Pension Protection Fund

The 2018/19 Levy Policy Statement

December 2017

Foreword

I am delighted to introduce our final policy statement, which concludes the development of the levy rules for 2018/19, and sets the framework for 2019/20 and 2020/21. This publication marks the conclusion of a two year process of development supported by significant engagement with stakeholders including through meetings across the UK, several webinars, and two consultations.

I am very grateful to all those who have engaged with us; those who responded to our consultations, our industry steering group and all others whose views have helped us to shape and improve our levy rules. In particular, we have developed our approach to assessing the risk of sponsor insolvency by better assessing the risk of rated entities and SMEs, reflecting stakeholder feedback.

We take a long-term view of risk and set the levy rules accordingly, aiming to keep the rules stable for three years. Even in these uncertain times, our funding strategy remains robust and able to withstand the claims we face. Accordingly, we can confirm the Levy Scaling Factor for 2018/19 will be 0.48 and the Levy Estimate £550 million, over 10 per cent lower than the 2017/18 figure.

The changes proposed in our consultation were widely welcomed. We have considered carefully the limited issues that were raised and set out here our analysis and conclusions on those matters. As a result, we will be making a small number of changes in response to stakeholder feedback. These include allowing all investment expenses to be excluded when calculating deficit reducing payments and technical changes in relation to asset backed structures and contingent assets - all of which should make certification easier.

We consulted separately on contingent asset standard forms, given the complex nature of the issues and the need to take account of commercial practice. The input we have received has been hugely valuable and has helped us refine and improve our approach. We have, in particular, concluded that guarantors should be able to limit their liability for pre-insolvency claims under the guarantee and that guarantees without a fixed cap may not need to be re-executed.

There is much that schemes and their sponsoring employers can still do to influence the levies they will pay. Now that we have set the rules, I would encourage them to put in place risk reduction measures by the relevant deadlines in March and April. In particular, the new simplified arrangements for certifying deficit reducing payments provide an easier route to ensure schemes pay a levy that reflects their most up to date funding position.

David Taylor
General Counsel

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1. Introduction and Executive Summary

1.1 Introduction

1.1.1 On 27 September 2017 we launched the consultation on the Levy Rules for 2018/19 which closed on 1 November 2017. We received a total of 25 responses. These were considered by the Board in determining the final Levy Rules.

1.1.2 This document summarises the responses we received, our analysis of the issues raised and the conclusions we reached.

1.2 The Levy Rules (the Determination) for 2018/19

1.2.1 The Levy Rules that will govern the calculation of the levies for 2018/19, as specified in the Board's Determination under section 175(5) of the Pensions Act 2004, are published alongside this Policy Statement.

1.3 The Board's Levy Estimate and the levy parameters

1.3.1 We announced in the Consultation Document that the Board proposed a Levy Scaling Factor ('LSF') of 0.48 and Scheme-Based Levy Multiplier of 0.000021. We also announced that the Levy Estimate – the amount we estimated these parameters would raise – was £550 million for 2018/19.

1.3.2 We are now confirming that for 2018/19 we will use the LSF of 0.48, the Scheme-Based Levy Multiplier of 0.000021, and the Levy Estimate of £550 million.

1.3.3 We received a number of requests for additional information about the basis of the Estimate calculation and we have set this out in chapter 2.

1.4 The measurement of insolvency risk

1.4.1 We initially set out our proposals for updating the PPF-specific model in our March 2017 "triennium" consultation. In the September Policy Statement and Consultation Document we set out our analysis of the more than 70 responses received and our conclusion that the key changes consulted on should proceed. We did, however, also propose some limited changes – very few stakeholders commented on these.

1.4.2 A small number of respondents noted the significant increases in levy seen by a small proportion of schemes due to the updating of the model and suggested we consider action to cap increases.

1.4.3 The suggestion that there ought to be protection for schemes seeing a large one-off increase in levy has been an occasional minority theme in consultations over the years.

1.4.4 We have generally taken the view that it is inappropriate to cap increases in levy as that would imply the schemes benefitting would be under-paying for the risk they pose, meaning other schemes paying more to offset the effect of capping. However, three years ago we consulted on a possible approach for capping large increases, prompted by the significant impact on levies of the move to the PPF specificmodel as the basis for measuring insolvency risk. Stakeholder responses at that time were largely negative – with around twice as many responses opposing as favouring capping. Typically, responses argued it would reflect a continuation of an unfair subsidy to those that "had been paying too little". As a result, in the absence of broad support, we concluded it would not be appropriate to implement capping of increases.

1.4.5 In response to stakeholder comments, we reviewed this position for the third triennium. Significantly fewer schemes are expected to see substantive changes in levy as a result of rule changes for the third triennium than was the case for the second. Even so, we found that to cap levies to a meaningful extent would require a substantive compensating increase in levies to other schemes – for example, if we were to restrict increases in the Risk Based Levy (RBL) to 100 per cent, we would need to double the scheme-based levy for everyone in order to compensate. Our view, therefore, is that capping remains inappropriate and would be unlikely to receive broad support.

1.4.6 A new issue raised with us was the possibility that non-UK employers[1] might be disproportionately affected by not reporting – in their accounts - certain data items used in scorecard 1 (the scorecard most non-UK employers and non-UK ultimate parents are on). We use default values where there is missing data – which for some data items are a median and in others the minimum (worst) score. A deliberate feature of the new scorecards we have built for the third triennium is – for each variable - there are typically very low numbers of entities where the data is unavailable. We have determined that non-UK employers are not substantially more affected by data availability issues than UK employers (nor do they score more negatively). We are also satisfied that default values are reasonable.

1.4.7 We have reviewed the replacement values that are used for the Experian model when accounts data includes zeros (often shown in accounts as a dash) or data is unknown. We have concluded the replacement values for unknown scores are appropriate but in the case of log pre-tax profit, we should allow a reported zero to be treated as such in calculating the insolvency risk score (as opposed to a replacement value being imposed). Where zero pre-tax profit is

[1] We include here subsidiaries of non-UK ultimate parent companies – that receive a contribution to their score based on the ultimate parent's consolidated accounts – as that group strength component is assessed using scorecard 1.

recorded in accounts Experian will test it using other data in the accounts to confirm that the figure is genuinely zero.

1.4.8 Other comments made on specific aspects of the model included:

- Arguing that data items should be able to be adjusted from the published accounts figure to take account of particular circumstances;
- The sensitivity of scorecards to small movements – where a profit becomes a loss, and
- Definitional points (such as why net worth excludes intangible assets).

1.4.9 These points were also raised in response to the first consultation and we set out our views in chapter 2 of the September 2017 Policy Statement. In considering these points again, we have reflected on whether there is new evidence, or reason to believe we need to do further analysis, which might lead us to conclude differently. We set out additional analysis in chapter 2, and our conclusion that there is no case for further change to the model design.

1.4.10 We, therefore, intend to implement the updated PPF-Specific model and the recognition of credit ratings and the credit model for financial institutions, as proposed.

1.5 The Risk-Based Levy cap

1.5.1 Schemes which face the highest levies relative to their liabilities have in the past had their levy capped. We proposed in September to reduce the cap, from 0.75 per cent of liabilities to 0.5 per cent, reflecting the proportion of schemes protected by the cap had fallen in recent years, and is projected to fall further to 2020/21. This proposal drew broad support, in the context of a limited cost which would be covered by the existing Scheme-Based Levy, and we are, therefore, confirming the cap for 2018/19 will be set at 0.5 per cent of smoothed liabilities.

1.6 Levy Bands and rates

1.6.1 An employer's insolvency risk score – as generated by the PPF-specific model (or in future in some cases by credit ratings and the S&P Credit Model) – leads to the employer being placed in one of ten levy bands. A levy rate (reflecting expected risk of insolvency plus a risk margin) is assigned to each levy band and it is this rate that is then used in the calculation of the Risk-Based Levy.

