Pension Protection Fund

Consultation document

Levy rules 2022/23

Foreword

This consultation sets out our proposals for the calculation of 2022/23 levies. In developing these proposals, the impacts of COVID-19 have continued to be foremost in our minds.

Last year we said we would move away temporarily from setting the rules on a multi-year basis. This move was designed to allow us to be more reactive to economic changes, and to help us set an appropriate level for the levy overall - which is particularly challenging in this environment.

The PPF's foremost responsibility is to ensure we can pay all our current and future members the compensation to which they are entitled. At the same time, we are acutely aware of the cost of the levy to schemes and employers, and the challenges facing businesses at this time.

It is clear that the full economic impact of the pandemic is yet to unfold as Government support is reduced and more company accounts are filed that reflect COVID-19 impacted trading. From a PPF perspective this means the risks we face have the potential to increase, with the possibility of significantly higher claims, and this continues to be a key concern for us.

However, we have a strong funding position, as will be shown in our annual report and accounts later this year, meaning that we are able to wait and see what happens to the level of claims, rather than pre-emptively seeking to increase the levy. We are therefore proposing to leave the key levy parameters, in particular the headline levy scaling factor, unchanged from last year. This, coupled with improvements to scheme funding, and the resilience of sponsoring employers demonstrated to date throughout the pandemic, leads us to expect the 2022/23 levy to collect £415m. This is a reduction from 2021/22 of £105m, and means around 82 per cent of schemes that pay the risk-based levy will see a reduction in their levy.

This is the second year D&B have been scoring scheme employers since introducing them as our new insolvency risk partner in 2021/22. We are pleased that the insolvency risk model they operate on our behalf is performing well, and are not proposing any changes to it.

We are proposing very limited changes to other areas of our methodology for calculating scheme levies. For the great majority of schemes, the only change will be the move to reflect our new valuation basis (A10) in the levy calculation – which for 99 per cent of schemes serves to reduce the levy.

Support measures introduced in 2021/22 have been widely appreciated in uncertain times, so we are committing to continue to offer these – unchanged - for 2022/23.

We hope the policy and service measures we are proposing will provide stability and support to levy payers whilst maintaining a risk reflective levy, and I am looking forward to hearing stakeholder views. We will publish our conclusions in due course.

David Taylor
Executive Director and General Counsel

Contents

1. Key proposals

This document sets out our proposals and the underlying analysis for the 2022/23 levy rules. These rules will determine how levy bills to be issued in autumn 2022 will be calculated. The headline proposals are:

The Board's Levy Estimate and the levy parameters

- We intend to set the Levy Estimate at £415m.
- The Levy Scaling Factor ('LSF') and Scheme-Based Multiplier are proposed to remain at 0.48 and 0.000021 respectively, and the risk-based levy cap at 0.25 per cent of scheme liabilities.
- Measures introduced in 2021/22 to support schemes through the pandemic will remain in place.

Insolvency risk model

- We propose to continue to measure insolvency risk on the basis in use since April 2021, using credit ratings and the PPF specific model operated by Dun & Bradstreet (D&B).
- The mapping of Credit Ratings to Levy Bands / Rates has been updated in line with our policy statement in January 2021.

Section 179 valuation basis

- Following the updated s179 assumptions guidance which came into force earlier this year, we're changing the s179 valuation output basis from version A9 to A10.
- These changes bring our assumptions in line with the bulk annuity market and are expected, typically, to reduce schemes' s179 liability values used to calculate the levy.

Consolidators and schemes without a substantive sponsor (SWOSS)

- We are bringing together the previously separate rules covering commercial consolidators and schemes without a substantive sponsor (or SWOSS) into a single appendix, widening the definition so that all schemes without a conventional sponsorship structure can be treated consistently.
- We are interested in industry feedback to allow us to gauge the extent to which such schemes currently exist and how these propositions may evolve in future.

More about our analysis and rationale for decisions, along with information about other subjects under consultation can be found in the following sections of this consultation document.

2. Overview: Our Policy Framework in light of COVID-19

2.1. The context: our September 2020 proposals

2.1.1. This time last year, the impacts of the pandemic were impossible to predict. Few would have been surprised to see a very substantial increase in insolvencies and in claims on the PPF. However, we did not intervene to increase the levy; rather, we left all key parameters unchanged from 2020/21, alongside introducing focused support measures, meaning we would collect around £520m in levy for 2021/22. A year later, we have more data on how COVID-19 has affected the universe we protect – though substantial uncertainty remains. Nonetheless, we propose to leave parameters unchanged for a further year, meaning that for 2022/23, the levy will fall to around £415m. We set out below further detail on the thinking behind our approach.

2.1.2. We set out analysis in 2020 on the likely trends as a result of the COVID-19 pandemic. The natural lag between company trading, and its reporting in annual accounts meant that we were still waiting to see the impact of the pandemic on company financials, which we expected to be adverse. We anticipated this would start to be seen over 2021 and as a consequence we could see a deterioration of levy insolvency risk scores. Modelling suggested this could have a significant impact on scheme levies, and, therefore, require changes to our calculation methodology or parameters - such as adjusting the Levy Scaling Factor ('LSF') to maintain an appropriate levy (including to ensure the levy stayed within the legislative 25 per cent limit on year on year increases).

2.1.3. At that time, we also noted that concerted support extended by both governments and central banks had led to a subdued number of insolvencies. September 2020 was however also the time when the Chancellor announced the Winter Economy Plan, which set out a road map for tapering that same government support. At the time the PPF therefore considered the risk that once government support ended we were likely to face an increased risk of claims.

2.1.4. Taken together this meant significant uncertainty about whether we would need to change our rules to collect less, to fit within the legal limits on the levy, or conversely collect more to help address large claims. Given these considerable uncertainties, we proposed and implemented a temporary move away from our typical multi-year approach to designing the levy rules. This was to allow us to take a more flexible approach to assessing the right balance of responsive action as the economic impact unfolded, should it be needed. There was general stakeholder support for this move to a more year by year approach.

2.1.5. In the light of the PPF's strong funding position entering the pandemic, we chose to avoid seeking to proactively raise the levy in the short term:

- Allowing the overall levy collected to fall from the £620m estimate for 2019/20 to £520m;
- Reducing the cap set on the risk-based levy from 0.5 per cent of scheme liabilities to 0.25 per cent;
- Introducing the Small Scheme Adjustment (or SSA), a long-term adjustment to better reflect the risk posed to us by small schemes; and

- Offering flexibility over payment terms, providing schemes and sponsoring employers valuable support in uncertain times.

2.1.6. This combined policy package aimed to support schemes and sponsoring employers through the uncertain times presented by the COVID-19 pandemic whilst maintaining a risk reflective levy.

2.1.7. We set out below a range of information, which updates our view. While much remains uncertain, the picture appears more positive than we expected last year.

2.2. A year on: what are we seeing?

2.2.1. It is clear that the last eighteen months has been a uniquely challenging period for the companies that support defined benefit pension schemes. What has been striking, so far, is that despite the profound effects of the pandemic the insolvency rate has remained low. This reflects both continued Government support and businesses taking difficult and challenging decisions to adjust their business models. This may have involved moving to online-based transactions, for example, or placing employees on a temporary leave of absence from work with pay, with the aim of bringing furloughed staff back into the business when able.

2.2.2. The impact of business's efforts to respond flexibly can be seen in a report from the Bank of England in June 2021. This reported that the average SME between April 2020 and December 2020 has been able to reduce cash-expenses by as much as turnover fell. Cash flow impact from normal business operations was therefore relatively small for the average SME which sends a positive signal about their financial health. While the Bank of England report did not focus on the largest of businesses, it is reasonable to expect that typically they would be at least as able to respond flexibly. Of course, the impact on individual businesses varies, and there are sectoral differences, with the Bank of England identifying the most impacted sectors being "Arts and Recreation" and "Accommodation and Food".

2.2.3. The positive signals identified in the Bank of England report are consistent with our latest analysis of 1,129 annual reports relating to accounting periods ending on or after 1 September 2020 (later referred to as pandemic period accounts) so far been available to us, for which we can make a comparison to the previous year[1]. For these employers we are seeing a degree of movement in levy bands that is consistent with a 'normal' year – the average change in levy band for these employers is close to the average levy band change between levy years 2008/9 to 2018/19. In fact, there is a small net improvement in levy band on the prior year. That said, we are conscious that more than 85 per cent of employers still have to file pandemic period accounts. So, the pattern observed to date may change as more businesses report results for 2020. We will continue to monitor this key area of uncertainty carefully, especially over the next few months as most December 2020 accounts are filed. This should provide us with the evidence base, at the end of the consultation period, to identify whether any action is needed (though there is nothing so far to suggest it will be).

[1] We have captured more accounts than this, but exclude those where the company has changed scorecard or prior year accounts are not available.

