Pension
Protection
Fund

Consultation Document

The 2014/15 Pension Protection Levy Consultation Document

September 2013

Foreword

2014/15 will be the third year of the New Levy Framework which we put in place in 2012 to deliver a stable and predictable approach for schemes. Our Framework commits us to keeping the levy rules the same until 2014/15 – except in limited circumstances - and accepting that the total we charge will rise or fall depending on changes to the level of risk posed by individual schemes.

Against this backdrop, we are now confirming that we intend to make no change to the levy parameters for 2014/15. Taken together with the data we collect from schemes and movements in financial indices, this governs how much we estimate we will collect in levy next year.

We have accordingly calculated a Levy Estimate for 2014/15 of £695 million, an increase of about 10 per cent on the previous year. This is consistent with the expectation we signalled to levy payers last year and, again, in June 2013.

It is worth emphasising that this figure is truly an estimate – much of the data on which bills are calculated has yet to be collected , so the final amount we invoice could change depending on circumstances. For instance, if gilt yields continue to rise as they have done in recent months, we would collect less than our Estimate.

Also, I want to make it clear that this increase is not a reaction to individual events, such as large single claims. Nor have we made any allowance for the possible impact of the proposed changes to the PPF compensation cap and the objectives of the Pensions Regulator.

Looking at the position of the wider economy, we are seeing some signs of economic recovery which, if they become stronger, may see a reduction in the risks we face. This may have positive implications for the probability of meeting our 2030 funding objective which feeds into our considerations as we look to set the levy rules for the next three years from 2015/16.

The 2015/16 levy year also coincides with the point at which we switch to Experian as our new insolvency risk provider after eight years of working with Dun & Bradstreet. We are grateful to Dun & Bradstreet for their support over this time and look forward to working with our new partners. While we expect we will have to make some changes from 2015/16 to accommodate the move to Experian, we are keen not to make change for change's sake and will only consider amending the rules if there is clear evidence to support change. We have once again established an industry group to help us think through the impact of the move to Experian and other changes.

We believe that maintaining stable levy rules for 2014/15 is the right decision for both us and for levy payers; a decision which will deliver the predictability we promised schemes when we introduced the New Levy Framework three years ago.

Alan Rubenstein
Chief Executive

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1. Introduction and Executive Summary

1.1 The 2014/15 Pension Protection Levy Consultation

Overview

1.1.1 This consultation document sets out the basis on which the Board intends to charge the Pension Protection Levy for the 2014/15 Levy Year. This includes the Levy Estimate (the overall amount the Board aims to collect), the levy scaling factor, the scheme-based levy multiplier, and associated rules and guidance.

1.1.2 We put in place far-reaching changes to the design of the Pension Protection Levy from 2012/13, as announced in A New Framework: Policy Statement.[1] As we announced then, our aim is to maintain stability in the way in which the levy is calculated, as far as that is possible over a three year period (or triennium). This objective covers both the parameters for the levy, and other aspects of the Levy Rules.

1.1.3 As a result, the total the Board expects to collect, the Levy Estimate, will rise or fall depending on changes in overall risk over the triennium. Later in this document we set out how risk, as we measure it, has moved in the past year.

1.1.4 However, the determination of our Levy Rules and publication of the Levy Estimate for the year remains an annual process (as required by the Pensions Act), so we have given consideration to whether each of the levy parameters remains appropriate and calculated our Levy Estimate for 2014/15 based on those parameters. In reviewing the parameters we have had regard to the objective of the New Levy Framework to offer improved stability and predictability over the years to 2014/15, and have concluded no changes need be made.

Factors influencing the Levy Estimate

1.1.5 Overall, underfunding risk, as measured in the PPF levy, is projected to increase over the year to 31 March 2014.

1.1.6 This is an anticipated result of the transformation methodology, including the smoothing of scheme funding that the PPF applies in assessing the funding position of schemes. By using smoothing over a five year period, we reduce the impact in any one year of a change in asset values and yields. However, over time, periods when yields have been low have replaced earlier periods when yields were higher, so that there has been a gradual increase in liabilities and hence a reduction in funding levels to the extent that smoothed asset growth does not compensate. Now that yields have begun to recover, this pattern may begin to reverse, though we have made no allowance in our estimate for any improvement that may occur between July this year and March 2014, given uncertainties about the extent and timing of any further change. To the extent that there is any further increase in yields before March 2014 this would mean that, other things equal, bills would be lower than currently predicted and the PPF would collect

[1] The Policy Statement and other related documents are available on the PPF website: http://www.pensionprotectionfund.org.uk

less than our Levy Estimate (though were recent trends to reverse, the impact would be to raise collections).

1.1.7 As a result, primarily of these changes in scheme funding, but also of other factors such as changes in risk reduction measures put in place by schemes and movements in insolvency risk, our Levy Estimate has risen to £695 million (from £630 million in 2013/14).

1.1.8 This Levy Estimate depends on a series of assumptions, as the scheme data that will be used to calculate individual schemes' levy bills for 2014/15 will not be collected until March 2014.

1.1.9 The assumptions the Board has made, have been upon the advice of its actuaries who in turn have researched opinions of consultants active in the area as well as analysing our past experience.

1.1.10 Inevitably, the individual assumptions we choose will not be borne out entirely in practice, and so will lead to a net under or over collection of levy compared to the published estimate. However, we have used the same methodology as last year to develop the assumptions and we also checked our ideas informally with a range of consultants.