1.6.2 The September Consultation set out proposals to maintain the current insolvency probabilities which form the boundaries for each band but to adjust the levy rates applied to some of the levy bands. Our proposal reflected that we have limited experience on which to base our distinctions in risk within bands 1-4 – so that statistical confidence intervals for the expected insolvency rate overlapped to a significant degree for adjacent bands. This suggested only a moderate increase in levy could be justified across investment grades.

1.6.3 The overall level of response to our proposals in relation to levy rates was limited - just over a third of the 25 responses covered this. There was a mixture of views with some supportive of the change and others preferring to see the current significant changes in levy between bands retained.

1.6.4 A small number of responses suggested we ought to consider altering the insolvency rates for the band boundaries in order to create a distribution that was more similar to the distribution initially intended for the second triennium. We considered this, but do not believe that a change would be warranted. We are, therefore, retaining the existing band boundaries.

1.6.5 In response to comments suggesting there was some evidence for significant differences in default rate for investment grade rated entities we reviewed the evidence again. However, even for rated entities the evidence for distinguishing between the strongest entities is limited – Moody's, for example, cite overlaps in confidence intervals for investment grade ratings – and supposedly equivalent ratings from different agencies exhibit different default rates. And evidence for differential insolvency rates is still less strong for the PPF-specific model (for bands 1-4). Accordingly we have concluded there is still no strong evidence to support significant differentials in levy rates for this population.

1.6.6 We also received suggestions that we could achieve the same outcome in impact terms through an alternate approach to adjusting levy rates and the levy scaling factor. We have evaluated this alternative – which has no impact in distributional terms. Whilst we see some merit in the proposition in principle, we are concerned that introducing a different approach at this late stage might cause confusion. We are accordingly retaining the approach we proposed in September and implementing a narrowing of levy rates for bands 1-4 through increasing the levy rates for the first three bands.

1.7 Asset and liability stresses

1.7.1 The new asset and liability stresses that we proposed were generally welcomed. There were a small number of comments making points regarding the limitations of the current standard approach to assessing investment risk – and its limited capacity to reflect the risk-reducing investment strategies widely used even by relatively small schemes. We recognise these limitations, and it is our ambition – working with the Pensions Regulator (TPR) - to develop the information gathered in the scheme return to better capture scheme investment risk, in future years.

1.8 Contingent assets

1.8.1 Very few points were made in relation to our proposals regarding contingent assets. There was a general welcome for our indication that we would take more time to update the standard forms of agreement, publishing them in the New Year and not expecting re-execution until March 2019.

1.8.2 A specific consultation on the standard forms closed on 21 November, and we expect to publish final forms in mid-January. The key changes to the forms that we expect to make are:

- For the versions of the standard form involving a fixed cap, wording to confirm that the fixed cap on the guarantor's liability is unaffected by any claim, whether under the guarantee or otherwise, prior to insolvency;
- Additionally, an optional clause for agreements with a fixed post-insolvency cap to limit pre-insolvency liability, though with a requirement that the pre-insolvency limit be substantial (by reference either to the post insolvency limit or to the regular annual payments under the schedule of contributions), and
- Revised wording for the approach to amendment and replacement requirements – which will include clarifying that (as with the present standard forms) it is open to the trustees to agree to changes in situations where the amendment and replacement rules do not require it.

1.8.3 We have decided that wider changes, explored in the consultation, will not be necessary. As a result, our intention is that whilst we expect to require re-execution of contingent assets that involve a fixed cap, there will be no need to seek re-execution for those contingent assets limited solely to either a proportion of s179 liabilities, or to the full s75 liability. This will significantly reduce the number of schemes for which an exercise to update their agreement is necessary.

1.9 Other issues

1.9.1 Our proposals to simplify the regime for certifying Deficit-Reduction Contributions (DRCs) were generally welcomed. We received a number of comments seeking clarity on specific issues, and have addressed these in the drafting of the appendix and in guidance - for example, by indicating that it will be possible to exclude all expenses associated with investment rather than just investment management expenses.

2. The Levy Scaling Factor and Levy Estimate

2.1 Summary of consultation proposals

2.1.1 Since 2012/13 our intention has been to set the amount of levy that we intend to collect in the first year of each triennium (our "Levy Estimate") having regard to three key factors - our Funding Strategy, which focuses on achieving self-sufficiency by our funding horizon, currently expected to be around 2030; likely shorter term trends, and the desirability of maintaining stability in overall policy on the levy. We then consult on a Levy Scaling Factor ("LSF") to be applied to the calculation of each scheme's levy. The LSF aims to ensure that the aggregate of all levies equals the Levy Estimate.

2.1.2 For the second and third years of each triennium, we intend to keep the LSF and other levy parameters unchanged if possible[2] so that the levy that we estimate we will collect from schemes varies with changes in insolvency and underfunding risk only.

2.1.3 2018/19 is the first year of the third levy triennium. We have decided to set the amount of levy we intend to collect from schemes in 2018/19 at £550 million, which is a reduction of around 10 per cent from our 2017/18 levy estimate of £615 million and represents the lowest levy that we have set out to collect from schemes. We indicated that we expect to set an LSF of 0.48 in order to collect £550 million in levies from schemes in 2018/19.

2.1.4 We also proposed to reduce the RBL cap from 0.75 per cent to 0.5 per cent of smoothed liabilities. This would increase the number of schemes benefiting from the RBL cap so that it is closer to our original policy intention of benefiting 5 per cent of schemes when the RBL cap was first introduced.

2.1.5 We didn't propose any change to the Scheme-Based Levy Multiplier (SBLM) as the current level raises a Scheme-Based Levy (SBL) that is sufficient to cover the cost of the RBL cap.

2.2 Consultation responses

2.2.1 We received 11 responses on our approach to calculating the LSF and 10 responses on our proposed reduction to the RBL cap. The majority of respondents were in support of our proposals. A few respondents asked questions about our approach to calculating the LSF and the impact of the RBL cap without being unsupportive of our proposals.

2.2.2 Two respondents asked why the LSF for 2018/19 of 0.48 is higher than the LSF of 0.37 used in our impact analysis.

2.2.3 Our impact assessment demonstrated the impact that the various policy changes would have on 2017/18 levy bills. In other words we were comparing "current policy" with "third triennium policy" but keeping other inputs unchanged. In particular, we used the data we hold on schemes and employers to calculate 2017/18 invoices and, in order to ensure a fair comparison, used the same levy estimate of £615m. In order to target the Levy Estimate when the "third triennium policy" is applied we needed to use a LSF of 0.37.

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[2] The circumstances in which we would make changes to the levy parameters are set out in Section 10.1 of the September Consultation, and in various other documents since 2012/13.

2.2.4 The final LSF for 2018/19 is higher – despite the reduced Levy Estimate - because we are anticipating improvements in insolvency risk and underfunding risk in schemes between 2017/18 and 2018/19. These assumptions were set out in chapter 10 of the September document – and the most significant are:

- Anticipated improvements in scores on the PPF-specific model – reflecting that the move to new scorecards is likely to lead to efforts to improve scores.
- New s179 valuations are expected to show schemes as better funded than the s179s they replace – even after allowing for DRCs.
- The significant changes to the DRC and contingent asset regimes are expected to boost levels of certification.

2.2.5 We make these "global assumptions" every year and they reflect our best estimate of the future based on historical experience.

2.2.6 Three respondents questioned whether the extent of cross subsidy required to fund the RBL cap has increased and whether the SBLM would correspondingly need to be increased to cover the cost of the cross subsidy. The cost of the cross subsidy will be no greater than in the second levy triennium and is covered by the SBL that would be raised based on the current SBLM, which is 0.000021.

2.3 Decided view

2.3.1 The consultation responses we received did not challenge the proposed LSF of 0.48 and indicated broad support to reduce the RBL cap. As such, for 2018/19 we will be setting the LSF as 0.48 and the RBL cap as 0.5 per cent of smoothed liabilities.