2.2.4. We are also conscious that challenges still lie ahead. The government continues to move ahead with its ambition to reduce the economic support measures in a measured manner. For example, restrictions imposed during the coronavirus pandemic preventing businesses serving winding-up petitions against debtors will ease from the end of September, but only for debts of more than £10,000 compared with the pre-pandemic threshold of £750. There is - therefore - a possibility that we see a greater number of corporate insolvencies in the coming months and that both impact and timing might differ by size and type of business. That said, we expect the potential magnitude to be less severe than that which we previously outlined in our 2021/22 consultation.

2.3. The insolvency risk model

2.3.1. 2021/22 was the first levy year for which the PPF-specific insolvency model was delivered by Dun & Bradstreet (D&B). During an economic shock, all businesses, including those considered financially stronger, are more likely to experience an insolvency event. Insolvencies among financially stronger businesses impact the ability of credit scoring models to differentiate between solvent and insolvent businesses. Against the backdrop of a pandemic-induced recession, the ability of the PPF-specific model to accurately assess the risk of insolvency was a key concern when we set our levy rules for 2021/22, last autumn.

2.3.2. Regular performance monitoring over the last year - and an annual review carried out by D&B over the period April 2020 to March 2021 - have given us the confidence that the PPF-specific model has continued to be predictive and is fit for purpose. We therefore see no need to make changes to the scoring model. More information on our analysis is included in chapter 3.

2.3.3. With the next stage of the economic recovery being dependent on a combination of factors that remain uncertain, we will continue to monitor model performance closely and on a regular basis.

2.4. The PPF's financial position and our choice about the levy to collect

2.4.1. We will set out our financial position in detail in our annual report and accounts later this year. This will show that the PPF has bounced back from the reduced funding level at 31 March 2020, and is in a strong financial position. That said, as the annual report will show, we continue to face significant risks – many schemes still have significant deficits, in some cases measured in the billions of pounds. But our strong funding position means that we are able to wait to see the level of claims we receive, rather than seek to increase levy collection pre-emptively.

2.4.2. In this context, and with the PPF-specific model continuing to demonstrate that it is predictive and is fit for purpose, and pandemic period accounts to date not resulting in a significant aggregate change in levy, we propose to keep our levy rules broadly unchanged for 2022/23 and continue to offer the support measures introduced for 2021/22.

2.4.3. Maintaining the existing levy parameters – combined with the assumptions that we have made about scheme and employer data - results in a proposed Levy Estimate set at £415m. This is £105m less than the estimate for 2021/22. Our analysis suggests that around 82 per cent of schemes can expect to see a lower levy than in 2021/22.

2.4.4. A significant proportion of the reduction in our Levy Estimate is due to the incorporation of the latest actuarial assumption basis (version A10) for measuring funding levels. The updated actuarial assumptions reflect reductions in the price of buying out pensions with an insurance company.

2.4.5. More detail on how we have calculated our Levy Estimate, including the assumptions made, is in chapter 5.

2.5. Other policy development

2.5.1. We are making a small number of other changes to the levy rules. Most notable are:

- the bringing together of several levy rules which deal with how schemes without a conventional covenant are charged (set out in chapter 6); and,

- A revision to our approach to over-riding scores for companies that have had a restructuring plan or other insolvency related event (see section 3.2).

None of these changes are likely to have an impact on the majority of schemes, or the amount we will collect.

3. Insolvency risk

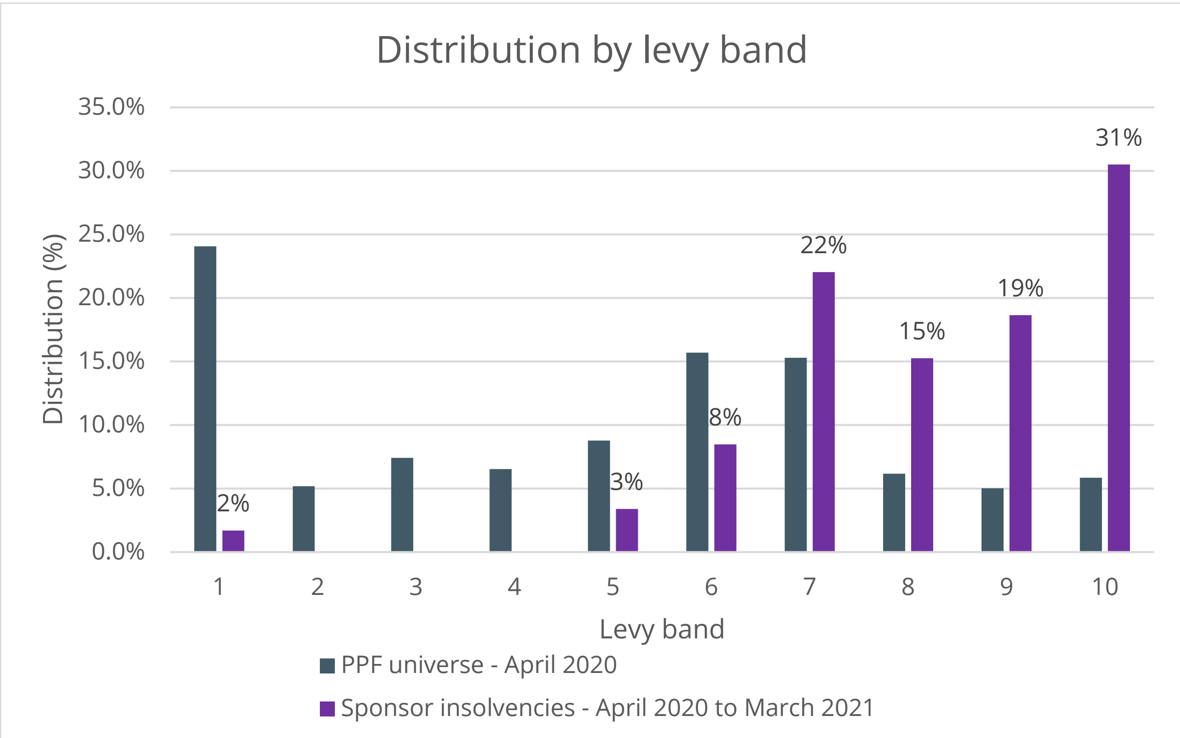
3.1. Model performance

3.1.1. The PPF applies a credit scoring model to calculate levy charges. During the year to April 2021the model continued to be fit for purpose while operating against a background of both a pandemic induced recession and Brexit uncertainty. Levy year 2021/22 is also the first levy year the PPF's insolvency risk partner D&B generated the scores using scorecards recalibrated on the basis of D&B data.

3.1.2. Ongoing monitoring of the performance of the credit scoring model is essential to evaluate whether the model continues to be fit for purpose. Performance is assessed against various metrics - critically the ability to discriminate between solvent and insolvent employers, ability to predict the number of insolvencies, and levy band volatility.

3.1.3. The Gini coefficient measures how well the PPF scorecards discriminate between solvent and insolvent sponsors. The Gini coefficient for the PPF scorecards over the period April 2020 – March 2021 is 69.4 per cent, which is considered strong. The graph below illustrates this. It will be seen that insolvencies are concentrated in the highest levy bands - although there are more companies in the better bands, as shown by the bars showing the PPF universe for April 2020. This suggests that, although trading conditions have been unprecedented, the strength of a business prior to the start of the pandemic has remained a good indicator of its risk of insolvency.

3.1.4. Given the economic shock caused by the pandemic we were not surprised to see one insolvency event among employers in levy band 1, which are considered relatively low risk but not zero risk.



3.1.5. A second performance metric measures the scorecards' ability to predict the insolvency count correctly. For the 2021/22 levy year the PPF-specific model predicted that between 0.54 per cent and 0.80 per cent of employers scored would experience an insolvency event (and on average 0.69 per cent). D&B identified 59 qualifying insolvencies, which translates into 0.60 per cent of employers scored having experienced an insolvency event. A level of 0.60 per cent lies comfortably in the range predicted by the PPF-specific model. There have been no qualifying insolvencies among publicly rated entities, although three ultimate parents were classified as having defaulted by the three credit rating agencies.

3.1.6. A third performance metric is levy band volatility. During the pandemic we have seen 56.6 per cent of the population remain in the same levy bands, which is higher than in recent years and higher than the long-term average. Extreme movements (i.e. at least 5 levy bands) were observed for 2.8 per cent of the population, which is in line with the level of change observed when the predecessor scorecards were introduced as well as the average level of change annually over the period from 2008.

