HYMANS ROBERTSON

Sixty second summary

The Pension Protection Fund ('PPF') has launched its consultation on the levy framework for 2021/22 i.e. those levies that will be invoiced in Autumn 2021. This follows a consultation earlier in the year which focussed on calculation of insolvency risk specifically.

The PPF have published their consultation on proposed changes to the levy framework for the 2021/22 levy year. Normally, the levy framework is fixed for three years and the results of this review would have applied to the 2021/22, 2022/23 and 2023/24 levy years. However, due to the Covid-19 pandemic, a shorter-term focus is being applied and so only the 2021/22 levy year is being considered at this stage. A return to triennial reviews is expected to re-commence from 2023/24.

Covid-19

Unsurprisingly, the topic of Covid-19 looms large throughout the consultation. The economic and business risks could be significant. Particularly, from a levy perspective, the potential for future insolvency events to increase the number of claims on the PPF needs to be considered carefully to ensure this risk remains 'fairly' priced. That is, levies are risk-reflective whilst not putting undue pressure on already distressed businesses.

Current rates of sponsor insolvency remain low, perhaps due to the significant Government support schemes that have been put in place. As these measures expire, and to the extent that full economic activity is slow to recover, insolvency experience is expected to increase, although to what extent remains highly uncertain. There is also a measurement lag; most of the information used to assess insolvency risk for the 2021/22 levy will come from financial statements published before Covid-19 was understood to be a global pandemic.

Levy estimate

The PPF expect to receive c£520m in levies for 2021/22. This is a c£100m reduction from the previous year. A like-for-like levy would have generated c£570m in levy funding – the updates noted below have therefore eased the collective levy burden of UK plc by c£50m. Whilst there is a case for increasing levies, PPF funding remains strong due to the extensive interest rate and inflation hedging applied and there is a recognition that many sponsors will be constrained in terms of cash flow. Of those schemes paying a risk-based levy, it is estimated that 89% will see a reduction in their levy for 2021/22 versus that paid in 2020/21. It may be, however, that 2022/23 levies increase materially as post-Covid-19 financial statements are published (noting that there is a legislative cap on the increase in overall levy amount that can be raised as well as an individual risk-based levy cap).

Scheme support

The PPF acknowledge the challenging circumstances that many sponsors are experiencing. Payment of levies, often a large and uncertain expense, will be particularly difficult for entities starved of revenue since March 2020. Accordingly, the cap on the risk-based component of the levy (typically the majority of a scheme's total PPF levy) is being halved from 0.5% of liabilities to 0.25% of liabilities. This will protect around 4% of levy payers and mean that schemes with the highest levies relative to liabilities pay around 100 times the levy, per pound of underfunding, compared with the lowest risks. The broad intention of a levy cap is to protect c5% of schemes – the level of protection here is lower due to the additional measures that have been put in place for small schemes.

Small schemes are more likely to see the highest levies as a proportion of scheme liabilities – 3 times higher for schemes under £20m vs those over £100m. Whilst this may in some cases be risk-reflective, it could also be driven by smaller schemes not having access to the same level of advice and mitigative action that larger schemes have. Additionally, small schemes contribute very little to the overall levy take and their sponsors may be less resilient in the current environment. Accordingly, risk-based levies will be reduced by 50% relative to the uncapped calculation for schemes with liabilities less than £20m. A taper will apply such that the reduction factor reduces to zero at £50m. Given the relatively small quantum, the underpayment of levies from small schemes will not be recouped from larger schemes.

Insolvency risk

The current environment is one in which rates of insolvency may be expected to increase substantially. The PPF have therefore applied stresses to their model to try and forecast insolvency rates in the current environment. Their analysis showed a doubling of the anticipated aggregate insolvency rate from 0.55% (the expected 1 April 2019 to 31 March 2020 insolvency rate) to 1.13%. Clearly, however, observed rates will be specific to sector and individual company performance.

The performance of the insolvency risk model has also been closely monitored. Over the period 1 April 2020 – 30 June 2020, the model continued to effectively discriminate between solvent and insolvent employers. As employer metrics worsen, a migration towards higher risk buckets is anticipated. However, the above stress test has revealed that the predictiveness of the model, whilst reduced, remains good.

A couple of significant milestones remain in terms of assessing whether the model continues to perform satisfactorily: July 2020 – November 2020 (the period coming out of lock-down) and January 2021 – March 2021 (the period following the end of the UK's post-Brexit transition period.

Other changes

The PPF will adopt their most recent version of s179 assumptions (A9) for levy calculation purposes which was widely anticipated. This will, all else being equal, reduce levies. Except for the risk-based levy cap and small scheme adjustment factor, the other fixed levy parameters remain unchanged.

Review and possible updating of asset transformations and stresses has been postponed to the 2022/23 levy year to coincide the Pensions Regulator review of asset classifications on Exchange.

This is not a normal levy consultation. The Covid-19 pandemic has resulted in the PPF trying to balance consistency of approach with a short-term year-by-year focus, and to price risk appropriately without applying too much pressure to cash-strapped businesses. There's much in the consultation that will come as a relief to levy payers, particularly those with relatively small schemes. Overall, levies are expected to reduce rather than increase as may have been expected. It's early days though and once audited data is filed showing the severity of Covid-19 for businesses, levies will be expected to rise. The PPF's funding remains strong although the Government's consultation on the future of RPI, and whether index-linked gilt holders will be compensated for any losses, could be significant. Close monitoring from now on will be required although there are legislative constraints on the extent to which levies, overall, can increase. For now, at least, levy payers needn't expect large increases in levies.

Please contact your regular Hymans Robertson consultant or PPFteam@hymans.co.uk if you would like to discuss what this might mean for your scheme.

This communication has been compiled by Hymans Robertson LLP based upon our understanding of the state of affairs at the time of publication. It is not a definitive analysis of the subjects covered, nor is it specific to the circumstances of any person, scheme or organisation. It is not advice, and should not be considered a substitute for advice specific to individual circumstances. Where the subject matter involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance upon any statement or opinion.

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global.
© Hymans Robertson LLP.