Reducing your Pension Protection Fund (PPF) levy for 2017/18

January 2017 Pension briefing

HIGHLIGHTS

2017/18 is the third year in the Pension Protection Fund (PPF)'s levy "triennium" under the new levy framework.

Trustees who wish to reduce their pension scheme's risk-based levy by taking account of contingent assets or asset-backed contributions need to pay careful attention to the certification processes that have a deadline of midnight on 31 March 2017.

The deadlines to remember are:

- **Certification (or re-certification) of contingent assets on Exchange and submission of hard copy supporting documents to PPF** – Midnight 31 March 2017
- **Certification of asset-backed contributions to PPF** – Midnight 31 March 2017
- **Certification of mortgages and other security by submitting an officers' certificate and associated hard copy documents to Experian** – Midnight 31 March 2017
- **Certification of accounting standard change with supporting evidence to Experian** – Midnight 31 March 2017
- **Submit data to Experian to impact Monthly Experian Scores** – one calendar month prior to the Score Measurement Date (for new guarantors, by midnight on 31 March 2017.
- **Certification of deficit reduction contributions on Exchange** – 5pm, 28 April 2017
- **Certification of block transfers on Exchange (or sent to PPF in limited circumstances)** – 5pm, 30 June 2017

Invoicing for the 2017/18 levy year is expected to start in autumn 2017.

CONTINGENT ASSETS – BACKGROUND

Contingent assets may be put in place to shore up a scheme's funding position (and so reduce the amount of the scheme's PPF risk-based levy) without the sponsoring employer having to put extra cash into the scheme.

The PPF recognises three types of contingent asset:

- "Type A": guarantees given by an "Employer's Associate", which may be a company or undertaking in the same corporate group as a sponsoring employer of the scheme, or an entity which has a pre-existing legal or commercial relationship with a sponsoring employer. The PPF toughened its stance on accepting guarantees from 2015/16. For details on the PPF's approach, please see the next page;
- "Type B": security given to the trustees over cash, real estate or securities; and
- "Type C": letters of credit and bank guarantees.

The PPF has produced standard documents for putting in place contingent assets. The standards were last reissued on 17 December 2014 and have not subsequently been amended (apart from a minor change to the standard letter of credit / bank guarantee). The latest versions must be used for any contingent asset arrangement entered into with effect from 17 December 2014.

NEW CONTINGENT ASSETS

If a contingent asset is to be recognised by the PPF it must be:

- put in place using the PPF's standard form documentation;
- supported by various associated documents, including a legal opinion and, in some cases, confirmation that the benefit to the company providing the contingent asset has been considered and established; and
- submitted to the PPF in hard copy by midnight on 31 March 2017.

In addition, the trustees must submit a contingent asset certificate via the Pension Regulator's on-line Exchange system.

We can help prepare all the necessary documentation.

RECERTIFYING EXISTING CONTINGENT ASSETS

Existing contingent assets must be recertified via Exchange to be recognised for the purposes of the 2017/18 risk-based levy calculation, no later than midnight on 31 March 2017.

Further documentation may also be needed if, for example, the contingent asset has been amended.

If your scheme's existing contingent asset was put in place using documentation other than the PPF's standard form current at that time, the contingent asset should be re-executed using up-to-date standard form documents.

We can help with any questions about the recertification process and, where necessary, assist in preparing any further documentation that needs to be submitted to the PPF.

2015/16 CHANGES TO TRUSTEE CERTIFICATIONS OF CONTINGENT ASSETS

Following changes made in 2015/16, trustees are required to:

- certify the amount they consider to be the "**Realisable Recovery**" under the guarantee. This will involve identifying a specific sum the trustees are satisfied that the guarantor could pay if the guarantee is called on. Broadly, the Realisable Recovery will be the lower of this figure and any cap stated in the guarantee documentation; and
- confirm to the PPF that "*having made reasonable enquiry into the financial position of each Certified Guarantor, [the trustees] are reasonably satisfied that each Certified Guarantor, as at the date of the certificate, could meet in full the Realisable Recovery certified, having taken account of the likely impact of the immediate insolvency of all the Employers (other than the Certified Guarantor where that Certified Guarantor is also an Employer)*."

Under the certification requirements applicable from 2015/16, the trustees must:

- give a positive statement about the amount of money they are satisfied the guarantor could pay; and
- expressly consider the likely impact of the immediate insolvency of all scheme employers on the guarantor's ability to pay (although this was previously a feature of PPF guidance).

The PPF points out that a different Realisable Recovery may be certified year on year, as trustees' views of the guarantor's financial strength and the scheme's funding position may change.

How do we approach the certification requirement?

PPF guidance states that trustees should take proportionate steps in order to assess the Realisable Recovery. In some cases, it may be appropriate for trustees to obtain professional covenant advice. If the trustees do not obtain professional advice, they should document the reasons why it was considered unnecessary: the PPF may request information about the trustee's analysis of the strength of the guarantor at a later date.

The PPF has emphasised the importance of trustees asking probing questions. In particular, it is essential for trustees to consider in detail what the knock on effect of the employer's insolvency will be on the rest of the group.

Practical steps the trustees could take include making enquiries of the guarantor's directors and management or seeking a letter of comfort from the guarantor. However, trustees should be able to demonstrate that they have challenged assertions made by the guarantor and, where appropriate, obtained third party evidence to support their view. In addition, trustees should not give the confirmation purely on the basis that they have attempted to obtain information and been unsuccessful.

Where a review of the guarantor has previously been conducted that is consistent with current PPF guidance on contingent assets, a simple update that considers what has changed since that review will generally be acceptable.

ASSET-BACKED CONTRIBUTIONS

Asset-backed contribution arrangement (ABC) will only be recognised as a scheme asset for PPF levy purposes if it is certified by the scheme trustees.

