SQUIRE PATTON BOGGS

Pension Protection Fund Levy 2019/20

Headlines and Deadlines

February 2019

On 12 December 2018, the Pension Protection Fund (PPF) published its rules governing the calculation of levies for the 2019/20 levy year.

The PPF made substantial changes to its insolvency risk modelling for the 2018/19 levy year, which was the start of the third triennium. The PPF has therefore steered away from making any significant changes in this regard. This year, the focus has been on PPF levy rules for commercial consolidator vehicles, its rules for re-execution of certain contingent assets and, to a lesser extent, the way in which recent court decisions impact the calculation of PPF compensation and section 179 valuations. The levy estimate is £500 million and the PPF Board will use a levy scaling factor of 0.48 and scheme-based levy multiplier of 0.000021.

We provide more information on the key areas of change below, together with this year's deadlines.

This is only a summary – trustees and employers who are relying on a levy reduction method are advised to check the revised rules and assess the actions they need to take, noting that it will take time to obtain advice, update valuations (where necessary) and finalise documentation. This is particularly the case in respect of the re-execution of Type B contingent assets (security over assets), which should be carried out in February, in order to ensure timescales can be met for the 2019/20 levy year. Legal advice should be obtained at an early stage. You can find more information on the PPF 2019/20 levy page.

Contingent Asset Agreements

The PPF announced last year that certain Type A and Type B contingent asset agreements must be in the PPF's new standard form issued in January 2018, otherwise the PPF will not take them into account for levy calculation purposes for levy years 2019/20 onwards. The types of contingent assets caught by this requirement are those with a liability cap of a fixed amount or a cap that is the lower of a fixed amount and fluctuating liabilities.

Methods for Re-executing Existing Contingent Asset Agreements

There are two possible methods for the re-execution of Type A contingent assets (guarantees). These can be re-executed by either:

- All parties entering into a brand new agreement
- Amending and restating the original agreement

Type B contingent assets, such as charges over property, may only be re-executed by the parties entering into brand new documentation. This could create some logistical difficulties for trustees with Type B contingent assets, such as the timing of the release of an existing charge. Ordinarily, if a contingent asset is released part way through a levy year, the PPF will recalculate the levy payable in respect of that year.

The PPF has recognised this as an issue in Part 3 of its contingent asset guidance and has said that: "Where there are no other changes other than the move to the new standard form, we would not expect that the mid-year removal of a contingent asset in these circumstances would lead to a recalculated 2018/19 levy, but we ask that schemes contact us in the usual way."

Note that Type B security over property must be registered with HM Land Registry before a legal opinion can be provided. Time must be allowed for registration. We recommend that Type B documents are executed in February in order to allow sufficient time for HM Land Registry registration.

Documents to Be Provided to the PPF

On re-execution of an existing contingent asset agreement in the new format, the same documents that would have been submitted on a **new certification** will need to be submitted to the PPF. This is regardless of whether a Type A guarantee has simply been amended. While the PPF has said that it will accept refresher legal opinions and guarantor strength reports in some circumstances, it is unlikely to be appropriate in most cases and legal advice should be sought at the earliest opportunity. Hard copy documents must be full and complete – so trustees would need to append any prior reports to which a refresher opinion relates.

Updating Exchange

There will be a new category to look out for on Exchange in respect of contingent assets that have been re-executed (as opposed to new contingent assets and ordinary re-certifications where documents are already in the correct form).

Contingent Asset Guidance

The contingent asset guidance has been updated to incorporate some of the comments received on the new standard form documents during the levy consultation process, but the standard form documents have not been amended.

Special Category Employers

A new rule was introduced last year in relation to employers that had a connection with government and/or are established by legislation. The Consultation for 2019/20 proposed a rule so that employers granted Special Category Employer (SCE) status for 2018/19 would remain so classified, provided that they complete certain confirmation requirements. The PPF plans to contact employers with SCE status (for example, in January each year), asking for confirmation that no change in the entity's circumstances has taken place and the certificate is still valid. Employers that fall within this category should ensure that they respond to the PPF's email. If an employer is in any doubt whether it falls within this category, it should seek advice.

Invoicing

Levy invoices are payable within 28 days. A payment plan might be an option if a scheme has difficulty paying the PPF levy, but legislation requires that each scheme must be considered on a case-by-case basis. There is no guarantee that the PPF would exercise its discretion to allow a payment plan. Given that there is a short timescale available for payment, schemes should make sure that the scheme return on Exchange includes a relevant billing address in paragraph 2.3 of the scheme return. The PPF says that only 15% of schemes currently provide an address for levy billing purposes.

