



Institute
and Faculty
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The PPF Levy: Third Triennium

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Levy framework

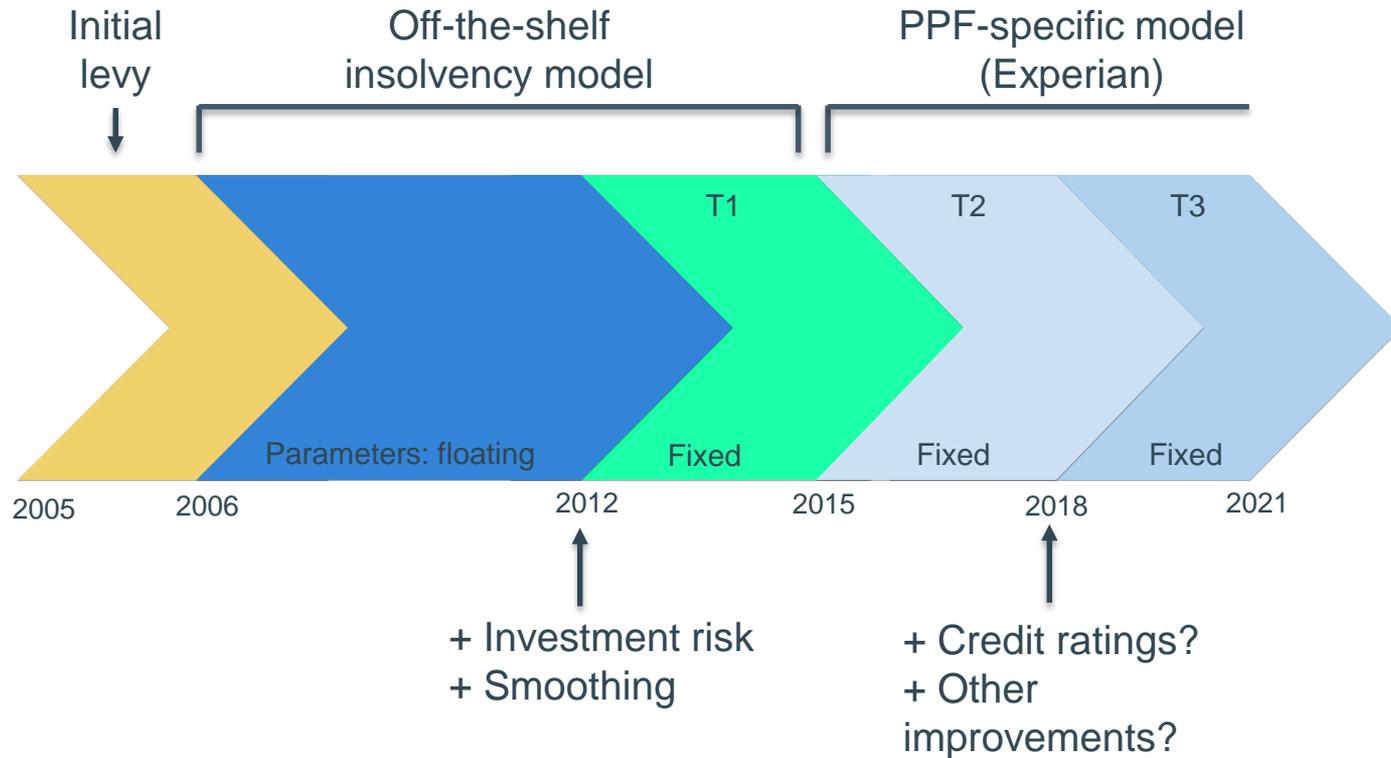
- Legislation sets broad framework. Must publish rules in advance of levy year and consult when making changes.
- Small part of what we collect, the scheme-based levy, simply a proportion of scheme liabilities. **95% of levy is risk-based**
- **Underfunding risk** for an individual scheme is the amount of extra money we might need to pay the scheme members PPF compensation
- **Insolvency Risk** reflects the risk that the scheme will enter the PPF in the next year



