



Response to consultation

s143 valuation guidance
October 2024

1 Introduction

- 1.1 In March we published a consultation on changes to the actuarial assumptions required for valuations carried out under sections 143, 152, 156, 158 and 179 of the Pensions Act 2004. The consultation lasted six weeks and there were nine responses, from the eight companies/organisations listed in appendix 1 and one individual respondent. We would like to thank all those who took the time to respond, as well as the insurance companies and PPF panel firms who helped us shape the proposals.
- 1.2 Following consideration of the responses, we have decided to implement the proposed guidance for section 143 (s143) and section 152 valuations in line with the consultation document. The new assumptions guidance takes effect for valuations with effective dates on or after 31 May 2024.
- 1.3 The updated valuation and assumptions guidance documents are now available on our website (versions B11 / H9 for section 143 and version D6 for section 152). This document provides a summary of the responses that were given to the consultation.

2 Overview

- 2.1 Our consultation document included the ten principles that we adopt when setting assumptions for s143, section 179, and similar valuations. These have been reproduced in appendix 2 to this document.
- 2.2 The consultation was based on the premise that the standard s143 assumptions result in understated liabilities for smaller schemes compared with bulk annuity pricing. We suggested 'smaller' could currently mean liability values in the order of £50 million or less.
- 2.3 In the absence of any consistent and specific differences between the s143 assumptions and bulk annuity pricing bases – save for expenses, for which a justifiable bespoke assumption may already be used – we proposed that downward adjustments to the discount rate could be used to result in liability values that better reflect the reality of bulk annuity pricing for smaller schemes. For this we would add the discount rate to the list of s143 assumptions for which a bespoke alternative may be used.
- 2.4 There was general agreement among non-individual respondents that our proposals are appropriate and helpful for the intended purpose, but care will be needed to avoid the risk of a scheme transferring to the PPF when it could have secured benefits better than PPF compensation in the insurance or consolidator market. The individual respondent expressed the view that it is for the PPF to set the PPF's entry price, and not the s143 actuary, on whom our proposal would place too much responsibility. On the whole, the responses were sufficiently supportive that we have decided to proceed with our proposals.

3 Responses to the four questions in the consultation

- 3.1 ***Q1: Do you agree that we should introduce the new section 143 valuation guidance from 31 May 2024? If not, what date(s) would be more appropriate?***
 - 3.1.1 No respondent expressed concern with this date or suggested an alternative, although one noted that should the response to the consultation lead to a more significant

overhaul than we originally envisaged, a different date may be appropriate. It was also raised that the new guidance could instead apply to s143 valuations *signed* after 31 May 2024 as opposed to valuations with effective dates after 31 May. While that would be helpful for those schemes currently in an assessment period and in the situation our proposals are trying to avoid, it could lead to issues of inconsistency between schemes that had similar valuation dates but whose valuations happened to be signed at different points in time.

3.1.2 One respondent suggested that s152 or s158 valuations might require a quicker implementation as there tends not to be as much time between a scheme's reapplication date and the s152 and s158 valuation being required. They did, however, note that there are relatively few such cases, and the use of a bespoke discount rate is in any case optional.

3.2 Q2: Do you believe that the proposal is appropriate and helpful? If not, why not? What would you propose instead, and why? By 'proposal', we mean a) introducing the ability to use a bespoke discount rate assumption for s143, s152, and s158 valuations, b) including additional wording in the guidance but otherwise making no changes to the assumptions, and c) making no changes to s179 and s156 valuations.

3.2.1 Generally respondents agreed that pricing appears to be different for smaller schemes. One respondent identified reasons why this may be, noting that reinsurance terms may be unattractive, and that bespoke mortality assumptions may be used for larger schemes which tend to have more extensive mortality experience data.

3.2.2 There was broad support for the additional flexibility proposed, and the intended purpose of helping small schemes that cannot secure benefits outside of the PPF avoid showing as overfunded in their s143 valuations. This support was largely accompanied by the desire to ensure appropriate safeguarding of scheme member outcomes. One respondent explicitly advised that the flexibilities are only used when there is clear evidence that PPF benefits are not affordable in the insurance market. Another suggested, in response to Q3, that where there is doubt, it would be safest for the trustees to fully investigate the possibility of securing benefits outside of the PPF.