1.1.11 The Board indicated in last year's consultation exercise that it would only propose to intervene to control the change in levy for 2014/15 were it to exceed a 25 per cent year on year shift, and then only to reduce the change to that limit. The 2014/15 Levy Estimate of £695 million is within the range of a maximum 25 per cent year on year change for the Levy Estimate[2] (and in line with the 10 per cent increase that the Board indicated was likely last autumn). The Board is therefore confirming that it does not intend to adjust the levy scaling factor for 2014/15.

1.1.12 In taking this judgement, the Board has focused on the objective of maintaining stability in methodology – and therefore the predictability of the levy – which stakeholders told us they wanted and we reflected in the New Levy Framework (NLF).

1.1.13 As the parameters for the NLF were confirmed in late 2011, they could not take account of changes in the regulatory or broader pensions environment in the latter part of its triennium. Therefore no account has been taken of:

- the change that DWP have indicated will be made to the compensation cap, which means that long-serving employees may receive higher compensation than previously on an insolvency, or
- the potential impact of the Pensions Regulator's proposed new objective to minimise any adverse impact on the sustainable growth of an employer.

[2] There is a legal requirement that the levy estimate not rise by more than 25 per cent in a single year, and the Board considers it prudent not to allow it to fall by more, given the risk that this could lead to large subsequent increases. Accordingly, the New Levy Framework commits to intervening where the year on year change would otherwise exceed 25 per cent.

As more evidence becomes available we will seek to quantify the potential impacts and this may feature in our thinking for the second triennium.

1.1.14 For the same reason we have not attempted to take into account, at this time, the effect of future regulations which will bring into effect the changes to the definition of money purchase benefits that the Government made in the Pensions Act 2011. If so required by that legislation, we may subsequently need to recalculate some scheme's levies, in particular by reference to new DB liabilities and their corresponding assets. In Section 3 we explain the type of rule we propose to introduce in the finalised Determination for 2014/15.

1.1.15 We will be publishing our annual accounts for 2012/13 together with the annual review of our funding strategy later this autumn. Whilst the work on this is not yet complete indications thus far are that claims will be at record levels but this has been more than offset by other factors such as levy income and positive returns in excess of our liabilities. We may also see some improvement in our probability of success in reaching our 2030 funding target. We will consider the funding position in detail – and how it might be reflected in the levy - next year when the levy parameters for 2015/16, the first year of the second triennium, are set. We plan to ensure that work on the annual review of funding as at 31 March 2014 can be taken into account for the triennium review.

1.1.16 It is worth noting that an increase of 10 per cent in the levy estimate does not mean that all invoices will increase by that amount. Global factors – in particular the reduction in the size of the levy paying universe – are also factored in to the 10 per cent estimate. In addition, the individual circumstances of the scheme play a role, so there will be some schemes that see a fall in levy, others that see larger increases. We have carried out an impact analysis on the impact on individual scheme bills and this is included at chapter 4 below.

1.2 The Board's Determination under section 175(5) of the Pensions Act 2004: the Levy Rules

1.2.1 The draft Determination under section 175(5) of the Pensions Act 2004 is published alongside this consultation document. These Levy Rules express the Board's policy in legal form.

1.2.2 Policy changes in the draft Levy Rules for 2014/15 are extremely limited, in order to deliver the stability in rules which allows levies to be predictable.

1.2.3 We have, though, responded to experience from stakeholders of difficulties in recertifying contingent assets in three ways:

- By including with the determination consultation a draft of our guidance. The four guidance notes aren't formally part of the consultation, since they are guidance documents rather than rules. Changes from the corresponding 2013/14 documents are limited

and primarily focus on reducing repetition and improving clarity. However, if there are aspects of the guidance that are unclear, we will have the opportunity to clarify them early.

- We have adjusted the rule which requires any contingent asset being recertified to have been certified in the preceding levy year. In future it will be possible to recertify a contingent asset that was last certified in a previous year other than the immediately preceding levy year, so long as the underlying agreement remained in place throughout the period. This will avoid schemes having to recertify a contingent asset that offers no benefit for 2014/15 just to ensure that it can be recertified in the following year if need be.

- We have also proposed minor changes to the wording of the trustees' certification in relation to guarantors' ability to pay out under contingent assets. This is not expected to materially alter the substantive standard for certification, but is designed to tackle an unintended difficulty reported by some trustees.

1.3 The levy for 2015/16 and later years

1.3.1 For 2015/16, we will reflect on the experience of the first triennium of the NLF. We believe the framework has worked well in its early years and we will seek to maintain maximum stability, previously identified as a significant benefit, in the second triennium. We will only be making changes where there is clear evidence to support them, whether to the Levy Rules generally, or the levels at which the parameters are set.

1.3.2 There will be two stages to this work:

- A consultation on the rules, for the three years to 2017/18, to include the levy parameters (with the exception of the levy scaling factor and scheme-based levy multiplier) early in 2014.

- A consultation on the final levy rules for 2015/16, which will include the levy scaling factor and scheme-based multiplier that will apply for 2015/16 (and which we expect to apply for the remaining years of the second triennium), in the autumn of 2014.

1.3.3 In the 2013/14 levy consultation process we indicated that our contract with Dun & Bradstreet (D&B) was due to expire during the first triennium and that we would hold a competitive re-tendering exercise with a view to the appointment of a provider for the subsequent period. We have now completed that process and announced that there will be a new insolvency risk provider, Experian.

1.3.4 We are now working with Experian on the details of how they plan to measure insolvency risk for our universe of scheme sponsors, and are involving a group of industry stakeholders in that process. Part of the work done will be to look at how Experian's measurement of insolvency risk fits with the insolvency risk bands and levy rates used in the first triennium, and our first 2014 consultation will set out any changes that are proposed.

