

The Board of the Pension Protection Fund (the “PPF”)

PPF Levy Practice Guidance in respect of the financial year 1 April 2012 – 31 March 2013

Guidance on the use of discretionary powers

The PPF’s levy Determination, issued under section 175(5) of the Pensions Act 2004, contains a number of discretionary powers for the PPF. This guidance note sets out principles and case studies showing how the PPF expects to exercise those discretionary powers in relation to:

- (a) scheme data; and
- (b) deficit-reduction contributions.

Details of the Board’s exercise of discretion in relation to contingent assets, including practical examples regarding the partial recognition of and amendments to contingent assets, can now be found in the Contingent Asset Guidance at:

- (a) Paragraph 5.4 (partial recognition of contingent assets); and
- (b) Paragraphs 9.3 and 9.4 (reduction and replacement – exercise of the Board’s discretion).

This guidance is not part of the Determination and it is not a binding restriction on the way in which the PPF will exercise its powers. The guidance should be read in addition to, rather than as a substitute for, the Determination.

The PPF will update this guidance from time to time in the light of its experience, either for the current levy year or for future years. The PPF will have regard to this guidance but may decide to depart from it when the circumstances of an individual case make it appropriate to do so or when the PPF is persuaded that the approach indicated in this guidance is no longer appropriate.

This guidance is not a binding interpretation of the law, which can only be supplied by the courts.

The first part of this guidance focuses on the limited circumstances in which the PPF may calculate the levies using something other than data submitted on the Pensions Regulator's Exchange system at the relevant deadline. The second part covers deficit reduction contributions. Finally we include a reminder of how scheme trustees can appeal their invoices, including the exercise of any relevant discretions.

I. DISCRETIONS RELATING TO SCHEME DATA

A. Introduction

As is made clear by the Determination, in the vast majority of cases (and except where expressly stated, such as in the case of contingent assets, where hard copy documentation will be equally relevant) the fundamental basis of the calculation of the levies will be the data submitted on Exchange at the relevant measurement time, together with the data provided to Dun & Bradstreet in respect of that time. Cases for the use of PPF discretion will be exceptional. Most cases will be determined by a straightforward application of the basic rules in the Determination.

B. Exercising the discretionary powers

There are a number of different categories of case in which exercise of discretion may be relevant:

1. Cases where it is not possible to produce an invoice which complies with the Determination – usually, this will be because the data supplied to the PPF is insufficient.
2. Data errors including (a) cases where the PPF's own plausibility tests indicate that there is an error; and (b) other data errors, that do not fit into category (a).
3. Mistaken analysis/presentation of the scheme's partial winding up provisions or the persons who were the employers in relation to the scheme.
4. Post-deadline changes to information on Exchange and accepting late data.
5. Cases where the information on full block transfers expected by the PPF has not been provided, or has not been provided in full, by the relevant deadline.

1. *Inability to produce an invoice*

This (rare) situation may arise where the data supplied by the scheme via Exchange is insufficient to allow the calculation of an invoice which complies with the Determination. The PPF will generally take steps to improve the quality of data – including, potentially, through contacting a scheme – and only when this process has failed will the levy calculation usually be undertaken through the application of prudent assumptions, for example it will be assumed that the scheme is amongst the least well funded schemes.

2. *Data errors*

The PPF does not generally allow data corrections. Some of the reasons for this are as follows:

- We think that it is reasonable for us to expect schemes to supply us with correct data and to encourage appropriate behaviour. Provision of scheme return data is a legal obligation¹, and schemes and their advisers have now had a number of years to generally get used to the system.
- Requests for corrections cause an administrative and cost burden in making changes to our databases and generating new invoices.
- The need to issue new invoices extends the invoicing period and delays the receipt by the PPF of the levies and thereby delays the investment of levy revenue. We are trying to increase stability in the levy estimate, reduce the invoicing period and create conditions in which schemes can know and budget for their invoices in advance. The provision of correct information by the deadlines makes an important contribution to achieving this. The sooner the PPF has accurate data on all schemes, the sooner we can validate it and begin invoicing, and the shorter the invoicing period.

