CONSULTATION ON CHANGES TO LEVY METHODOLOGY FOR THE 2021/22 LEVY YEAR

PLSA'S RESPONSE TO PPF'S CONSULTATION PAPER

NOVEMBER 2020

ABOUT THE PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers. Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

EXECUTIVE SUMMARY

- Overall, the PLSA supports the proposals put forward to ease the burden on smaller schemes and to mitigate the risks from Covid-19. We appreciate the proposals to make the invoicing system more streamlined and the measures to ensure security for users of the system.

- There are mixed views on the PPF's approach to set the Levy Rules for 2021/2022on a year by year basis, as this provides a degree of uncertainty for future changes to the levy, which could make business planning more difficult. However, on balance, the PLSA believes that given wider economic circumstances, this year by year approach is overall helpful.

- In addition to the year by year levy rule setting, the PLSA feels that additional measures could be considered simultaneously, given that the impacts from the global pandemic will persist for some time.

- The proposal to introduce an adjustment to the levy calculation to reduce the financial burden for small schemes, based on the smoothed liabilities, is broadly welcomed by the PLSA, as is the proposal to taper the reduction to avoid a cliff edge at £20 million, so that a full levy is paid at £50 million liabilities.

- PLSA are supportive of moves to reduce the risk-based levy cap from 0.5% to 0.25% of unstressed liabilities, and in particular would find this a helpful intervention while the financial risks of Covid-19 are not yet known. However, it will be important to keep short-term measures to combat challenges from the pandemic under regular review, to ensure that over time there will not be a shift of levy allocation from genuinely risky schemes onto other schemes that are less risky.

INTRODUCTION

1. The Pensions and Lifetime Savings Association (PLSA) welcomes the opportunity to respond to the PPF's Levy Consultation 2021/22.

RESPONSE

<u>Question 1: Individual year assessment for 2021/22</u>

2. 2021/22 would have been the start of the next three-year period over which the PPF would typically aim to hold rules steady. However, COVID-19 has introduced uncertainties and there may be significant changes to the PPF's assessment of insolvency risk over the coming

years. If the rules are set for a multi-year period, it could potentially lead to a substantial increase in levies charged in subsequent years, as it may not be possible to predict and integrate all risks into the current levy calculations. The PPF states that the impact of COVID-19 is still emerging – and it is not until mid to late 2021 that they expect to have sufficient evidence to judge whether any changes to our insolvency risk model are necessary.

Consultation Question: Do you have any views on our approach for the Levy Rules for 2021/22 and 2022/23 being set on an individual, year by year, basis?

3. There are mixed views on the PPF's approach to set the Levy Rules for 2021/2022 and 2022/2023 on a year by year basis, as this provides a degree of uncertainty for future changes to the levy, which could make business planning more difficult. However, on balance, the PLSA believes that given wider economic circumstances, this year by year approach is overall helpful.

4. In addition to the year by year levy rule setting, the PLSA feels that additional measures could be considered simultaneously, given that impacts from the global pandemic will persist for some time. For instance, it was raised by the PLSA membership that it might be helpful for employer solvency for a levy cap to be put in place for the medium term.

<u>Question 2. Insolvency risk model performance</u>

5. The levy is currently capped at 0.5% of scheme liabilities but most schemes pay a levy that is less than 0.1% of liabilities.

6. The PPF observed that amongst those paying higher levies relative to size of scheme, a high proportion were small and medium sized schemes, so they have focused their review on exploring appropriate changes to the methodology to support schemes facing the biggest levy bills as a proportion of their liabilities. They have two core proposals – the introduction of a small scheme adjustment; and changes to the level of the risk-based levy cap. The PPF also propose carrying forward the COVID-19 payment easement introduced for 2020/21 invoicing.

Consultation question: Do you agree with our proposal to not make any changes to the PPF-Specific model in light of COVID-19 for 2021/22?

7. The PLSA agrees with the proposal to not make any changes to the PPF-specific model at this time.

<u>Question 3. Introducing a small scheme adjustment</u>

8. The PPF review of the levy for 2021/22 identified the particular impact of the levy on smaller schemes as an area to review. Small schemes – c. 2,200 schemes with liabilities below £20 million - see levies that are higher (as a proportion of scheme liabilities) and vary more from year to year than larger schemes.

9. The PPF propose to introduce an adjustment to the levy calculation to reduce the levy for small schemes based on the smoothed liabilities used in the levy calculation. A factor of 50 percent will apply to those with below £20 million of liabilities. This would be applied before the cap on the RBL. In order to avoid a cliff edge, where schemes would see a significant rise in levy at the £20m threshold, the PPF propose tapering the reduction away, so as to charge a full levy at £50m liabilities. A reduction of this level will reduce the levy they collect by around £10 million.