2. Levy Estimate and Parameters for 2014/15

2.1 Introduction

2.1.1 The New Levy Framework (NLF) fixes the formula (parameters) for the levy, other than in specific limited circumstances, for the triennium covering levy years 2012/13 to 2014/15. Those circumstances are if it would:

- exceed the levy ceiling
- result in the scheme-based levy estimate exceeding the statutory maximum of 20 per cent of the total levy, or,
- vary by more than 25 per cent from the 2013/14 published estimate of £630 million.

2.1.2 The first two of the above 'triggers' are prescribed by legislation, as is the 'cap' contained within the third point (i.e. the requirement that the levy estimate for any year should not exceed the estimate for the preceding year by more than 25 per cent). The corresponding 'floor' is not a legislative requirement but was introduced as part of the NLF in order to provide some protection against under-collection during a levy triennium leading to unnecessary increases in later years.

2.1.3 We calculate the Levy Estimate for 2014/15 on the basis of unchanged parameters from 2013/14, using assumptions for data that has not been yet been captured (mainly on the basis of scheme returns), or is not yet known (as it includes data up to March 2014). We then consider whether the resulting estimate would breach any of the circumstances set out above. None have and so we are setting a Levy Estimate on the basis of unchanged parameters.

2.2 Our assumptions for 2014/15 Levy Estimate

2.2.1 Assumptions are needed because we produce the estimate well in advance of having any of the data that will be used in levy invoice calculations. Scheme return data and contingent asset certifications/re-certifications will not be submitted until March 2014; monthly failure score information will be used up until March 2014; and other information about deficit reduction contributions and block transfers is received later.

2.2.2 In setting our assumptions we have looked at experience of trends in previous years, market data where available and also sought input from a number of firms of actuaries, to take account of their views of scheme behaviour in the run up to 2014/15. It is always difficult to judge the setting of individual assumptions but taken together the Board considers that these assumptions provide a balanced view of the factors that may affect the total levy.

2.2.3 Existing scheme data, together with our assumptions, is used to estimate the impact of changes in areas such as the size and make up of the defined benefit universe, scheme funding, insolvency risk and PPF approved contingent assets on levy invoices. Our assumptions for

each of these areas are set out in more detail below and are generally consistent with the approach taken last year. Consultancy responses to our stakeholder questionnaire (relating to likely scheme behaviour over the period to the 2014/15 levy year) suggest that the maintenance of this approach is reasonable.

Changes in the defined benefit universe

2.2.4 Each year a proportion of schemes will cease to be eligible for the PPF levy. This may be because they have bought out their liabilities, or otherwise transferred them out of the levyable universe, or it may be because the scheme has entered an assessment period.

2.2.5 We have removed those schemes which have entered assessment to date in 2013/14. In addition we have removed from our assumptions some schemes whose particular circumstances mean that they are highly likely to enter assessment in the immediate future. We have incorporated a pro-rata allowance based on the actual impact in 2013/14 together with an allowance for schemes expected to be in assessment by March 2014. All else being equal, these adjustments act to reduce our Levy Estimate.

Changes in funding

2.2.6 Each year the funding risk of schemes will change as a result of market movements, new accrual and payments to reduce deficits. The assumptions for market movements (which are used when we roll forward and smooth scheme return data for invoicing) are particularly critical as these include the gilt yields used to discount liabilities, as well as the indices used to value assets.

2.2.7 To reduce volatility in invoice amounts arising from market movements, the calculation of the underfunding risk smoothes market conditions over a period of five years. As a result assumptions are required regarding market yields and indices over the period from the date on which the levy estimate is calculated up to 31 March 2014.

2.2.8 The Levy Estimate is particularly sensitive to this assumption. While gilt yields have increased recently, prompting an improved funding position for many schemes, they remain at a relatively low level. We have based our assumption for gilt yields for the remaining part of the five years from the date the assumption was calculated to 31 March 2014 on the most recent three months' data. We have also used this approach for other parts of the smoothing calculation.

2.2.9 In relation to new accrual since schemes' latest S179 valuations, our assumption is that this is balanced by regular payments into the schemes. This is unchanged from previous years.

2.2.10 In relation to payments certified to reduce deficits, we have assumed that payments made by schemes continue at the rate they have been made in the past two years. We have considered schemes that certified payments, and the date of their last s179, in order to forecast what their certification will be by the end of April 2014 on current trends. This assumption is based on the three year cycle of actuarial valuations which typically determines the contribution levels to be set for the next three years.

2.2.11 Investment risk forms a part of the assessment of scheme funding in the NLF meaning that for 2014/15 we need to consider assumptions about:

- shifts in the asset mix between reporting in 2013/14 and the data that will be collected in the Pension Regulator's Exchange system for 2014/15, and
- the impact of bespoke stress tests, which the largest schemes must carry out, and which a proportion of other schemes choose to do, where this would better reflect risk reduction measures.

2.2.12 There is little reason to expect a substantial shift in investment strategies amongst the majority of schemes so we have assumed that the asset mix of schemes as reported by March 2014 will be the same as the mix for 2013/14.

2.2.13 In 2013/14 the submission of bespoke stress information had the effect of reducing levies by £12 million. In 2013/14 we saw an increase in the number of schemes that submitted voluntary bespoke calculations. We have assumed that for 2014/15 the same schemes will submit voluntary returns.

Changes in insolvency risk

2.2.14 We also need to make assumptions in relation to the failure scores that underlie our measurement of insolvency risk, since these are collected for the year to end of March 2014, and may change after that date if there is an appeal in relation to the score.