¹ Under s.64 Pensions Act 2004, with civil penalties for non compliance. The scheme return submitted must contain all the information the Pensions Regulator asks for (s.65). The importance of accuracy is underlined by the criminal sanctions which may apply where false or misleading information is supplied knowingly or recklessly (s80 and s195) – which applies more broadly than scheme return information.

Notwithstanding this, some sensible exceptions need to be made, so we still reserve the discretion to allow schemes to correct incorrect data or indeed to correct it ourselves. The discretion only applies where the information originally supplied was, in fact, incorrect (as opposed to where the scheme could have submitted later information or presented the information more advantageously but chose not to). One area where we recognise that schemes are not necessarily well placed to provide accurate data is in relation to DUNS numbers, which are a D&B proprietary tool used for employer identification purposes, rather than an item of scheme information that is maintained by the Scheme. For that reason, where the other employer data (apart from the DUNS number) supplied by the scheme was correct and would have led to the correct employer being matched by D&B, the Board intends generally to exercise a discretion to correct the DUNS number.

(a) Plausibility tests

Over its short history, the PPF has developed a data testing regime designed to flag data which we believe, based on our experience, is likely to be incorrect. Clearly, these tests cannot be designed to cover all data (for example, we cannot test whether a scheme has established who its employers are correctly), but we have tried to develop a significant body of tests. In doing so, we aim to ensure that we are protected to a certain extent from gaming of the levy system. Where possible, we also carry out these tests very shortly after the Measurement Time², so that we can capture any changes in the scaling factor.

The fact that a test has been triggered does not necessarily mean that the data is incorrect. The tests are designed to flag data which we think is inconsistent or unusual, in some cases, as compared with other data. Nor will tests detect all erroneous data – so schemes should not rely upon them to pick up their errors.

Where a test is triggered, we conduct data cleansing activities on the particular piece of data that is flagged as inconsistent or unusual. In these circumstances, we will contact the trustees or their advisers to confirm whether the data is correct and seek an explanation if it is and correct data if it is not.

² As defined in Rule A2.3 of the Determination.

In most cases, where the information referred to in our correspondence is confirmed to be incorrect, we will correct it.

However, equally, in most cases, we will not permit other data (in respect of which no tests have been triggered) to be amended at the same time. If we allowed other corrections once a plausibility test had been triggered, this would render the data deadlines meaningless for any scheme where any plausibility test was triggered. This would not be fair for those for whom no plausibility test was triggered.

(b) Other data errors

In considering whether or not to exercise its discretionary powers, the PPF will consider the following circumstances:

- a. The effect of the error on the calculation of the levies.
- b. The reason that erroneous data was submitted³.
- c. Responsibility for the erroneous data, including whether any professional indemnity insurance may compensate the scheme.
- d. The speed with which the error was identified.
- e. The reason for the error.

Where an error has resulted in under-calculation of the levies, the PPF is more likely to exercise its discretionary power to make a data correction⁴. Where the error has resulted in the scheme paying higher levies as a result of a mistake by someone with responsibility for the scheme, it is not usually unfair to collect and retain the higher levies, as the scheme has not provided the

³ In particular, where the scheme can establish that it has had difficulty with Exchange (e.g. the system does not allow correct data to be input or is misleading) and has made an error as a result, the PPF might be more likely to allow the correction.

⁴ If the scheme appears deliberately to have entered incorrect data in an attempt to reduce their invoice, a correction will almost certainly be made. An offence may also have been committed.

correct information anticipated by the Act⁵. In a case where the extra cost is caused by the carelessness of professional advisers, the trustees may be able to take action against those advisers for any loss suffered as a result.

3. *Winding up provisions and employer relationship*

The PPF accepts that some of the matters reported through Exchange – such as the nature of winding up provisions and the identity of the employers – are subject to uncertainty and complex analysis. In considering whether or not to exercise its discretionary powers, the PPF will take account of the circumstances set out in 2 above, including taking account of questions as to whether there is a good explanation as to why the incorrect analysis was used.

4. *Late data*

The Pensions Regulator's Exchange system allows for updates of information right up to the relevant deadline. Therefore, requests for exercise of discretion based on changes in information which are not updated will not normally be accepted. Notwithstanding this, the Board does retain the right to obtain data from schemes after the relevant deadlines and may exercise this discretion, for example, where the levy will otherwise be understated.

