Consultation Response

2024/25 PPF Levy Consultation

October 2023

Guide and Information

Contents

Executive Summary

We are pleased to be able to provide our thoughts on the PPF levy consultation for 2024/25.

We are generally supportive of the PPF's direction of travel, namely:

- Reducing the overall levy it wishes to collect,
- Updating its methodology to reflect changes in market conditions which means many more schemes no longer pay a risk based levy, and
- Seeking ways to simplify its methodology.

As the PPF's financial position improves and the PPF levy becomes less of a burden on schemes then any steps that can be taken to simplify the process, thereby reducing costs, is to be welcomed.

We understand the legislative constraints that limits the PPF's options, and we continue to express our disappointment that this has not yet been resolved by the UK government. The outcome of which is that schemes are being asked to pay levies totalling £100m, when even the PPF does not believe this is required.

The changes being proposed are, to a large extent, as a result of these legislative constraints and they do not seem unreasonable in this context. We would, however, like the PPF to be more radical in its thinking about how it collects data from schemes. We believe there are plenty of opportunities to improve this, benefiting both the PPF and pension schemes.

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Responses

1- **Do you agree that our approach to charging a minimum levy is appropriate given the legislative framework?**

We believe that the levy should reflect the financial realities at that time and if that means charging a zero levy then the legislation should be changed to allow this. However, given the legislative constraints then we would agree that charging a minimum levy is appropriate.

With regards to the actual minimum level being proposed, i.e. £100m, we would like to see more analysis or evidence that the £100m and six year term are appropriate. For example, the PPF has stated that no changes to the methodology this year would result in a £90m levy estimate. Why is £90m insufficient as a minimum level.

2- **Do you agree with our approach to introducing simplifications to the levy over time?**

Yes, as the PPF levy becomes less and less of an issue for schemes it makes sense to simplify the process, to make it easier and cheaper for scheme managers to provide data and for the PPF to manage the process of issuing levies.

Whilst we can understand the PPF's rationale to reduce its own costs in calculating insolvency risk, we would be cautious about using alternative approaches, such as TPR gradings. Employer covenant gradings used for valuation purposes may not be appropriate for PPF levies (as it is often focused on affordability rather than risk of insolvency). This is presumably why TPR has not used the PPF model for funding purposes.

Whatever approach is adopted over time, the PPF should consider the overall cost to pension schemes and not just its own costs (which are ultimately met by schemes anyway). The total cost to the PPF of setting up and running one model for all schemes, will likely be more cost effective than requiring individual schemes to meet the cost of its own assessment.

We would also want to avoid a scenario whereby TPR justifies requiring schemes carry out costly employer covenant reviews “because it is required by the PPF”.

The approach taken in maintaining a separate methodology for superfunds seems appropriate to us.

3- **Do you consider there are any areas where simplification should be considered more urgently?**

When simplifying the process, we believe that reducing the amount of data being collected should be preferable than just changing the data collected.

The PPF levy is calculated based on S179 valuation data and scheme asset allocation in the Scheme Return. The costs of providing these can be significant, in particular the cost of carrying out a S179 valuation may be several thousands of pounds. This seems disproportionate in cases when the PPF levy can be less than a few hundred pounds.

In the short term, the information requirements around asset information for well funded schemes could be simplified. We find that for these schemes there is a disproportional amount of expense in calculating the required asset split information.

4- Do you agree with our proposal to minimise changes (delaying the introduction of A11, and the updating of asset and liability stress factors) to limit adjustments to the levy scaling factor (LSF) for 2024/25?

Yes, we agree that this seems like a reasonable approach for now. There were a lot of changes to the methodology last year and minimising these changes for now seems sensible.

It does reiterate the rather perverse situation whereby the PPF is not using the latest available data, which would reduce PPF levies further, in order to manipulate the outcome due to legislative constraints.

5- Do you agree that focusing the risk-based levy on a diminishing pool of risk-based levy payers is undesirable?

Yes. Whilst we support the underlying principle that those schemes that present the highest risk should pay the highest levy; all schemes present some risk to the PPF. Requiring a smaller and smaller group of schemes to pay a notional fixed amount would be disproportionate.

With regards to the options presented, increasing investment stresses by considering worse case economic scenarios would be preferable, as these extreme scenarios may be more likely at the point that an increased number of schemes would potentially enter the PPF.

6- Do you agree with our proposed criteria to assess the different options? If not, what do you consider the criteria should be?

The PPF has, in recent years, acknowledged that the cost of managing and paying the PPF levy has disproportionately fallen on smaller schemes.

We would propose this is reflected in the criteria and would suggest an additional criteria to ensure that any changes would not have an unfair material impact on smaller schemes.

7- Should we add an additional factor to the liabilities to limit the scale of increases in the levy scaling factor (LSF)? If so, do you have comments on how we should balance using the levy scaling factor and an adjustment factor for liabilities?

Whilst introducing an additional liability factor may seem attractive to resolve the current imbalance between those that pay a risk based levy and those that don't, it would just add an additional complication, when the PPF is looking to simplify the calculation. The current methodology of smoothing and stressing the liability has many different steps and we would rather see tweaks to this rather than add another parameter.

Further, we agree with the PPF's comment that an adjustment factor wouldn't take into consideration hedging in schemes, which would result in schemes with very low risk investment strategies being penalised, when their risks are well mitigated.

8- Do you agree that it would be appropriate to align the levy methodology to the reason for charging the levy – to provide against highly adverse claims - by altering the asset and liability stresses?

Yes, we agree that this is a fair and balanced approach.

9- Do you agree that altering asset and liability stresses are more suited to a one-off adjustment rather than being adjusted every year to scale the overall levy up or down?

We agree that changing the stresses year on year could be very volatile, we would be happier if the stresses were a fair representation of the risk associated with each asset class and these were adjusted to reflect the changes in these risks over time.

10- Do you have any other ideas or suggestions to ensure a risk reflective approach to the levy in future years?

Our experience of the buy-out market over the past twelve to eighteen months is that there are now lots of well funded schemes, with low risk investment strategies, that are either preparing to approach insurers or are in the buy-out process. These schemes represent a very low risk to the PPF, which is reflected in PPF levies that are typically very small.

However, they still face all the fixed costs of providing information to the PPF to calculate the levy (S179 valuations and Scheme Returns). Could the PPF consider options whereby schemes can opt-out of having to provide this information in return for a slightly higher PPF levy. For example, a fully funded closed scheme, invested 100% in bonds, would not have to complete another S179 valuation but that its PPF levy is increased by 50% say. This could benefit the PPF and result in significant savings to schemes.

11- Do you agree with our approach to simplify the process for special category employers?

Yes, our experience of identifying and successfully applying for special category status has been mixed. We would therefore welcome the proposal to simplify the process for eligible employers.

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