2.2.15 Last year we assumed that the average failure score over the period April 2012 to March 2013 (used in the 2013/14 levy) would remain the same as for the preceding year. Overall failure scores were higher than expected. We consider that schemes may now have taken most steps possible to improve failure scores and the estimate for 2014/15 therefore assumes that average failure scores from April 2013 to March 2014 will remain in line with the actual average scores from April 2012 to March 2013.

2.2.16 In estimating changes in D&B appeals we have drawn on recent actual experience.

Year	Reduction in levy collections (£m)
2010/11	47
2011/12	34
2012/13	26

2.2.17 We have seen a marked downward trend in the total impact of D&B appeals. As noted above, we think that schemes may have taken most steps they could to improve failure scores and so we have assumed that D&B appeals will now level out, reducing levy collections by £26 million (the 2012/13 figure) in 2014/15.

2.2.18 We have assumed that other changes to data (i.e. those not pertaining to insolvency risk) will continue to have a very limited effect. We have assumed the experience of 2012/13 is repeated.

Contingent assets

2.2.19 We make assumptions both in respect of the recertification of existing contingent assets and the impact of new contingent assets.

2.2.20 In 2012/13 we saw a significant fall in both recertification and in new certificates. It was the first year that we introduced the guarantor strength certification requirements for trustees and the testing of some of the contingent assets to confirm whether the guarantor was able to meet the guaranteed amount.

2.2.21 A number of contingent assets certified for 2012/13 were not recertified for 2013/14, estimated to increase collections by £17 million. We have assumed that all those certified for 2013/14 will be recertified in 2014/15 – on the basis that no substantive change has been made to our Rules or Guidance.

2.2.22 We estimate that the impact of new contingent assets in 2013/14 will reduce levy collections by around 1.5 per cent, or £10 million. We have assumed a similar impact for 2014/15.

2.2.23 We expect rejected contingent assets (arising from the testing of guarantor strength exercise) for 2013/14 to result in approximately £8 million of levy collection. No allowance has been made for 2014/15 as we expect that by then schemes will have been deterred from certifying guarantees at a level where the guarantor's ability to pay would be in doubt.

2.3 Our levy parameters and estimate for 2014/15

2.3.1 Our analysis indicates that with unchanged levy parameters from 2013/14, then, based on the assumptions set out in the previous sections, the Levy Estimate for 2014/15 will be £695 million. This represents an increase of around 10 per cent on the 2013/14 estimate (of £630 million).

2.3.2 This amount is well within the legal limit of a 25 per cent increase in the estimate year to year. We indicated last year that an increase was expected in 2014/15 and that we would not hold down levies again if risk increased. Therefore we are setting the Levy Estimate for 2014/15 at £695 million.

2.3.3 We have reviewed the other levy parameters (investment risk stress factors, levy rates etc) as we do annually. We have concluded that these remain appropriate, in the context of our desire to maintain stable rules. There will therefore be no changes to the parameters. All of the levy parameters will be reviewed next year for the 2015/16 levy, which forms the first year for the second levy triennium.

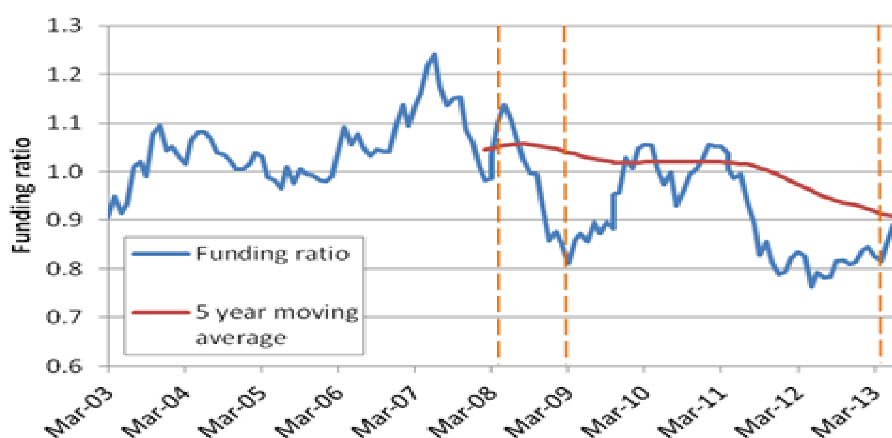
2.4 Scheme Funding and the Levy

2.4.1 The Board has not considered its funding position in setting the 2014/15 Levy Estimate. However we report here on movements in funding as this helps explain why the Levy Estimate is rising at a time when the PPF 7800 index has risen.

2.4.2 Although there has been some improvement in scheme funding on a s179 basis for our universe of schemes since May 2013, the funding ratio in July, at 91 per cent, was still well below the historic average since 2003 (96 per cent). Indeed, the five year moving average of the funding ratio, relevant for the PPF levy, has continued falling, the 91 per cent in July 2013 representing a record low reflecting exceptionally low gilt yields. This helps illustrate that the impact of smoothing is that when scheme funding is worsening the full impact can be lessened and delayed, and vice versa when it improves.