Additionally, where a communication failure has occurred, Rule B4 of the Determination may apply. This generally requires evidence that the information was despatched at an appropriate time, but was delayed by the post or by breakdown in electronic communications. For example, where contingent asset hard copy documentation has been sent to us by courier, we would generally expect you to be able to provide us with:

- a copy of the collection receipt from the courier indicating the time of collection by the courier; and
- evidence of the service level requested from the courier.

From these, we could then establish whether the documents were indeed despatched at an appropriate time and were delayed.

5. *Block transfers*

⁵ See footnote 1 above

Where there is a 'full' block transfer – i.e., the transferring scheme ceases to be eligible – the PPF expects the schemes involved to provide full information through Exchange, as described in Rule F2 of the Determination. Where that information has not been provided in full or at all by the relevant deadline, the levies for the scheme(s) receiving the block transfer are to be calculated using the "poor data methodology" set out in the Transfers Appendix to the Determination. This involves using the asset and liability figures of the transferring scheme but applying a discount to the assets.

The provision of full information about a transfer involves a degree of cooperation and coordination between the transferring and receiving schemes, which the PPF considers to be reasonable in circumstances where assets and liabilities are being moved between the schemes. However the PPF recognises that transfers can be complex - for example, a large scheme may receive a very large number of small transfers in, all of which are full transfers - and that in some circumstances there may be minor deficiencies in the information provided which are beyond the control of the receiving scheme. Accordingly, within Rule F2.5 the PPF retains the discretion to calculate the levy differently in circumstances where the trustees of the receiving scheme have made all efforts that were reasonable in the circumstances to ensure full submission of the requisite information.

C. Examples

Example 1 – correction request accepted

The ABC Pension Scheme was established in 1998, but had received a transfer from the XYZ Pension Scheme, which was established in 1985. Andrew, the chairman of trustees of the ABC Pension Scheme, was completing the scheme return online, but found that Exchange would not allow him to enter a figure in the "pre 1997" liabilities box. He emailed the PPF's stakeholder support team to let them know that there was a problem in specifying the figure that should be in the box.

When Andrew receives his invoice, it seems quite high. He writes to the PPF's stakeholder support team, the next day, to check what figure had been used for the pre-1997 liabilities, explaining the problem with Exchange and referring to his previous email.

Andrew's correction is granted and his invoice adjusted. The problem here was with Exchange and Andrew could not have been expected to provide accurate data online.

Example 2 – correction request denied

The DEF Senior Pension Scheme has asked its actuary, John, to fill in the scheme return for it. John asks his temporary secretary to extract the data for the latest s179 valuation from his firm's system. Unfortunately, he gives the secretary the scheme name of the "DEF Pension Scheme", and no PSR number, and the secretary inputs the valuation data from the DEF (Works) Pension Scheme, instead of the DEF Senior Pension Scheme. John fails to check her work. As a result, John submits the wrong valuation results. To make matters worse, the DEF (Works) Pension Scheme is a bigger scheme with a greater deficit.

John realises the mistake a week later, when trying to certify a deficit-reduction contributions certificate. John does not continue with the certification, and does nothing until the DEF Senior Pension Scheme gets its invoice. Peter, the chairman of trustees, calls John and expresses his concern at the size of the invoice. Peter asks for the correct figures, but John does not provide them until six weeks after his conversation with Peter, at which point he writes to the PPF the next day, requesting that his invoice is adjusted by using the correct figures for the DEF Senior Pension Scheme's s179 valuation results. Peter estimates that the mistakes have increased the invoice from £45,000 to £150,000.

Peter's request is refused. Whilst the mistake has had an impact on the scheme's invoice, the mistake could reasonably have been avoided, and there was an unreasonable delay in taking action. The Trustees will no doubt be considering whether they should seek to recover the increased levy cost against their advisers, who will be required to carry professional indemnity insurance.

