Briefing

BURGES SALMON

Pensions

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Importance ★★★☆

PPF levy 2015/16: insolvency scoring confirmed and changes on guarantees

The PPF is going ahead with the new insolvency scoring system developed by Experian.

It is also raising its requirements for contingent asset guarantees.

The PPF expects some big increases in levies in 2015/16, particularly for schemes with weaker covenants. It urges trustees and employers to use Experian's dedicated portal to check the data it holds and to explore the impact of any levy reduction measures under consideration: **https://www.ppfscore.co.uk/**. You should do this now and continue to review the data regularly in the run-up to the new levy year starting in April.

According to the May consultation about insolvency rating, Experian's system will lead to a redistribution of around £200 million of levy.

Some 1,500 schemes are expected to have an increase, 900 of up to £50,000 and 200 of over £200,000 (some well over).

About 1,400 schemes are likely to see a reduction of up to £50,000 and 300 of over £100,000.

For fuller figures, see *Redistribution* below.

Insolvency scoring by Experian

As well as confirming the new insolvency scoring system, the PPF has outlined its approach to the levy for the next three years and put the levy rules for the 2015/16 year out to consultation. The rules will be published in final form in December.

Next year will be the first in a new cycle of three when, as for the last three, the PPF intends to make the levy stable and reasonably predictable. Any major changes will normally happen, as now, between three year cycles.

Unlike D&B, Experian focuses almost exclusively on financial data as the category of information most strongly predictive of insolvency risk. It allocates employers to one of eight scorecards by size of turnover but also taking account of corporate structure and whether they file full or abbreviated accounts.

NB - the monthly Experian scores to be used in the 2015/16 levy will be those between 31 October 2014 and 31 March 2015.

The main changes as a result of the consultation on the Experian system relate to mortgage age and asset backed contributions.

Mortgage age

Experian assesses secured charges, particularly new ones, to be a strong indicator of insolvency risk. The indicator is being retained but there will be a materiality test to exclude minor charges with no bearing on insolvency risk. The PPF invites views on how to define materiality in the longer term but for 2015/16 will ignore these specific charges:

- charges given when refinancing on equal or better terms,
- charges in favour of the pension scheme, including type B (real estate) contingent assets, and
- rent deposit charges.

Details of some of these charges may be visible to Experian on databases it searches but not all. Trustees and employers need to ensure it receives the necessary information.

Asset backed contributions

The PPF will recognise asset backed contributions (ABCs) based on any class of underlying asset, not just those based on real estate as originally proposed.

However, concerned about giving undue credit, it will require trustees to certify (in a standard form) the value of an ABC at the lower of:

- the insolvency value of their interest in the vehicle holding the asset (allowing for the stressed insolvency value of the asset) and
- the fair value of the interest as reported in the latest scheme accounts.

The insolvency valuation will have to be carried out on prescribed principles, including:

- *basis:* assumptions that all scheme employers (and any guarantors) are in insolvency and the asset must be realised within a year, and taking account of the risk of these insolvencies to any wider group companies,
- *reliance:* the valuation report must state that the PPF can rely on it legally,
- *assumptions and frequency:* the valuation assumptions must be set out and there must be a valuation exercise each year. This can be a desktop review where appropriate

but the PPF expects a full valuation each year for more esoteric assets,

- *a list of specific considerations:* for example, the trustees' legal rights (and any limitations on them) under the ABC documentation, whether the asset will have value when separated from the original business, and the costs and challenges of realising any overseas asset.

Evidently a range of professional input might be needed in what could be a lengthy valuation process. The PPF will not check valuations, nor routinely require sight of valuation reports. But it will require that a suitable professional with insurance does the valuation.

Not-for-profit bodies

The PPF confirms its plan to assess not-for-profit (NFP) bodies using a single, specifically designed scorecard. It acknowledges the scorecard will fit some NFP structures better than others but considers there are insufficient data to build additional scorecards for different sub-groups.

If Experian does not class your organisation as NPF and you think it ought to, the PPF encourages you to send Experian constitutional documents showing it is required not to act for profit and is broadly equivalent to the bodies included in the definition of NFP in draft levy rule E3.1(8): see **http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1516_draft_Determination.pdf**.

More generally, the PPF is conscious it lacks financial data on NFPs and strongly encourages them to volunteer information that is not available to Experian from public or commercial sources. Experian has recently arranged access to a dozen new sources listed in chapter 10 of the consultation document: **http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1516_levy_consultation.pdf**

Arbitrage

Steps will be taken to reduce the scope for arbitrage between scorecards. On the original proposals, individual companies in a group could come under different, more or less beneficial scorecards according to the particular group structure and whether they consolidated their accounts. The criteria for the different scorecards will be tightened.