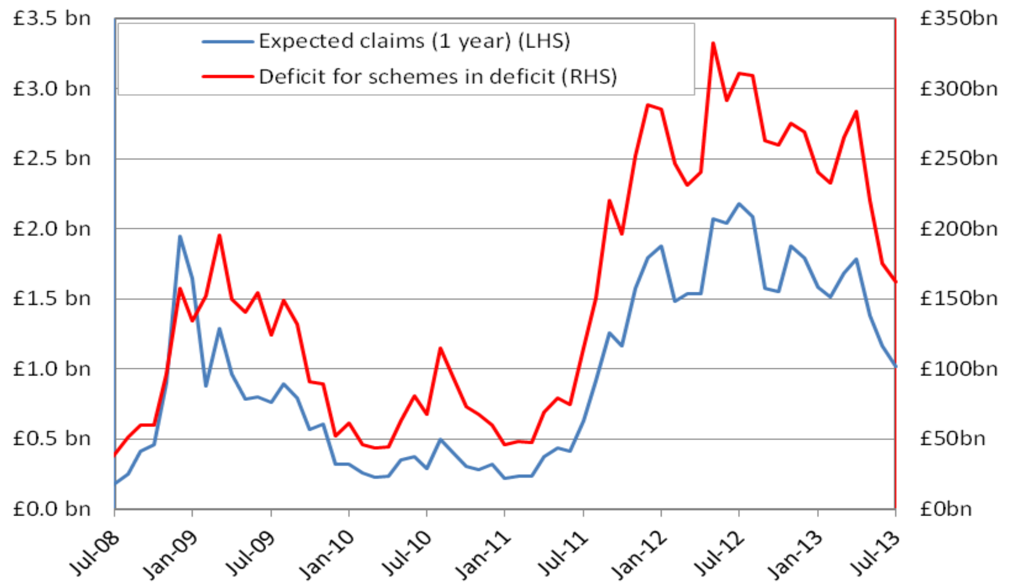
2.4.3 This effect can be seen in chart 1 below, and is a result of funding for the year 2013/14 replacing funding for the year 2008/09 in the five year average to March 2014.

Chart 1: Estimated aggregate funding ratio (assets divided by s179 liabilities) for schemes in the PPF universe



2.4.4 Insolvency risk has been broadly unchanged over the last year. The 1-year ahead insolvency probability for the company sponsors of our 500 biggest risks fluctuated between 0.6 and 0.7 per cent. Meanwhile the aggregate deficit of schemes in deficit has fallen from £310 billion to £160 billion over the same period. Combining this unchanged insolvency risk and the lower deficit of schemes in deficit means that our expected annual claim amount before recoveries has fallen compared with summer 2012, but still remains high at around £1 billion.

Chart 2: Deficit of schemes in deficit and 1-year expected claims



3. Draft 2014/15 Levy Rules

3.1 Overview of Determination and Appendices

3.1.1 There are no major changes proposed to the levy rules for 2014/15, consistent with our policy objective to maintain stability in the levy rules for the three years of the levy triennium (2012/13 – 2014/15), where possible.

3.2 Proposals for change in 2014/15

Contingent Assets

3.2.1 We have however reviewed the requirements for recertifying contingent assets and are proposing a simplification. In the past it has only been possible to recertify a contingent asset if it was certified in the immediately preceding levy year. This has led to a practice of recertifying even where it makes no difference to a scheme's levy, in order to avoid having to undertake the more onerous certification and submission as a new contingent asset in a later year. Instead, we propose to allow schemes to recertify where they have certified in any previous levy year (providing the last certification/recertification was not more than five levy years previously) and the underlying guarantee has been in place throughout the intervening period, without having to re-submit all the papers that would otherwise be required for a new certification.

3.2.2 It is our intention that the Exchange system will be changed to allow schemes to roll forward a contingent asset from a previous levy year. If such a systems change is not possible prior to the issue of the final Determination, it will remain our intention to allow schemes to resubmit such contingent assets but the Levy Rules will be changed to allow such a submission to be carried out on Exchange as a new contingent asset certificate but without all the attendant documentation requirements for a new contingent asset.

Question 1: Do you agree with our proposal to allow re-certification where certification or recertification has occurred not more than five levy years previously?

3.2.3 We have also altered the certification that scheme trustees give in relation to the resources of the guarantor, to meet stakeholder concerns about the previous language. Stakeholders advised us that some trustees were concerned about the opening part of the trustees' certification 'The trustees have no reason to believe…' required in 2012/13 and 2013/14. It was felt this could act as a block to certification where perhaps an isolated negative factor was known by the trustees but was outweighed by a number of positive factors. While the overall view could be positive, the inclusion of the words 'no reason' might lead some trustees to conclude they could not certify.

3.2.4 A revised version has been shared with a group of stakeholders and now forms part of this consultation. The proposed new wording would 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 its full commitment under the contingent asset as certified, having taken account of the likely impact of the immediate insolvency of all of the relevant employers."

3.2.5 We believe that this revised wording remains consistent with our 2013/14 guidance on certification and do not expect it to affect the way in which trustees consider the value of the guaranteed amount or the assessment of the guarantor (outside of the issue highlighted above) provided that trustees have been following that guidance. As our guidance makes clear we consider that "trustees need to be comfortable (i.e. rather than certain) that the guarantor could meet its full commitment under the guarantee if called upon to do so." (2013/14 Contingent Asset Guidance). With this in mind, we have also changed the current requirement for trustees to certify that they "believe" the guarantor is able to meet its full certified commitment to the trustees "are reasonably satisfied" that the guarantor could do so[3]. We have also included in the draft an express reference to two of the key points first made in the 2013/14 guidance, and included in our revised draft for 2014/15.

- The need for trustees to investigate the guarantor's financial position before certifying.
- The need for trustees making "reasonable enquiry" to consider the impact of the employer's insolvency on the guarantor's ability to meet its certified commitment.

3.2.6 What constitutes "reasonable enquiry" to ensure trustees are "reasonably satisfied" will be very specific to the circumstances of individual schemes and we will not publish prescriptive requirements that trustees should follow. Trustees should refer to the guidance, which already provides examples of the investigations we believe trustees should consider in order to feel comfortable that they can give the certification.

3.2.7 Whilst these points are new to the Determination, they do not change our existing approach in relation to what trustees should do before providing the certification, but simply now mirror the points contained in our current Contingent Asset Guidance.

