PENSIONS AND LIFETIME SAVINGS ASSOCIATION

CONSULTATION ON THE THIRD LEVY TRIENNIUM – 2018/ 19 TO 2020/21: CONSULTATION RESPONSE BY THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

15 May 2017

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

INTRODUCTION

The PPF levy is an important consideration for pension schemes, therefore we welcome the PPF's efforts to assess and improve on the results of the changes made in the last triennium. Many of the changes recommended for the 2018/2021 triennium seem to meet the PPF's stated intention of only making changes where there is a compelling case to do so. However, we are concerned that, in aggregate, the proposals mark a significant departure from the existing system and there is a risk that a multi-tiered system emerges. At this time, it is difficult to fully assess the impact of that risk, and what it would do for individual schemes and across the scorecards.

We are also concerned that, as presented, the changes imply that the scorecard methodology doesn't seem to work for significant sections of the universe, which may impact levy payers confidence in their scores and in the future stability of the Levy.

In addition, there are tensions between some of the proposals put forward in DWP's Green Paper consultation and the way the levy framework assesses insolvency risk. One area which stands out is the extent to which government policies might be encouraging an inefficient allocation of scheme capital, and the PPF framework can encourage lower volatility investment strategies. The PPF should review the levy framework in more detail to take into account evidence collected by DWP in its consultation process.

ANSWERS TO CONSULTATION QUESTIONS

1. DO YOU AGREE WITH THE AREAS OF THE LEVY SELECTED FOR REVIEW IN THE THIRD TRIENNIUM?

N/A

2. DO YOU AGREE WITH THE SCOPE OF OUR REVIEW OF THE PPF-SPECIFIC MODEL – THAT THAT LED TO US REBUILD FIVE SCORECARDS AND PROPOSE RECALIBRATION OF THE THREE GROUP SCORECARDS?

N/A

3. DO YOU AGREE WITH OUR CONCLUSION THAT THE RE-BUILT SCORECARDS PRESENT SUFFICIENT BENEFITS THAT THEY SHOULD REPLACE THE EXISTING SCORECARDS?

We support the proposed changes to the "large and complex" and "independent full" scorecards, as we agree that the risk of gaming should be reduced to ensure that schemes are paying a fair levy. It is not clear from the consultation paper however whether there is clear evidence that gaming is currently taking place, or that it is material, so we would welcome further clarification about the basis for the change.

4. DO YOU AGREE WITH OUR PROPOSAL TO USE PUBLIC CREDIT RATINGS IN PREFERENCE TO THE PPF-SPECIFIC MODEL?

We support the need to improve the assessment of insolvency risk for large employers that account for a significant proportion of the levy.

While we accept that the use of public credit ratings would improve the accuracy of insolvency risks we would like to the PPF to consider a number of aspects in more detail.

Firstly, by way of observation, there are a number of reasons why some sponsors might not regularly monitor their credit rating; for example, some international sponsors may not pay particular attention to their UK credit rating, because of limited credit activity in that jurisdiction. Secondly, it may drive other behaviours, for example some sponsors may not opt to seek credit ratings because of the impact this would have on their levy score. Thirdly, as stated above, this proposal, alongside others, would introduce multi-tier levy system, and we are concerned that this undermines the PPF scorecard methodology more generally.

5. DO YOU AGREE WITH OUR PROPOSAL TO USE INDUSTRY SCORECARDS FOR REGULATED FINANCIAL INSTITUTIONS THAT ARE NOT THEMSELVES RATED, IN PREFERENCE TO THE PPF-SPECIFIC MODEL?

See answer to question 4 above.

6. DO YOU AGREE WITH OUR PROPOSED BASIS OF SCORING WHERE PUBLIC CREDIT RATINGS OR INDUSTRY SCORECARDS ARE USED?

N/A

7. DO YOU AGREE THAT WE SHOULD SEEK AN ALTERNATIVE APPROACH FOR EMPLOYERS THAT CANNOT BE ASSESSED BY REFERENCE TO FINANCIAL INFORMATION ALONE? DO YOU HAVE ANY COMMENTS ON OUR DRAFT RULE?

All schemes that are eligible for PPF entry they should pay a levy that reflects their true level of risk. Given the complexities or potential variation amongst such schemes we would expect the PPF to scrutinise very carefully whether this lower levy band is warranted. In the long-term it would be preferable the position of schemes that cannot currently enter the PPF but are eligible for the levy is clarified in legislation.

For the purposes of calculating the levy it might be preferable to create a separate scorecard for these entities, such that their risks are calibrated to their particular financial features, or to explore different ways to secure a Governmental guarantee as the 'ultimate parent' where applicable.

We would note that as currently drafted, the criteria determining which schemes would fall under this scope does not take into account schemes set up by or owned by the Scottish or the Northern Ireland Government, the PPF should discuss this further with these bodies.

8. DO YOU THINK THAT WE SHOULD MOVE TO A SINGLE POINT CALCULATION OF INSOLVENCY RISK AT 31 MARCH? IF NOT DO YOU CONSIDER THAT A CHANGE SHOULD BE MADE TO THE NUMBER OF INSOLVENCY RISK SCORES THAT ARE AVERAGED?

N/A

9. DO YOU HAVE SUGGESTIONS OF IMPROVEMENTS AND SIMPLIFICATIONS THAT WOULD PARTICULARLY HELP SMALLER SCHEMES?

The PLSA would support measures to reduce the complexity of engaging with the levy for smaller schemes, in particular considering the small total amount of levy collected from these entities. Altering the proportion of the levy charged to schemes via the risk based levy (the first option proposed in the consultation) would seem to be the fairest way of doing this as the allocation winners and losers in this process would be driven by risk based factors.