Example 3 – correction request granted

Martin, a trustee of the UVW Pension Scheme, is filling in the scheme return. He is completing the scheme structure question and examines the trust deed to check what the scheme provides in terms of partial winding up. He reads clause 32 of the deed, which states as follows:

"Upon a Participating Company ceasing to participate in the Scheme the Principal Employer may, subject to Rule 33, segregate a part of the assets of the Scheme in relation to-

- (i) those Active Members who are then in the Service of the Participating Company; and (if the Principal Employer so decides)*

(ii) Members in the Service of the Participating Company who are not Active Members, and other Members who were formerly in its Service and persons whose benefits arise in respect of such Members,

the choice of (i) or (ii)(or neither) being determined by the Principal Employer at its absolute discretion."

Martin fills in the scheme return ticking the box which says that the scheme has a discretion to segregate. He is later discussing the issues around partial winding up rules with his legal adviser, David. David tells him that, whilst on its face, it might appear that Martin had ticked the right box, in fact, the correct analysis is that the scheme does not have a provision for partial winding up. He explains that this is because of the precise wording of the legislation, which only treats the scheme as having an option to segregate if that option is given to the trustees, not the Principal Employer as the deed provides.

Martin contacts the PPF and asks if he can amend this. He explains that he filled in the scheme return on the basis of what he thought was appropriate and had seen no reason to seek legal advice on this issue.

The invoice for the UVW Scheme is adjusted on the basis that the scheme is a scheme without a provision for partial winding up. Martin has made a mistake on a highly technical legal matter, but one which (as a lay trustee) he reasonably thought was straightforward.

Example 4 – request to use late post-transfer valuation denied; “Poor data methodology” applied to scheme

The GHI Pension Scheme transferred all its assets and liabilities to the RST Pension Scheme on 1 January 2012. As part of the transfer agreement, the Trustees of the GHI Pension Scheme undertook to “take all such actions as are required to ensure that appropriate notification is made in relation to the transfer to ensure that no fines or other loss is suffered by the RST Pension Scheme”. However, Paul, the scheme administrator of the GHI pension scheme who is charged with doing this task takes a 6 month sabbatical starting in February and forgets to pass on this task to his colleagues. Because it was Paul’s task, nobody at the RST Pension Scheme takes a note and consequently nobody chases Paul.

When the chairman of trustees of the GHI Pension Scheme, receives a levy invoice for the 2012/13 levy year, she informs the PPF’s eligibility team that

the GHI scheme has fewer than two members. The eligibility team ask her to explain in a bit more detail and she tells them about the transfer.

As a result, the RST Pension Scheme (which has not yet been invoiced) receives an invoice based on an underfunding figure which Ayesha, a trustee of the RST Pension Scheme, finds surprisingly high. Ayesha queries this and is referred to the requirements in respect of block transfers. She asks if she can resolve the situation by making sure all the required information is submitted in the next week. Her request is rejected. She has provided no reason as to why the transfer was not properly notified and she may be able to recover the loss through the transfer agreement provisions. Even if she were not so able, she had the opportunity to insist on something more specific in the transfer agreement which would have allowed her to make a claim.

Example 5 - request to use late post-transfer valuation granted

The JKL Pension Scheme transferred all its assets and liabilities to the OPQ Pension Scheme on 1 January 2012. As part of the transfer agreement, the Trustees of the JKL Pension Scheme undertook to “take all such actions as are required to ensure that appropriate notification is made in relation to the transfer to ensure that no fines or other loss is suffered by the OPQ Pension Scheme”.

Jin, the scheme administrator of the JKL Pension Scheme who is charged with doing this task immediately starts the notification process and Jane, the administrator of the OPQ Scheme confirms the basic details in February 2011. Jane then asks Tim, the scheme actuary, to supply her with a valuation of the OPQ Scheme after the transfer, which she posts on Exchange on 15th May.

However, Jin takes a 3 month sabbatical starting at the beginning of May and forgets to pass on the task of supplying the post-transfer valuation for the JKL Pension Scheme to his colleagues. He does not put an out of office note on his emails. Jane, the administrator of the OPQ Pension Scheme, emails Jin with increasing urgency as the 29 June deadline approaches and also emails the trustees direct, to remind them of the information expected by the PPF. She points out that the information they are expected to supply is extremely simple (as they will have no assets or liabilities) and highlights the effect that their failure could have on the OPQ Scheme. Lastly, on 26th June, she emails the PPF stakeholder support team to explain her difficulty.

