Briefing

BURGES SALMON

Pensions

January 2015

Importance ★★★☆

PPF levy 2015/16: final rules

The PPF's final levy rules for 2015/16 published at the end of last year largely confirmed the consultation drafts but included changes in some details.

We recap on what was known before the final rules came out. Then we look at the changes in the final rules.

Changes already confirmed

Insolvency scoring
The PPF-specific insolvency scoring system developed by Experian goes ahead. It allocates employers to one of eight scorecards that specify a series of financial variables that will be used to measure insolvency risk. It is expected to lead to big changes, up and down, in some levy bills.

Most scorecards include the age of the newest charge (mortgage age). But the following are disregarded:

- charges given when refinancing on equal or better terms i.e. no increase in the amount borrowed or the interest rate, and regular repayments are no higher,
- charges in favour of a PPF eligible pension scheme and
- rent deposit charges.

If a charge is to be disregarded, a director or company secretary of the employer (or similar in other forms of organisation) must file a certificate and extensive supporting documentation with Experian by the appropriate deadline (see table). In some cases, Experian may have information that allows it to identify a charge as one that can be disregarded. But employers should not rely on this and start from the premise that they need to certify in all cases.

If a valid certificate is filed, all monthly Experian scores from October 2014 to March 2015 will then be recalculated to take account of it.

It will take time to put together a certificate: start early.

For the PPF's requirements, see: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1516_mortgage_guidance.pdf

Transitional protection
There will be no transitional protection for schemes hit hard by the new scoring system.

Not-for-profit bodies
There is a single, specifically designed scorecard for not-for-profit organisations.

If Experian does not class your organisation as NPF and you think this is wrong, send in 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 the Levy Rule E3.1(8) (see below for where to find the Levy Rules).

Contingent asset guarantees
A new, stronger form of certificate of a group guarantor's strength is required for existing and new guarantees. It is positive rather than negative and must specify a cash amount the guarantee could realise: so, the 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.

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

Where Experian's insolvency scoring means levies fall, some guarantees might not be recertified this year. Schemes facing large increases might look at setting up new ones.

Levy bands
There are 10 levy bands, with 20% of employers band 1 and 10% in bands 2 to 8. Bands 9 and 10 each have 5%.

Last man standing schemes
Broadly, a last man standing (LMS) multi-employer scheme is one where, when an employer ceases to participate, there is neither a requirement in the scheme rules for the trustees to earmark part of the assets for affected members, nor a discretion for them to do so. This procedure is sometimes referred to as a "partial winding up".

Participation can end for a number of reasons e.g. a company is sold or goes into insolvency.

In the past, LMS schemes have had a standard 10% discount on their levy. For the coming year, this is replaced by a graded reduction of up to 10% according to how dispersed the membership is among the scheme's employers; the more dispersed, the higher the discount.

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In order to qualify, there is a new requirement that the trustees confirm to the Pensions Regulator they have had legal advice their scheme is indeed LMS. In principle, this advice need not be obtained specifically for levy purposes. That said, we recommend it is taken this year in relation to any scheme that it is hoped will count as LMS. This is for two reasons:

- for levy purposes, "LMS" has a particular definition and previous advice about the cessation of participation might have been taken in a context where the term had a more general meaning e.g. on a corporate restructuring. Applying the PPF definition could produce a different answer and
- in some respects, the PPF definition is at odds with the way the LMS idea is presented in the guidance notes on scheme structure in scheme returns (see section 6.1 of the sample return below). This may mean schemes have been incorrectly identified for PPF purposes in the past. Some research into the facts may be needed before a legal opinion can be given.

The schemes that will be asked to confirm they have had advice will be those that have identified themselves as LMS in their scheme return. The Regulator will contact them after 31 March 2015 and they will have until 29 May to respond.

Sample scheme return accessed 14/1/15: **http://www.thepensionsregulator.gov.uk/docs/db-scheme-return-example-form-2014.pdf**

Further changes

The final levy rules and related documents published at the end of last year included these further changes to insolvency scoring.

Scorecard eligibility

These changes are to the eligibility criteria for the Large and Complex group scorecard:

- employers that are in practice stand-alone because they have only dormant subsidiaries will be measured using the appropriate Independent scorecard rather than the Large and Complex group card;
- the same applies to ultimate parent companies that file abbreviated accounts since these omit data that are key to the Large and Complex card and
- where a non-UK employer would be allocated to this scorecard by default because essential data do not appear in its accounts, it will have the option to provide Experian with information to show a different scorecard is appropriate.

Variables linked to number of employees

A number of variables are ratios of a quantity – for example, average pay or capital employed – to employee headcount. Given the prevalence of part-time working in some sectors, employers can elect to use full-time equivalent figures where this information is in their accounts or is certified separately by their auditors. Employers should contact Experian about the figures they want to use.