Question 2: Do you agree with the proposed re-wording of the trustees' certification? Would you favour implementation of a change of wording in 2014/15 or prefer a delay to 2015/16?

[3] The PPF carries out its own assessment of a selection of certified Type A contingent assets to ensure that they meet the terms of Rule G2.3 - to ensure any levy reduction is consistent with the risk reduction that results. There has been no change to this rule from 2013/14 and the draft Contingent Asset Guidance explains how the PPF carries out its assessment.

3.2.8 In considering any change to this certification, we are aware that guarantor strength checking is a relatively new area and that trustees and advisors have had to modify their approach as we have developed the rules. We are therefore aware that some stakeholders may favour maintaining the existing wording – with its limitations – with which they are familiar. However it is clear that introducing guarantor certification has had a substantial effect in removing dubious guarantees from the system. We would welcome specific feedback on this.

3.2.9 The second triennium (beginning in 2015/16) may offer an opportunity to review aspects of the contingent assets processes/requirements raised by stakeholders and so we consider further change for 2014/15 unnecessary.

D&B: Non-UK Failure Scores

3.2.10 D&B have updated their Foreign Probability Comparison Table for 2014/15 (which converts non-UK Failure Scores between April 2013 and March 2014) with respect to Denmark, Sweden and Hungary. The new equivalent UK Failure Scores can be found within the draft Insolvency Risk Appendix.

3.2.11 We have been advised by D&B that they expect to make a change to the conversion scores for the Netherlands very shortly. While there is generally an advantage to having a single conversion score for the whole levy year, in this case we expect the new scores to apply for six or seven months. We therefore intend to use the updated scores for the months that they apply, providing we receive the updated information prior to finalising the Determination. We will publish the revised table for the Netherlands on our website as early as we can.

3.2.12 As a general point, schemes and advisers are reminded that the data sources used by D&B to calculate Failure Scores and equivalent measures vary from country to country, depending among other things on the local reporting requirements. It is therefore important to be aware of the local factors that will (and will not) be taken into account in calculating scores. Information can be obtained directly from D&B in this regard.

Legislation recharacterising money purchase benefits

3.2.13 In August 2011 DWP undertook to introduce legislation which would recharacterise some benefits formerly considered to be money purchase, following the Supreme Court decision in Houldsworth and another (Respondents) v Bridge Trustees Limited and another (Respondents) and Secretary of State for Work and Pensions (Appellant) (the "Bridge case"). Section 29 of the Pensions Act 2011 is expected to be brought into force during 2014, together with regulations setting out the detailed requirements.

3.2.14 When those regulations do come into force, this is likely to affect (increase) the defined benefit liabilities, and hence the overall s179 liabilities, of some schemes.

3.2.15 We have discussed the development of these regulations and in particular their impact on the levy with DWP. The detailed regulations

will be put out for consultation by DWP in due course. This may mean that we need to provide in the Determination for the ability to review levy calculations for 2014/15 to take into account the impact of these regulations. At this time it is difficult to take a firm view of the effect of the proposed legislative changes.

3.2.16 As a result we have not yet included the proposed drafting for a rule, but if appropriate will do so in the final Determination for 2014/15. Such a rule change would need to allow us to be able to take account of new information about the valuation of affected schemes, where it is appropriate to do so.

Question 3: We would welcome suggestions or comments based upon this approach. We would also welcome comments on the impacts of such an approach.

Publication of draft guidance

3.2.17 In a change from 2013/14 we are publishing our draft guidance with the draft Levy Rules. Formally speaking, the guidance does not form part of the rules, and so we don't consult on it. But following experience last year when the late publication of some contingent asset guidance material caused difficulties for some schemes wishing to recertify, we believe that early publication will help schemes have clarity sooner on how to meet the rules, and also provide an opportunity to comment on anything which is unclear or not explained. The Board does not necessarily intend to repeat this approach in the future.

3.2.18 Revisions to the guidance are primarily intended to remove repetition or clarify points already made.

Question 4: Please include any comments on the draft guidance with your response to the consultation, distinguishing clearly between comments on the consultation and those on the guidance.

3.3 Issues from the 2013/14 consultation

3.3.1 In the 2013/14 Policy Statement we identified two areas that were raised in the responses to the consultation that we would consider further.

Custodian requirements

3.3.2 In 2013/14 we reduced the credit rating for an 'Acceptable Financial Institution' from AA- to A-. This affected the issuers of letters of credit or bank guarantees (Type C contingent assets) and also custodians of Type B (iii) contingent assets – security over securities. While this change was generally welcomed, it was suggested that any credit rating requirement was unnecessary for custodians and that the terms of the custody agreement should be considered instead.

3.3.3 We said that we would look at whether there was evidence of schemes experiencing difficulty in submitting Type B (iii) contingent assets in

2013/14 despite the reduction in the rating requirement and then consider whether further changes were necessary.

3.3.4 The use of Type B (iii) contingent assets has been very limited over several years. Within that context the change made for 2013/14 has encouraged an extension of their use.

3.3.5 We are not aware of a significant number of schemes that would want to put such contingent assets in place were the credit rating requirement dropped.

3.3.6 Given the limited demand for such a change we do not propose to make a change for 2014/15 but if any scheme who favours such a development is willing to take the lead in preparing draft documentation suitable for general use we are willing to consider proposals for future years (as an alternative to the current arrangements including the A- credit rating requirement). We would consult on any new terms and documents that might result.

D&B Parental Risk Override

3.3.7 We received representations during the 2013/14 consultation about the way in which the failure score of employers can be affected where their global or domestic ultimate parent company is at severe risk of insolvency.