Impact of Recent Court Judgments

The PPF has published some frequently asked questions on its website explaining how recent court decisions will affect section 179 valuations. In *Hampshire v PPF*, the Court of Justice of the European Union ruled that pension scheme members are entitled to at least 50% of their original pension entitlement. In *Beaton v PPF*, the High Court ruled that certain benefits transferred into a pension scheme are subject to a separate cap from the main scheme benefits.

Additionally, the PPF noted in its levy policy statement that the recent case of *Lloyds Banking Group Pension Trustees Limited v Lloyds Bank PLC* and others will mean that some scheme employers may need to make accounting adjustments to reflect higher scheme liabilities at the next opportunity. This could, in turn, lead to a worsening of the employer's insolvency risk score. The PPF has confirmed that it does not plan to allow any adjustments to be made in order to prevent a score worsening. This is because the ruling effectively confirms a liability that a scheme has and it could be argued that the scoring of the employer in the past (which had ignored guaranteed minimum pension equalisation liabilities) was too generous and understated the employer's insolvency risk.

Commercial Consolidators

Finally, whilst the PPF's rules in relation to commercial consolidators are unlikely to be relevant for many of our clients, a summary of the way in which the PPF will be dealing with commercial consolidators in the early stages is set out below, for information.

The PPF is taking a flexible approach to the definition of commercial consolidator vehicles (superfunds) for levy year 2019/20, whilst the government consults on the definition that should be used in legislation. The main aim is to ensure that the levy is set at a level that does not result in ordinary not for profit trust based schemes picking up the cost of failed schemes set up for commercial gain. The PPF has said that it will use its discretion to exclude schemes from the definition of commercial consolidator where the employer covenant does not change, such as established master trust arrangements. In assessing an appropriate levy amount, the PPF will take into account the:

- Amount of capital buffer available to the superfund and the circumstances in which this may be accessed
- Winding up triggers for the superfund (to ensure that there is no "PPF drift", which would ultimately increase costs for the PPF and other levy payers)
- Manner in which profit may be extracted by investors

The PPF rules allow the PPF to take a principles based approach in relation to capital buffer funds. In assessing proposals against these principles, the PPF has said that it will have regard to the requirements of The Pensions Regulator (TPR) and in due course regulations in relation to buffer funds. The PPF will aim to carry out any assessment required for levy purposes alongside TPR clearance/authorisation activity in order that engagement is as streamlined as possible. The PPF considers that this principles-based approach is most suited to the initial stages of the development of the consolidation model, but it expects to develop the principles over time and says that it could develop standard forms in future years.

The PPF notes that the premise for commercial consolidators is that investors will be able to extract profit from the arrangement, either during the course of its lifetime or at the point at which the consolidator vehicle is wound up. The PPF has devised a straightforward way to assess a consolidator vehicle that does aim to return assets to investors before all liabilities are discharged. Provided that profit extraction is only permitted at a fixed point in the year and the section 179 valuation is supplied to the PPF net of profit available for distribution during that levy year, a commercial consolidator will be treated as having no capacity to extract profit.

Deadlines

The PPF has set its key deadlines as follows:

Documents	Deadlines
Scheme return to be submitted on Exchange	By midnight, 31 March 2019
Guarantor strength reports (where relevant) to be completed	By midnight, 31 March 2019
Contingent asset certificates to be submitted on Exchange	By midnight, 31 March 2019
Hard copy contingent asset documents where required (including guarantor strength reports) to be delivered to the PPF	By 5 p.m., 1 April 2019
ABC certificates to be sent to the PPF by email	By midnight, 31 March 2019
Mortgage exclusion (officers') certificates and supporting evidence to be sent to Experian by email	By midnight, 31 March 2019
Accounting standard change certificate to be sent to Experian by email	By midnight, 31 March 2019
Special category employer applications (and confirmation of no change) to be sent to the PPF by email	By midnight, 31 March 2019
Deficit reduction contribution certificates to be submitted on Exchange	By 5 p.m., 30 April 2019
Exempt transfer applications with supporting evidence to be sent to the PPF by email	By 5 p.m., 30 April 2019
Certification of full block transfers to be completed on Exchange or sent to the PPF (in limited circumstances)	By 5 p.m., 28 June 2019

Further Information

Please note that the PPF's procedural requirements are stringent and its deadlines are firm. Trustees and employers who are relying on a levy reduction method are advised to check the 2019/20 rules and assess the actions they need to take and to seek advice at an early stage, especially if they need to re-execute a Type B contingent asset involving security over property.

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