3. Insolvency Risk

3.1 Experian model issues

3.1.1 We had 15 responses raising issues about the PPF-specific model. As with past consultations, most raised particular features of scorecards or individual variables that the respondent felt did not 'work' in the particular circumstances of their entity or those of a small sub-group of entities. Most of the issues raised were investigated in the development work for the first consultation and we considered whether there was any new evidence we could draw upon or develop in considering whether to make changes.

3.2 Comments on Scorecards and Variables

3.2.1 One response suggested the use of replacement values for the cash by liabilities and trade creditors (sales based) variables might be unfair for non-UK entities as it was believed their accounts were less likely to include current liabilities and trade creditor data.

3.2.2 We re-examined the information that Experian has about "fill rates" (the percentage of entities for whom the data item is available for use by Experian). We found that for current liabilities on scorecard 1 there were very high fill rates for both UK and non UK entities (100 per cent and 96 per cent). By comparison, Log Creditor Days (Sales Based) has a lower fill rate for both UK and non UK entities (88 per cent and 76 per cent). The lower fill rate for this variable also pertains for scorecard 2 (70 per cent) which is dominated by UK entities (and was observed during the second triennium on scorecards using creditor data). The lower fill rate for Log Creditor Days (Sales Based) is thus neither new nor unique to foreign employers but intrinsic to the variable itself. We have also confirmed that for UK and non UK entities the median observed for Log Creditor Days (Sales Based) is sufficiently similar to give us confidence that the use of the replacement value (based upon median Log Creditor Days (Sales Based) is appropriate for both UK and non-UK entities. In view of the contribution the variable makes to the predictiveness of scorecards it is appropriate to retain it.

3.2.3 Three stakeholders suggested that the log pre-tax profit variable is too sensitive to changes in profit and in particular the movement from a small profit to a small loss. In the policy statement on the first consultation we explained that the sensitivity of log variables, particularly at low positive and negative values, had been highlighted as a negative aspect of the new model. This led us to develop the proposals for the use of plateaus for these low values. The evidence we included in the policy statement showed that there was a clear difference in the insolvency experience of profit making and loss making entities.

3.2.4 We have reviewed this position, including carrying out additional analysis, and have reached the same conclusion that the evidential justification for a substantive distinction in insolvency scores between profit and loss making entities remains strong. It is notable that the Gini of the log profit variable in isolation is one of the strongest within the model (but less predictive than the scorecard as a whole).

Table 1: Ginis for log profit and for all variables

	Scorecard 1 (> £30m)	Scorecard 2 (< £30m)	NFP
Gini 3rd Triennium Model 2007-2015	57.8%	59.7%	51.3%
Gini Log Profit Variable	53.0%	47.0%	34.0%

3.2.5 Requests were made for adjustments to be allowed to figures published in an entity's published accounts. For example, a mutual organisation requested that distributions – which they equated to dividends but which are deducted from pre-tax profit in their accounts - should be added back to increase the pre-tax profit figure. We have had similar requests, both in the consultation earlier this year, and during the second triennium to adjust reported accounts numbers in a range of circumstances, but have concluded it would be impractical to adjust individual accounting numbers – as many sets of accounts would then be open to debate, and we would not have robust evidence to support decisions about whether or not to adjust.

3.2.6 We also received individual requests for changes to particular variables - for example, cash, turnover - but remain satisfied that the evidence used to build the model supports their continued inclusion.

3.2.7 One respondent questioned the basis of the log net worth definition (on scorecard 1) suggesting that intangible assets should not be excluded. It was felt that the exclusion particularly impacted on employers/ ultimate parents in fields such as technology. In developing the new scorecards Experian considered a wide range of potential variables related to those finally selected. For example, Total Net Assets (which is Net Worth plus intangible assets) was considered as an alternative to the Net Worth variable, but was found to be less predictive. More broadly, it is not possible to tailor the scorecards to reflect particular features of individual entities or small groups of companies, since we could not do so in an evidence-based way. We will not, therefore, be changing the basis of the net worth calculation.

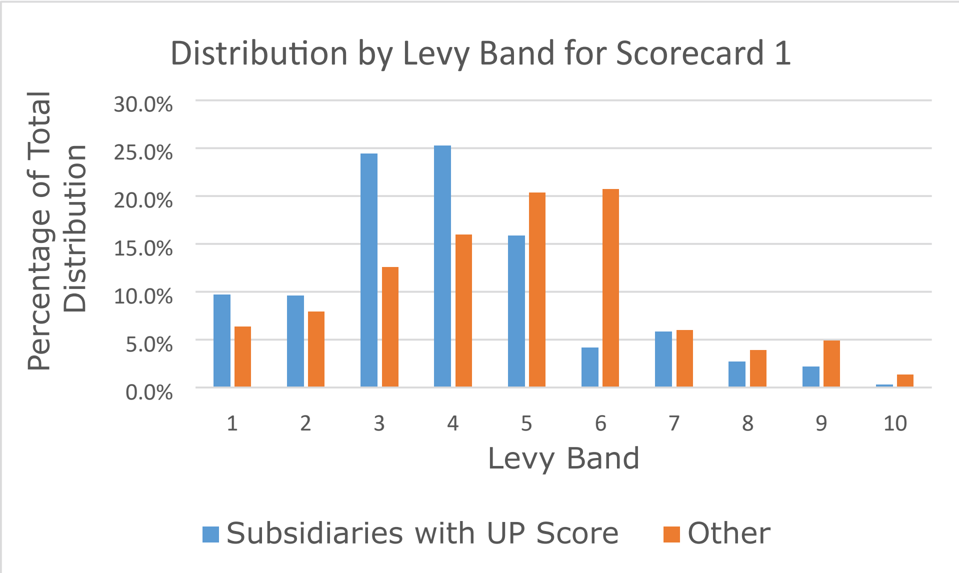
3.2.8 We were asked to consider whether large subsidiary employers (with turnover of £50 million and assets of £500m) were unduly penalised given the absence of a group strength measure for them. This is an issue we have considered previously. A key general point is that scorecard 1 has been built to score the population on it (subsidiaries and non- subsidiaries). A large proportion of that population is made up of subsidiaries and we can, therefore, be confident that they are scored appropriately. However, in light of responses, we have extended the analysis Experian did ahead of the first consultation in particular to assess whether large subsidiaries are unjustly "penalised".

3.2.9 The chart below shows the levy bands of those currently on scorecard 1 when split into two separate groups:

- Those which are a subsidiary and where Experian has sufficient information to credit score the ultimate parent, and
- All others – eg, ultimate parents, etc.

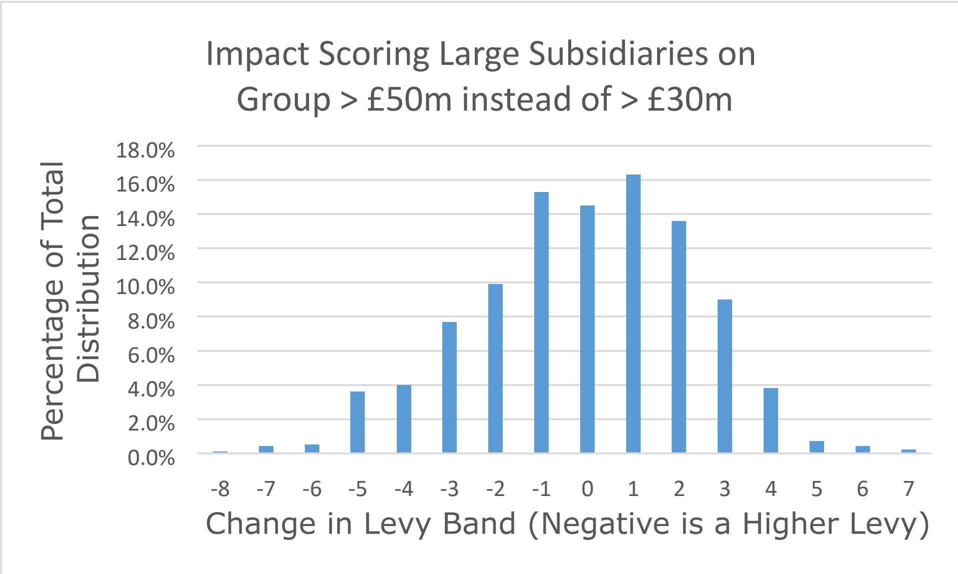
3.2.10 It can be seen (in Chart 1 below) that the first group – subsidiaries – actually score more favourably than ultimate parents. It is also worth noting that the insolvency rate of this scorecard's population is about half that of the overall population.

