Guidance in relation to Asset-Backed Contributions

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Glossary

Part 1. Overview of the asset-backed contribution (ABC) regime

This Guidance relates to the Levy Rules and the ABC Appendix and is intended primarily for advisers involved in the valuation and certification of ABCs. A glossary is provided at the back which provides a simplified explanantion of some key concepts used in this Guidance and in the Levy Rules Appendices. These terms are written in bold where they first appear in this guidance.

The Board's objectives

1.1 The Board's key objective in terms of **ABC Arrangements** is to ensure that they are treated for levy purposes in a way that best reflects their value – thus contributing to a fair levy allocation. To achieve this overall aim, the Board has the following specific objectives:

1.1.1 To attribute a value which it believes could be relied upon to form part of the scheme assets in the event that an insolvency event had occurred in respect of the **Employers** and **PPF Guarantors;** and

1.1.2 To give schemes that have entered into ABC Arrangements the opportunity to obtain appropriate credit for these in assessing their RBL.

1.2 The Board is mindful that ABC Arrangements are bespoke arrangements. It is therefore appropriate to place responsibility for setting most of the appropriate assumptions with advisers, rather than the Board making standard assumptions.

Why are we not giving "going concern" values to ABC Arrangements?

1.3 The PPF operates in a particular context (i.e. insolvency) and it is therefore appropriate for it to assess distribution of levy in that context. As such, it is reasonable that the value of a scheme asset for levy purposes can differ from the "going concern" accounting value stated in the scheme accounts - even if that might result in an asset having no or a trivial value for levy purposes.

1.4 ABC Arrangements are generally related to the Employer's (or group's) business[1]. Therefore, in the insolvency context, the risks associated with investments of this nature are higher than those associated with other, unrelated, scheme assets. The Board has decided to focus on the amount the trustee could expect to realise from that investment in an insolvency situation. The Board would expect that the value of the underlying ABC Asset will play an important part in valuing the trustee's investment.

[1] Note, the Board is not expressing a view on the technical legal definition of employer-related investments here, but is merely commenting on the position in practice.

1.5 For this reason, in very broad terms, the Board's approach to ABC Arrangements will be to start by excluding the value attributed to them in the assets data used for levy purposes (usually the scheme accounts which feed into the latest s179 valuation). If full information is not available to allow the Board to do this, then approximate data or prudent assumptions will be made.

1.6 Following that, the Board will seek to add back in the value of the ABC Investment calculated on the insolvency basis referred to above (subject to a maximum value as explained in paragraph 2.8(a) of this Guidance). This is referred to as the **ABC Value**. In addition, credit will be given for any **ABC Payments** actually made to the scheme between the date of the actuarial valuation used for levy purposes (the **Levy Valuation**) and the Latest Scheme Accounts date.

What this Guidance covers

1.7 This Guidance primarily covers the process of obtaining a valuation of the **ABC Investment** on the insolvency basis referred to, and the requirements and confirmations required to be given in the **ABC Certificate** in order that the ABC Value may be taken into account in setting the relevant levy for the 2016/17 levy year.

1.8 It also covers what schemes can do if they don't wish to seek credit for their ABC Value but do wish to seek credit for the ABC Payments that have actually been made from the ABC Arrangement, and/or if they wish to ensure that the amount attributed to the ABC Arrangement in the levy calculation (i.e. the amount deducted from the scheme assets) is accurate. See section 8 for further details. It also covers one rare scenario where no credit can be given (where the ABC Arrangement is entered into after the date of the Levy Valuation and is funded by existing scheme assets – see para 2.10).

1.9 This Guidance supplements the Board's Determination under s175(5) of the Pensions Act 2004 (the **Determination**), in particular, the Levy Rules and the ABC Appendix and should be read in conjunction with those documents. In the event of any conflict between the Determination and this Guidance, the Determination will take precedence.

1.10 General guidance on the allocation between different asset categories (including a general description of the key characteristics of each asset category and some examples) is included in the "help file" accessible on **Exchange** (Asset Breakdown section of the Scheme Return) and in the Appendix to the Board's Investment Risk Guidance. There are also some examples given in part 3 of this Guidance.

Part 2. The Board's requirements in relation to ABC Arrangements

What does the trustee have to do to get credit in the levy for the ABC Value?

2.1 To have the ABC Value taken into account in the levy, the trustee will need to go through a number of steps.

2.2 First of all, the trustee will need to provide certain mandatory information such as the name of the partnership it has its interest in.

Stripping out the ABC

2.3 Next, we will be asking for confirmation of the value attributed to the ABC Investment in the assets that feed into the Levy Valuation, so that we know the correct amount to exclude (prior to smoothing and stressing scheme assets as part of calculating underfunding). This is called the **s179 ABC Amount**. So, the trustee will need to confirm the value attributed to the ABC Investment in the assets for the purposes of the Levy Valuation.

2.4 In most cases, that will be a s179 Valuation, but it may be that it is a Post-Transfer Valuation which has already been provided for a previous levy year when the ABC Certificate is being submitted. A Post-Transfer Valuation is used where there has been a Block Transfer (i.e. scheme merger) to which Part F of the Levy Rules applies. See section 10 for further guidance on block transfers.