The starting point is that the face value of the ABC arrangement, as shown in the scheme assets data, will be deducted from the value of the total scheme assets for the purposes of valuing the scheme's PPF deficit.

The trustees may then certify a value for the ABC (the "ABC Value") which will be added back into the scheme assets if it meets the PPF's requirements. Trustees are permitted to certify the lower of:

- the "**fair value**" of the ABC (based approximately on the value given to it in scheme accounts); and
- the "**stressed insolvency value**" of the ABC, reflecting the amount the trustees could reasonably rely upon recovering if all scheme employers (and guarantors) became insolvent.

To complete the certification process, steps the trustee will need to take include the following.

- Obtaining a valuation of their ABC arrangement from a suitably qualified professional in line with PPF guidance. The PPF's guidance allows for a lead valuer to prepare the valuation using information provided by other advisers.
- Where the PPF has recognised an ABC arrangement for a previous levy year, the ABC may be recertified with either an updated version of the previous valuation or a full valuation: it is for the valuer to decide whether a full valuation is required.
- Obtaining legal advice about the legal structure and enforceability of the ABC arrangement and the trustees' rights under it if all scheme employers (and guarantors) become insolvent. The legal advice needs to be given to the professional valuation expert.
- Where an ABC has previously been certified and the underlying legal position has not changed, the valuer may rely on the previous legal advice, provided that the legal advisers confirm that their previous advice remains current and that there are no material changes which may materially affect the basis on which the advice was given.
- Both the valuation and the legal advice must contain express wording that they can be relied upon by the PPF.
- The trustees must certify online to the PPF that, having regard to legal advice, the ABC arrangement is legally binding, valid and enforceable and does not breach employer-related investment restrictions.

- The trustees must also certify other basic information about the ABC arrangement online by midnight on 31 March 2017.

The PPF does not provide standard form templates for the valuation or legal advice, so trustees and their advisers should consult the PPF's determination and guidance to ensure that all applicable requirements are met.

If the scheme has more than one ABC arrangement, separate certificates must be completed for each arrangement.

If the trustees decide against completing a valuation and certification process for an ABC arrangement, they may still gain credit for any payments actually made to the scheme under the arrangement. A separate, but less comprehensive, certification process applies to this. This alternative process also allows trustees to check that the amount deducted from their scheme assets in respect of the ABC arrangement is accurate.

Where other payments have been made towards repairing the deficit, or a block transfer made, in a scheme with one or more ABCs, trustees should consider the interaction between these and their ABC certification.

What is an ABC?

In recent years, many schemes and sponsoring employers have put in place asset-backed contribution arrangements (ABCs) as a means of supporting a scheme's funding position while reducing the risk of "trapped surplus". ABCs vary but, typically, an income-producing asset (such as property) will be held by a third party (usually a Scottish limited partnership), with income from the asset being passed to the scheme trustees via distributions from the partnership.

The capitalised value of the trustees' interest in the partnership is treated as a scheme asset, thereby increasing total scheme assets and reducing or eliminating a deficit. In practice, the arrangement typically provides for the distribution to the trustees to be paid over a number of years. The governing documents of the partnership may specify events (such as insolvency of the employer) which will cause the arrangement to be "unwound" ahead of schedule, in which case a final payment may be made to the trustees.

Why are trustees required to certify ABCs?

The PPF considers that assets held within ABC arrangements are typically related to the employer's business (for example, a factory which is then leased to the employer) and their value is therefore connected with the employer's financial health. There is concern that the value given to an ABC arrangement in the scheme's accounts may be greater than the amount the trustees could reasonably expect to obtain if they had to sell the ABC asset in an insolvency scenario.

The PPF is concerned with a pension scheme's likely position should its sponsoring employers (and any guarantors) become insolvent. The PPF has therefore decided that only the realistic value of an ABC asset on insolvency should be taken into account in any reduction in a scheme's risk-based levy.

INSOLVENCY RISK: "MORTGAGE AGE" CERTIFICATIONS

As part of Experian's method of assessing employer insolvency risk when calculating PPF levies, "**mortgage age**" is taken into account, starting with the 2015/16 levy year. The mortgage age is the age of the newest registered mortgage or other charge over the employer's assets. The PPF considers that, in general, businesses with more recent charges have a greater risk of insolvency.

Some types of mortgage or other charge need not be taken into account when calculating insolvency risk. These types of mortgage or charge are considered to be unconnected with higher insolvency risk, provided they meet the PPF's requirements. The five categories are:

- mortgages or other charges created on refinancing, where the refinancing is on the same or better terms than the original finance arrangement (a "Refinancing Mortgage");
- security given by tenants to landlords over deposits for leasing a property (a "Rent Deposit Mortgage");
- security given by an employer in favour of pension scheme trustees (a "Pension Scheme Mortgage"); and
- security which is "immaterial" compared to the employer's total assets (an "Immaterial Mortgage");
- all mortgages and other security where the employer's group has a sufficiently strong credit rating and certain other criteria are met.

To ensure that a mortgage or other charge is not taken into account by Experian, one of the categories above must apply, and the employer must provide a certificate and associated documents (including copies of relevant contractual documents) to Experian by midnight on 31 March 2017. Experian will not accept late certifications.

Certificates previously accepted in respect of Refinance Mortgages, Rent Deposit Mortgages, Pension Scheme Mortgages and mortgages where the credit rating requirement is met for 2017/18 will automatically be carried over for use in calculating the 2017/18 levies. In contrast, certificates for Immaterial Mortgages will need to be submitted for each levy year. A new certificate should also be submitted where the credit rating exclusion is being relied on, if the basis on which the credit rating test is met is different from the basis on which it was met in previous levy years.

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