3.1.7. We have also looked at the performance of the scorecards at an individual level, looking solely at data for 2020/21. Caution is needed in interpreting the results of this analysis – as the number of insolvencies is too small to draw robust conclusions over a single year. All but one scorecard performed well, the exception being scorecard 6 which is used for companies that are part of a group and file small company accounts. Scores for employers on this scorecard are concentrated in bands 6-10 (i.e. most companies are relatively high risk) and the 12 insolvencies that occurred were spread across these levy bands rather than being concentrated in bands 9-10 as they have been in previous years.

3.1.8. We investigated all the insolvencies to assess whether the factors involved may be idiosyncratic or point to a developing problem with that scorecard. We did indeed identify atypical factors at play for the insolvencies of the 10 companies (of those 12) which scored better than levy band 10. Five insolvencies were part of the same corporate group and for all 10 companies the filed financials suggested the entities were relatively strong compared to employers allocated to levy band 10. However, we noted the presence of unusually high intercompany balances owed from a relatively weak parent. Had these intercompany balances been adjusted for recoverability the companies might have in reality been balance sheet insolvent even when their previous accounts were filed – which would have led to their insolvency scores being markedly worse[2].

3.1.9. The ability to look through intercompany balances and objectively assess their liquidity and recoverability is an area we have considered in the past. Given the challenges this poses, our practice is to treat them in line with their reflection in the accounts[3]. We think this remains the right approach, but the experience with insolvent companies on scorecard 6 makes a case for taking a fresh look at these challenges.

[2] The scorecards are designed to capture the fact that in our modelling data balance sheet insolvent employers are three times more likely to experience an insolvency event than balance sheet solvent employers

[3] In the past, some stakeholders have argued that intercompany balances should be considered cash equivalent when such balances are associated with a group entity performing a treasury function. Entities performing a treasury function are also a good example of entities which by design have material intercompany balances. Meaning that material intercompany balances in itself are not by definition a concern.

3.1.10. We will continue to monitor the performance of scorecard 6 and take the lessons learned for the last year into account when recalibrating the scorecard in the future. It should be emphasised, however, that looked at over the full period for which we have data (2008-2021) scorecard 6 performance remains satisfactory.

Consultation question:

Do you agree with our intention not to make any changes to the PPF-Specific model for 2022/23?

3.2. Monthly score overrides – restructuring plans

3.2.1. In our 2021/22 levy rule consultation, we asked for views on proposed changes to contingent asset standard forms in light of newly introduced legislation, the Corporate Insolvency & Governance Act 2020 (CIGA). While stakeholders supported the changes we proposed, which have now been introduced, we also committed for the 2022/23 rules to consider the impact on insolvency risk scores resulting from companies entering into moratoriums and / or restructuring plans.

3.2.2. Under the current levy rules, set out in paragraph 5.1 of the insolvency risk appendix, any company that enters into an insolvency event categorised under section 121 of the Pensions Act 2004 - or any other overseas event considered analogous with a section 121 insolvency event - has an override of 100 per cent insolvency probability placed on monthly scores. This override applies to all scores within the scoring period (April through to March of the year preceding the year in which the levy invoice is issued) – and on an ongoing basis thereafter.

3.2.3. Companies entering into a moratorium or a restructuring plan will be in a stressed, or distressed position. Entry conditions set out in legislation state that for moratoriums, the company is, or is likely to become, unable to pay its debts; and for restructuring plans, the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern. We think that, in principle, it is reasonable to reflect this in an adjustment to the company's score.

3.2.4. However, a moratorium in and of itself is not an insolvency or restructuring procedure – it is intended to provide an entity with a relatively brief 'breathing space' (initially 20 days) whilst considering next steps in order to maximise the chances of the company continuing as a going concern. It is perhaps most likely that a moratorium will result in a restructuring arrangement such as a Company Voluntary Arrangement (CVA) or administration – events which already lead to a score override. So, whilst the start of a moratorium signals that the risk of an employer becoming insolvent has significantly increased, we think the short-term nature of moratoriums (as well as the uncertain outcome) on balance means we need not alter scores. If the outcome is an insolvency or restructuring procedure, a score override already applies. We will continue to monitor the use of moratoriums and keep this decision under review.

3.2.5. We consider that a restructuring plan, however, is much more analogous to a section 121 insolvency event – much like Chapter 11 proceedings under the United States Bankruptcy Code. The High Court has also recently concluded that it is an insolvency proceeding[4]. So, there is a

[4]See Gategroup Guarantee Ltd -, Re [2021] EWHC 304 (Ch) (17 February 2021)

strong case to override the company's monthly scores as we do for insolvency procedures (with a 100 per cent probability of insolvency).

3.2.6. We do recognise that restructuring plans (unlike other insolvency events) do not trigger a PPF assessment period. However, we consider that – because the employer has to be in significant financial difficulties to enter the restructuring – the business that results will potentially still present a high risk of failure.

3.2.7. As a result, we do not think it is appropriate to continue scoring the employer on the basis of its prior accounts which may considerably pre-date the restructuring plan. To do so in the knowledge that a restructuring plan has been entered into (especially because of the pre-conditions noted above) would be inappropriate. We therefore consider it is appropriate to apply the same override that applies to section 121 insolvency events to restructuring plans[5].

3.2.8. It is of course entirely possible for a business to run on for a longer period following a restructuring plan – as indeed with some existing insolvency events such as CVAs, Administrations and Chapter 11 proceedings. However, our existing rules do not provide for any potential recovery following any of these insolvency events (the 100 per cent override is permanent), and accordingly we have reviewed our approach.

3.2.9. We propose to incorporate a rule that allows for scores to recognise recovery into the paragraph 5.1 override. This will allow rescued companies to return to standard scoring under the PPF-specific model after ratification of the restructuring plan by the court and its implementation by the employer; and once it files new accounts following the restructuring. We do not consider the override can be removed prior to new accounts being filed as any financial information prior to a restructuring event cannot be relied upon as a basis for assessing the business after the restructuring and the accounts will include the auditor's opinion on 'going concern'.

3.2.10. Notwithstanding a return to monthly scoring under the PPF-specific model, the impact of a single monthly score at 100 per cent would still mean that the impacted company would have its levy calculated for that year as if it were scored in Band 10 (the highest risk of insolvency for the purposes of levy calculations).

3.2.11. The recovery rule therefore has also been designed to exclude the overridden scores for the scoring period in which rescue occurred for the purposes of calculating a Mean Score. I.e. once the restructuring plan has been ratified by the court and implemented by the employer, or where a rescue notice has been issued, and new accounts have been submitted. As a result, the Mean Score would then just reflect the post-restructuring accounts, ignoring any overridden scores for months within the scoring period.

3.2.12. Information currently collected by D&B from Companies House does not distinguish between these procedures or the type of event the company has entered into. With this in mind, we are working with D&B on how to accommodate the change. This may mean that, for the purposes

[5] We did consider whether there was a case for an override at a different percentage, but there is no data on which to base an alternative. In addition, any percentage above 36 per cent would place an employer in the highest levy band after a single month.

of having a rescue reflected, eligible schemes will need to engage with us or D&B to prove that a rescue has indeed occurred.

3.2.13. It is worth noting that current evidence suggests that volumes for these procedures are very low.

Consultation question:

Do you agree with our proposals to apply an override to companies entering restructuring plans, and the introduction of a recovery rule for companies that are rescued following a CVA, Administration, Chapter 11 proceedings and restructuring plans?

3.3. Credit rating realignment

3.3.1. In our 2021/22 policy statement, we confirmed – with stakeholder support in consultation responses – that we would review the calibration of credit ratings to levy bands as at 31 December 2020. A revised mapping has now been implemented and applied retrospectively to monthly scores from April 2021 (and will be used to calculate levy invoices in 2022/23).