Chart 1: Comparison of subsidiary and ultimate parent scores on scorecard 1



3.2.11 We then looked at the impact of scoring large subsidiaries on the Group Scorecard > £50m where a component is included for parental strength. The result, shown in Chart 2, was that there was no bias in the change in levy band observed, suggesting that there is no obvious benefit or disadvantage associated with this group being scored on the Group Scorecard > £50m.

Chart 2: Impact of scoring large subsidiaries on group company scorecard



3.2.12 In summary we concluded that there is no evidence that scoring subsidiaries on scorecard 1, without a variable capturing parental strength, unfairly disadvantages those subsidiaries. In addition there is also the practical consideration that building a statistically valid scorecard for this population of subsidiaries would be impossible as the number of insolvencies is far too limited to provide robust evidence on the factors correlated with insolvency.

3.3 Replacement values

3.3.1 In the light of some stakeholder responses - especially in relation to the log pre-tax profit and log creditor days (sales based) variables - we have reviewed the treatment of missing data items and reported zeros in accounts.

3.3.2 Companies supplying data may in the annual report leave data blank or put in a zero when the number is in fact unknown or rolled into an over-arching broader balance sheet item. Therefore, "zero"/"unknown" values had to be assigned an appropriate score (replacement value). In all cases apart from calculated variables and log profit Experian treat reported or derived zeros as zero[3]. In the case of log trade creditors there was concern that trade creditors might simply not be reported and/or included in a wider current liabilities total. The median insolvency probability for the population of entities that did not report trade creditors was calculated and this has been selected as the replacement value. We are satisfied that this is appropriate.

3.3.3 In the case of pre-tax profit the risk was that entities might simply choose to not report it. It was possible that a median profit level might

[3] In order to allow a log calculation to be completed 1 is added to the reported 0.

be significantly preferable to their actual profit (or loss) level. Therefore, it was considered appropriate to use a minimum (or worst case) basis for the replacement value.

3.3.4 We are satisfied that where the data is genuinely unknown we should continue to use the minimum value.

3.3.5 However, where the accounts used to derive a score are found to be a genuine zero we do not consider it is appropriate to apply the minimum value. We have, therefore, made an adjustment so that where the profit reported in the accounts is zero it will be treated as such in the calculation of an entity's insolvency risk score.

3.4 Permitted Sources and Dormant Accounts

3.4.1 We have reviewed the sources that Experian collect accounts from and have amended the rules to reflect where and how often it is practical to collect accounts information from these sources. In addition to Companies House and the Charity Commission, Experian will be using data obtained from the following other sources:

- The Higher Education Funding Council of England ("HEFCE")
- The Certification Officer appointed pursuant to the Trade Union and Labour Relations (Consolidation) Act 1992
- The Financial Conduct Authority, and
- The Homes & Communities Agency.

3.4.2 Experian will carry out an annual collection exercise for these four sources, in January, for accounts filed by 31 December, with scores using the new accounts from February. Experian are additionally happy to receive updated accounts submitted to them voluntarily by schemes/employers who file with any of these organisations.

3.4.3 In the light of some individual cases we have seen we do not believe it is appropriate for Experian to use dormant accounts where they relate to periods before the employer was active – ie, a shelf company before a change to an operational entity. In these circumstances we will consider instructing Experian to disregard dormant accounts if - they relate to the pre-active period; there are alternative post active accounts that can be used – either filed (or interim accounts provided) to base at least one monthly score upon; and where we accept that applying the normal rules would not fundamentally capture the risk of the entity becoming insolvent.

3.5 Credit Rating issues

3.5.1 There were three responses on credit ratings all of which were supportive and one further response raising procedural/customer services issues.

3.5.2 We have had questions raised about the timing of changes to credit ratings scores. The change to a rating will be reflected in the month following the month of the change. For example, a rating improving on 5 January 2018 would be reflected in a changed Monthly Score for February 2018.

3.5.3 We were asked about appeal options in relation to credit ratings scores and we are publishing a frequently asked question (FAQ) to explain how to appeal a credit rating or credit model based score.

3.6 Special Category Employers

3.6.1 In our March consultation we proposed a new rule for a small group of entities for which, in our view, the PPF scoring model does not provide appropriate scores, and which are judged to be of very low risk (all employers with these characteristics have close links to government). The proposed rule would allocate these entities to levy band 1.

3.6.2 In the September Consultation we reported that respondees on this issue were overwhelmingly in favour of the proposal. Some of the responses were from organisations that came outside the scope of the rule as consulted upon. In response, we made minor amendments to the rule without fundamentally broadening its scope - for example, clarifying 'Employers established by legislation' includes employers established under international treaty and reference to 'central government' entities includes foreign governments and entities close to foreign governments.

3.6.3 We received one response on the form of the Officer's Certificate (page 6 of the Combined Third Triennium Policy Statement and 2018/19 Consultation Appendices). Employers who believe they could come within this Special Category rule can apply using a self-certification form in which an officer of the company sets out the grounds for satisfying the tests (a draft Officer's certificate was included in the consultation package). The response pointed out that certain entities do not have an individual who could be classed as a director, member or general partner of such entities as required by the certificate. We have considered this point and have amended the form to include a senior manager (who has authority to bind the entity) for organisations that do not have director or partner roles. The final form is now available on our website, and we encourage any entity that believes that it comes within scope of the rule to apply in good time, to provide the opportunity to address any issues with the application ahead of the 31 March 2018 deadline.

3.7 Capping for schemes with large increases

3.7.1 A very small number of respondents noted the significant increases in levy seen by some stakeholders due to the updating of the model and suggested we consider action to cap increases.

3.7.2 The suggestion that there ought to be protection for schemes seeing a large one-off increase in levy has been an occasional minority theme in consultations over the years.

3.7.3 We have generally taken the view that it is inappropriate to cap increases in levy as that implies schemes are under-paying for the risk they pose, meaning other schemes are paying more to offset the effect of capping. However, in view of the significant impact on levies of the 2015/16 move to the PPF specific-model as the basis for measuring insolvency risk, we consulted on a possible approach for capping large increases. Consultation responses then were largely negative – with around twice as many responses opposing as favouring capping. Typically, responses argued it would reflect a continuation of an unfair subsidy to those that "had been paying too little". As a result, in the absence of broad support, we concluded it would not be appropriate to implement capping of increases.

3.7.4 Our impact analysis showed that the number of schemes seeing significant changes in levies as a result of rule changes for the third triennium was significantly lower than for the second triennium. Accordingly, and given the reservations that have been expressed previously, we did not initially explore the possibility of capping. In response to stakeholder comments we have considered the case for capping large increases again.

3.7.5 Significantly fewer schemes are expected to see substantive changes in levy as a result of rule changes for the third triennium than was the case for the second. Even so, we found that to cap levies to a meaningful extent would require a substantive compensating increase in levies to other schemes – for example, doubling the SBL if we were to restrict increases to 100 per cent. Our view, therefore, is that capping remains inappropriate and would be unlikely to receive broad support.

4. Customer Service

4.1 Small schemes and estimates

4.1.1 As highlighted in the September consultation document, we have decided that it will be possible to implement simplifications to the regime for certifying DRCs. All schemes will be able to ignore certain expenses relating to investment in the calculation of the contributions while smaller schemes, closed to accrual and with a Recovery Plan will have the option of certifying based on those Recovery Plan payments.

4.1.2 We anticipate this will enable some smaller schemes to certify their contributions where previously, the costs of doing so outweighed the resulting levy reduction, producing a more risk-reflective levy for these schemes. Further detail is set out in Section 7.