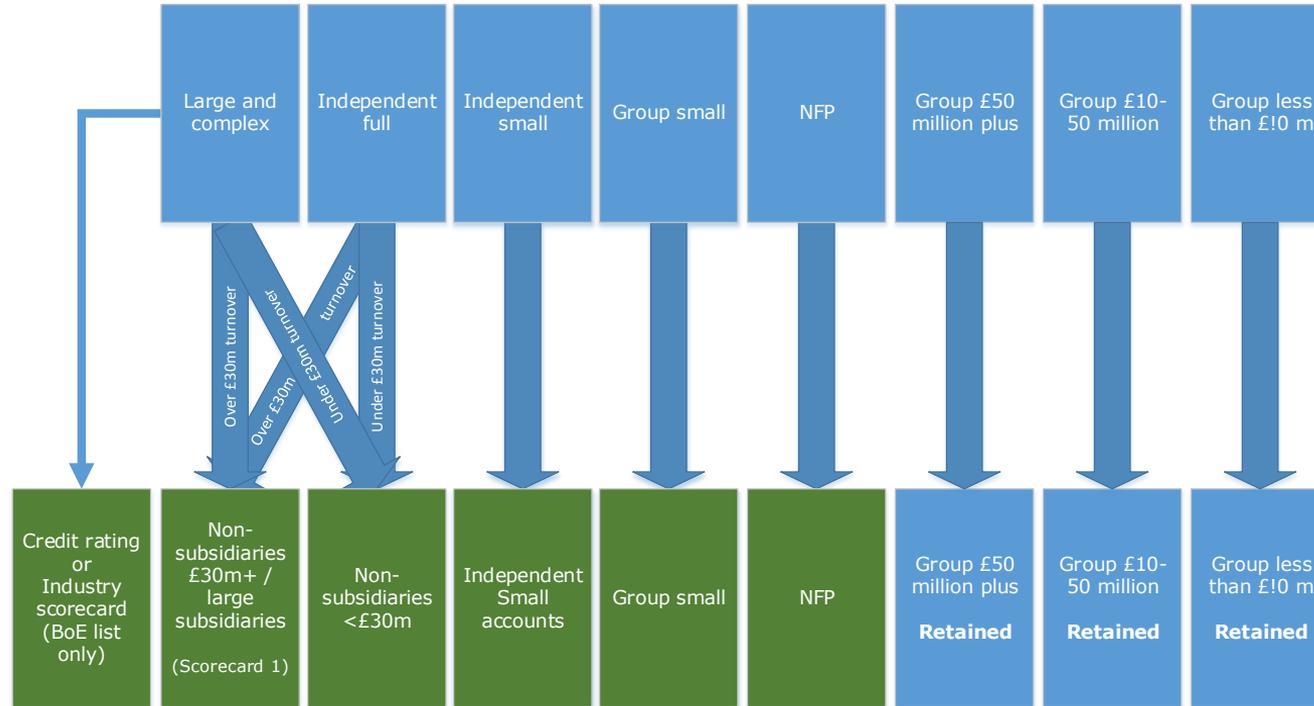
- **Levy Scaling Factor** is a constant used to scale the other two factors up to the £ amount we want to collect
- We must publish a **levy estimate** - for 2018/19 is £550m



Evolution of the PPF levy



Review of Experian scorecards: credit ratings, segmentation changes and rebuilding



PPF Specific Model

Responses received positive on scope of review

- On new scorecards, views expressed by number of entities adversely affected by particular feature of new model. We investigated merits of points raised:

Is > £30m Scorecard justified given impacts?

- Gini comparable
- Population on scorecard has altered radically, so right to rebuild
- Less scope for Scorecard management – lowest rated moving off the scorecard
- Recalibration of existing scorecard would have meant same impact anyway...

Should mortgage age variable be removed from scorecards not rebuilt?

- removal reduced predictiveness, no obvious replacement variable,
- On the remaining scorecards – we almost always have the data needed – so don't have scores based on “unknowns”

Do log variables produce reasonable results?