2.5 Note that, in some circumstances (e.g. where the ABC Arrangement has come into effect after the date of the Levy Valuation) this value may be nil. However, in these circumstances, we will be asking the trustee to certify whether existing scheme assets have been used to purchase the ABC Investment. See further 2.9 below. Where existing scheme assets were not used to purchase an ABC Investment that post-dates the most recent valuation, no adjustment will be made to that valuation to reflect any ABC value.

2.6 Where a scheme has reported an ABC Arrangement on Exchange but we do not receive a certificate, we will use valuation information on Exchange or, in the absence of that, make a conservative assumption[2] as to the value attributed to the ABC Investment for the purposes of excluding it from the assets that feed into the levy calculation. We also need to know if any payments relating to an ABC Arrangement (e.g. the initial set up contribution) have been included in a previous **DRC** certificate and would ordinarily be carried forward.

[2] the assumption is to reduce the assets by 25%.

Coupons

2.7 Coupon Payments recognised will depend on the individual circumstances[3]:

- Where the ABC Arrangement is entered into after the date of the Levy Valuation and is funded by existing scheme assets, no Coupon Payments will be recognised.
- Where the ABC Value certified is nil, Coupon Payments made after the date of the Levy Valuation up to 31 March 2016 can be recognised, if reported on the certificate.
- Otherwise, only Coupon Payments made after the date of the Levy Valuation up to the "as at" date of the Latest Scheme Accounts will be recognised as there will otherwise be double counting in relation to payments falling after this date.

We will reduce the Scheme underfunding by the amount of the ABC Payments we recognise.

Credit for Value of the ABC

2.8 Finally, to get credit for the value of the ABC Investment itself, the trustee will need to certify the ABC Value. To do that, they will need to obtain an annual valuation from an appropriately qualified valuer and submit a voluntary certificate. The certificate is available on the PPF website and includes the information and confirmations listed in the ABC Appendix. The ABC Value that the trustee will be certifying is the lower of:

(a) the **Fair Value** – usually this is the value attributed to the ABC Investment in the Latest Scheme Accounts. However, the Board will allow an amount calculated at the same date and on the same basis, but with any allowance for the credit risk relating to the Employers and PPF Guarantors removed, provided that amount is included within the advice that is covered by the duty of care wording set out in section 6.

(b) the **Stressed Insolvency Value** - the amount the trustee could reasonably rely upon recovering, pursuant to its rights under the ABC Arrangement, in an insolvency situation, taking into account the standard PPF stresses when valuing the **ABC Asset**.

All the calculations should be carried out as at the date of the Latest Scheme Accounts. Further details on how to do the valuation in (ii) are set out at part 3 of this Guidance below.

2.9 Where the ABC Investment has been purchased after the date of the Levy Valuation, it will (in most circumstances) still be possible to obtain credit for the ABC Arrangement.

(a) Where the ABC Arrangement has been entered into after the date of the most recent Scheme Accounts, the trustee will either need to bring forward their accounting reference date, or will need to obtain a special purpose set of audited

[3] Note, where there is also a block transfer, section 10 should also be considered.

accounts or a report based upon agreed-upon procedures from an appropriately qualified independent audit professional (so that they can assess the "fair value" element of the valuation). They will also need to obtain the stressed insolvency valuation as described below, as at the same date as the "fair value" element. In these cases, the valuation date should be the date the ABC Arrangement was entered into.

(b) If the ABC is entered into after the date of the Levy Valuation, the trustee will also need to confirm that existing scheme assets were not used to purchase the ABC Investment (in other words, that the ABC Investment has been funded in full by the Employer or its group). If existing scheme assets have been used then the ABC Arrangement will not be able to receive credit (and neither will credit be given for ABC Payments) until the scheme's next Levy Valuation.

2.10 The trustee must certify the ABC Value, ABC Payments and Actual s179 ABC Amount annually. It should be noted that the same approach to deadlines will be taken in relation to **ABC Certificates** as to other certificates/submissions required for levy purposes. **The deadline for submission of ABC Certificates is 31 March 2016.**

2.11 Where a Scheme has more than one ABC Arrangement, a separate ABC Certificate must be completed for each ABC Arrangement. The Board will sum the relevant amounts (e.g. the ABC Value, the ABC Payments and the s179 ABC Amount) when it comes to calculate the levy.

Recertification of ABCs

2.12 Where an ABC Arrangement has been recognised in the previous levy year, it can be recertified for levy recognition for the 2016/17 levy year. Trustees will however still need to Submit an ABC certificate by the Measurement Time.

2.13 Where an ABC Arrangement is to be recertified, trustees must obtain a valuation for the purposes of the recertification. This valuation may either be an updated version of the existing valuation or a full valuation. It is the responsibility of the valuer to decide whether an updated valuation or a full valuation is required in the circumstances, based on their assessment of the ABC Value since the ABC Arrangement was last certified.

2.14 The valuer, in providing a valuation for the purposes of recertification, must also:

(i) confirm that the previous valuation of the ABC Asset was taken into account;

(ii) opine on the current value of the ABC asset; and

(iii) accept a duty of care to the Board in providing the valuation.

2.15 Where the valuer is of the opinion that an updated version of the previous valuation is appropriate, rather than a full valuation, they must also set out the basis for their opinion when providing the updated valuation.