4.1.3 We have also been exploring the possibility of providing estimates of levy amounts to schemes ahead of invoicing, and have been seeking views about the usefulness of this from stakeholders. Feedback has indicated there is general support for the proposal, and, so we will continue to work with stakeholders to consider the feasibility and possible options for providing this sort of service.

4.2 PPF/Experian portal

4.2.1 While we continue to receive positive feedback in relation to the PPF/Experian web portal, some users have expressed frustration with the way automated email alerts currently function – specifically, the fact that they receive alerts whenever employer data has changed, regardless of whether the change has translated to a levy band change.

4.2.2 We have been working with Experian and their third party developers, and, in order to address this issue, are planning to implement changes to alert functionality in the New Year. The changes will give portal users the option to change the way their alerts work, including so that they are only triggered by levy band changes.

Credit ratings

4.2.3 Since October 2017 we have been able to display credit ratings and model scores in the portal, allowing stakeholders to track scores. From January 2018 we expect to add a link to an S&P "what-if" tool that will allow relevant stakeholders to understand how changes to accounting information will affect their credit model score.

Portal user group

4.2.4 We are planning another portal user group discussion in February 2018, to explore other ways we can improve the service the portal provides. Some stakeholders will already have received invitations to the session, and we look forward to hearing their suggestions.

5. Levy Rates and Bands

5.1 Summary of consultation proposals

5.1.1 In the 2018/19 Consultation Document we set out our proposals on levy bands and rates for the third triennium. We proposed retaining the existing ten band structure and minimum and maximum insolvency probability boundaries. We also proposed narrowing the levy rate differential between bands 1 to 4, achieved by increasing the levy rates for Bands 1 to 3, and leaving the rates for 4 to 10 unchanged.

5.2 Levy band structure

5.2.1 Few responses directly referred to the existing levy band structure and those that did were mostly supportive of the existing 10 band structure -

though one respondent suggested a reduction in the number of bands within their comments on our levy rates proposal.

5.2.2 A small number of respondents commented upon the distribution of employers by levy band shown in the impact analysis, and the significant proportion of entities in Bands 6 and 7, and one noted that the distribution was different to that anticipated prior to the second triennium.

5.2.3 We explained in the Consultation Document that maintaining the existing band structure was consistent with accepted practice in segmenting risk (including the number of bands, the number covering higher risk entities, and the difference between the most and least populated bands).

5.2.4 With the move to a wholly new basis for calculating insolvency risks in the second triennium we were obliged to set a distribution for the 10 bands. The initial design for the levy bands for the second triennium was for ten bands, with 20 per cent of employers and guarantors in the top band, 5 per cent in the bottom two bands, and 10 per cent in other bands. Underlying the design was the desire for scores to be more evenly spread than at the end of the first triennium (when more than half of employers were scored in the top two bands) but to ensure change in the distribution was at a reasonable level.

5.2.5 We did not then, and do not now, consider that this was a specifically desirable distribution. The distribution on the new scorecards (shown in our impact analysis) reflects the distribution of scores on 8 scorecards – in most cases these show a broadly normal distribution of scores – centred around bands 5, 6 or 7. In two cases, the Not for Profit (NFP) population and scorecard 1, the scorecard has a distribution that centres around much better scores. It is the combination of these different populations that leads to a combined pattern with a peak in band 1 and a separate peak in bands 6-7, and this appears an empirically reasonable outcome.

5.2.6 In practice scores during the second triennium were more heavily skewed toward the best bands than expected, with around 30 per cent of entities in levy band 1. This is more than seven times the allocation to bands 8 or 9 and is not consistent with good practice which is for a differential of not more than five times.

5.2.7 The development of new scorecards for the PPF-specific model for the third triennium has altered the distribution of employers across our current levy bands, and we considered the case for action to alter the distribution of entities to fit the expected distribution at the start of the second triennium (by adjusting the minimum and maximum range points) but this would have a number of consequences. We set these out in our September consultation (at 11.1.9) and have not received responses which suggest a positive case for an alternative distribution.

5.2.8 We have concluded that given our preference to maintain stability of rules, unless there is evidence to support a change; the fact that maintaining the existing structure is consistent with good practice, and the absence of significant stakeholder demand for change, we should maintain the existing ten band structure and minimum and maximum insolvency probability boundaries.

5.3 Levy Rates

5.3.1 Most of the responses on bands and rates concentrated on our proposal to draw the rates for bands 1 to 4 close together by raising the rates of 1 to 3 and a number of respondents opposed. Some of the opposition focussed on the position of Band 1 in particular arguing that employers in this band should see a significantly lower levy and two responses suggested an alternative approach with band 1 remaining at the 2017/18 level (0.17 per cent) and bands 2 to 10 being lowered to achieve the same relationship of rates as our proposal – acknowledging that this would require an increased LSF to achieve the same Levy Estimate.

5.3.2 Individual responses suggested maintaining the existing differentials for the best levy bands, either because those in band 1 in particular should be better 'rewarded' in levy terms and having a larger differential encouraged stakeholder engagement with the Experian portal.

5.3.3 One respondent asked us to consider a report by Deutsche Bank[4] which it was argued supported maintaining a significant difference in levy rate between an A rating (in band 1) and a BBB rating (in band 3).

5.3.4 The report focuses on five year default rates, rather than one-year insolvency rates (as used in the calculation of insolvency risk for levy purposes) and only uses data from one agency. The evidence we reported on in our March consultation included evidence from all three main credit rating agencies and so the data used in this report is a subset of the evidence we considered.

5.3.5 The report notes that default rates are very low in absolute terms for the highest ratings. This is particularly true for defaults over a 12 month period. So public credit ratings suffer from the same limitations as the PPF model, which results in wide confidence intervals around expected values. This in turn impacts the level of confidence one can have that over a 12 month period the default experience truly differs – and this is exacerbated as insolvencies represent a minority of those defaults.

5.3.6 We are aware of another publication - Moody's - that indicates that for those rated A- or better the confidence intervals are so wide that they overlap. The importance of being able to perform the confidence interval calculations ourselves is strengthened by the fact that for ratings judged to be comparable between rating agencies the historic default experience can materially differ. (This is why we created a transition matrix which was the weighted average of three rating agencies.)

5.3.7 While we understand why the argument is being made we believe that one should be cautious in using the five year cumulative default rates of a single provider even for the credit rated population. Furthermore, even if we were persuaded that we could be confident of different insolvency

[4] Annual Default Study (dated 11 April 2016)

rates for each levy band for the credit rated population, the great bulk of scored employers/guarantors in bands 1 to 4 receive an Experian score rather than a rating, and our analysis shows that we can have only limited confidence for different insolvency rates by band.

5.3.8 We have therefore concluded that we should not revert to having larger distinctions between bands 1 and 4.

Alternative basis for narrowing the spread of levy rates

5.3.9 Two stakeholders suggested an alternative way of narrowing the spread of levy rates between bands 1 to 4. This approach would leave the band 1 levy rate unchanged and the rates for bands 2 to 10 reduced. In order to have a neutral levy impact this would require a higher levy scaling factor. It was argued that this approach would be more consistent with moving towards the charging of a levy based upon expected risk only in the years beyond 2030.

5.3.10 The following table shows how the existing levy rates and Levy Scaling Factor would change if the alternative approach was followed.

Table 2: Proposed adjustment to levy rates and alternate adjustment

	2017/18	2018/19 proposed	2018/19 alternative
Band 1	0.17%	0.28%	0.17%
Band 2	0.23%	0.31%	0.19%
Band 3	0.30%	0.35%	0.21%
Band 4	0.40%	0.40%	0.24%
Band 5	0.53%	0.53%	0.32%
Band 6	0.81%	0.81%	0.49%
Band 7	1.26%	1.26%	0.77%
Band 8	1.76%	1.76%	1.07%
Band 9	2.39%	2.39%	1.45%
Band 10	3.83%	3.83%	2.33%
LSF	0.65	0.48	0.79

5.3.11 The proposed combination of levy rates and Scaling Factor and the alternative would result in almost identical levy invoices for schemes – the only differences being created by small rounding impacts. This can be seen from comparing the "effective levy rate" (the levy rate multiplied by the LSF, essentially the levy charged per pound of underfunding risk) for a given band. For example, Band 4 has an effective levy rate of 0.0040 x 0.48 = 0.0019 under the initial proposal, or 0.0024 x 0.79 = 0.0019 under the alternative proposal.