10. DO YOU SUPPORT OUR PROPOSALS TO AMEND THE APPROACH FOR CALCULATING CERTIFIED DRC AMOUNTS? IF SO, WHICH FACTORS DO YOU CONSIDER SHOULD BE USED TO ALLOCATE SCHEMES BETWEEN THE TWO OPTIONS (A) AND (B) (WHICH COULD INCLUDE APPLYING A SINGLE OPTION TO ALL SCHEMES)?

We agree that the process for certifying DRCs is too costly and disproportionate to the benefits gained. This is a particular issue for SMEs.

We support the second option (allowing schemes to certify contributions paid under their recovery plan) as this would most likely be the most straightforward for schemes of all sizes to certify.

11. DO YOU HAVE VIEWS ON THE PROPOSED REQUIREMENT FOR A GUARANTOR STRENGTH REPORT TO BE HELD BY THE TRUSTEES AT THE TIME OF CERTIFICATION OF TYPE A CONTINGENT ASSETS? DO YOU HAVE VIEWS ON THE PROPOSED THRESHOLD OF £100 MILLION AND ARE THERE ANY ALTERNATIVES WE SHOULD CONSIDER?

There needs to be more clarity about who should be qualified to produce a guarantor strength report, and for there to be very clear guidelines from the PPF on what ought to be included. This will help ensure that schemes and guarantors understand what is expect and avoids disproportionate costs for potentially excessive advisor fees. We are concerned that advisors could use this as a further opportunity to charge disproportionate costs and there is a danger that this could act as a disincentive for sponsors to provide a guarantee in the first instance. This proposal would increase the cost of providing a parental guarantee and may consequently reduce the incentives for group parents to provide them. However, we recognise that it is important for these guarantees to be robust in the event of insolvency. Applying a threshold of £100 million helps to mitigate this impact. It will be important to ensure that the benefits or receiving a guarantee strength report outweigh the costs of commissioning it to continue to incentivise group parents to provide them. We would encourage the PPF to keep this under review.

12. DO YOU HAVE SUGGESTIONS ON UPDATES TO THE CONTINGENT ASSET GUIDANCE YOU WOULD EXPECT FROM US TO HELP MEET THE GUARANTOR REPORT REQUIREMENTS

N/A

13. DO YOU HAVE VIEWS ON THE TWO PROPOSED OPTIONS WHERE A GUARANTOR IS ALSO A SCHEME EMPLOYER?

N/A

14. DO YOU SUPPORT THE PROPOSAL TO ALLOW TRUSTEES TO CERTIFY DIFFERENT REALISABLE RECOVERY AMOUNTS FOR PARENTAL GUARANTEES (TYPE A CONTINGENT ASSETS) WHICH HAVE MORE THAN ONE GUARANTOR?

N/A

15. DO YOU HAVE ANY SUGGESTIONS ON THE DRAFTING OF THE CURRENT STANDARD FORM CONTINGENT ASSET DOCUMENTATION? DO YOU FORESEE ANY PRACTICAL DIFFICULTIES IN

RE-EXECUTING AGREEMENTS? DO YOU HAVE VIEWS ON ISSUES TO CONSIDER IN SETTING A TIMEFRAME FOR REEXECUTION?

N/A

16. DO YOU HAVE VIEWS ON THE OPTIONS WE SET OUT ON HOW WE MIGHT BETTER REFLECT THE LEVEL OF RISK OF THE STRUCTURE OF LOAN NOTE ABCS IN THE LEVY?

N/A

17. DO YOU HAVE VIEWS AND/OR EVIDENCE ON THE EXTENT TO WHICH GOOD GOVERNANCE LEADS TO A REDUCTION IN RISK, OF ONE OR MORE OF THE FACTORS ALLOWED FOR IN LEGISLATION, TO THE PPF? IF SO ARE THERE PARTICULAR ASPECTS OF GOVERNANCE THAT SHOULD BE FOCUSED ON FOR THE PURPOSES OF AWARDING ANY LEVY DISCOUNT?

The idea of using the PPF levy to incentivise good governance is an interesting proposition, although it would not be easy to implement. While we would not like to deter efforts to improve governance standards, we think that this goal can be achieved more effectively via different channels, such as the work being undertaken by the Regulator on 21st century trusteeship.

The levy determination is based on financial, quantitative factors and not qualitative criteria. Many aspects of good governance are driven by qualitative criteria, and so it is not clear how this could be incorporated into the levy determination. There is a danger that the result of a framework that incorporates a quantitative assessment of good governance would incentivise a focus on 'outputs' rather than 'inputs' to the governance process.

There are some quantitative measures, which may be worth further exploration benchmarks, including of timeliness of administration compliance and or record keeping.

We recommend that any further development in this area needs to be consistent with the PPF's specific role and to dovetail with any standards or recommendations set by the Regulator.

The PLSA will publish a discussion paper on good governance later this summer. We will be happy to discuss this work further with the PPF.

18. DO YOU HAVE PROPOSALS FOR THE IDENTIFICATION AND MEASUREMENT OF GOOD GOVERNANCE SUFFICIENTLY LINKED TO A REDUCTION IN RISK FOR THE PPF THAT MEET THE BROAD AIMS OF AVOIDING A TICK BOX APPROACH, AVOID ADMINISTRATIVE BURDENS AND ARE NOT DESIGNED TO BE WIDELY AVAILABLE? DO YOU HAVE SUGGESTIONS ON WHO SHOULD ADMINISTER SUCH A PROCESS AND HOW?

N/A