When Jessica, the chairman of trustees of the JKL Pension Scheme, receives a levy invoice for the 2012/13 levy year, she informs the PPF’s eligibility team

that the JKL scheme has fewer than two members. The eligibility team ask her to explain in a bit more detail and she tells them about the transfer.

As a result, the OPQ Pension Scheme (which has not yet been invoiced) receives an invoice based on an underfunding figure which Tim finds surprisingly high. Fiona, the chairman of the trustees, queries this and is referred to the requirements in respect of block transfers. She explains that Jane had done everything she could to comply with the provisions and had tried to ensure that the JKL Pension Scheme did too. She refers the stakeholder support team to the data she submitted on Exchange and sends in copies of Jane's increasingly urgent emails to the JKL Pension Scheme.

Her request to adjust the invoice for the OPQ Pension Scheme (to use the post-transfer valuation she has supplied) is accepted. Jane has indeed done everything she could to properly notify the transfer and, although she may be able to recover the loss through the transfer agreement provisions, given her exemplary efforts, it is unduly harsh to require the scheme to pursue that route.

Example 6 – correction imposed

MNO Pension Scheme entered its Section 179 Valuation data on Exchange on 27 March 2011. In the liabilities section, the sum of the liabilities excluding expenses for active members, deferred members, pensioner members, estimated costs of winding up, estimated expenses of benefit installation/payment and external liabilities came to £100,000 less than the figure entered in the total protected liabilities box. The mismatch in the figures triggered a PPF plausibility test and on 6 April 2011 the PPF data cleansing team contacted MNO Pension Scheme to seek an explanation. Rachel, the scheme actuary, realised that she had mistakenly entered the liabilities in respect of the deferred members to be £100,000 less than the actual liabilities in respect of deferred members. The PPF imposes the data correction.

Example 7 – Correction to DUNS number accepted

The TPO scheme supplies information about the employer to the scheme on Exchange, but mistakenly includes a DUNS number for an unrelated business along with other information sufficient to accurately identify the sponsoring employer. This DUNS number is then used to calculate the levy invoice. On reviewing the levy invoice TPO become aware of the error and appeal the failure score with D&B.

D&B review the evidence they have on the identity of the employer and confirm that had there been no DUNS present on Exchange, they would have matched the employer to the correct DUNS because the scheme's employer information was in all other respects entirely correct and consistent. The PPF consider whether to correct the data. The inconsistency was not identified on receipt of information from Exchange, at which point data cleaning could have confirmed the appropriate basis for the levy. The DUNS number is not an item of scheme information for which a scheme is ultimately responsible. The discretion to correct is utilised and a revised bill is generated.

II. DEFICIT REDUCTION CONTRIBUTIONS

It is intended that the deficit-reduction contribution regime recognises, for levy purposes, only those contributions that have the effect of reducing the difference between a scheme's assets and liabilities (or increasing that difference where the assets exceed the liabilities). It is for the Board to decide to what extent a deficit-reduction contribution certificate will be recognised for levy purposes.

The Board anticipates that it will only exercise this discretion not to recognise a deficit reduction contribution for levy purposes in situations where the Board is of the clear opinion that the certified contribution was not made in accordance with the Board's intention.

Where an actuary certifies a deficit-reduction contributions certificate on Exchange, this certification should be made with due regard to the requirement, set out in Rule G1.1(iii) of the Determination, that the certified contribution has the effect of reducing the difference between a scheme's assets and protected liabilities where protected liabilities exceed the assets, or increasing that difference where the assets exceed the protected liabilities. The Board also expects that where prudent estimation is used, the appropriate level of prudence is considered with regard to Rule G1.1(iii).