5.3.12 We do see some attractions in this alternative proposal. However, we are concerned about the potential for a change at this stage to create confusion. It would require a substantial increase in the LSF to be revenue neutral, which might lead to the mistaken belief that a significant change has been made. Conversely those stakeholders who understand that the changes offset each other may regard a change that doesn't affect anyone's bill as being a distraction.

5.3.13 We have concluded that the levy rates should be confirmed as set out in our Consultation Document.

6. Contingent assets

6.1 Consultation proposals

6.1.1 We set out in our March consultation proposals that for the largest Type A (group company) guarantees, certification of the amount available from the guarantee (in the event of employer insolvency) would have to be backed by a report to trustees on the ability of the guarantor to meet the sum certified. Initially, we had proposed that the threshold for reporting would be set by reference to the sum guaranteed, but in the light of responses from stakeholders, we modified our proposal to have a limit based on levy saving – set at £100,000 (which would apply to around 1 in 5 guarantees).

6.1.2 We indicated in March, in response to specific concerns, that we expected to update our standard form contingent asset agreements and to ask trustees and guarantors to re-execute agreements on the new basis, in order for them to be taken into account from 2018/19 onward.

6.1.3 In response to comments from stakeholders, and in reviewing the wider policy underlying the contingent asset agreements, we revised our proposals, and launched a separate consultation from 19 October to 21 November 2017. This provided an opportunity to ensure that before requiring a significant step such as re-execution to be undertaken by schemes and guarantors:

- the agreements continue to appropriately reflect the types of obligations entered into in the marketplace for pension risk reduction, and
- the levy credit that we offer for such risk reduction measures is appropriate.

6.1.4 The questions in the consultation covered five themes. Namely: (i) caps on liability; (ii) the support offered by the guarantee; (iii) interaction with multi-employer schemes; (iv) amendment and release criteria; and (v) re-execution.

6.1.5 In addition to consulting further, we indicated that whilst new contingent asset agreements entered into after the new forms are published will be required to be on these new forms, for existing Type A and Type B agreements we expected to require action to be taken for 2019/20, but not for 2018/19.

6.2 Comments on proposals to require pre-certification reports

6.2.1 We did not request further comments on the issues we concluded in the first consultation and only four responses covered issues connected with pre-certification reports or more general questions about the extent of levy credit for these arrangements (not covered within the separate contingent assets consultation).

6.2.2 Two consultancies raised questions about the duty of care required to be given by the person producing the guarantor strength report. It has been suggested that concerns about the extent of uncapped liability might mean that advisors that have traditionally provided similar

services would be unwilling to continue. There was a suggestion that a direct contractual link with the PPF – through a general letter of engagement be used to create contractual certainty on the scope of the duty of care. We are not convinced such an approach is necessary to meet the concerns that had been expressed, and note that most consultants have not indicated there is an issue with the duty of care.

6.2.3 Instead, therefore, we believe it is appropriate to clarify here the extent of the duty of care – ie, that it is in relation to the levy that is saved as a result of the contingent asset being accepted (by contrast with the scheme which may have a loss due to not receiving the sum guaranteed) and that it relates to the year for which the report was issued, and that we have no objection to the advisor asserting a limit of six years for recognising any duty of care. Our intention in requiring recognition of a duty of care, is not to create an absolute liability in the event a guarantor is not able to meet its obligations, but rather to provide assurance that the report was not given negligently. In so doing we are able to simplify the process of reviewing certified contingent assets and deliver increased certainty for levy payers on whether their contingent asset will be accepted. We expect this clarification to provide covenant advisors with additional certainty about the nature and extent of any risks they are accepting in granting the duty of care.

6.2.4 We received a request for clarification of whether guarantors scored by the S&P Credit Model would be subject to the guarantor adjustment based upon the impact of the realisable recovery if it were treated as being immediately payable. The stakeholder noted that, although the draft insolvency risk appendix indicated that an adjustment could apply the draft insolvency risk guidance was not consistent with that. We have, therefore, clarified this in the guidance.

6.2.5 Finally, we received a request to adjust the basis on which we assessed group strength. The response included reference to the use of guarantees but appeared to be more focussed on the assessment of parental strength. Within the review of insolvency risk we include an explanation of the review we carried out on whether the absence of a parental strength measure for large subsidiaries disadvantaged them.

6.3 Comments on the standard forms consultation

The October consultation on standard forms received 15 responses. In addition, there were informal discussions with parties including the Association of Pension Lawyers, which were valuable in developing our thinking.

Current range of caps

6.3.1 Responses suggested we should retain all the current caps, in order to allow for flexibility and choice. In particular, some respondents noted that requiring re-execution onto a different cap may make re-negotiation more difficult.

6.3.2 While, in principle, there might be potential downsides in retaining the full current flexibility - for example, complexity for schemes that are new to Type A contingent assets - nonetheless, we are persuaded by the responses, and therefore concluded we should retain the existing range of liability caps.

The operation of fixed caps

6.3.4 The October consultation noted that the standard form requires that the guarantor guarantees all of the present and future liabilities of the employer to the scheme, but the relevant cap limits the amount of those liabilities that can be recovered from the guarantor, and explored how that might most appropriately operate where there was a fixed cap.

6.3.5 We proposed that guarantees should continue to cover ongoing demands and insolvency demands, but the fixed cap should only attach to insolvency demands. We noted that in practice there was little evidence that payments were in fact made under a guarantee prior to insolvency, but that the existence of the pre-insolvency guarantee might allow trustees to leverage contributions made outside the guarantee.

6.3.6 A number of stakeholders agreed with our proposed option. There was also support for the view that the guarantee being available in principle prior to insolvency was helpful for trustees even if it was not directly called in practice. A typical response stated, "In our view the existence of guarantees and charges are of central importance in making counterparties (and other group employers) support their schemes and/or put employers in funds to enable them to provide that support". However there were also a number of reservations expressed about the option we proposed.

6.3.7 Generally, those responses expressing reservations did not object to there being a pre-insolvency liability per se (only two stakeholders suggested Option 2 which would restrict the guarantee to post-insolvency claims), rather they were concerned that the pre-insolvency liability was, as they saw it, "uncapped". Strictly speaking, the guarantee is not truly unlimited, as it will always be capped at the overarching level of the guaranteed employers' obligations to the scheme, but some responses noted that there are jurisdictions in which all guarantees must be formally limited. And even without a legal requirement to have a cap in all circumstances, some respondents thought we might lose the prospect of good guarantees, "some trustees will find that their employers are unwilling to engage using the PPF's revised "full s.75debt" documentation for a number of reasons including:

- because they consider it to be too risky as a result of the perceived open-ended nature of the guarantee language
- because they are prohibited under local law from giving uncapped guarantees
- because they have prohibitions in their banking documentation from giving uncapped guarantees".

6.3.8 As a result, a number of stakeholders suggested that our "option 5" where the agreement covers ongoing demands and insolvency demands, and there are separate fixed caps for (i) the aggregate of ongoing demands and (ii) for insolvency demands, would be an appropriate alternative model.

6.3.9 We continue to consider that option 4 offers the simplest drafting, and given the lack of evidence of guarantees being called prior to insolvency, is unlikely to change the guarantor's position in practice. However, we can see that could give rise to difficulties in securing re-execution in some cases, and that there are persuasive reasons why option 4 would not be possible in all circumstances. We will, therefore, draft the relevant clause of the guarantee to be as described by option 4, but will provide additional text that can be included to limit the pre-insolvency claim, subject to the requirements that any limit in the pre-insolvency cap is at least equal to either the post insolvency cap or the largest annual contribution due on the schedule of contributions.