- Sensitive around zero – creation of 2 plateaus (£10K – zero / zero - minus £10K)

Credit ratings and credit model

Credit ratings:

- Initially considered recognising credit ratings for Second Triennium
- Now intend to introduce methodology to override Experian model scores, which maps default risk across to insolvency risk
- Improved predictiveness
- Applies to employers and to ultimate parent companies where used in group strength component of scores

S&P Credit model / industry specific scorecard for regulated financial institutions

- Overrides Experian model score
- Will keep under review whether to extend to other regulated entities in future.

Consultation responses received overwhelmingly in favour of ratings/credit model -Issues raised:

- Proposed mapping Levy Band BBB? – consistent with Moody’s statistical analysis
- “Second Best” approach fair? - consistent with proposal Basel Committee on Banking Supervision
- Agencies quicker to downgrade? – no material difference (Watch DNG 87 vs UPG 99)
- Size bias? – no minimum size cap, median factor weight on size is 15% (~ 2 notches)

Certifying deficit reductions

Offered two options to simplify DRC regime in response to stakeholder feedback, either:

- Specify standard assumptions in complex areas
- Allow schemes to use information directly from recovery plans

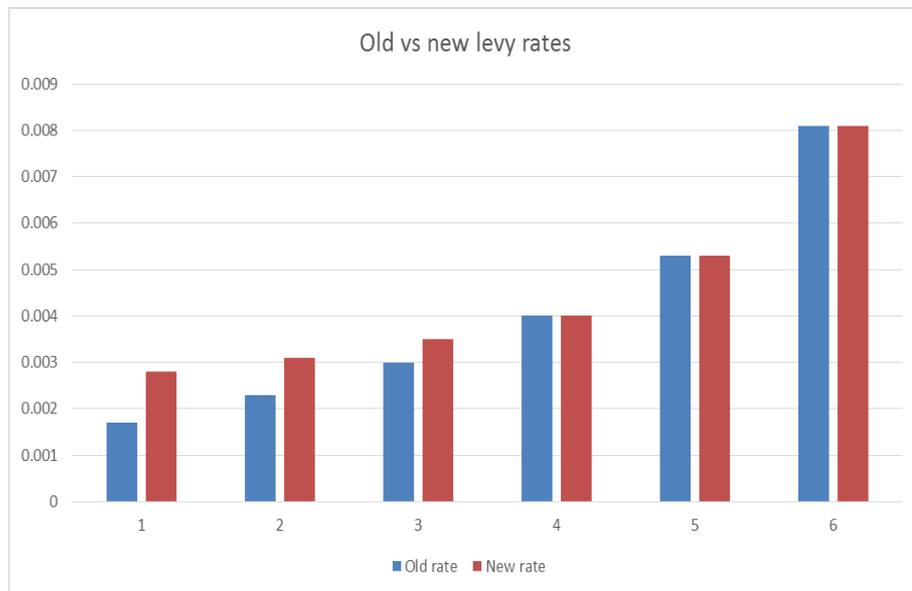
Feedback positive – but mixed views on which was preferable

Propose to implement both:

- Simplified current approach available to all
- Recovery plan basis for schemes under £10m liabilities*. No actuary needed if sum certified <£1m*

Legal basis for different treatment according to size: our understanding that small schemes were making DRCs without certifying them.

Levy rates – proposed changes

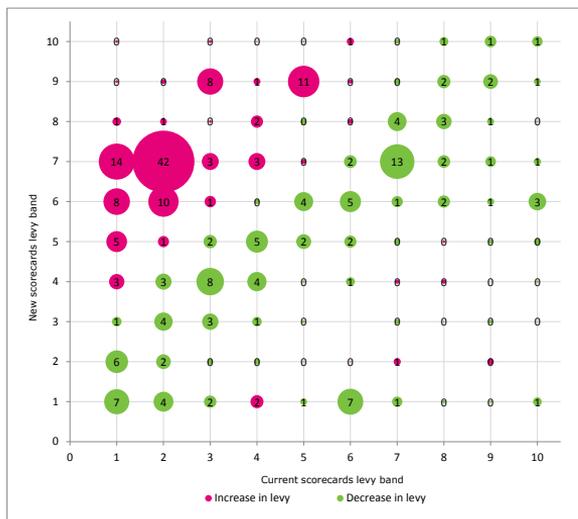


- Levy rates for bands 1-3 adjusted
- Start at levy rate of 0.28
- creates smoother progression
- move from band 1 to 4 = 1 band change elsewhere
- Better reflection of confidence we have in different insolvency rates
- Impact is to lessen reductions in levies for those remaining in band 1 and lessen impacts on those moving down a number of bands