2.16 The circumstances in which an updated version of the previous valuation may be appropriate will vary from scheme to scheme. For example, the valuer may consider that this is appropriate where the assets are unchanged since the last valuation, a full valuation has been undertaken in the last three years, or where the ABC Value to be certified is the

Fair Value, on the basis that the Stressed Insolvency Value exceeds the Fair Value to the extent where a change in the former is unlikely to impact on the ABC Value.

2.17 However, it is ultimately for the valuer to decide what form of valuation is appropriate based on their own assessment. The Board is unable to offer prescriptive guidance on this point.

2.18 If (a) there has been any amendment to the terms of the ABC Arrangement, or (b) the trustees are aware of any other matter, which in each case may materially affect the basis upon which the legal advice previously supplied to the valuer was given, revised legal advice must be obtained by the trustees and be supplied to the valuer in substitution of the pre-existing legal advice, for the purposes of producing the valuation.

2.19 Where the underlying legal position has not changed since the ABC was last certified, the ABC Valuer may continue to rely on the previously supplied legal advice provided that the legal advisers confirm that their previous advice remains current and that no changes have been made to the terms of the ABC Arrangement which may materially affect the basis on which that advice was given.

Part 3. What should be taken into account in assessing the Stressed Insolvency Value of the ABC Investment?

3.1 In assessing the Stressed Insolvency Value, the **ABC Valuer** and any other relevant professionals – see parts 4 and 5 - should be instructed to use his or her professional expertise and knowledge (and, as necessary, that of other relevant professionals), taking into account relevant considerations relating to the specific ABC Investment, including the following[4].

3.2 In making the assumption that all the Employers and all PPF Guarantors have suffered an insolvency event (for PPF purposes) the full range of scenarios should be considered (subject to paragraph 3.14 below). There may be a range of scenarios in which an insolvency event occurs, each of which may be more or less likely and have different impacts on the Stressed Insolvency Value and which should be factored into the valuation process to produce a balanced and realistic valuation[5]. For the avoidance of doubt, it would be inappropriate to exclude from consideration a scenario where insolvency is connected with the fundamentals of the business that is paying the rent/royalty/licence income.

3.3 In order to reach the balanced and realistic valuation, the Board would expect the valuer to make an appropriate assumption about the level of dividend (if any) that might be available for unsecured creditors following the insolvency events suffered by the Employers and PPF Guarantors. Valuers should carefully assess all relevant factors (such as the amount of secured debt) that might affect this and seek advice from other professionals (such as insolvency practitioners) if appropriate.

3.4 Where there is a wider group involved in the ABC Arrangement, the impact on that wider group of the insolvency of all the Employers and PPF Guarantors should also be considered. Insolvencies across corporate groups are often highly correlated. An assumption that the wider group (or parts of it) will remain solvent is only appropriate if it is reasonable to regard the risk of insolvency spreading or occurring in relation to that wider group as very remote.

3.5 Finally, for the avoidance of doubt, the level of *risk* of insolvency per se is not part of the calculation. What the Board requires is an *assumption* of insolvency (even where there may be considered to be a very low risk). Insolvency risk itself is taken into account elsewhere in the levy formula.

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[4] Note, this list is not intended to be exhaustive. Additionally, it is recognised that different professionals may need to take different subsets of the considerations set out in this section 3 into account – some may be more relevant to the ABC Valuer and others to the Asset Valuer or Appropriate Solicitor.

[5] It has been suggested to the Board that one approach might be to assess the likelihood of each insolvency scenario, assess the value that would be recovered in each and then apply a weighted averaging approach. This type of approach would appear reasonable to the Board, though there may, of course, be other reasonable approaches.

3.6 The trustee's powers to bring about a sale of the ABC Asset(s) on insolvency should be taken into account. So the basis of valuation must be consistent with the triggers for, and nature of, any trustee step-in rights (see further part 4).

3.7 The extent to which the ABC Asset(s) are separable from the Employer's/group's business and the practicality of selling them (and realising significant value) in an insolvency scenario should be considered. This might include considering, in the case of real estate, the number of possible buyers, particularly where the real estate is used for specialised purposes by the business. Equally, one might expect that, as a general rule, registered patents might be more likely to retain value than brands.

3.8 In a case where the ABC Asset is part and parcel of the value in the business (for instance, in the case of brands), the question of how to divide value between the business and the ABC Asset should be carefully considered. This may involve considering:

- whether business failure would mean that the ABC Asset is likely to be damaged; or
- whether the ABC Asset would continue to have customer value (e.g. in the case of brands, this might be more likely where the brand sits within a diverse brand portfolio).

3.9 The expected costs of realising the ABC Asset(s), including sale costs, prior or **pari passu** claims on the value of the ABC Asset[6] and care and maintenance of it during a marketing period should all be included.

3.10 In respect of non-UK ABC Assets, the costs and challenges of repatriation of the asset (or the sale proceeds) should also be considered.

3.11 The question of whether the ABC Asset is in an easily/immediately saleable state should be considered (e.g. immature products, parts of infrastructure assets may not be).

3.12 The amount of time it could take to dispose of the ABC Asset and any discount applicable as a result should be assessed. It should be assumed that the sale will need to be made quickly (i.e. within 6-9 months), so that it would occur within a typical administration period.

3.13 It should be considered whether there are contractual provisions that might generate a different value to that which the ABC Asset(s) could realise in a sale.