3.2.3 Some respondents suggested that the definition of 'smaller' schemes could include where liability values are larger than £50 million e.g. up to £100 million.

3.2.4 A number of respondents observed that it is not simply scheme size that determines whether terms equivalent to the s143 basis can be secured, but it is also highly contingent on other circumstances. For example, the capacity within the market at any one time was noted as being crucial, with one respondent noting that at times pricing in the market can be surprisingly cheap.

3.2.5 One respondent thought that our proposed non-prescriptive approach seems appropriate where it would be used sparingly, but if it were to become more widespread, we may need to reconsider being more prescriptive.

3.2.6 Two respondents suggested using a liability uplift (i.e. a percentage loading) instead of an adjustment to the discount rate assumptions.

3.2.7 The individual respondent was uncomfortable with our proposal, suggesting that it is for the PPF to set the PPF's entry price, and not the s143 actuary, on whom our proposal would place too much responsibility.

3.2.8 No respondent disagreed with our proposal not to introduce the ability to use an alternative discount rate assumption in s179 valuations.

3.3 Q3: Do you foresee any undesirable consequences of our proposal?

3.3.1 Most respondents, including the individual, mentioned the risk of a scheme entering the PPF when it could have secured higher benefits with an insurer. One said explicitly that care will be needed to ensure all involved parties act in the best interests of scheme members, with others saying something similar.

3.3.2 A few respondents pointed out that not all s143 actuaries will have, or work for a firm that has, sufficient knowledge of (current) bulk annuity pricing in order to propose an appropriate and justifiable alternative assumption. Therefore, it may be appropriate to make use of our PPF+ advisory panel to recommend the bespoke rate.

3.3.3 Two respondents pointed out that extra time and cost will be involved in identifying alternative assumptions and performing additional s143 valuation calculations using them, but that savings would be made elsewhere.

3.3.4 One respondent identified the risk of inconsistencies between similar schemes as a result of differing actuarial judgement in different cases.

3.3.5 One respondent noted the Work and Pensions Select Committee's recommendation for the Government to review the levels of PPF compensation, and how this creates the risk of schemes securing what the trustee believes to be PPF+ benefits but future PPF compensation improvements might mean that members would have been better off in the PPF. They noted that it would be useful to have more certainty about whether PPF compensation will be improved as a result of the PPF's strong funding position.

3.4 Q4: Do you have comments on any other matter in this consultation document which is not included in responses to the questions above?

3.4.1 Some respondents indicated that the size of a scheme is not the only cause of the departure of bulk annuity pricing from that estimated by the s143 basis. Insurer capacity being another factor, for example.

3.4.2 One respondent said that guidance on setting a bespoke discount rate will be key, and that this should include what evidence will be needed, and an indication of how large the adjustment could be, particularly in light of the PPF's principle to err on the side of understating liabilities in order to avoid blocking schemes from testing the markets.

3.4.3 One respondent made the point, as it also did in response to the previous consultation on s143 and related assumptions, that bulk annuity pricing's relativity to gilts is volatile, particularly as credit spreads change. It subsequently recommends that the s143 basis is generally reviewed more regularly to ensure it remains appropriate, and similarly for inflation as the relative gap/shape between the gilt and swap curves change constantly.

3.4.4 In respect of the additional detail we provided around the inflation assumptions, one respondent asked whether the PPF will review the appropriateness of a 1 March 2030 alignment of RPI with CPIH as we approach that date and the potential for the market to price-in that known change.