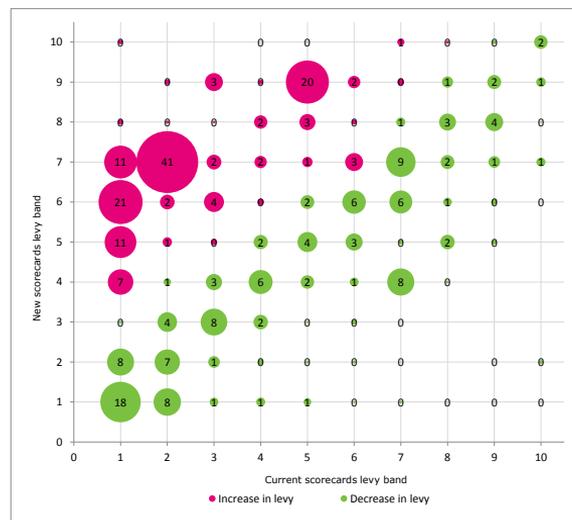


Levy rates – proposed changes

Second consultation (with all policy changes)



First consultation (new scorecards only)



- Smaller decreases in levy for schemes in bands 1-3 as the increase in levy rates offsets the reduction in the LSF.
- Profile of bubbles is otherwise broadly similar to the first consultation.

Contingent assets - proposed T3 changes

Will require trustees to obtain a consultants report before certifying a contingent asset– as we already do with ABCs.

- Threshold will be £100k levy saving
- If exceed threshold, without having report, then no levy credit*

More flexible approach to realisable recovery

Contingent assets – standard forms

Contingent assets have been recognised in the levy from its inception

We have provided standardised agreements to ensure consistent levy credit

The levy rules have evolved over the years, but the standard forms themselves have remained broadly the same (and agreements on the older versions continue to be recognised in the levy)

The issue with the forms, as explained in the Consultation on Contingent Assets:

- The cap interpretation: in Type A and Type B agreements, the fixed cap could be interpreted as reducing when any payments outside the guarantee are made.
- The cap operation: whether the fixed cap is regarded as reducing when payments are made under the guarantee.



The fixed cap

What should the fixed cap do, when payments are made before an insolvency?

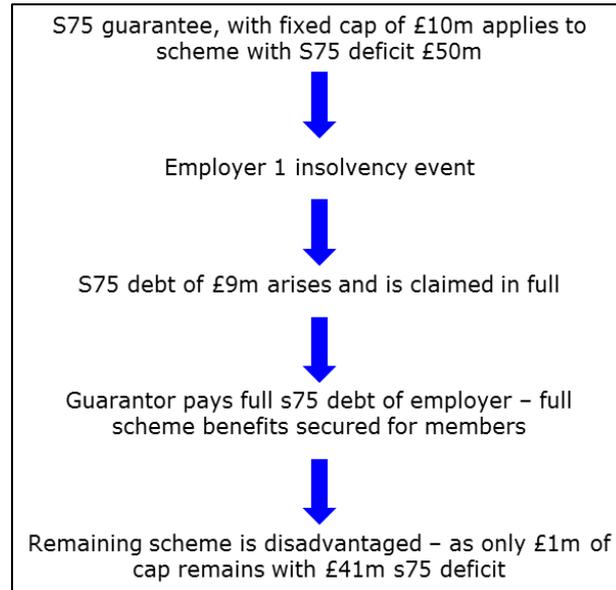
- Erode? Gives certainty to guarantors - but may not improve outcomes for schemes if the guarantor pays when the employer is able to.
- Not erode? Less certainty for guarantors (but not the same as an uncapped guarantee).