3.3.2. The revised mapping table is shown in the below table:

	Old mapping		**New mapping**	
Public credit rating	Insolvency score (per cent)	Levy Band	Insolvency score (per cent)	Levy Band
AAA / Aaa	0.0002	1	0.0007	1
AA+ /Aa1	0.0020	1	0.0009	1
AA / Aa2	0.0031	1	0.0011	1
AA- / Aa3	0.0106	1	0.0071	1
A+ / A1	0.0165	1	0.0134	1
A / A2	0.0167	1	0.0143	1
A- / A3	0.0258	1	0.0153	1
BBB+ / Baa1	0.0433	2	0.0344	2
BBB / Baa2*	0.0546	3	0.0386	2
BBB- / Baa3*	0.1113	4	0.0773	3
BB+ / Ba1*	0.1880	5	0.1187	4
BB / Ba2*	0.2788	6	0.1941	5
BB- / Ba3*	0.4922	7	0.3393	6
B+ / B1	0.8750	7	0.5920	7
B / B2	1.5302	8	1.3882	8
B- / B3	2.7007	9	2.4828	9
CCC+ / Caa1	4.2786	10	3.3220	10
CCC / Caa2	7.7381	10	4.3623	10
CCC- / Caa3	14.4170	10	9.5968	10
CC	31.2570	10	24.4175	10
C	29.9233	10	31.9216	10
D / Ca-C / SD	42.1400	10	39.7201	10

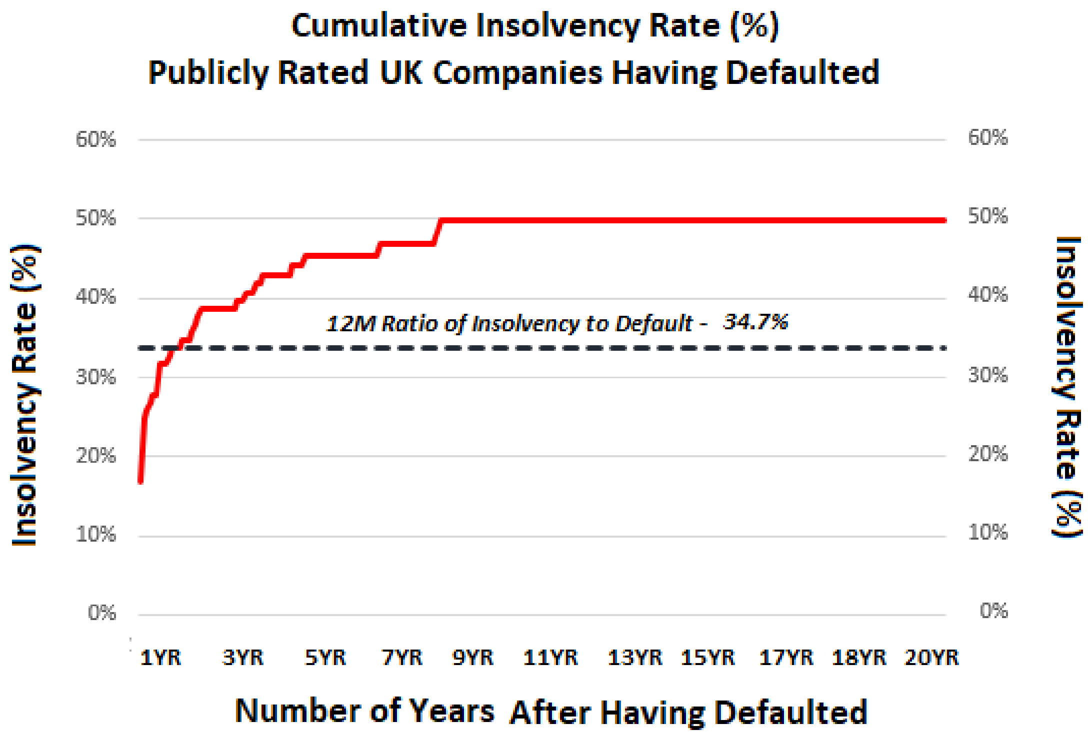
* Credit ratings from BBB / Baa2 to BB- / Ba3 have seen an improvement of 1 levy band under the recalibrated mapping.

Methodology and impact

3.3.3. This mapping results in the same or a more favourable levy band allocation compared to the previous version for all ratings. This reflects reductions in default rates across the majority of the range of credit ratings, and also a slight reduction in the proportion of defaults that have been observed to result in an insolvency within 12 months.

3.3.4. Rating agencies use empirically observed defaults as proxies for expected default experience. We source these empirically observed default probabilities for all three agencies to calculate an issuer weighted average annual default probability for each credit rating. The most recent evidence has been that default rates have dropped for each credit rating.

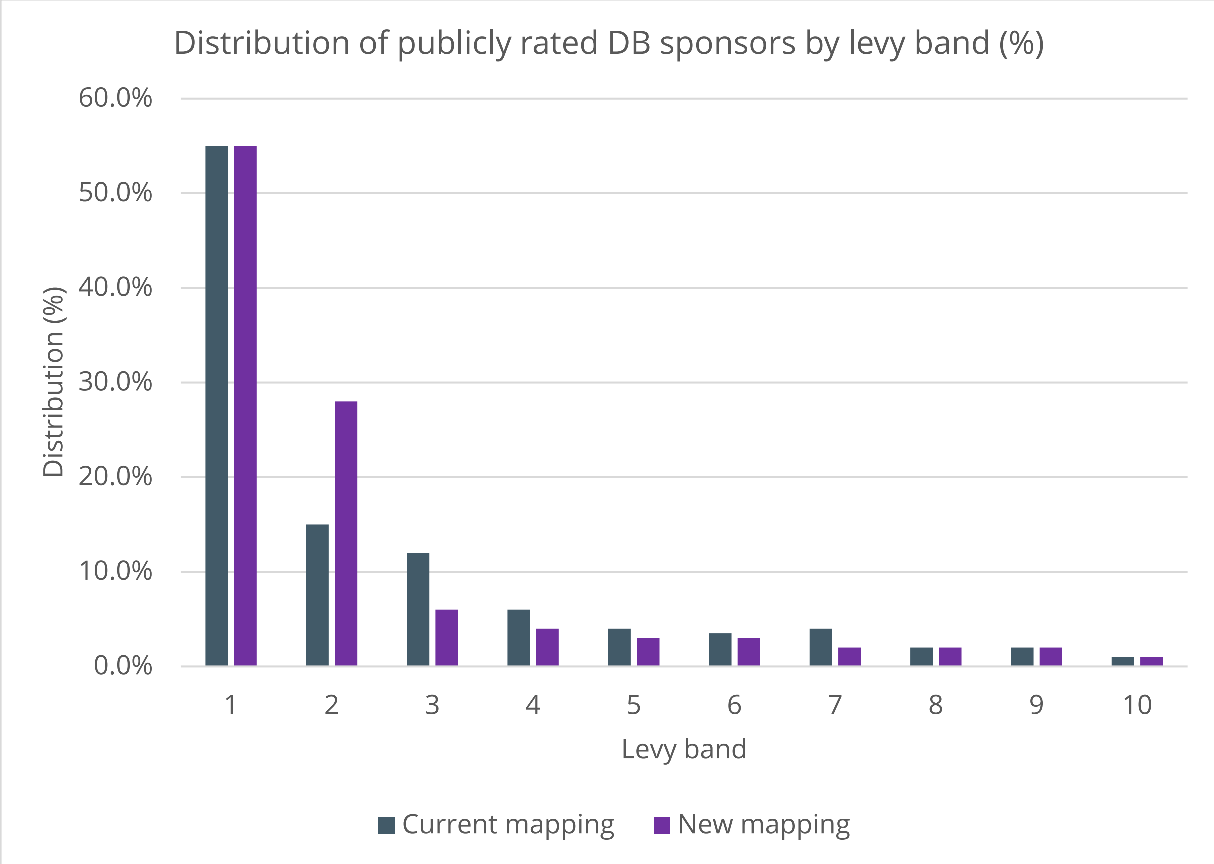
3.3.5. In order to map these default rates to levy bands we first need to reduce the default rates to recognise that only a minority of defaults actually lead to an insolvency[6] within one year of having defaulted. The empirically observed ratio of insolvency to default has dropped at the time of our calculations to 34.7 per cent (from 36.7 per cent).



3.3.6. Having calculated an insolvency probability for each rating we then map to the most appropriate levy band.

3.3.7. Looking at the distribution by levy band, a quarter of publicly rated DB sponsors experience an improvement of one levy band. The remaining three quarters experience no change.

[6] For example, paying interest more than 2 days late is regarded as a default event but may not be followed by insolvency



3.3.8. Publicly rated ultimate parents are not assigned a levy band but a parental score. But to give an illustration of how changes to the mapping will impact ultimate parents, we have also mapped publicly rated ultimate parents to a levy band, and see 44.4 per cent experience an improvement of one levy band. The remaining 55.6 per cent experience no change.

3.3.9. Monthly scores already generated for use in levy calculations for 2022/23 (March 2021 to April 2022) have been updated on our portal to reflect the new mapping.

4. Underfunding Risk

4.1. Measurement of underfunding

4.1.1. In addition to insolvency scores, the other key determinant of schemes' risk-based levies is the extent of underfunding. This is typically influenced by movements in economic market conditions and for the 2022/23 levy year, will be measured based on market conditions as at 31 March 2022 (subject in the usual way to a 5-year smoothing period).

4.1.2. Market movements since last year's estimate have served to slightly reduce overall underfunding in the universe, driven primarily by positive investment performance for schemes. Our assumption is that the current level of key economic indicators will persist for the remainder of the measurement period and, therefore, contributes a reduction in the overall Levy Estimate of approximately £10m.