3.3.8 Employers whose ultimate parent is at severe risk of insolvency get their failure score over-ridden, on a specific PPF basis, in the month(s) concerned if the parent is still at severe risk at the year end.

3.3.9 The submissions we received in the 2013/14 consultation said that Part 3.1 (f) of the Insolvency Risk Appendix should either be removed or 'revised so that companies would only have their Failure Scores overwritten where D&B would apply such an adjustment to their publicly quoted Scores'. It was claimed that the focus on the position of the parent at the end of March was not consistent with the general principle of averaging Failure Scores more generally when calculating insolvency risk in the risk based levy. It was also stated that there were issues of transparency and ease of checking D&B scores.

3.3.10 We have explored suggestions made by two of the respondents. We explored the possibility of a simplification of the rule which retained the principle that parental weakness has an impact on the employer. However this would be likely to increase the proportion of schemes affected by the override and it would seem undesirable to make a change after most of the insolvency data on which the 2014/15 levy will be based has been collected.

3.3.11 In addition, our announced change of insolvency risk information provider means that we are not attracted to making changes to the insolvency risk rules that would only last for a single levy year. The work we are currently doing with Experian will include consideration of how their systems will take account of parental weakness.

4. Impact Analysis

4.1 Introduction

4.1.1 This chapter considers the impact of our proposals for 2014/15 on individual schemes' levies by comparison with the previous levy year.

4.1.2 As set out in section 2, keeping the parameters constant for 2014/15 results in a Levy Estimate of £695 million, an aggregate increase of 10 per cent on the previous year.

4.1.3 Levy increases at the individual scheme level are expected on average to exceed the 10 per cent increase in the Levy Estimate. This is primarily due to reductions in the defined benefit universe and the impact of factors that cannot be assigned to specific schemes such as new contingent assets and data corrections.

4.2 Comparison of 2014/15 with expected bills for 2013/14

4.2.1 Schemes are now beginning to receive their 2013/14 levy invoices. Accordingly, we have focused our assessment on how anticipated levies based on our levy estimate for 2014/15 compare with the levies actually or expected to be invoiced in the next few weeks. For these purposes we assume that contingent assets validly certified for 2013/14 remain in place unchanged for 2014/15.

4.2.2 Comparing the projected levy payments for 2013/14 and 2014/15 shows that:

- around half of schemes will see a levy increase of 15 per cent or less
- around a fifth of schemes see increases of over 25 per cent in their levy. However, as discussed below, those with large percentage increases are generally still paying comparatively low levies, and
- around 4 per cent of schemes will see a levy reduction.

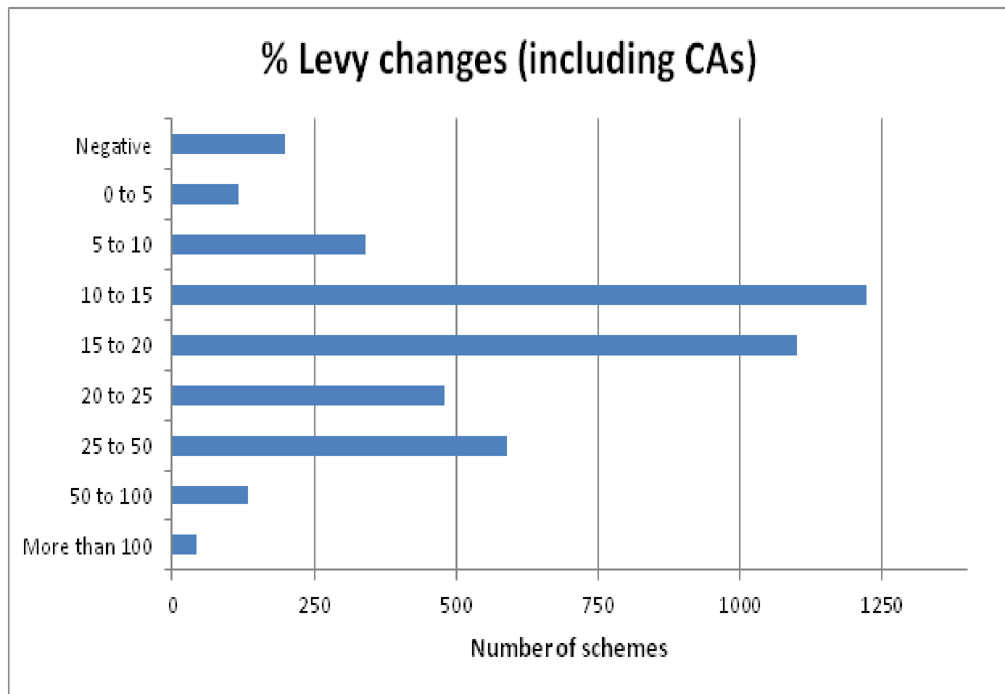
4.2.3 Changes to levies are driven by the impact of declining funding (and increases in liabilities) on the individual scheme.

4.2.4 Schemes that will see the greatest proportionate increase in their levy are those who were close to 100 per cent funded [4] in 2013/14 and for whom a decline in funding is expected during 2014/15. There are around 1000 schemes in this category. For these schemes a small decrease in funding can have a big percentage impact on deficit and hence levy; however these impacts are on a low base levy. So, whilst the increases average 53 per cent for this group of schemes, the levy income from this group represents only £11 million in aggregate.

4.2.5 The graph below shows the distribution of the percentage levy change for all remaining schemes. These schemes will on average see an

[4] These schemes will therefore have paid no or a very small risk-based levy in 2013/14. None pay more than £2500 in 2013/14.

increase of just under 14 per cent. Actual increases for individual schemes will depend on their individual circumstances, for example their actual investment split.

