Briefing

BURGES SALMON

Pensions

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PPF levy: major changes to insolvency scores

Importance: ★★★☆

Many schemes will see a sharp increase in their levy next year as a result of the PPF's new and more discriminative insolvency scoring system.

To give you an idea, the PPF expects:

- £200m of levy will be redistributed (some 30% based on this year's figures), over half of it as a result of employers dropping 5 or more of the 10 insolvency bands,
- 1,500 schemes to have an average increase in levy of 150%,
- 200 to have an increase over £200,000, with some apparently in the millions and
- a third of schemes to see a reduction of an average of 40%.

Trustees and, in particular, employers need to understand how the new system will work and to consider what steps they can take to contain their levy.

The new insolvency scoring system is the main subject of a consultation about the broad levy framework for the next three years, 2015/16 to 2017/18. The closing date is 9 July. If your scheme will be affected significantly, you should consider sending in a response.

In September, the PPF will carry out its annual consultation on the detail of the levy rules for 2015/16.

Other proposals

The consultation also proposes changes in relation to:

- the not-for-profit sector,
- the recognition of asset-backed funding arrangements,
- type A contingent asset guarantees and
- last man standing schemes.

These proposals will also have a significant impact on levy bills. See below for more.

Experian replaces D&B

Experian has created a scoring system specific to the characteristics of the sponsors of DB schemes e.g. typically larger, longer established and more often part of a group than most UK businesses. The system has a strong focus financial data and takes no account of the non-financial indicators of the type used by D&B, like industry sector, geographical location and board composition. Overdue trade bills matter only for small standalone businesses.

Sponsors are allocated to one of eight categories according to whether they are commercial or not-for-profit, part of a group or standalone and according to size. Each category has its own scorecard consisting of category-specific financial variables with different weightings towards the overall score.

For groups, the new system takes considerably more account (up to a top weighting of 33%) of the strength or weakness of the ultimate parent company than D&B's method.

Customer service

The new system will be transparent and user friendly. Employers will have free online access to the data Experian holds on them and to their score, making it easier to ensure information is correct and up to date. An email will alert them if their score changes.

Transition

The PPF invites views on whether it should offer transitional protection (for one year) to the schemes most affected by the changes. It suggests a reduction in levy (amount unspecified) where an employer's insolvency risk is more that 200% higher than for the current levy year. It estimates this would add up to £100m of levy.

For levy year 2015/16, an employer's final insolvency score will be the average of the six monthly scores from October 2014 to March 2015 (instead of the usual 12 month average).

Other issues

The PPF also invites for views on the following proposals that will also have marked effects on individual levy bills.

- It accepts that a scoring system designed for commercial enterprises is unsuitable for not-for-profit organisations (NFPs). So it proposes a dedicated scorecard and makes suggestions about how to define an NFP.

continued below

- For the largest employers (assets over £500m), should the Experian score be overridden by a credit rating from one of the leading agencies (Moody's, Standard & Poor's or Fitch)? This question arises because the Experian system is less accurate for this category than for others. If adopted, the override would apply whether it produced a more or less favourable result for an employer.
- An asset-backed funding (ABF) arrangement will not be recognised as a general scheme asset. Instead it will be subject to separate certification at the lower of the NPV of future cashflow and the value of the underlying asset on insolvency.

  In addition, the underlying asset will be restricted to the same classes as the PPF accepts for the closest analogy among the contingent assets it accepts (secured guarantees), being cash, securities and UK real estate. In practice, the PPF accepts this is likely to mean recognised ABFs will be confined to real estate.
- The PPF remains dissatisfied with the strength of covenant behind some parent guarantees submitted as contingent assets. It is considering tightening the requirements using one or more of these approaches:
  - be clearer about the value in issue by requiring trustees to certify the guarantor can meet a specific cash sum on an immediate group wide insolvency (rather than an amount opaquely defined by reference to an actuarial basis),
  - the insolvency scoring system for groups will give considerable weight to the strength or weakness of the ultimate parent company. The PPF believes this could reduce the incentive for putting guarantees in place, and
  - treat a guarantee as increasing the guarantor's gearing, giving it a higher insolvency risk score.
- To sharpen the requirements in relation to last man standing schemes, the PPF proposes to require a certificate, based on legal advice, that a scheme is indeed last man standing. Secondly, it proposes to develop a scheme specific discount factor to replace the current uniform 10%.

The consultation documents (which include YouTube videos) are available here: **http://www.pensionprotectionfund.org.uk/levy/Pages/PensionProtectionLevy.aspx**

More information

If you would like more information, please get in touch with your usual contact in our pensions team or with **Richard Knight, Partner, Head of Pensions, tel: +44 (0) 117 939 2259 or email: richard.knight@burges-salmon.com**

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