4.1.3. We propose to update the output basis for transforming and rolling forward s179 valuations from version A9 to A10 of our assumptions guidance. A10 is the current version applicable to schemes carrying out s179 valuations, and reflects improvements in buyout pricing over recent years. Consequently, we are able to assess schemes as being generally better funded and thereby reduce overall levy collection. Indeed, 99 per cent of all schemes forecast to pay a risk-based levy are expected to see a reduction as a result of the move to A10, while the Levy Estimate is brought down by approximately £65m from this change.

4.2. Stress factors

4.2.1. We have carried out a high-level review of the current asset and liability stress factors by refreshing data on market volatility up to 31 March 2021 on all of the asset classes currently in use.

4.2.2. On the whole, despite recent market fluctuations resulting from the global pandemic, the latest 15-year volatility statistics are reasonably consistent with those on which the existing stress factors were based. This allows us to conclude that they remain appropriate for continued use in 2022/23.

4.2.3. We intend shortly to commission the next independent review of the overall system of asset and liability stress factors. That review will include any updates to the asset allocation information collected annually by TPR that may be required following the recent consultation run jointly by the PPF and TPR. The new asset stresses based on the review will not be used in the levy before 2023/24.

5. How much levy we will collect and impact on schemes

5.1. Introduction

5.1.1. Each year, we are required to set an estimate of overall levy collection. We do that by modelling each scheme's expected underfunding and sponsor insolvency scores to arrive at a scheme-level estimate and combine that with the more general trends and impacts we anticipate.

5.1.2. As set out in chapter 2, we have decided to retain the levy parameters that applied in 2021/22. Therefore, the change in the levy will be driven by the change in underfunding risk and insolvency risk of individual schemes. The following sections set out our methodology and analysis on these movements that have led to our Levy Estimate of £415m for 2022/23.

5.1.3. We have arrived at the 2022/23 estimate after making assumptions about data which will not be known until April 2022 or later.

5.2. Insolvency scores

5.2.1. As described earlier, we have followed developments in sponsors' insolvency scores closely as financial statements impacted by COVID-19 have begun to be filed. While, in aggregate, scores have remained stable so far, we have in the past month or so observed a modest deterioration for a number of companies that sponsor schemes with large deficits. It remains our expectation that *some* companies have been materially adversely affected by the pandemic and accordingly we expect this may lead to a rise in levy bills for those schemes, as more sponsors file pandemic period accounts.

5.2.2. Insolvency score movements to date serve to increase the Levy Estimate by approximately £15m, and we have allowed for a further £15m increase in anticipation of a slight net increase in levies as new accounts are filed up to the 31 March 2022 measurement date.

5.3. Risk reduction

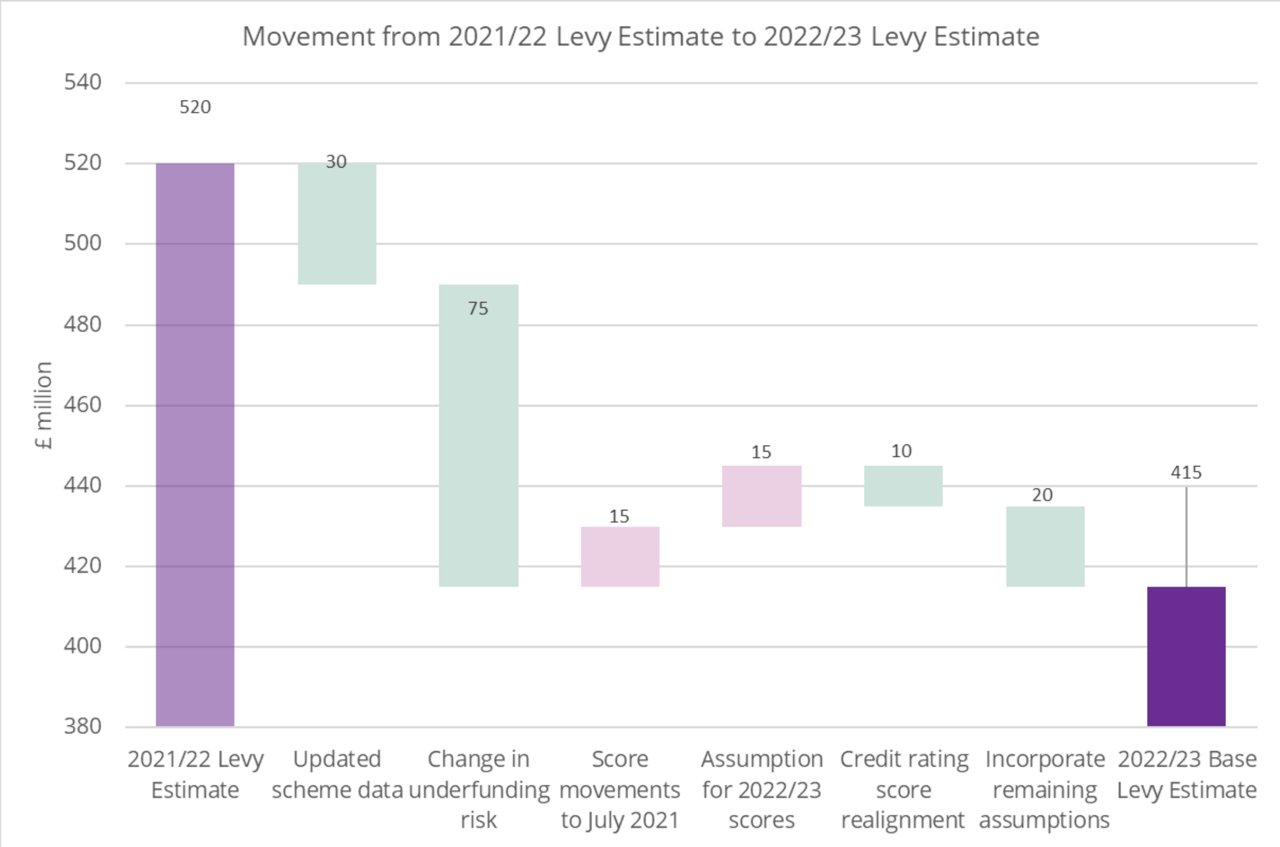
5.3.1. We have retained our assumption for the reduction in levy deriving from new contingent assets and asset-backed contributions at the same level as for 2021/22. However, we have assumed that deficit-reduction contributions (DRCs) and new s179 valuation filings will provide a smaller levy reduction than previous years. This has been supported by experience for the 2021/22 year, along with the expectation that some sponsors will pay lower contributions this year. These assumptions, in combination, reduce our Levy Estimate by approximately £20m.

5.4. Credit rating realignment

5.4.1. The credit rating realignment detailed earlier yields an immediate impact on affected sponsors' insolvency scores. We have assumed that credit-rated entities will maintain their existing rating through to the end of the score averaging period (31 March 2022) and, accordingly, we estimate that this effect reduces the Levy Estimate by approximately £10m.

