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Sixty second summary

Pension Protection Fund ('PPF') publishes consultation on the next triennium.

The PPF have published their consultation on the next levy triennium setting out details of their proposed approach to calculating the 2018/19, 2019/2020 and 2020/21 levies. The triennial review is a more fundamental and expansive review than that conducted annually. Some restructuring of the Experian insolvency model is proposed along with an invitation to suggest simplifications to the levy for small schemes and how to potentially reflect governance standards within the levy framework.

Insolvency model

Currently, sponsoring companies are assessed on one of eight 'scorecards' with each scorecard containing a number of metrics deemed to be predictive of insolvency experience for that particular population of companies. The PPF are proposing to amend this model as follows:

- Scorecard restructure- generally, there has been a decline in the predictiveness of the model over the last three years. Consequently, there will be some amendments with the lower performing scorecards seeing a more substantial overhaul. In summary:
  - The 'Large and Complex' (typically parents or large subsidiaries) and 'Independent Full' (those independent companies filing full accounts) populations will be combined and then assessed on two new scorecards according to size (using a threshold of £30m annual turnover). This has been driven by the current model predicting a significant decline in insolvency amongst such groups, whilst actual experience has shown only a modest decline. To avoid understating the risk, the scorecards have therefore been rebuilt;
  - A similar approach applies to the two 'small accounts' scorecards;
  - Not For Profit ('NFP') entities have experienced higher rates of insolvency than predicted by the current model. Additionally, data from the Charity Commission is now available to Experian and so a more predictive scorecard has been devised;
  - The remaining scorecards will see less significant changes.
- Use of credit ratings- where available, these will be used in place of the Experian scores and will directly map to a levy band. Whilst most investment-graded entities will likely see small levy changes, those with non-investment grade ratings may see significant levy increases;
- Use of industry scorecard- the PPF have identified an alternative 'off the shelf' model that can be used for regulated financial services businesses. This is deemed to be a better measure of insolvency risk than the Experian model (although not as good as credit ratings, which would be used if available);
- In terms of the metrics used to assess insolvency there is now a reduced reliance on trend variables (where it's the change in a value over time, rather than its absolute value at a particular point in time) and removal of certain variables that have a relatively narrow range of values (e.g. variables based on the age of secured borrowing);
- Given the increased stability of the new scores, it is unlikely that a 12 month average will be used to determine the overall score e.g. single scores as at 31 March may be used instead.

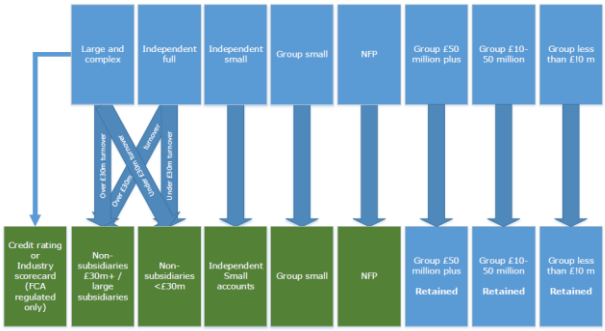

Diagram: illustration of proposed scorecard restructuring

There has been a general fall in Experian bands for most companies which means the levy scaling factor can reduce and that the old band 1 is not directly comparable to the new band 1. Broadly speaking, for companies currently in bands 1 - 3, a fall of two levy bands will mean no change in levy and for bands 4 – 9 a fall of one band will mean no change in levy.

Levy treatment for small schemes

Around a third of eligible schemes contribute a small proportion of overall levies. Given the lack of resources available to these schemes, the PPF is asking for suggestions on ways to simplify the levy framework. This extends to levy mitigations such as contingent assets and certification of deficit reduction contributions ('DRCs').

Certifying risk reduction

The PPF are asking for suggestions on ways to simplify the current approach to DRCs. In terms of contingent assets:

- For very high value type A contingent assets, a guarantor strength report must be prepared in advance of certification, demonstrating that the guarantee could be met in an insolvency situation. This would typically be prepared by a specialist covenant assessor;
- Certification will now be easier for cases with multiple guarantors;
- There will be a full review of the legal documentation governing contingent assets. This will likely require schemes to amend their existing documentation in order to gain future recognition.

Good governance

The Work and Pensions Select Committee has tasked the PPF to examine how the levy framework could incentivise schemes to improve their governance. Views are therefore being sought on what a suitable charging structure might look like and how it could be implemented.

The PPF's triennial review is less revolutionary than prior reviews reflecting the consensus amongst stakeholders that the current levy framework is broadly in the right place; namely transparent, risk-reflective and relatively immune from arbitrage. The refinements to the Experian model seem reasonable in that they are demonstrably better at predicting insolvency. We would encourage levy payers to engage with these changes early on to ascertain what the new framework means for their scores (new Experian scores can be obtained via the web portal). Particularly, NFPs and sub-investment graded companies could see large increases in their levy and so early engagement here is particularly recommended. The proposals seek to redistribute the levy amongst levy payers rather than increase the overall levy amount. The 'good governance' item is an interesting proposition: whilst objectively measuring what good governance looks like is difficult, well-governed schemes will pose less risk to the PPF and, in theory, ought to pay less for protection.