- there may be a limit on the trustee's total recovery (e.g. it may be capped at the deficit amount), regardless of the value of the ABC Asset(s);

[6] For example, the ABC Arrangement may involve more than one Scheme

- there may be other contractual provisions in place as part of the termination provisions which provide for a cash payment as an alternative.[7]

3.14 The valuation should initially be done on the basis that any wider market conditions which may result in an insolvency scenario within the Employer's Group remain as at the date of valuation, including the possibility of a sectoral downturn. There is, though, no requirement to assume that this is an insolvency in the context of a general economic downturn. For example, in valuing a large holding of a commodity it is not necessary to consider the possibility that the economic market (as opposed to the relevant sector) might generally have shrunk - valuation should be on the basis of current commodity prices. Conversely, the effect on the market price of seeking to dispose of a large holding should be considered.

3.15 The appropriate asset stresses (which the PPF applies to all assets when calculating the levy) should be applied for the purposes of valuing the ABC Asset(s) themselves. These are set out in paragraph 4.2 of the Transformation Appendix. This should be covered in the ABC Valuer's report, as advice may be needed to assess to which asset class the ABC Asset(s) should be assigned. The stresses should be applied <u>after</u> valuing the ABC Asset on the insolvency basis. The ABC Value certified should never be higher than the Insolvency Value of the ABC Asset(s), as stressed in this way. Clearly, when considering other contractual provisions which might limit the trustee's recovery to a fixed amount of cash, no stress need be added to that amount.

3.16 In order to assist, we have looked at some common ABC Assets and suggested the appropriate asset class to which the ABC Asset should be assigned for the purposes of applying those stresses. However, the trustee may still need advice on this subject in certain cases.

ABC Asset	Investment Risk Stress
Real Estate	Property
Brands/Intellectual Property	Other
Intra-Company loans	Non Government Bonds
Infrastructure	Other (unless another asset class is predominant – such as real estate)
Government Bonds	Government Bonds
Non Government Bonds	Non Government Bonds
Inflation linked Bonds	Inflation linked Bonds
Receivables	Other
Commercial loan portfolio	Non Government Bonds
Other	Other

[7] One example might be put/call options. Plainly, whilst these options could still be relevant, it is also possible that they might fall away on insolvency (and, if so, should be ignored) and it will also need to be borne in mind that the ability to exercise/benefit from them might be heavily limited in the insolvency scenario, by both financial and legal factors.

3.17 As will be apparent, in order to arrive at the balanced and realistic valuation, the valuer will need to draw upon not only his own professional expertise but also that of other professionals. As to which, see parts 4 and 5 below.

3.18 The complexity of the valuation process is expected to be heavily influenced by the complexity of the structure (and ABC Asset). The Board would expect a heavily over-collateralised ABC based on UK real estate, with a range of potential purchasers and strong step-in rights, to be more straightforward than more esoteric arrangements with weaker or less clear step in rights – especially where the value in the asset would depend much more critically upon the circumstances of the employer's insolvency.

3.19 It is acceptable for the valuer to make a prudent estimation of the ABC Asset's value. The valuer may certify the value of the ABC Asset as being "no less than £X", provided that the valuation clearly sets out the basis for this approach and the Board's other requirements in relation to valuations are complied with.

Part 4. Requirement to obtain legal advice

4.1 Plainly, the Stressed Insolvency Value will be heavily dependent on the content and enforceability of the trustee's legal rights under the ABC documentation. For example, does the trustee have step-in rights which, in the event of the insolvency of the Employers and PPF Guarantors, would allow it to bring about a sale of the ABC Asset, and does it then have a right to all or part of the proceeds of that sale?

4.2 Paragraph 4(4) of the ABC Appendix therefore requires that legal advice be obtained from one or more Appropriate Solicitor(s) to inform the valuer's assessment. As a minimum, this must cover the legal structure and enforceability of the ABC Arrangement and the trustee's rights under it in the event that all of the Employers and PPF Guarantors suffer a **PPF Insolvency Event**.

4.3 However, the advice should also cover any other relevant factors (in the context of the particular structure in question) which are needed for the valuer to make a proper assessment of the Stressed Insolvency Value. Examples of issues that may be relevant are as follows[8]:

- The validity and enforceability (and any other relevant considerations) under Scottish law and any other relevant cross-jurisdictional issues.
- The precise nature of the trustee's step-in rights, including the triggers and the number of tiers in the structure;
- The powers retained by the Employer's group in the insolvency scenario (if any), and any other impediments to the trustee's control and ability to bring about a sale of the ABC Asset(s);
- What the triggers are for termination of the ABC Arrangement and the consequences of/options which arise on termination or default;
- The way in which substitution of assets is dealt with in the documentation. In particular, but not limited to, whether the ABC Asset(s) can be substituted, and if so, what requirements there are to ensure that the value of the ABC Asset(s) is maintained and how effective those provisions would be in the insolvency scenario (e.g. is the comparison of value done on an insolvency basis and, if not, how would that impact on effectiveness?).

Lawyers should comment, where appropriate on the way/extent to which they would anticipate that these factors could impact on the Stressed Insolvency Value of the ABC Investment.[9]

[8] Note, this list is not intended to be exhaustive and the lawyer should give full consideration to all relevant factors.
[9] So, for example, in considering a put option, insolvency law considerations, such as an administrator's duty to perform his funcations in the interests of the creditors as a whole, will clearly be relevant.

