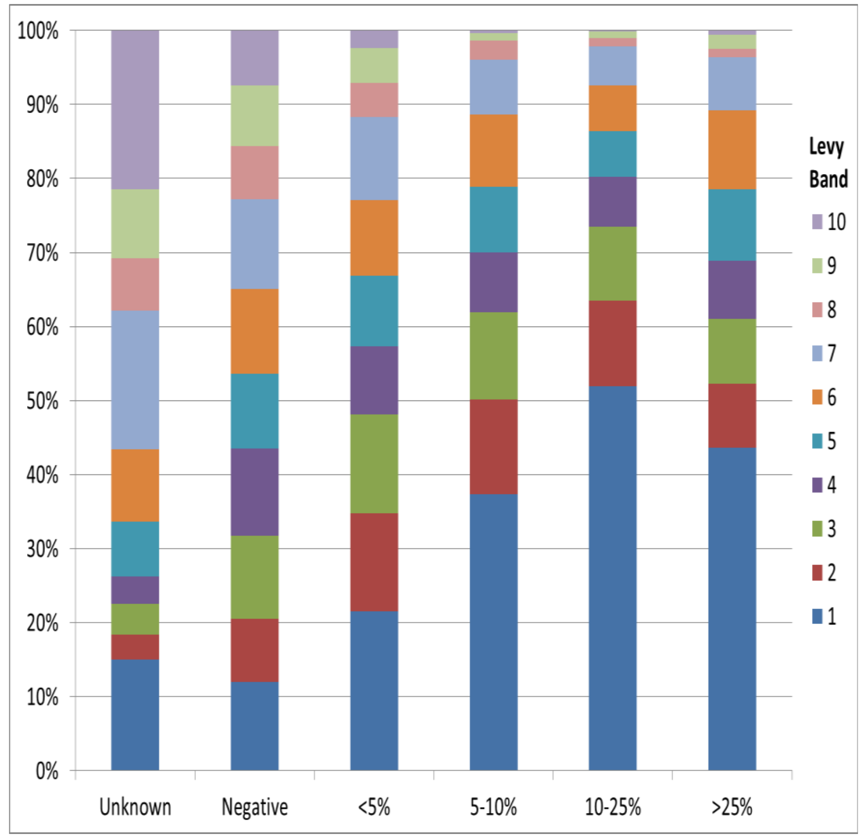


Levy Band distribution by Shareholders Funds and Profit Margin

Shareholders Funds



Pre-tax Profit Margin



Consultation

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May consultation

- New PPF specific model
- More predictive, more transparent, more customer focused
- Plus proposals on ABCs and group company guarantees

122 responses
Strong support
but… issues of detail and challenge on ABCs

October policy statement

- Confirmed PPF specific model
- No transitional protection, no use of credit ratings
- Levy estimate of £635m

October consultation

- Draft rules for 2015/16
- Proposals on mortgages
- ABCs guidance

64 responses

Since October …

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Main issues raised

- Large and complex scorecard "entry criteria"
  - Small companies
  - Dormant subsidiaries
- Use of employee numbers
- Treatment of mortgages
- ABCs – comments on proposals and guidance

Consideration of all responses (not just those on consultation issues)

December publication

- Final policy
- Final levy rules
- Certificates
- Guidance

Published 18 December

Policy largely unchanged from October

Age of most recent secured charge (mortgage age)

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- Powerfully predictive variable, but:
  - Data not always available – these are given a 'neutral' score
  - Experian will exclude from calculation:
    - Charges in favour of the pension scheme
    - Rental deposit charges
    - Re-financing on similar terms
    - Immaterial items – 0.5% test, or CRA test
- Certification required in most cases
    - Deadline 31/03/15

Asset Backed Structures (ABCs)

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- Certification possible for ABCs supported by any asset class
- Guidance flags key issues
- Certify insolvency value of ABC and/or coupons paid
- Insolvency valuation - on basis of report from adviser owing duty of care to PPF
- Be aware of interaction with DRCs
- PPF will review post 31/3

Contingent assets: context

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- PPF values contingent assets where risk reduction is proportionate

- Experience of limited value – plus concerns raised with us

- As result have revised levy requirements and put in place testing regime:

  - Guarantor strength adjustment
  - Testing regime involves challenging sample of CAs, reviewing with input from professionals

Certifying contingent assets

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- Revised Trustee certification for 15/16
- Moved to require Trustee certification of "realisable recovery"
  - This is lower of what the Guarantor good for and any fixed limit in underlying guarantee
- Trustees must make enquiries
- Trustees must start from assumption of employer insolvency
- At stakeholder request, a positive certification: "reasonably satisfied…could meet in full"

Certifying contingent assets

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- Experience of testing for 2014/15: high failure rate
- Lessons learned published last week -
  - Summary - Trustees not thinking rigorously, at time of certification…
  - Too big to fail
  - Can the guarantor still trade?
  - Impacts of employer insolvency not sufficiently considered
  - Limited recognition in values of insolvency
  - Assertion rather than evidence – independent evidence required
  - Document at the time of assessment

Forthcoming deadlines

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31/03/15	Main data deadline	• Ensure data Experian need has been supplied • Ensure Employers identified correctly etc • Certify CAs
30/04/15	DRC deadline	Ensure not including ABC transactions in DRCs
29/06/15	Block transfer deadlines	Scores to be used by Experian
01/09/15	Invoicing commences	Timescales broadly as for 14/15, Guarantor testing earlier
September	Consultation on draft levy rules 16/17	Includes Levy Estimate
December	Final Rules for 16/17 levy year published	Start point for 16/17 certfication

Any questions?