5.5. Development of Levy Estimate

5.5.1. The chart below shows the evolution of the Levy Estimate from 2021/22 to 2022/23.

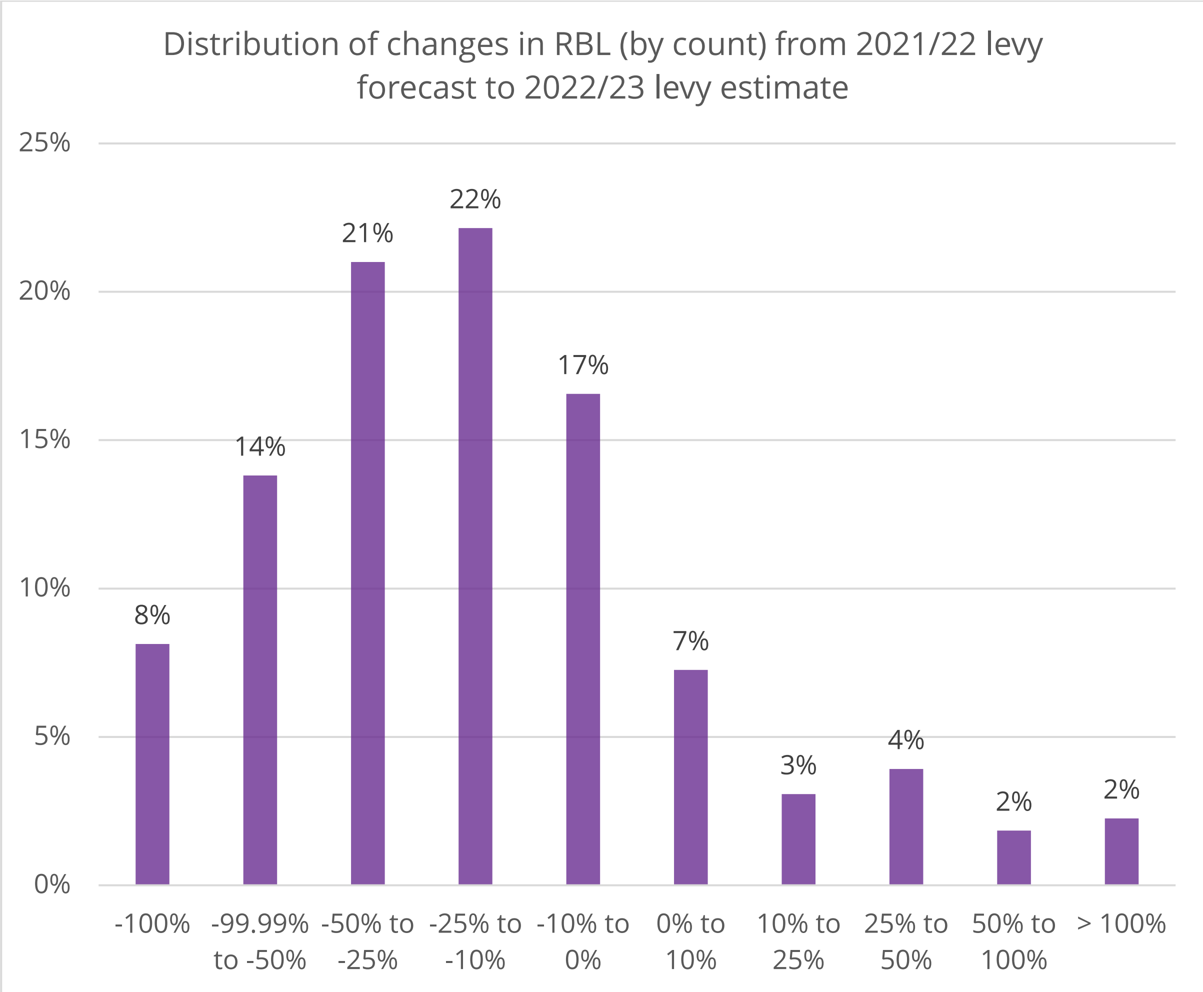


5.6. Impact assessment

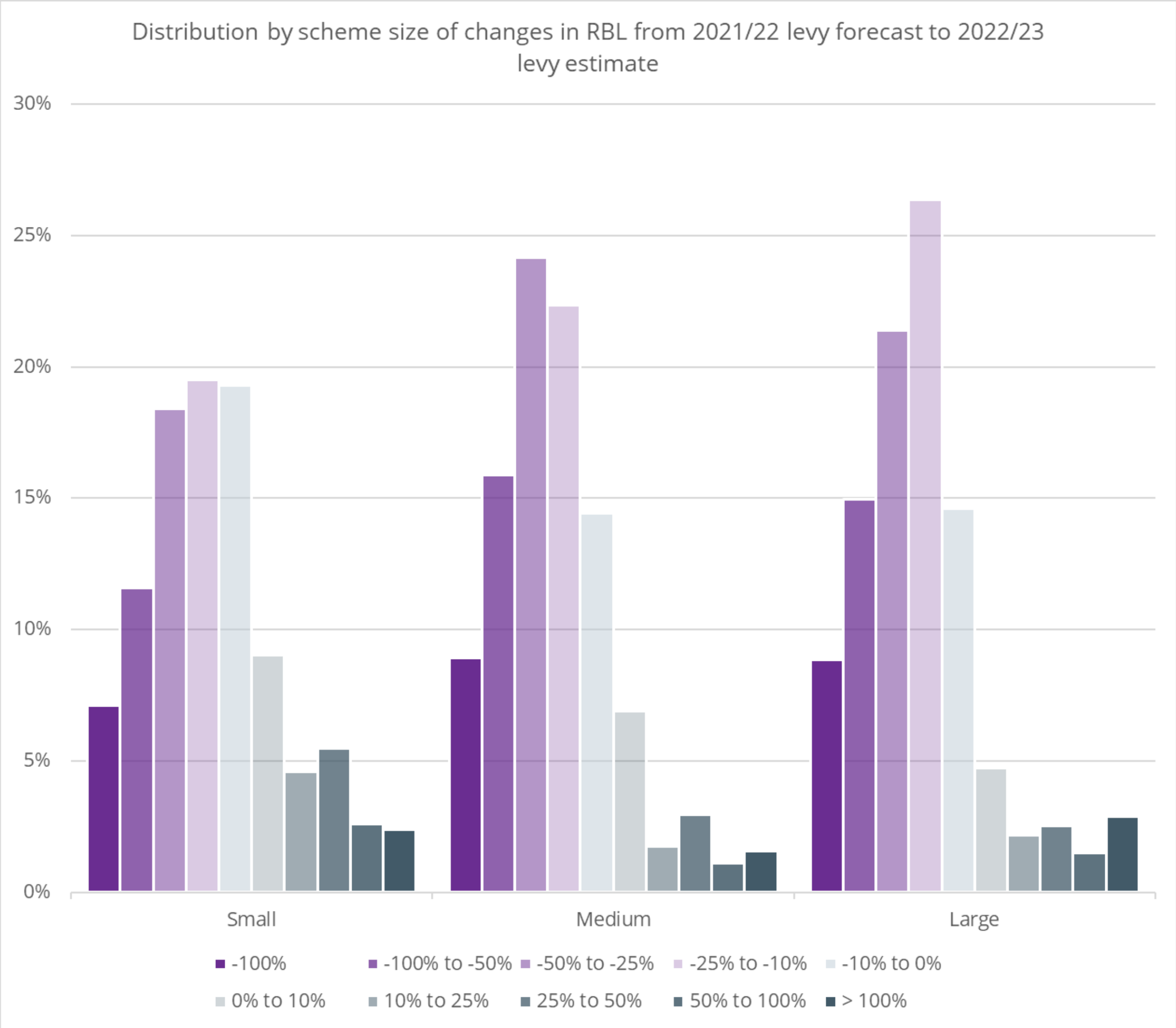
5.6.1. We have carried out an impact analysis to show the projected impact on levy bills for 2022/23 of known changes in the environment (including economic market data and information on insolvency scores to end-July 2021) and our move to the A10 assumptions basis.

5.6.2. The chart below shows the expected change in levy from 2021/22 to 2022/23 for all schemes that paid a risk-based levy last year. The great majority of schemes are projected to see a fall in levy compared to 2021/22, due mainly to a reduction in assessed underfunding risk. The key features seen are:

- 82 per cent of schemes paying a risk-based levy in 2021/22 are expected to see a levy that is lower in 2022/23 than 2021/22.
- This includes nearly 300 schemes which are projected to move to paying no risk-based levy.
- Some schemes will still see significant levy increases where there has been a worsening in the sponsor's insolvency score. Our modelling indicates that 2 per cent of schemes may see a doubling of their levy (a similar proportion to previous years).



5.6.3. The chart below shows that the patterns are broadly consistent between small, medium-sized and large schemes – although the proportion of schemes seeing a reduction in levy rises with size.



5.6.4. If we isolate the impact of the move from A9 to A10 (i.e. removing the effects of changes in insolvency risk and other variables), our analysis shows that 99 per cent of schemes are expected to see a reduction in levy as a result of this change. The patterns are again broadly consistent between small, medium-sized and large schemes.

5.6.5. Our analysis has focused on schemes paying a risk-based levy, for whom changes in levy may be considered material. However, nearly 40 per cent of schemes are projected to pay only a scheme-based levy (SBL) for 2022/23. A majority of these schemes see an increase, because the SBL is based on scheme liabilities rather than the deficit, and liabilities have risen for many schemes. (Assets have typically risen faster, though, cutting the deficit). Schemes paying only a scheme-based levy represent 45 per cent of scheme liabilities, and in aggregate pay only four per cent of the levy.

6. Policy Development

6.1. Consolidators and other endgame solutions

6.1.1. Our general intention is to leave our levy rules broadly unaltered this year. However, one area that we propose to update is the levy rules that apply to Consolidators and Schemes Without a Substantive Sponsor (SWOSS). These rules recognise that – for these entities - the risk of a claim on the PPF relates to the failure of the scheme's investment strategy (and that of any associated buffer or guarantee arrangement) and not the failure of a sponsor with a genuine business. The rules establish a shared charging methodology appropriate to this risk based on option pricing.

6.1.2. While new schemes that fall into these categories have yet to emerge we have continued to engage with stakeholders exploring options for 'DB endgame solutions' and how these arrangements could impact both the PPF and scheme members. As well as consolidator vehicles, we are aware that a range of approaches are being developed as an endgame solution for schemes, albeit these are at an early stage of development.