4.4 Lawyers should also expressly explain the nature of the specific structure used and its impact on the trustee's position and rights under the ABC Arrangement. In particular, the Board is aware of certain ABC Arrangements where neither the **Trustee LP** nor **Second LP** owns the ABC Asset(s) but, instead, the Trustee LP benefits from a loan note issued by an entity which does own the ABC Asset(s). Particularly where this structure is used, lawyers should consider carefully whether (and, if so, the extent to which) this structure provides any benefit in security terms. Clearly, there will be a number of relevant factors to consider here, including:

- the identity of the relevant parties;
- the existence and precise content of actual (fixed or floating) security or negative pledges;
- provision for the subordination of other creditors; and/or
- other contractual undertakings given by the entity which owns the ABC Asset(s).

4.5 There is also a separate requirement for the trustee to certify that, having regard to Appropriate Legal Advice it has received from one or more Appropriate Solicitor(s), the trustee believes that:

- the ABC Arrangement is legally binding, valid and enforceable[10];
- the value of the ABC Investment does not fall to be excluded from the value of the scheme's assets by virtue of regulation 3(b)(iii) of the Pension Protection Fund (Valuation) Regulations 2005 (i.e. it does not breach the employer-related investment restrictions in s40 of the Pensions Act 1995).

4.6 The legal advice should be provided by a suitably qualified lawyer as set out in the definition of Appropriate Solicitor. The lawyer should not be employed within the Employer’s Group or by the trustee and should be fully independent of the Employer’s Group.

4.7 Please note that the Board will not provide a standard template for the legal advice. It is up to the valuer and trustee to obtain the requisite legal advice which fulfils the requirements set out in the ABC Appendix and this Guidance. If trustees already have legal advice that could meet the Board’s requirements, it would suffice for that advice to be updated, rather than an entirely new piece of advice to be obtained.

4.8 The legal adviser may make certain assumptions of fact and include caveats in his advice. However, neither should unreasonably limit the effect of the advice (e.g. an assumption relating to a party's capacity to enter into the ABC Arrangement is not acceptable unless that party is based overseas and there is an overseas opinion which addresses the capacity of the party to execute the agreements). The Board will be

[10] Note, this covers enforceability of all documents comprising the ABC Arrangement and all parties to it.

looking critically at the use of assumptions and caveats to ensure that the legal advice remains meaningful and is sufficient to allow the valuer to give his advice with confidence.

Part 5. Requirement to obtain an ABC Asset valuation and option of other advice

5.1 As part of the process, a valuation of the ABC Asset itself on the stressed insolvency assumption will be needed to feed into the calculation of the ABC Value. This valuation can be provided by the same organisation which provides the valuation of the ABC Investment (if it has the requisite experience) but, otherwise, should be obtained from an appropriately qualified professional with relevant industry knowledge and appropriate experience to value the relevant ABC Asset in an insolvency situation. Where a professional body exists (such as the RICS, or the ICAEW) the ABC Asset valuer should be a member.

5.2 The complexity of the ABC Arrangement and the difficulty in valuation of the ABC Asset should be taken into account in selecting appropriate professional advisers.

5.3 It may also be considered appropriate in some cases to obtain other specialist advice (e.g. from an insolvency practitioner). The valuer may do this and rely on their advice, so long as the requirements as to reliance and PI cover/liability limitation are met (see part 6 below).

5.4 A lead valuer may be used by the scheme to prepare the valuation using information provided to the valuer from the other advisers. In this situation, the duty of care will need to be given either by each individual adviser in respect of their own advice, or alternatively the lead valuer may take responsibility and provide a duty of care in respect of the other advisers. In the latter situation, the lead adviser may wish to consider obtaining contractual cover from the other advisers.

5.5 Where each individual adviser is providing a separate duty of care, the lead adviser's own duty of care will extend to confirming the ABC Value, based on the information which has been provided to them from other advisers.

Part 6. Reliance, PI Cover and Limitation of liability

6.1 The Board needs to be able to place reliance on the valuations produced for levy purposes (and the advice which feeds into them). This is because the trustee would not have suffered any loss arising from the scheme paying a lower levy, so the duties that advisers already owe to the trustee would not assist the Board in recovering the lost levy. The loss the Board is seeking to cover through establishing a duty of care is the lost levy, not any other losses (albeit that certain other losses may fall to be recovered by the Board standing in the shoes of the trustee if the scheme transfers to the Board under s161 of the Pensions Act 2004).

6.2 Given that the valuation is being used for the purposes of allowing the Board to give *credit* for the ABC Arrangement, it is in both the Board's and the trustee/Trustee LP's interests for the valuation to be prepared properly and in accordance with this Guidance (as any other approach might mean that the Board will not be able to give that credit).

6.3 The valuation providing the ABC Value and any other advice which the ABC Valuer is relying upon for the purposes of providing the ABC Value should contain the following wording:

"Our advice is given for the [purposes of informing the valuation to be provided by X valuer to the PPF Board and for the] benefit of the [XYZ trustee]/[Trustee LP]/[Second LP]. It may be provided to and relied upon by the [Trustee LP and the] XYZ trustee. We also acknowledge that our advice will or may affect the amount of the PPF Levy which is collected by the PPF Board, and we accept a duty of care to the PPF Board in giving that advice, and further acknowledge that it may be relied upon for the purposes of calculating the PPF Levy (subject to the limits on liability set out at paragraph [X]). For the avoidance of doubt, we do not purport to exclude liability to the PPF Board, whether arising pursuant to the Pensions Act 2004 or otherwise."