Consultation question: Do you agree with our proposal to introduce a small scheme adjustment?

10. The PPF's intention to introduce an adjustment to the levy calculation to reduce the financial burden for small schemes, based on the smoothed liabilities, is broadly welcomed by the PLSA, as is the proposal to taper the reduction to avoid a cliff edge at £20 million, so that a full levy is paid at £50 million liabilities.

11. These are on balance reasonable measures, especially given that small schemes are disproportionately impacted by the levy – as their levies are more often based on a higher proportion of their scheme liabilities. The tapering effect will also go some way to help protect against from arbitrary boundaries.

12. There is however, the view within our membership that larger schemes often act to cross-subsidise smaller schemes and that this broad principle should be taken into consideration for future policy proposals. It would be helpful if the PPF could provide further evidence to demonstrate how the levy is apportioned, to help determine whether this is evidenced. In addition, there is the opinion that the impact of a small scheme falling into the PPF is limited in comparison to the impact of a large scheme failing. The emphasis of financial burden alleviation should therefore not necessarily just be on the smaller schemes.

<u>Question 4. Reducing the cap</u>

13. The PPF are proposing changes that will seek to reduce the impact of increased levy charges for the schemes in most difficulty by reducing the risk-based levy cap - which limits the maximum risk-based levy schemes can be charged.

14. Before accounting for the small scheme adjustment (SSA), the cap reduces levies for under 3% of schemes, whereby after the SSA, it would account for 2% of schemes. Including the impact of the SSA, we project this will fall below 1%. Every three years the PPF typically review the level of the cap, so that it captures around 5% of schemes, though the SSA could be considered to reduce the number of schemes that need protecting. So they would ordinarily be considering adjusting the cap downward to 0.35% or 0.3%, all else being equal. Financial pressures on scheme sponsors over the next 12 to 18 months due to COVID-19 make a case for reducing the cap further, although once the immediate pressures of COVID-19 have receded, the PPF may consider the level of the cap again.

15. The PPF proposal is to halve the rate from 0.0050 (0.5%) of unstressed liabilities to 0.0025 (0.25%).

Consultation Question: Do you agree that the PPF should reduce the risk-based levy cap from 0.5% to 0.25% of unstressed liabilities?

16. PLSA are supportive of moves to reduce the risk-based levy cap from 0.5% to 0.25% of unstressed liabilities, and in particular would find this a helpful intervention while the full impact of Covid-19 are not yet known.
17. However, it will be important to keep short-term measures to combat challenges from the pandemic under regular review, to ensure that over time there will not be a shift of levy allocation from genuinely risky schemes onto other schemes that are less risky.

<u>Question 5. Support with payments</u>

18. PPF announced earlier in the summer that they were introducing additional payment flexibility for the levy for invoicing this autumn (the 2020/21 levy) – to help schemes with sponsors impacted by COVID-19.

Consultation question: Do you think the easement measures for COVID-19 impact should be extended to the 2021/22 levy year?

19. PLSA have previously called for the introduction of additional payment flexibility for levy invoicing, so we are pleased to see these measures continued. We endorse the easement measures for Covid-19 being extended into the 2021/22 levy year.

The second part of the consultation looks at PPFs move to use D&B as their partner to measure the insolvency risk of scheme employers.

20. The model has now been operating for only a few months, and PPF are not proposing to make any further changes to the method under which it calculates insolvency risk.

<u>Question 6. Looks at ultimate parent identification</u>

21. The PPF have carried out monitoring and have identified - for some complex, international company structures – that there can be frequent changes in the ultimate parent identified as a result of D&B's approach to building corporate linkages. While this has not been raised as a concern by any schemes or employers, the PPF are analysing the extent to which this occurs, and whether it is problematic for the purposes of levy calculations.

Consultation question: If you've had any experiences in relation to this particular scenario, the PPF would like to hear your views.

22. Our members have not reported frequent changes in the ultimate parent company.

<u>Question 7. Looks at the consultation process and the ease with responding to consultations</u>

23. The main point raised by stakeholders was that it is difficult for several individuals to collaborate on a 'full' consultation response when it is solely online. The PPF have therefore, introduced the ability to download an offline version of the consultation that can be completed and then uploaded to our website when complete. The downloadable document is in editable PDF format and is designed to work in conjunction with our consultation document, setting out clear areas where consultation questions can be responded to. There is still the ability to respond online without downloading the editable PDF document, and the 'quick' version of the consultation will be available online too.

Consultation question: Do you have any feedback on the newly introduced functionality for consultation responses?

24. PLSA have found the recent functionalities, introduced by the PPF, helpful with the online resources for consultation responses.