6.1.3. This has led us to conclude that the distinctions between the two types of scheme may not prove clear-cut in future – and that some schemes for which an option pricing methodology is appropriate might fall outside the existing definitions. We have also noted that the wider range of options identified for charging in the consolidator appendix could be relevant to some schemes that might emerge as a SWOSS. As an example, we are aware of standalone SWOSS propositions that would nonetheless utilise a buffer arrangement (a provision not allowed for in the current SWOSS rules). We therefore think the time is right to:

- Bring the two sets of rules together into one under the categorisation Alternative Covenant Schemes (ACS); and
- Revise the definition to ensure that schemes that ought to be within scope are included.

6.2. Revising the definitions

6.2.1. We propose to create a definition for an Alternative Covenant Scheme, which brings together both commercial consolidators and Schemes without a Substantive Sponsor (SWOSS). The new definition will allow us to designate schemes where there is a not a conventional employer covenant and the 'employer' has no substantial employment relationship to the members. The broadened definition would bring these schemes into scope for a charging methodology based on that of our current consolidator rules – which are based on an option pricing model and provide a range of options for charging depending on the particular features of the schemes and the surrounding arrangements.

6.2.2. Drafting such a rule with limited real-life examples to date is difficult, and it is likely that as experience develops we may need to modify the definition further. However, we hope that in setting our approach now we can give clarity over our policy intent.

6.2.3. The proposed definition is set out at the end of this section, and draws on the definitions used in the past for a commercial consolidator (subsections (a) and (b) - colour coded green) and a SWOSS (subsection c – colour coded blue) but adds two additional criteria (subsection d and e -

colour coded purple). These are aimed at identifying whether the employer is a special purpose vehicle (SPV) testing whether scheme members had substantial service with the employer, and whether it has resources other than a fixed buffer / level of guarantee.

6.2.4. The new definition would mean a scheme making arrangements to operate as a SWOSS, now or in future, will fall within the scope of the rule – when there is not a substantive sponsor – whether or not there is an ongoing governance arrangement which meets TPR expectations[7]. The rules then mirror the existing consolidator charging methodology so that such a scheme might expect to pay a higher levy if the protections implied by meeting TPR expectations are not in place. Conversely, it also means that if such a scheme has some of the risk-reducing features expected of consolidators (e.g. an external buffer or guarantee) that this could be reflected in the calculation.

6.2.5. We recognise that with a broader definition, there is a possibility that some schemes we don't consider should be charged on this methodology could be in scope and we intend to provide for a discretion to exclude them (see text at the end of the box below). This will allow flexibility to scope out schemes we do not think justify an option pricing approach. For example, this might be appropriate where a restructuring has led to members being linked to an 'employer' few have service with but where a substantial conventional covenant remains.

6.2.6. We don't intend, for 2022/23, to apply the rule to any schemes that have historically established as a SWOSS, but reserve the right to do so in future, so that the risk such schemes pose is reflected. We have used a cut-off date for historic arrangements of 1 January 2017, as the point at which we set out our views on the appropriate basis for charging a levy to schemes of this nature. We also recognise we may need to review our policy approach to reflect any changing expectations from TPR.

6.2.7. Adopting the A10 assumptions has reduced the difference between the s179 assumptions and the PPF's internal basis. This difference is reflected in 'conversion factors' set out in the Alternative Covenant Scheme Appendix and which were specified in the SWOSS and Commercial Consolidator Appendices for previous levy years. The factors result in a lower levy, if we are satisfied the scheme meets certain criteria[8]. The introduction of the A10 assumptions would in theory suggest an increase to the factors (and hence a smaller levy discount). Although we have not adjusted the factors to take account of this, we will consider the case for doing so in 2023/24, in the light of our funding strategy review. Our policy objective is to ensure that levies charged to Alternative Covenant Schemes accurately reflect the extent to which they risk having an impact on our funding position, so that they do not imply a cross-subsidy from conventional schemes.

[7] https://www.thepensionsregulator.gov.uk/en/document-//library/regulatory-guidance/db-superfunds

[8] In particular, the conversion factors serve to reduce the scheme's s179 non-pensioner liabilities by 12 per cent when determining the strike price.

Proposed Definition

C5.1 Application of this Rule C5 (1) This Rule C5 applies to an Alternative Covenant Scheme, which is a scheme to which C5.1(2) and C5.1(3) apply.

(2) This Rule C5.1(2) applies to a Scheme that the Board has confirmed as meeting any one of the following criteria at any time:

(a) It is a Scheme where one of the purposes of its establishment and/or the nature of the ongoing operation of the Scheme and/or of its surrounding arrangements is, in the opinion of the Board, to effect consolidation of Schemes' liabilities;

(b) It is a Scheme where one of the purposes of its establishment and/or the nature of the ongoing operation of the Scheme and/or of its surrounding arrangements is, in the opinion of the Board, to enable a return to be payable otherwise than to Members;

(c) It is a Scheme which meets or has met any one of the following criteria at any time on or after 1 January 2017 and before 1 April 2022 (or such later date as the Board may in its discretion decide):

(i) in relation to which an Ongoing Governance Arrangement has been entered into; or
(ii) in relation to which the Board is satisfied that it has been agreed by TPR that an Ongoing Governance Arrangement will be entered into at some future date, whether in the current Levy Year or not.

Such a Scheme will be an Alternative Covenant scheme if it meets the criteria in (c)(i) above during the period described in (c) above, even if it has already met the criteria in (c)(ii) before that period.

(d) It is a Scheme where the sole or last man standing Scheme Employer was responsible for all of the Scheme's liabilities, but that Employer has been replaced by another Employer and:

(i) the replacement took place on or after 1 January 2017; and
(ii) the replacement Employer that has no material resource of its own to meet the Scheme's liabilities; and/or
(iii) apart from the Scheme's assets and any funding obligations that may be imposed on any entity by TPR, the only additional source of funding available to the Scheme to meet its liabilities is held outside the Scheme, is of a fixed value, and is only available to the Scheme when pre-agreed specified funding triggers are reached.

(e) It is a Scheme where:

(i) the purposes of any employment relationship entered into on or after 1 January 2017 between the Scheme Employer and the Scheme Members are, in the Board's opinion, designed to ensure that the Scheme becomes or continues to be eligible for, PPF compensation; and
(ii) the majority of the Scheme's liabilities have accrued with an Employer that does not participate in the Scheme and has no obligations towards such liabilities (or where such a funding obligation exists, has insufficient resources to meet it).

(3) This Rule C5.1(3) applies to a Scheme in respect of which the nature of the Scheme, the features it exhibits, and/or the risk posed to the Board is such that in the opinion of the Board it is more appropriate for the Levy Rules in the Alternative Covenant Scheme Appendix, in so far as they apply to any Scheme which falls within the definition of Alternative Covenant Scheme, to apply to the Scheme than the Levy Rules that would otherwise apply.

Consultation questions:

Do you agree with our proposals to change the definition?
Do you agree with our proposals to bring together Consolidator and SWOSS approaches under one appendix, 'Alternative Covenant Employers'?

7. Customer service

7.1. Developments to our portal

7.1.1. In response to feedback - and as part of our ongoing commitment to ensuring your data is as secure as possible - on 31 August 2021, we moved to a new authentication system for the PPF-Scores portal. We also extended the password expiry window from 90 days to 180 days.

7.1.2. We hope this will improve your experience when using the portal. In order for the transition to the new system to be fully implemented, all users were required to reset their password using the 'forgotten password' link displayed on the login screen.

7.1.3. If you are a user of the portal and have not yet reset your password, please ensure you do so. You can access the portal at ppf.co.uk/scores.

7.1.4. Please note, the portal requires high strength passwords. When you reset, you will need to choose a new one that meets the following requirements:

- The minimum password length is 10 characters, and you cannot use a password that has been used before.
- Your new password should also contain at least 3 of the following:
  - a number
  - an upper case letter
  - a lower case letter
  - a special character (e.g. @&!)

7.1.5. Once this is complete, your access to the portal will be as normal and running under the new security.

7.2. Helping with invoicing

7.2.1. Starting with invoices issued from September 2020 (the 2020/21 levy), we issued paper invoices addressed to the scheme trustees as usual, and also sent electronic PDF invoices to scheme contacts listed on TPR's Exchange database. We also introduced a paperless invoicing consent form on our website, that allows scheme trustees or authorised scheme managers to opt to receive only electronic invoices.

7.2.2. We asked for views on the service in our consultation issued in September 2020 and have considered the feedback received to make improvements. The main points raised focussed on:

- the email address the electronic invoice was sent to; and
- a concern over the legitimacy of the email received

7.2.3. The hierarchy introduced for the contacts that receive the electronic invoice emails started with the Levy Contact, and moved to the Scheme Contact or the Trustee contact(s) in the event that a Levy Contact was not present in the Pensions Regulator's Exchange database.

7.2.4. Feedback received suggested that the 'contact types' (Levy Contact and Scheme Contact) taken from TPR were not well known with schemes. Following this feedback, we have adopted a new approach where the hierarchy will continue to use the Levy Contact first, and the Scheme Contact in the absence of a Levy Contact, but we will also send a copy of the invoice to the trustee email addresses listed for the scheme in all instances.