Multi-employer schemes

6.3.10 The October consultation asked a variety of questions in relation to contingent assets and multi-employer schemes. For example, whether the cap should be apportioned in relation to sequential employer insolvencies (ie, across time) and/or in relation to segregated sections (ie, across the scheme). We also asked about the way that in practice trustees might apply the proceeds of a claim, where the scheme will or may segregate.

6.3.11 The responses contained a mix of views. The main theme was that the scheme-specific context meant that designing a one-size-fits-all formula would be difficult and possibly prohibitively complex for use. In particular, there are two significant variables that we do not control, namely the order and timing in which insolvencies might happen (they may all be on the same day, or they may be years apart), and the decisions that trustees make as to how to apply any money received (which is governed by individual scheme rules). It was noted, in this context, that a change of law would be needed to achieve a consistent approach.

6.3.12 The issues that are at play here arise in the wider pensions law context, and we consider that the contingent asset regime may not be the right place to try to address these. We also note that there is virtually no consensus in the consultation responses on this, apart from a few respondents who thought it would be fairer if trustees apportioned amounts recovered. Our conclusion is that rather than try to address this scenario in the agreements, schemes with concerns in relation to apportionment should ensure their trust deed and rules contains the powers they would like in order to enable them to act appropriately for all their members. And in particular, we do not think it would be appropriate to artificially constrain a claim because of an expectation about how the trustees might use the funds.

6.3.13 Our conclusion is, therefore, that:

- the fixed cap should continue to apply across the whole scheme, and erode on each employer’s insolvency, and
- the fluctuating cap should also continue to apply across the whole scheme.

6.3.14 This may result, for example, in a large proportion of a fixed cap being called in relation to a single initial insolvency for a scheme with many employers, if the section 75 debt for the section is high by comparison with the fixed cap. It may also result, in the case of a fluctuating cap (and as highlighted in the consultation document), in the guarantor paying a different amount to what it might have expected because the relevant comparison, when identifying the claim under the guarantee, would be the section 75 debt in respect of the section as compared to the fluctuating cap across the whole scheme. However, responses flagged to us that this is not something we should seek to influence through the agreements. For the fixed cap, for example, the outcome does not necessarily mean that the amount claimed would be applied just to the section. Many respondents have emphasised that schemespecific – eg, powers afforded under the scheme rules - factors are likely to govern the trustees’ actions, and we recommend that trustees reflect on their rules and practices in regard to the operation of the cap, and consider making amendments if they have concerns about their ability to appropriately balance the interests of members in such a situation.

Amendment and release

6.3.15 There were a mix of responses on the clause 9 amendment and release criteria and whether the clause offers protection for the trustees or whether it is a negotiation point. Most responses seemed to recognise the complexity of clause 9 one way or another. Some trustees delete clause 9 and the amendment/release criteria in their entirety.

6.3.16 Some responses noted the potential for "abuse" in that the current rules permit a guarantor to request the withdrawal of a guarantee in circumstances where the guarantee continues to offer a clear benefit to the scheme. For example, a section 75 guarantee can be removed if the scheme is fully funded on a section 179 basis - although in these circumstances, it remains open to the trustees to refuse the request as it would be reasonable for them to do so.

6.3.17 Recognising that there seems to be some misunderstanding as to when the amendment and release criteria can be utilised, we intend to update the drafting to make clear that amendments can be made by mutual agreement at any time.

6.3.18 We also note, though, that there are downsides to a much simpler approach that leaves the trustees with the ability to agree or to disagree with changes proposed by the guarantor. The current approach does at least give trustees a clear basis to say no to some approaches. We are continuing to develop our thoughts on this as we finalise the new forms.

Re-execution

6.3.19 Responses generally welcomed extra time for re-execution, with some responses asserting that even a deadline of March 2019 could be challenging for some – though others argued that a fixed deadline was important to prompt action.

6.3.20 Although we recognise that a re-execution exercise will involve effort on the part of schemes and guarantors, we remain persuaded that it is important that contingent assets reflect the changes we have indicated above. This will provide trustees, and us, with greater confidence regarding the value of the commitment made.

6.4 Conclusions

6.4.1 We plan to publish revised standard forms in mid-January. Contingent assets entered into after that date will need to be on the new forms. As in previous years, if a contingent asset is newly certified this year, but has an effective date prior to the publication of the new standard forms then that may be recognised (subject to meeting the normal requirements) for 2018/19.

6.4.2 We anticipate requiring existing Type A and B contingent assets which include a fixed cap to be re-executed in 2019/20 if they are to continue to be recognised in the levy. We plan, in the coming months, to provide additional early guidance to schemes well in advance of the usual 2019/20 publication deadlines.

7. Other issues

7.1 Revised asset and liability stresses

Summary of consultation proposals

7.1.1 In 2012/13, we introduced for the first time a measurement of investment risk within the levy framework, using standard liability stress factors and standard asset stress factors (or bespoke asset stress factors in the case of schemes with protected liabilities above £1.5 billion and others that wished to adopt this approach).

7.1.2 We believe the framework is working well but have looked to update the stress factors, incorporating up to date scheme data and market conditions. We also proposed to make a small number of changes to the methodology used to calculate the stress factors.

Consultation responses

7.1.3 We received six responses on the revised stress factors. Some were clear in their support of our proposals and others, whilst not being unsupportive, asked questions of detail on the factors and our approach.

7.1.4 There was a suggestion that it would be appropriate to add liability driven investment (LDI) as an asset class in its own right. However, as set out in the consultation, although we are looking to work with TPR to review asset classes in the future, we will not be making any changes to asset classes for 2018/19.

7.1.5 One respondent requested more guidance on how to allocate secure income alternative assets for the purposes of the stress test calculations, and also questioned the apparently inconsistent treatment regarding allocation of gilt repos and total return swaps. We agree these two types of instrument should be treated consistently. We have updated our Guidance for Bespoke Stress Test Calculation for assessing investment risk and appropriate Exchange help files to clarify our requirements in these areas.

Decided view

7.1.6 The consultation responses received indicated broad support for our proposals in this area and, as such, we will be proceeding with the changes to the methodology and stress factors for 2018/19 as set out in the consultation document.

As proposed, no changes will be made to asset classes and indices for 2018/19. Similarly, there will be no change to the bespoke stress test threshold.

7.2 Deficit Reduction Certificates (DRCs)

7.2.1 Our September Policy Statement set out our settled view, namely to introduce two approaches for the calculation of DRCs:

- Option Alpha – available to all schemes, representing a simplification of the existing methodology by removing the requirement for investment management expenses (both implicit and explicit) to be deducted when calculating the certified amount, and
- Option Beta – an alternative methodology based on recovery plan and certain 'special' contributions, available to schemes with input s179 liabilities less than £10 million, closed to accrual throughout the certification period and with a recovery plan in place.

7.2.2 These new methodologies are accompanied by relaxations of the certification requirements, namely:

- any qualified actuary with appropriate experience (including, but not restricted to, the Scheme Actuary) can complete the certificate on Exchange under Option Alpha, and
- certification under Option Beta can be carried out by a scheme trustee or a suitable representative of the sponsoring employer (rather than by the Scheme Actuary) in cases where the certified DRC amount does not exceed £1 million and relates only to contributions documented in the recovery plan.

7.2.3 Five respondents referred to our proposals, generally to express support. One respondent commented specifically on Option Beta, to request clarification of the scope of 'special' contributions which can be certified in addition to recovery plan contributions.

7.2.4 The DRC Appendix and DRC Guidance set out the scope of 'special' contributions, which will primarily be a matter for the Scheme Actuary to determine and quantify as part of the certification process. Option Beta is intended as a simplified way of calculating DRCs in relatively straightforward circumstances and it would not be practical for this approach to cover every type of contributions. Schemes retain the option to certify using Option Alpha if they consider that Option Beta would not give due recognition of the contributions actually received.

7.2.5 One respondent asked for clarification on whether expenses relating to investment consultancy and advice could also be excluded under Option Alpha, particularly as these may be difficult to separate from investment management expenses – eg, where fiduciary arrangements are in place.