Our proposal: the agreement covers pre- and post-insolvency demands, but the fixed cap must be available in full for a post-insolvency demand

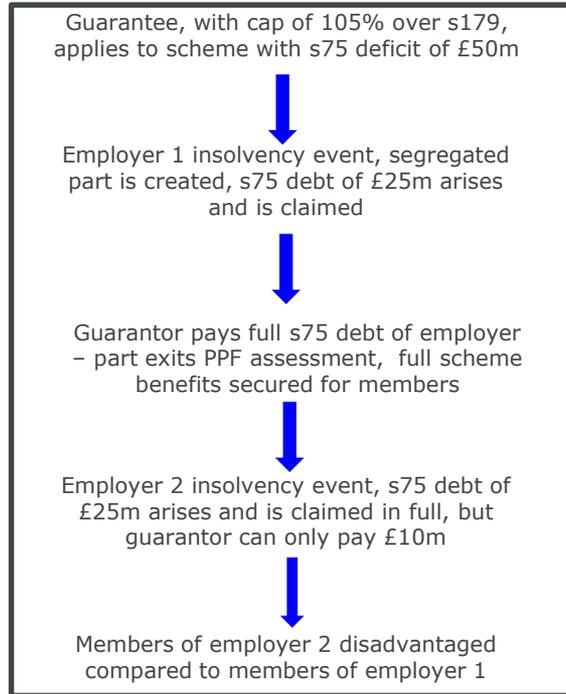
Multi-employer schemes – views sought on how the cap should operate

Multi-employer schemes – the issue

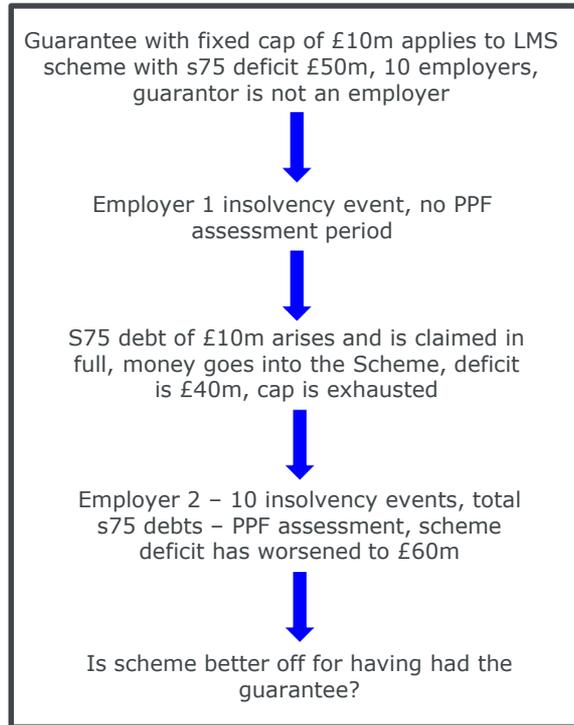
(Partial segregation scheme)



Partial segregation scheme, fluctuating cap



LMS scheme, fixed cap



Multi-employer schemes – questions

1. In a partial segregation scheme, should the cap be applied in respect of the whole scheme, or in respect of each employer's obligations on insolvency?
2. If the cap were applied across the whole scheme, should it be exhausted sequentially by insolvencies, or apportioned?
3. If a fixed cap applied across a whole scheme, should it erode on individual insolvencies?
4. Does the form of liability cap make a difference to the most appropriate solution?
5. Are there workable formulations of cap that do not currently feature, such as an overall fixed cap at scheme level but s179 caps at individual level?
6. Should money from a guarantor in respect of a segregated part be applied to that part? If so, how might this be achieved?



LMS scheme questions

- What suitable protection can a guarantee offer an LMS scheme? Is it more beneficial to the scheme if:
 1. The entire guaranteed amount is payable on the first insolvency?
 2. The guarantee is apportioned, either on a pre-fixed basis, or a share of fund basis?
 3. The guarantee is preserved until a Qualifying Insolvency Event?
- Should the position of LMS schemes differ where the guarantor is also a scheme employer?



Other consultation questions - themes

1. Is there still value in offering all the types of cap?
2. Current operation of the framework e.g. the agreements cover (i) ongoing payments on demand and (ii) payments on an employer insolvency. In practice, are both sets of obligations being enforced?
3. The amendment/replacement rules in the agreements
4. Re-execution – any practical difficulties?