Examples of deficit-reduction contributions which will not be recognised in full for levy purposes

- (i) A scheme has undertaken an enhanced transfer value exercise. The total enhancements amounted to £1,000,000 but the corresponding employer contribution was only £600,000. The scheme sought to certify the £1,000,000 as a deficit-reduction contribution. However, the net effect to the scheme of the exercise was a £400,000 loss. Therefore, the Board did not accept the deficit-reduction contribution certificate as the scheme

should not be treated as having reduced deficit if it had in fact created a new set of liabilities and partly paid contributions towards those, and the scheme actuary should have reflected the net loss to the scheme in any other deficit-reduction contribution certificates given in respect of the scheme.

- (ii) A scheme has undertaken an exercise with scheme members where pensioners have agreed to forgo pension increases in exchange for a higher, non-increasing pension. The scheme asked whether this benefit change would be counted as an augmentation and therefore deducted from the protected liabilities that could be regarded as reduced by a deficit-reduction contribution certificate. The Board decided that it should be treated as an augmentation, as the scheme had replaced a benefit that the Board would not provide for in PPF compensation (i.e. pre-1997 pension increases) for a fixed amount that the Board would have to cover. The Board's liabilities had therefore been increased by the exercise.
- (iii) A scheme secured a buyout of pensioner liabilities with an insurance company. As part of this transaction, the employer paid an additional contribution to the scheme in order to maintain the funding level on a scheme specific funding basis pre and post buyout. The scheme asked whether the additional contribution could be certified as a deficit-reduction contribution. The Board noted that the additional contribution was one of several factors pertaining to the buyout and that in the absence of further information it would not be possible to accept the contribution in isolation as certifiable for deficit-reduction purposes. In particular, before certifying a deficit-reduction contribution the scheme actuary should assess the overall impact of the buy-out exercise upon the scheme's s179 funding position. This would include consideration of the terms offered by the insurance company compared to the s179 valuation basis and the benefits bought out compared to PPF compensation levels, as well as allowing for the additional contribution.

Treatment of investment management expenses in determining deficit-reduction contributions

Paragraph 11 of the Deficit-Reduction Contributions Appendix provides that the certified amount of deficit-reduction contributions should be net of expenses (including investment management expenses) which are met out of

scheme assets and incurred between **date 1** and the end of **date 2** (both dates as defined in the Deficit-Reduction Contributions Appendix). The relevant amount of expenses for this purpose is defined as **c**.

The Board is aware that investment managers may recoup expenses in a variety of ways, for example as an explicit deduction from the assets or implicitly through the investment charging structure. The latter scenario could include cancellation of units, adjustments to unit prices or a bid/offer spread.

The Board's intention is that **c** should include all investment management expenses. It may be helpful in this context for schemes to consider the treatment of such expenses in their audited accounts. Generally speaking, expense types which appear as outgoings in the revenue account are readily quantifiable and are levied separately and distinctly, while other expense types levied through the charging structure may be more complex to quantify and emerge as a component of the overall investment gain or loss.

Paragraph 14 of the Deficit-Reduction Contributions Appendix specifies that prudent estimation is acceptable and in particular that **c** should not be underestimated. This principle will be particularly relevant for schemes with investment management expenses levied through the charging structure.

This means that the calculation of **c** requires a prudent estimate of the investment management expenses which would be contained in the scheme accounts for the period between **date 1** and the end of **date 2**, if accounts for this period were to be prepared. This calculation should cover both explicit outgoings in the revenue account and the implicit contribution of investment management expenses to the overall investment gain or loss.

III. APPEALING A LEVY INVOICE

The calculation of a levy invoice is a 'reviewable matter' under section 207 of the Pensions Act 2004. The formal review process considers whether the PPF has followed the rules of the Determination when calculating the levy. Accordingly, if the trustees of a scheme are unhappy about the way in which the PPF has exercised any of the limited discretions reserved in the Determination, and described above, they should apply for a review in the normal way.

It is important to note that the PPF cannot change or depart from the levy Determination itself, including the levy formula, or any of the policies or rules contained in it, when calculating individual invoices. So, for example, in a

case where D&B have properly provided a failure score for the employer in relation to the scheme, an application which argues that the PPF should depart from the Determination and use something other than that D&B score will not be successful, as there is no discretion in this regard.

Details of how to apply for a review of a levy invoice, and of levy consultations and how to respond, can be found on the PPF website:

www.pensionprotectionfund.org.uk