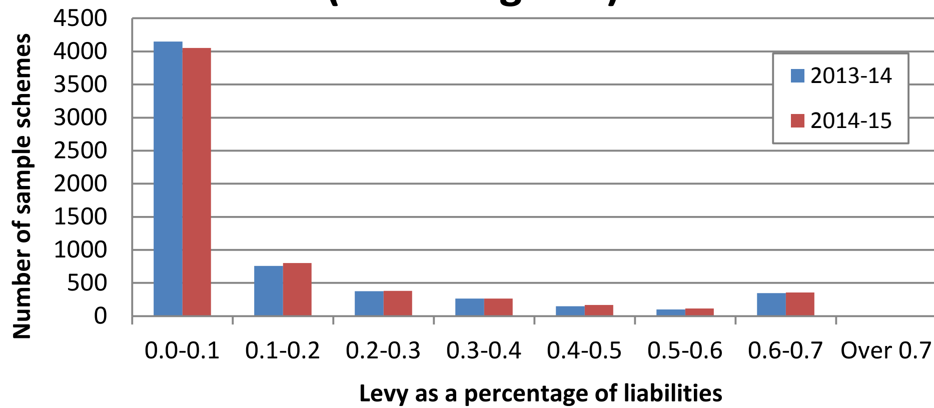


4.2.6 Within this group, a group of schemes that see higher increases are those that have a contingent asset which will not cover their full (2014/15) underfunding. The extent of the increase will depend on how much of the increase in underfunding is assessed at the sponsor's insolvency risk compared to last year. In total 167 schemes were identified as falling into this category, of which 67 see an increase greater than 25 per cent and a further 17 are between 20-25 per cent.

4.2.7 Also within this group we have approximately 350 schemes whose levies are expected to be capped in 2014/15 and 976 schemes which pay no risk-based levy due to high funding. Both these groups will see their levy rise by around 12 per cent, reflecting the increase in liability values which for any given scheme increases both its levy cap and its scheme based levy.

4.2.8 The extent to which rises in individual levies are a result of the increase in scheme liabilities caused by continued low gilt yields can be seen from the following chart. This shows that relative to liabilities[5], the levy has remained highly consistent in 2014/15 compared to 2013/14.

[5] Liabilities expressed on a stressed and smoothed basis.



4.2.9 The average, across all schemes, of levy as a percentage of stressed liabilities is expected to be 0.14 per cent (or 0.16 per cent of unstressed liabilities) in 2014/15 compared to 0.13 per cent in 2013/14.

5. Consultation Arrangements and Key Dates

5.1 Introduction

5.1.1 This chapter provides contact details to respond to this consultation. Key dates for the calculation of 2014/15 levies are also set out below.

5.2 Summary of Consultation Questions/Issues

Q1	**Do you agree with our proposal to allow re-certification where certification or recertification has occurred not more than five levy years previously?**
Q2	**Do you agree with the proposed re-wording of the trustees' certification?** **Would you favour implementation of a change of wording in 2014/15 or prefer a delay to 2015/16?**
Q3	**We would welcome suggestions or comments on our proposed approach in relation to the "Bridge" case.** **We would also welcome comments on the impacts of such an approach.**
Q4	**Please include any comments on the draft guidance with your response to the consultation, distinguishing clearly between comments on the consultation and those on the guidance.**

5.3 Consultation Arrangements

5.3.1 The consultation on the 2014/15 Determination will run from 5 September 2013 to 5pm on 24 October 2013. Please ensure that your response reaches us by the deadline. Submissions may be made by email or post, using the details below.

Email: consultation@ppf.gsi.gov.uk

Postal address: Chris Collins
Chief Policy Adviser
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon, Surrey
CR0 6SR

5.3.2 Please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear who the organisation

represents and, where applicable, how the views of members were assembled.

5.3.3 Under the Freedom of Information Act 2000 (FoIA), all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication.

5.3.4 If this is not the case, the respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with FoIA obligations and general law on this issue. Further information can be found on the website of the Ministry of Justice at:

http://www.justice.gov.uk/guidance/freedom-and-rights/freedom-of-information .

5.3.5 A summary of responses and the Board's final Determination and confirmed policy will be published on the PPF website at:

http://www.pensionprotectionfund.org.uk in December 2013.

5.4 Key Dates

5.4.1 Under the new framework, we will continue to use information from the annual scheme return that is submitted via the Pension Regulator's Exchange system to calculate levies. The deadline for submission is 5pm on Monday 31 March 2014, except as detailed below.[6]

Item	Key dates
Monthly D&B Failure Scores	Between 30 April 2013 - 31 March 2014
Submit scheme returns on Exchange	By 5pm, 31 March 2014
Reference period over which funding is smoothed	5-year period to 31 March 2014
Certification of contingent assets	By 5pm, 31 March 2014
Certification of deficit-reduction contributions	By 5pm, 30 April 2014
Certification of full block transfers	By 5pm, 30 June 2014
Invoicing starts	Autumn 2014

[6] This document was updated on 25 September 2013 to correct typographical errors, concerning the main measurement date, so that it matches the dates in the draft Determination.

5.5 Comments on the Consultation Arrangements

5.5.1 This consultation is being conducted in line with the Cabinet Office's Consultation Principles that can be found on their website at:

http://www.cabinetoffice.gov.uk/resource-library/consultation-principles- guidance

5.5.2 The Board would welcome feedback on the consultation process. If you have any comments, please contact:

Richard Williams
Head of Corporate Affairs
Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
CR0 6SR

Email: Richard.williams@ppf.gsi.gov.uk