7.2.5. Cyber security - as part of ensuring that electronic communication is safe – is paramount when introducing a new system. To this end, all electronic invoices are issued using a system provided by Mimecast. Mimecast is a cybersecurity provider that helps thousands of organisations worldwide make email safer and bolster cyber resilience. Our invoices will originate from 'noreply@mail.ppf.co.uk'. However, if you are in any doubt about the legitimacy of an invoicing email please do contact us to confirm – as several levy payers did last year.

7.3. Support with payments

7.3.1. We announced in summer 2020 that we were introducing additional payment flexibility for the levy we invoiced in autumn 2020 (the 2020/21 levy) – to help schemes with sponsors impacted by COVID-19.

7.3.2. Based on stakeholder feedback, and on what we're permitted to do by legislation, we developed a new repayment plan option. Affected schemes or their sponsoring employers could submit a notification form via our website – within 28 days of receiving their invoice – explaining how they have been negatively affected by COVID-19 and request an extension to payment terms. If approved, interest charges that would have normally accrued due to late payment would be waived for up to 90 days (as long as payment was made within those 90 days).

7.3.3. Where schemes/employers needed longer than 90 days (or there are other reasons why they would face particular difficulties paying on time) applications could be made under the existing payment plan process.

7.3.4. This flexibility was introduced to address concerns about cash flow availability in the short term, given declines in turnover during the lockdown period. While we expect that such concerns are reducing, we have decided to offer the same repayment plan options for invoices issued in autumn 2021 (the 2021/22 levy).

7.3.5. Our policies, FAQs and forms relating to payment plans and our COVID-19 easement can be found on our website at ppf.co.uk/levy-payers/pay-your-levy/help-paying-your-levy

7.3.6. We would also be interested in views on the merits of our decision to extend the flexibility to cover the 2022/23 levy on which we are consulting now.

Consultation question:

Do you think the easement measures for COVID-19 impact will provide benefit for the 2022/23 levy year?

8. Draft Levy Rules 2022/23

8.1. Introduction

8.1.1. As with 2021/22, we have moved away from publishing a full suite of draft documents with our consultation, instead opting to publish only the draft Determination and Appendices where substantive change has been made. Feedback on this approach was supportive, and we intend to continue this going forward.

8.1.2. The main changes to the Levy Rules have been to reflect:

- the policy proposals set out in this consultation; and
- the update of our assumptions basis from A9 to A10.

Drafting changes can be found in the Determination and Appendices published alongside this consultation document, but a summary of the changes is also set out below. Other changes to the rules mainly relate to date changes and the move from A9 to A10 of our assumptions guidance. All rule documents will be published when the Determination is finalised.

8.1.3. The Court of Appeal issued its judgment on the Hughes judicial review on 19 July 2021, confirming, in particular, that the PPF is required to disapply the compensation cap when determining compensation payable to members. This ruling has potential implications for schemes carrying out s179 valuations and we intend to issue updated s179 valuation guidance later in the year clarifying the position (at which point we will also update our webpage *'How recent court judgments impact s179 valuations'*[9]).

8.1.4. The disapplication of the compensation cap has ancillary impacts on certain documents which form part of our levy rules but are not published alongside this consultation document (notably, the Deficit-Reduction Contributions Appendix). We will update these documents accordingly and publish them when the Determination is finalised.

8.2. Alternative covenant schemes

8.2.1. Other than in relation to the scope of the rule, we are making limited changes to our existing rules and methodology for levying SWOSS and consolidators. We outline below the main changes we have needed to make to the rules and guidance to bring the two different approaches under Alternative Covenant Schemes:

- We have altered the definition, (and the purpose) of an Ongoing Governance Arrangement, to reflect only arrangements that TPR have confirmed as meeting their expectations. This is because in the future being an OGA will primarily be a route to simplifying the information a scheme needs to get its circumstances reflected.
- We have included within the Alternative Covenant Schemes (ACS) Appendix a rule providing a discretion for the PPF to agree with a scheme with an Ongoing Governance Arrangement to take account of scheme-specific factors in assessing liabilities. This recreates a rule in the previous SWOSS appendix and we are maintaining its limited applicability. We will

[9] https://www.ppf.co.uk/trustees-advisers/valuation-guidance/how-recent-court-judgments-impact-s179-valuations

consider in the light of experience the extent that such a flexibility is needed at all, as well as whether it should be extended to other schemes with an alternative covenant.

8.3. Other changes

8.3.1. We have also made the following changes:

General

(a) The Companies Act reference in the definition of Annual Return has been updated

The Determination

(b) Rule E2.7(1)(c) of the Determination has been removed – the rule had been in place for Levy Year 2021/22 to provide additional flexibility for submission of information for April 2020 scores only.

(c) Rule E7.9 of the Determination has been amended to include provision for situations where D&B might be unable to conduct an appeal for any reason.

Insolvency Risk Appendix

(d) Insolvency Risk Appendix: paragraph 1.3 has been reinstated (it was removed for Levy Year 2021/22) so that where a company has voluntarily submitted full accounts in a previous year, they will continue to be categorised on the basis of full accounts for the 2022/23 levy.

(e) Insolvency Risk Appendix: paragraphs 1.4 and 3.7 have been amended to clarify the approach taken to currency conversion where accounts are expressed in a currency other than sterling.

(f) Insolvency Risk Appendix: paragraph 5.1 has been amended to include proposed changes to the overrides for entities who have undergone specified forms of restructuring / insolvency events.

(g) Insolvency Risk Appendix: Table 4 in paragraph 4.7 has been revised to reflect the mapping and realignment of credit ratings.

Transfers Appendix

(h) Transfers Appendix: paragraph 20 has been amended to clarify the requirements in respect of Exempt Transfers (transfers exempt from our full requirements), specifically in respect of nominal accrual.

Transfers Guidance

(i) Transfers Guidance: relevant paragraphs (in particular paragraphs 3.20 and 3.28) have been amended in line with the proposed changes to Exempt Transfers set out in the Transfers Appendix.

9. Next steps and Key Dates

9.1. Next Steps

9.1.1. We expect to publish our final rules for the 2022/23 levy year in December 2021, along with our policy statement which finalises our proposals for change following feedback to this consultation.

9.2. Key dates

9.2.1. The following table sets out the proposed key dates in the coming year, as reflected in this consultation and our draft determination:

Item	Key dates and times
Closing date for the 2022/23 consultation	09 November 2021 – 5:00pm
Publication of final rules and Policy Statement	End December 2021 (expected)
Scheme returns and electronic contingent asset certificates to TPR	31 March 2022 - Midnight
ABC certificates and special category applications to us	31 March 2022 - Midnight
Send contingent asset documents to us	01 April 2022 – 5.00pm
Start of 2022/23 levy year	01 April 2022
Deficit-reduction contributions certificates to TPR	29 April 2022 - 5.00pm
Send exempt transfer applications to us	29 April 2022 - 5.00pm
Certify full block transfers with TPR	30 June 2022 - 5.00pm
Publication of Mean Scores	July 2022
Invoicing starts	Autumn 2022

10. Consultation Arrangements

10.1. Timing and responding

10.1.1. The consultation runs from 28 September 2021 to 5pm on 9 November 2021. Please ensure your response reaches us by the deadline. Submissions can be made online:

www.ppf.co.uk/levy-payers/help-shape-our-rules

10.1.2. There are two versions of online submission available to you, 'quick' and 'full':

- The 'quick' submission allows respondents to review a summary of key proposals set out in our consultation, and the opportunity to give their views. It is designed to take only 10 to 15 minutes to complete. This version is designed for those who may not have time to respond to our consultations in full.

- The 'full' version sets out all the questions we are asking in this consultation, allowing complete responses, along with free format text fields for additional views to be submitted. This version of submission can either be completed online, or via an offline template which can be downloaded and once complete, uploaded via our website.

10.1.3. Please ensure you state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear whom the organisation represents and, where applicable, how the views of members were assembled.

10.1.4. Under the Freedom of Information Act 2000 (FoIA), all information contained in the response, including personal information, may be subject to publication or disclosure.

10.1.5. The respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with FoIA obligations and general law on this issue. Further information can be found on the GOV.UK website:

https://www.gov.uk/make-a-freedom-of-information-request

10.1.6. A summary of responses and the Board's final confirmed policy will be published on the PPF website at:

https://www.ppf.co.uk/

11. Comments on the Consultation Process

11.1. The consultation is being conducted in line with the Cabinet Office's Consultation Principles:

https://www.gov.uk/government/publications/consultation-principles-guidance

The Board would welcome feedback on the consultation process. If you have any comments, please contact:

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