The different options within the wording reflect the different circumstances and also that the ABC Valuer must either:

(a) take full responsibility for all of the work involved in producing the ABC Value, subject to 6.8 below (and might, therefore, seek to ensure that it has a right of action against other advisers involved in the process); or

(b) ensure that, for any elements for which it does not accept responsibility (and on which its report states that an assumption has been made) the wording set out above is included in the advice relating to that element. The Board will assume that the ABC Valuer has agreed to accept full responsibility for the ABC Value, subject to 6.8 below, except to the extent expressly set out in the ABC Valuer's report (which should identify what other advice has been relied upon and confirm that such advice contains the above wording).

6.4 If an existing valuation (or other existing advice) is being relied upon then we would expect the adviser to issue a reliance letter stating that the valuation/advice can be relied upon by the Board subject to the same principles as set out in paragraph 6.3 above.

6.5 The intention is that this provides for flexibility. It is not intended that the advisers must take on liability for advice from others. The intention is that each adviser can be responsible for its own advice. The ABC Valuer will be permitted to make an assumption that the advice on which he has based his report is correct but, equally, the Board does not require other advisers to accept liability to the ABC Valuer.

6.6 Any adviser involved should confirm that it has professional indemnity cover in place. For lawyers, as with legal opinions for contingent assets, the lawyer should carry appropriate professional indemnity cover and not unduly limit his liability. The monetary amounts should be no lower than the minimum levels required by the SRA Indemnity Insurance Rules and rule O(1.8) of the SRA Code of Conduct.

6.7 For other advisers, the PI cover should be commensurate with other comparable valuers in the market in which it operates and the adviser should not unreasonably limit its liability, bearing in mind the context in terms of the size of the asset and potential levy reduction. In terms of monetary amounts (both in terms of limiting liability and level of PI cover available), the Board will look critically at amounts lower than £1m.

6.8 For the avoidance of doubt, the Board does not require the wording set out at paragraph 6.3 to apply in relation to the Fair Value of the ABC Investment where this is simply taken from the existing number in the Latest Scheme Accounts. However, that wording will apply where the Fair Value is re-calculated to strip out credit risk (see para 2.8).

6.9 The reports of all professionals must state that they are aware of the "Guidance in relation to Asset-Backed Contributions" published by the Board on its website.

Part 7. The Board's discretions

7.1 The Board has retained the discretion to require the trustee to provide the full documentation and details relating to any ABC Arrangement in respect of which an ABC Certificate has been submitted. Where the ABC Arrangement is subject to a confidentiality clause, the trustee should arrange for an express release of this. Failure to supply the requisite information may lead to the Board refusing to recognise the ABC Certificate with consequential effect on the levy payable. For example, the Board may raise doubts in relation to the reasonableness of the ABC Value certified, or need further information e.g. in relation to step-in under the agreement.

7.2 To recognise the ABC Arrangement, the Board will generally have to be satisfied that the ABC Value as set out in the ABC Certificate represents a reasonable valuation and that both that valuation and any advice used for the purposes of it have been arrived at in a manner substantially consistent with this Guidance. Where it is not so satisfied, the Board may refuse to recognise the ABC Arrangement at all.

7.3 The Board also retains a discretion to recognise the ABC Arranagement but at a lower value than that certified as being the ABC Value. In these circumstances, the Board will recognise the ABC at the value it considers could have been put forward as the ABC Value in the ABC Certificate and would have met all the relevant requirements. This discretion is likely to be used sparingly and will likely involve the Board adopting prudent assumptions. The Board is not yet able to give practical guidance on the circumstances in which it might exercise the discretion to give partial recognition to an ABC Arrangement, but will keep the position under review for future years.

Part 8. What should the trustee do if it doesn't want to go through the valuation process?

8.1 If the trustee does not wish to receive credit for an ABC Value but does wish to:

- ensure that the amount deducted from the assets in the Levy Valuation (before smoothing and stressing) is accurate; and/or
- get credit for ABC Payments actually made,

it should submit an ABC Certificate which just covers the relevant information. So, for example, a trustee wishing to do both of the above should go through the steps at paragraphs 2.2 – 2.7 only. As part of this, it will need to provide the standard certifications and two basic legal certifications.

8.2 Where a positive ABC Value is certified on the ABC Certificate (regardless of whether that value is ultimately credited) credit should only be sought (and will only be given) for ABC Payments made up to the date of the Latest Scheme Accounts. However, where the ABC Value certified is nil, ABC Payments made up to 31 March 2016 may be certified.

Part 9. Treatment of DRCs

9.1 Schemes should also note that, where the special contribution made to purchase the investment in the ABC Arrangement (or any Coupon Payments) has previously been certified as a DRC, but has not yet been included in the Levy Valuation, that DRC certificate will not be carried forward for the 2016/17 levy year. To do so would be contrary to the Board's policy as set out in this Guidance. **Schemes will therefore need to Submit a new DRC Certificate (capturing only non-ABC related contributions) for 2016/17[11].**

9.2 For the same reasons, any new DRC certificates should also not include the special contribution made to purchase the investment in the ABC Arrangement or any Coupon Payments.