4 Our decisions in response to the consultation

- 4.1 We have decided to introduce the additional flexibility in the manner proposed. We will not be prescriptive at this stage about the adjustments schemes can make, while the definition of 'smaller' schemes and an appropriate adjustment to reflect pricing can change. We also currently expect take-up of the option will be low – it is just there for the schemes that might need it – but if it were to become more common, we would review our approach.
- 4.2 The schemes that we expect to be able to use a bespoke discount rate at the current time are marginally overfunded small schemes. If they are overfunded, they will have a PPF+ panellist involved in their assessment. For larger schemes, it is less likely to be appropriate to deviate from the standard discount rate assumptions. If a scheme is much more than marginally overfunded it is unlikely that an appropriate discount rate adjustment will be enough to render the scheme underfunded, although this may need to be considered in conjunction with a bespoke expense assumption.
- 4.3 S143 assumptions, and the subsequent funding level, are calculated as at the date that a scheme entered assessment. Some schemes' funding will have improved since then, others' will have deteriorated. A bespoke discount rate is less likely to be appropriate in the former case than the latter, either because the scheme will be able to obtain an affordable buy-out quotation, or because the scheme is now too well funded for a bespoke discount rate adjustment to cause it to become underfunded.
- 4.4 As with all bespoke assumptions, we will need to agree any bespoke discount rate assumptions. We will require a scheme's trustees and PPF+ panellist to be in agreement with the s143 actuary's proposed discount rate assumption. In the event that the s143 actuary does not have, or works for a firm that does not have, sufficient knowledge of the bulk annuity market, the assumption should be on the advice of the PPF+ panellist in the first instance. At a given point in time (around a scheme's assessment date), we will have our own views on the definition of 'smaller' schemes and an appropriate adjustment to reflect pricing, gained from our most recent discussions with insurers. We will not be able to share this with the scheme's advisers for reasons of confidentiality, but if the proposed discount rate is at odds with our view of pricing we will reject the proposal without giving the scheme any quantification of how far out their rate is, and the scheme will have to use the standard assumptions. The need for our agreement, and therefore our involvement in each case, should also help to ensure consistency between schemes that propose a bespoke assumption.
- 4.5 The strongest evidence would be buy-out quotations that a scheme has received that are demonstrably unaffordable, but in some cases, it may be possible to avoid the time and expense incurred in obtaining these quotes to determine that securing benefits outside the PPF is not feasible.
- 4.6 The s143 actuary will decide the assumption used in the s143 valuation, subject to our having agreed that the bespoke discount rate was appropriate at the time of the assessment date. If the actuary is not comfortable using a bespoke assumption, then they should use the standard.
- 4.7 We do not propose to permit liability loadings instead of a discount rate adjustment as this would be inconsistent with the models we use to verify s143 valuations. Instead, we

would ask the actuary what discount rate adjustment would be equivalent to the proposed liability loading and then ask them to use that instead.

Other points raised in the consultation responses

- 4.8 This section addresses broader points raised by respondents that were not about our bespoke discount rate proposal per se, but in relation to the s143 assumptions or valuation guidance.
- 4.9 We will review the appropriateness of a 1 March 2030 changeover date in inflation margin assumption as we approach that date, including how much the market already prices-in the known change. We look at this annually as part of our own valuation assumptions setting, and discuss it with insurers at least twice a year.
- 4.10 In relation to s152 and s158 valuations requiring implementation sooner than s143 valuations, the s152 valuation guidance already permits alternative discount rates to be used in appropriate circumstances, and there is currently no separate s158 guidance on account of the low number of cases (although the assumptions would be the same as for s143).

5 Feedback on the consultation

- 5.1 We would value any feedback on the effectiveness of this consultation process. If you have any comments, please contact:

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Appendix 1: list of respondents to the consultation

We would like to thank the following organisations, as well as one individual respondent, for replying to our consultation:

Barnett Waddingham

Broadstone

Hymans Robertson

ISIO

PwC

Spence

The Society of Pension Professionals

Willis Towers Watson

Appendix 2: Policy principles around setting assumptions

The Board of the PPF has adopted the following ten principles to underlie the setting of assumptions for section 143, section 179, and similar valuations:

1. Compliance with the regulations. In particular, the assumptions are required to reflect insurance company buy-out pricing terms for PPF compensation.
2. Seeking evidence from confidential dialogue with market participants.
3. Seeking anecdotal evidence from consultants of the state of the market; a significant shift would indicate the need for a review of assumptions.
4. If the need for a review under principle 3 has not been invoked, nonetheless reviewing the market by speaking to market participants every year to eighteen months.
5. Proportionality – balancing the degree of precision with the cost, taking into account the purpose of the valuation.
6. Adoption of new tables and techniques as appropriate, having regard to the principle of proportionality.
7. Reasonable stability in the assumptions over time, i.e. frequent changes are undesirable.
8. Deliberately erring on the side of understating liabilities, i.e. assessing section 143 liabilities at a level that is believed for most schemes to be somewhat below the best market price.
9. Consulting with the pensions industry to check proposals.
10. Providing sufficient notification of changes.

These principles are not binding but the Board has made a commitment to follow them as far as possible.