Ideas dropped

These ideas floated in the May consultation are not being pursued:

- transitional protection for one year for schemes hardest hit by the new insolvency scoring system and
- an override for the largest employers that would have allowed a credit rating from a leading agency to trump an Experian insolvency score.

Contingent assets

The PPF is tightening the rules on contingent assets by requiring a stronger certificate and downgrading the guarantor's levy band in some cases. Contingent assets reduce the PPF levy.

Certificate of guarantor strength

Trustees with a contingent asset guarantee from a group company will be required to give a stronger certificate as to the guarantor's ability to pay. This reflects the PPF's continuing concern about the substance of some guarantees used to claim levy credit.

The certificate will be in positive terms rather than negative, and must specify a cash amount the guarantee could realise: so, trustees "*are reasonably satisfied* the guarantor *could pay* £x" instead of "*have no reason* to believe the guarantor *could not meet* its commitment". These are material changes.

More fully, the certificate will be: "the trustees, having made reasonable enquiry into the financial position of each certified guarantor, are reasonably satisfied that each certified guarantor, as at the date of the certificate, could meet in full £x [a specific sum known as the *realisable recovery*], having taken account of the likely impact of the immediate insolvency of all the employers".

As before, if there are multiple guarantors, the certificate is that each one could pay the full sum on its own. Trustees remain free to certify a *realisable recovery* below the maximum stipulated in the guarantee itself.

Guarantor's levy band

Unless a guarantor is the ultimate group parent and files consolidated accounts, its levy band will be downgraded if the guarantee implies a material increase in its gearing. An increase of between 10% and 49% will move it down one band, 50% to 99% two bands and 100% or more three bands.

The result of these changes and the new insolvency scoring might be that some current contingent assets will not be recertified (particularly where the covenant is strong) and schemes with weaker covenants might want to set up new contingent assets.

Last man standing schemes

A last man standing (LMS) multi-employer scheme is one where, when an employer quits the scheme (e.g. is sold), there is no segregation of part of the scheme assets to provide benefits for affected members.

In line with the May consultation, the PPF will no longer give LMS schemes a standard 10% discount on their levy. Instead it will give a graded reduction of up to 10% according to how well dispersed the membership is among the scheme's employers; the more dispersed, the higher the discount.

The PPF will also clarify which schemes are LMS. In future schemes will need to be able to say they have had legal advice that they are LMS. For 2015/16 the Regulator will ask all schemes that have identified themselves as LMS in their scheme returns to confirm they have had this advice.

The advice need not be obtained specifically for this the purpose of the levy as long as it clearly addresses the question.

Nor need it be repeated in future as long as the scheme structure is not changed. The deadline for confirming the advice to the Regulator will be 31 May 2015.

2015/16 levy

The levy the PPF estimates it will collect for 2015/16 is £635 million, 10% down on last year's estimate but held at the figure that would have been set had the insolvency scoring system not changed.

There will be 10 levy bands, with 20% of employers band 1, 10% in bands 2 to 8, and 5% in each of bands 9 and 10.

Redistribution

Here is the PPF's overview of the redistribution it expects.

It protects members of about 6,000 schemes. Around 2,600 pay low levies of less than £10,000. This group is omitted from the following figures.

Some 1,900 schemes will see an improvement in their levy, with an average reduction of 40%. Of these:

- 1,400 have a decrease below £50,000
- 200 between £50,000 and £100,000
- 300 over £100,000.

The 1,500 or so schemes seeing an increase will have an average rise of 130%. Of these:

- 900 have an increase of less than £50,000
- 200 between £50,000 and £100,000
- 200 between £100,000 and £200,000
- 200 more than £200,000.

Key dates

Provisionally these are the key deadlines for levy year 2015/16.

Monthly Experian scores to be used in 2015/16 levy	Between 31 October 2014 - 31 March 2015
Deadline for providing updated information (to Experian) to impact on monthly Experian scores	One calendar month before score measurement date (but 31 October for October score)
Submit scheme returns on Exchange	5pm, 31 March 2015
Reference period over which funding is smoothed	5-year period to 31 March 2015
Certify contingent assets	5pm, 31 March 2015
Certify asset backed contributions	5pm, 31 March 2015
Certify mortgages (to Experian)	31 March 2015
Certify deficit-reduction contributions	5pm, 30 April 2015
Certify full block transfers	5pm, 30 June 2015
Confirm legal advice on last man standing status to Regulator	31 May 2015
Levy invoicing starts	Autumn 2015

Contact

If you would like more information, please get in touch with your usual contact in our pensions team or with **Marcus Hellyer on 44 (0)117 902 7789 or at marcus.hellyer@burges-salmon.com**.

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