Part 10. Interaction with Block Transfers

10.1 It may be the case that ABC Arrangements are entered into alongside, before or after scheme mergers. The interaction of these two events needs to be considered carefully and this section covers what schemes should do in these circumstances. This part of the guidance should be read alongside the Guidance for calculating and certifying block transfers.

10.2 Full Transfer certified in a <u>previous</u> levy year where effective date of Post-Transfer Valuation <u>after</u> ABC Arrangement entered into

In these circumstances:

(a) when completing the ABC Certificate, the Actual s179 Amount certified should be the value attributed to the ABC Investment in the Post-Transfer Valuation already Submitted via Exchange.

(b) the Post-Transfer Valuation previously Submitted will be carried forwards in the usual way <u>but</u> the amount certified in (a) will be deducted from the assets certified as part of the Post-Transfer Valuation.

(c) the ABC Payments certified should only be the Coupon Payments made between:

(i) the effective date of the Post-Transfer Valuation; and

[11] This should be calculated as if it were first being submitted for the 2016/17 Levy Year.

(ii) the effective date of the Latest Scheme Accounts (unless the ABC Value has been certified as nil, in which case, this is extended to 31 March 2016).

10.3 Full Transfer certified in a <u>previous</u> levy year where effective date of Post-Transfer Valuation <u>before</u> ABC Arrangement entered into

In these circumstances:

(a) the Block Transfer certificate will have been Submitted via Exchange in the normal way.

(b) when Submitting the ABC Certificate, the Actual s179 Amount certified may be nil (provided that the ABC was wholly funded by the employer group, i.e. existing scheme assets were not used).

(c) ABC Payments certified should only be the Coupon Payments made between:

(i) the effective date of the ABC Arrangement; and

(ii) the effective date of the Latest Scheme Accounts[12] (unless the ABC Value has been certified as nil, in which case, this is extended to 31 March 2016).

10.4 Full Transfer to be certified for <u>current</u> levy year where effective date of Post-Transfer Valuation is <u>after</u> ABC Arrangement entered into and after the scheme accounts used to assess the ABC Value[13]

In these circumstances:

(a) the Block Transfer certificate should not be Submitted via Exchange but the manual certificate in the Appendix of the Block Transfer Guidance should be used and emailed to informatlon@ppf.gsi.gov.uk.

(b) when Submitting the Block Transfer certificate, the value attributed to the ABC Investment should be excluded from the value of the assets for the purposes of the Post-Transfer Valuation. Additionally, if an ABC Certificate has been submitted which seeks to obtain recognition of the ABC (i.e. where the ABC Value certified is not zero), you should also exclude the value of any Coupon Payments made between the date the ABC Value was assessed and the effective date of the Post-Transfer Valuation.

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[12] Note that the Latest Scheme Accounts might be as at the same (or an earlier) date than the ABC Arrangement was entered into, in which case, the Coupons certified should be nil.

[13] There could be circumstances where there is a set of scheme accounts at a later date than the effective date of the Post-Transfer Valuation, where the situation would be different. Please contact stakeholder support if you need guidance in this scenario.

(c) when completing the ABC Certificate, the Actual s179 Amount certified should be the amount in the existing s179 valuation in force at the date the certificate is submitted (though assuming that the block transfer is correctly certified this valuation will be ignored);

(d) the ABC Payments certified should only be the Coupon Payments made between:

(i) the effective date of the existing s179 valuation in force at the date the certificate is submitted; and

(ii) the effective date of the Latest Scheme Accounts[14] (unless the ABC Value has been certified as nil, in which case, this is extended to 31 March 2016).

Assuming that the block transfer is correctly certified these Coupon Payments will be ignored

10.5 Full Transfer to be certified for current levy year where effective date of Post-Transfer Valuation is before ABC Arrangement entered into

In these circumstances:

(a) the Block Transfer certificate should be Submitted via Exchange in the normal way because at the effective date of the Post-Transfer Valuation the assets did not include the value attributed to the ABC Investment.

(b) when Submitting the ABC Certificate, the Actual s179 Amount certified may be nil (provided that the ABC was wholly funded by the employer group, i.e. existing scheme assets were not used).

(c) ABC Payments certified should be as follows:

(i) If an ABC Certificate has been Submitted which seeks to obtain recognition of the ABC (i.e. where the ABC Value certified is not zero), only Coupon Payments made between the effective date of the ABC Arrangment and the date of the Latest Scheme Accounts should be certified;[15]

(ii) If an ABC Certificate has been Submitted which does not seek to obtain recognition of the ABC (i.e. where the ABC Value certified is zero) the Coupon Payments made between the date that the ABC Arrangement became effective and 31 March 2016 can be certified.

[14] Note that the Latest Scheme Accounts might be as at the same (or an earlier) date than the ABC Arrangement was entered into, in which case, the Coupons certified should be nil.

[15] Note that, it may be the case that no Coupon Payments should be certified here because, in this scenario, the date of the Latest Scheme Accounts (the end date for coupons) may be the date of the Post-Transfer Valuation, which is before the date the ABC Arrangement became effective (the start date for coupons).

Glossary

Note: these definitions are intended to be simplified, so far as possible – for the precise definitions, readers should refer to the Board's Determination under s175(5) (the Levy Rules and ABC Appendix).