Mortgage age

These additional categories of charge will be disregarded for mortgage age on grounds of immateriality:

- where the employer, or the wider group, has an investment grade credit rating and
- where the amount secured by the charge(s) is less than 0.5% of total assets. Broadly, if a charge relates to an overdraft facility that has been available for a year (by March 2015), the amount will be the most drawn from it at any time during the year. Otherwise the full amount of the facility will be taken.

The certification requirements outlined above apply in these cases too.

No changes

Levy parameters

The levy parameters (the scaling factor and scheme based multiplier) are as originally proposed, as is the levy estimate of £635m.

Asset backed contributions

For completeness we set out here the requirements for the recognition of asset backed contributions (ABCs) for levy purposes. They are substantially unchanged from the consultation proposals.

The PPF will recognise ABCs based on any class of underlying asset. It will require trustees to certify the value of an ABC at the lower of:

- the insolvency value of their interest in the holding vehicle, 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 must follow prescribed principles, including:

- **legal reliance:** the valuer and other advisers must accept a duty of care to the PPF and have insurance in line with industry norms,
- **basis:** assumes all scheme employers (and any PPF guarantors) are in insolvency and the asset needs to be realised within a year. Account must be taken of the risk these insolvencies pose to other group companies. The valuation is to be "balanced and realistic", which means that it need not produce the lowest value (unless that is appropriate in the circumstances),
- **assumptions and frequency:** the valuation assumptions must be set out and there must be a valuation exercise each year. Where appropriate this can be a desktop review but more esoteric assets must have a full valuation each year and
- **specific considerations:** for example, the trustees' legal rights (and limitations on them) under the ABC documentation, whether the asset will have value when

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separated from the original business, and the costs and challenges of realising any overseas asset.

A range of professional input might be needed in what could be a lengthy process. The PPF will not check valuations, nor routinely require sight of valuation reports.

Steps to reduce levy

Here are some steps that could help reduce your levy.

Scheme

- Ensure the PPF and the Regulator hold full and correct data on your scheme
- Remedy any data problems
- Understand your scheme's investment risk and the most appropriate way to report it
- Certify any deficit reduction contributions
- Set up an intra-group contingent asset guarantee
- Obtain a third party guarantee
- Consider an out-of-cycle s179 valuation

Employers

- Do you agree your employers are allocated to the correct scorecard?
- Ensure Experian correctly identifies all entities in your group and the group structure
- Ensure Experian holds full and correct data on all entities
- Remedy any data problems
- Consult your auditors about whether the figures for any of the variables on your scorecard can be improved
- Consider with them whether any group restructuring would help
- Charges: if the loan to which a charge relates has been repaid, consider asking the bank to release the charge
- Understand your monthly Experian score and raise any questions
- Test the effect of levy reduction measures using Experian's "what if" function

Timetable

The main filing deadline is 5pm on 31 March 2015. But there are a number of others. The PPF will apply all the deadlines strictly.

Action	Key dates
Monthly Experian scores	Between 31 October 2014 - 31 March 2015
Submission of data to **Experian** to impact on monthly Experian scores	One calendar month before the month end (excluding weekends and Bank holidays) when an Experian score is taken
Submit scheme return on **Exchange**	5pm, 31 March 2015
Reference period over which funding is smoothed	5 years to 31 March 2015
Contingent asset certificates to be submitted on **Exchange** and, where necessary, hard copy documents to **PPF**	5pm, 31 March 2015
Asset backed contributions certificates to be sent to **PPF**	5pm, 31 March 2015
Mortgage exclusion certificates and supporting evidence to be sent to **Experian**	5pm, 31 March 2015
Deficit-reduction contributions certificates to be submitted **on Exchange**	5pm, 30 April 2015
Confirm legal advice held on LMS status to be sent **to PPF**	29 May 2015
Certification of full block transfers to be completed on **Exchange** or (in limited circumstances) sent **to PPF**	5pm, 30 June 2015
Invoicing starts	Autumn 2015

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Materials

The materials the 2015/16 levy are here:

http://www.pensionprotectionfund.org.uk/levy/Pages/1516_Levy_Determination.aspx

There is some brief, user-friendly information under the headings in the left hand pane of the above page, and the general FAQs facility.

The most accessible materials for non-specialist readers are the documents with "Guidance" in their title. These are not legal documents but provide helpful commentary. The most useful items are likely to be the guidance on contingent assets and exclusion of mortgages.

For legal purposes the top level requirements are in the Levy Rules. These form the bulk of the "Determination under section 175(5) of the Pensions Act 2004 in respect of the financial year 1 April 2015 – 31 March 2016".

The various appendices to that document contain the technical detail that fleshes out the Levy Rules.

More information

If you would like more information, please get in touch with your usual contact in our pensions team or:

Richard Knight
Partner, Head of Pensions

+44 (0)117 939 2259
richard.knight@burges-salmon.com

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