<u>Question 8. Invoicing system</u>

25. The introduction of Mimecast's secure messaging system does mean that the PPF have introduced some additional steps when an electronic invoice is received to ensure maximum security. The first time an electronic invoice is received, two emails from 'postmaster@ppf.co.uk' will be sent, one to notify that a secure message has been received; and one requesting that a password to access secure messages is set. Once a password is set, this can be used for all future secure electronic invoices sent.

Consultation question: If you have received an electronic levy invoice, do you have any feedback on the service?

26. PLSA fully supports the new steps in the electronic levy invoicing system, and we feel that it offers a further degree of security that is very welcomed by our members. Some feedback we received included that mimecast is excellent, but that some trustees have been slower to adapt to the system. There are some instances of sender errors or software firewalls at the receiving end causing some issues, but overall, our members have not reported any issues to us with the new system.

<u>Question 9. Corporate and Insolvency Governance Act 2020</u>

27. The Corporate Insolvency and Governance Act 2020 came into force on 26 June 2020, and introduced a new moratorium and restructuring plan. The PPF have considered whether any changes need to be made to the standard form contingent asset agreements to ensure that the agreements continue to work from a technical perspective, following the introduction of these new procedures. The PPF have concluded that no such changes are required.

Consultation question: The PPF would be interested to receive comments on points that we should consider in time for the 2022/23 Levy Rules and are also seeking views on whether any changes should be made in light of the Corporate Insolvency and Governance Act?

28. It is currently too early for our members to definitively say how the Corporate Insolvency and Governance Act will impact the pensions industry and in turn what factors should be considered now for the 2022/23 Levy Rules, in specific on the interaction between contingent asset agreements and the new insolvency procedures. We will monitor the situation and will raise any emerging issues with the PPF as soon as possible.

<u>Question 10. Consolidators and other endgame solutions</u>

29. The PPF would welcome thoughts at this stage on how these vehicles could be captured in the rules, but for 2021/22 the current rules for levying these types of arrangements will remain, whilst the market is developing. This means that arrangements which fit within PPFs definition of a Commercial Consolidator will be subject to the provisions of the Commercial Consolidator Appendix, while standard methodology will apply to other arrangements.

30. To assist schemes and their advisors in gaining a broad understanding of the provisions within the Levy Rules for Commercial Consolidators, the PPF have produced Commercial Consolidator Guidance that will be published alongside their final rules. This draws heavily on the material previously published in our 2019/20 Policy Statement. TPR has also produced its Superfunds Guidance, which sets out the standards TPR expects to be met before legislation is in place. This follows on from the DWP consultation on the

Consolidation of Defined Benefit Pension Schemes which set out proposals for a future regulatory regime for commercial consolidators. If there are schemes or sponsors that are proposing to proceed with transactions, PPF would encourage them to discuss their plans with TPR and them.

Consultation question: Do you have any views on how the PPF might amend the Levy Rules to capture 'DB end game solutions'?

31. For the time being, nothing has changed since the PPF Levy consultation in 2019 on this question; Superfunds have yet to be cleared by The Pensions Regulator and no transactions are under way. As such, with the information available, the current levy rules for commercial consolidators are suitable.

32. However, the PPF current guidance on those rules is from the 2019/20 Policy Statement from December 2018, which predates TPR's June 2020 interim regulatory regime for consolidators. It is important that PPF reviews how it can better align the PPF rules with the TPR framework in the guidance alongside the final PPF rules. Areas that could benefit from such a review, includes the following:

- The oversight and control of the investment strategy, approach, assets held and risk in any buffer arrangements;

- The triggers that give trustees control over any buffer arrangements and those that require the winding-up of a scheme or section; and

- Information required and ongoing monitoring of buffer arrangements.

33. As the "DB end game solutions" market continues to grow, it will become increasingly important that the levy rules ensure that Superfunds are charged levies which are appropriate for their risk to avoid any cross subsidies either from or to non-commercial occupational pension schemes. Please refer to our cover note for further comments.

<u>Question 11. Credit rating realignment</u>

37. PPF received feedback in December 2019 suggesting that stakeholders were in favour of the PPF recalibrating the mapping of credit ratings to levy bands, in line with recalibration of the D&B scorecards. PPF propose to recalibrate on the 31st December 2020. On the LT average default rates this will allow them to capture the more favourable default experience in the years prior to the current recession as well as the default experience during the current recession. For the ratio of insolvency to default this would allow them to capture the

insolvency experience over 2020 from UK companies having defaulted on or before the 31st December 2019.

Consultation question: Do you agree with the PPF's proposals to recalibrate the credit rating to levy band mapping as per the 31st December 2020?

38. PLSA are supportive of the proposals to recalibrate the credit rating to levy band mapping as per the 31st December 2020.