7.2.6 We considered this and think that it is appropriate to give schemes the option to exclude these expenses from the calculation of the DRC amount that can be certified, in order to keep the expenses calculation as simple as possible. The DRC appendix and guidance have been updated to reflect this point.

7.2.7 Another respondent raised a number of points of technical detail which, again, we have clarified in the DRC Appendix and DRC Guidance.

7.3 Block Transfers

7.3.1 Our proposals for the simplification of the requirements for Exempt Transfers (cases where a scheme self-segregated or where the whole assets and liabilities of a scheme or section were transferred and formed the only assets and liabilities of a new scheme or section – 1 to 1 transfers) were welcomed.

7.3.2 Some questions were raised about the detail of the proposal. It was suggested that the requirement for legal advice to be provided as part of the evidence to support treatment as a self-segregated exempt transfer was unnecessarily onerous. The reason we require this advice is because it allows us to be satisfied that we should treat the scheme as continuing and allowing the s179 triennial period to continue and to recognise contingent assets/ABCs to be carried over to the new PSR. In the event that the scheme was in fact, legally speaking, a different entity these arrangements might be invalid and have no value.

7.3.3 We have clarified the requirements for Exempt Transfers in the following ways;

(a) Requests for treatment under the Exempt Transfer rules should be made to the PPF (e-mail: information@ppf.gsi.gov.uk) by 5.00pm on 30th April 2018. In the event that such an application is not accepted, the usual deadline of 29 June 2018 to submit a block transfer valuation would apply.

(b) We have removed the certification that no change has been made to scheme benefits as a result of the sectionalisation. We accept that changes could have been made which would not impact on the accuracy of the s179 valuation – and the s179 certification that the Parent/transferring scheme fully reflects the position of the Parent section/Receiving scheme provides us with sufficient reassurance.

(c) We have removed the requirement for the actuary to certify when the next s179 valuation will be submitted but have included the timing of this in Rule F4 of the Determination

(d) It is possible for schemes that meet the criteria for a self-segregated Exempt Transfer to opt to request treatment as a 1:1 transfer if they would rather obtain the more limited evidence required or to follow the standard block transfer requirements. Equally a scheme that could meet the criteria to request treatment as a 1:1 may also choose to simply follow the standard requirements.

7.3.4 We also asked for views on ways in which the processes for the supply of data following a transfer could be improved. The responses we received on this asked that we work with TPR to allow a wider range of data to be provided than is contained in the existing block transfer certificate. In particular, including the breakdown of asset information and practical difficulties in providing data.

7.3.5 We are continuing to work on these issues with TPR and would suggest that schemes contact TPR on 0345 600 5666 (Option 3) or by e-mail: exchange@tpr.gov.uk if they are having difficulties with accessing the scheme return or providing information in other ways. We will consider with TPR whether to propose changes to the block transfer certificate for 2019/20.

7.4 Levy Rules and Appendices – drafting changes

7.4.1 We have also made the following drafting changes, to confirm how the rules are intended to operate, namely:

(a) Clarifying the definitions in respect of credit ratings to reflect their application to our mortgage exclusion rules.

(b) Reflecting the collection frequency of financial statements from sources other than Companies House, to confirm that statements will be collected as at 31 December each year.

(c) Amending the definition of Full Accounts so that in circumstances where the definition would include accounts (based on the account type indicator) that are not appropriately classified as Full Accounts, the Board has the ability to direct Experian to regard the accounts as Small Accounts.

(d) Confirming that where a PPF-compliant Type B(ii) contingent asset agreement is replaced with another PPF-compliant Type B(ii) agreement over the same asset, there is no requirement to submit a new mortgage exclusion certificate.

(e) confirming the changes in the Measurement Time, and specifically that notwithstanding the general Measurement Time of midnight on 31 March 2018, the Measurement Time for hard copy documents (such as contingent asset documentation) to be supplied to the Board is 5pm on Thursday 29 March 2018.

(f) Clarifying when financial information collected for the purpose of calculation of Credit Model scores will then be applied.

(g) Amending the rules to make clear that where Full Accounts have been self-submitted to Experian, these will be used in preference to any SME Accounts filed at Companies House.

(h) Inserting rule changes to clarify the requirements in respect of the new block transfer rules for certain transfers that do not need to comply with the full block transfer requirements.

(i) Inserting a new rule so that, in appropriate circumstances, monthly Score Measurement Dates that would otherwise be assessed by reference to dormant accounts will be disregarded from the averaging of monthly scores.

(j) Clarifying the circumstances in which a zero, when collected from financial statements, would be regarded as a true zero rather than as an unknown item.

(k) Confirming, in the Contingent Asset Guidance, in respect of guarantor strength reports, the acceptable limitations to the duty of care granted to the Board by the covenant advisor.

(l) Confirming, in the Levy Data Corrections Principles, the Board's intentions in respect of requests to correct data contained in filed financial statements.

(m) Confirming, where more than one property forms the ABC Asset within an ABC arrangement, either a certificate of title for those properties forming the certified ABC Value has been obtained or, where the ABC Value covers all of the properties, other appropriate evidence of title consistent with guidance issued by the Board.

8. Next steps for schemes and key dates

8.1 Introduction

8.1.1 This chapter outlines next steps and key dates for the calculation of 2018/19 levies. As confirmed in section 7.4 of this document we are revising/confirming the main deadline as midnight on 31 March.

8.2 Publication of Levy Rules and Guidance

8.2.1 The Levy Rules that will govern the calculation of the levies for 2018/19, as specified in the Board's Determination under section 175(5) of the Pensions Act 2004, are published alongside this Policy Statement.

8.2.2 Together with the Levy Rules we have published six documents providing guidance for schemes on how to meet the requirements of the Levy Rules, and to explain how we expect to make use of the areas where the Levy Rules provide us with flexibility. These are: •
Guidance on Asset Backed Contributions

- Guidance on Bespoke Investment Risk Calculation
- Guidance on Block Transfers
- Guidance on Contingent Assets (draft – guarantor strength only)
- Guidance on DRCs
- Guidance on Officer's certificates certifying secured charges and certain other matters
- Guidance on Accounting Standard Change Certificate
- Insolvency Risk Guidance.

8.2.3 In addition we are publishing with this document Officer's certificates in connection with ABC certification, FRS 102 certification, mortgage exclusions and applications to be considered a Special Category Employer.

8.3 Key dates

8.3.1 For 2018/19 we will use information from the annual scheme return that is submitted via the Pension Regulator's Exchange system to calculate levies. We will also use other data submitted to either the PPF or Experian as follows

8.3.2 The deadline for submission is midnight on 31 March 2018, except as detailed below. The ABC certificate can be found on the PPF website and the Mortgage Exclusion (Officer's) Certificates are available on the PPF/Experian portal.

Item	Key dates

Monthly Experian Scores	Between 31 October 2017 and 31 March 2018
Deadline for submission of data **to Experian** to impact on PPF-specific Monthly Scores	One calendar month prior to the Score Measurement Date
Submit scheme returns **on Exchange**	By midnight, 31 March 2018
Reference period over which funding is smoothed	5-year period to 31 March 2018
Contingent Asset Certificates to be submitted **on Exchange**	By midnight, 31 March 2018
Contingent Asset hard copy documents to be submitted as necessary **to PPF**	By 5pm, 29 March 2018
ABC Certificate to be sent by e-mail **to PPF**	By midnight, 31 March 2018
Mortgage Exclusion ('Officers') Certificates and supporting evidence to be sent **to Experian**	By midnight on 31 March 2018
Accounting Standard Change certificate	By midnight on 31 March 2018
Special category employer certificate	By midnight on 31 March 2018
DRCs Certificates to be submitted **on Exchange**	By 5pm, 30 April 2018
Certification of full block transfers to be completed **on Exchange** or sent to PPF (in limited circumstances)	By 5pm, 29 June 2018 (Exempt transfer application by 5pm 30 April 2018)
Invoicing starts	Autumn 2018