ABC Arrangement means a contractual arrangement under which the Scheme trustee:

(a) becomes a limited partner in a limited partnership (the **Trustee LP**) in which another entity within the Employer's Group is also a partner;

(b) as a result expects to receive one or more payments representing distributions of profits (or return of capital) in relation to the Trustee LP (**Coupon Payments**); and

(c) the Coupon Payments are expected to be wholly or mainly generated by virtue of one or more income producing asset(s) owned by one of the following:

  (i) the Trustee LP;

  (ii) another limited partnership of which the Trustee LP is a member (a **Second LP**);

  (iii) another entity within the Employer's Group which has issued a loan note to the Trustee LP,

or such other arrangement that the Board considers to be designed to have substantially the same effect as the above and, where the Board considers that such other arrangement is designed to have that effect, it will be treated in a manner which gives best effect in that situation to the general approach laid down by these Rules, the Transformation Appendix and the ABC Appendix.

Where the context so requires, references to an ABC Arrangement shall include all documents entered into as part of the transaction under which the Scheme trustee acquired its interest in the Trustee LP.

ABC Asset(s) are the underlying asset(s) held under the ABC structure. This can include cash where cash has been paid into the structure at the relevant time.

ABC Certificate means a certificate which complies with requirements of the ABC Appendix.

ABC Investment means the trustee's interest in the limited partnership in which it is a limited partner under the ABC Arrangement.

ABC Payments means[16] the Coupon Payments made between:

(a) the later of:

  (i) the date that the ABC Arrangement was entered into; and

[16] provided the ABC Investment has not been purchased using existing scheme assets

(ii) the date of the Levy Valuation; and

(b) the date as at which the Latest Scheme Accounts are prepared or, where the ABC Value certified by the trustee on the ABC Certificate is nil, 31 March 2016 or the date the certificate is Submitted, if earlier.

Note that, where there has been a full block transfer, if the effective date of the relevant Post-Transfer Valuation is later than the effective date of the valuation stated in the ABC Certificate or Partial ABC Certificate, the ABC Payments are deemed to be zero.

ABC Value is the amount added back to the assets where the Board recognises an ABC Arrangement. When certifying this, it must be calculated in accordance with paragraph 4 of the ABC Appendix. Where the Board considers that it has not been calculated appropriately, it may ascribe a different value pursuant to Rule H2.3.

ABC Valuer is the adviser who provides the Trustee with a report on the ABC Value.

Asset Valuer is the adviser who provides the Trustee LP/Second LP/Trustee with advice on the value of the underlying ABC Asset(s) for the purposes of informing the ABC Valuer in producing the ABC Value. For the avoidance of doubt, the ABC Valuer and the Asset Valuer may be the same adviser (i.e. the same company/firm).

Coupon Payments is the income stream the ABC Arrangement provides for the trustee to receive.

DRCs means Deficit Reduction Contributions.

Employer is as defined in section 318 of the Pensions Act 2014 and regulations made thereunder.

Exchange is the Pensions Regulator’s online scheme maintenance system.

Fair Value in most cases means the value of the ABC investment as stated in the Latest Scheme Accounts. However, if trustees wish to do so, they may certify an amount calculated at the same date and on the same basis but with any credit risk allowed for in relation to the employers and PPF guarantors. In these circumstances, the fair value valuation will be subject to the same requirements as to duty of care and PI cover as the Stressed Insolvency Value.

Latest Scheme Accounts in most cases, means the most recent audited accounts of the scheme. However, in certain circumstances, it can mean other accounts/reports, as follows:

- where the ABC Arrangement was entered into after the date as at which those Accounts were prepared, the trustee has the option to have a special purpose set of accounts prepared or use the valuation provided for the purposes of advising the trustee of the value of the ABC Investment, provided that this has been confirmed as reasonable by an appropriately qualified accountant in a report under agreed-upon procedures. In this instance, these valuations should be prepared at the date the ABC Arrengement was entered into;
- where there is also a scheme merger involved, and a Post-Transfer Valuation has been prepared with an effective date after the date as at which those accounts

were prepared, the trustee should refer to the assessment of assets used for the purposes of that Post-Transfer Valuation.

Levy Valuation means the actuarial valuation used by the PPF to calculate the risk-based levy, as prescribed by the Levy Rules.

Pari passu The pari passu principle means that all unsecured creditors in an insolvency must share equally any available assets, in proportion to the debts due to each creditor.

PPF Insolvency Event means an insolvency event under s121 of the Pensions Act 2004 and the regulations made under it – these are events that might trigger the PPF's involvement with the scheme.

PPF Guarantor means a person, who has provided the scheme with a Type A Contingent Asset, which either:

1 has been recognised for levy purposes in a previous levy year; or

2 has been (or is intended to be) certified to the Board for levy reduction purposes for the current levy year.

s179 ABC Amount means the amount which the Board will deduct from the assets in the Levy Valuation. See paragraphs 2.3 – 2.6.

Stressed Insolvency Value means the amount the trustee could reasonably rely upon recovering, pursuant to its rights under the ABC Arrangement, in the event that all the Employers and PPF Guarantors suffered a **PPF Insolvency Event**, taking into account the standard PPF stresses when valuing the ABC Asset. See part 3.

Trustee LP the limited partnership in which the Trustee is a limited partner as part of the ABC Arrangement.