Institute
and Faculty
of Actuaries

Consultation on the third PPF Levy Triennium - 2018/19 to 2020/21

IFoA response to the Pension Protection Fund

15 May 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute
and Faculty
of Actuaries

15 May 2017

Chris Collins
Chief Policy Adviser
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon, Surrey
CR0 2NA

Dear Chris

IFoA response to Pension Protection Fund (PPF) Consultation: Consultation on the third PPF Levy Triennium – 2018/19 to 2020/21

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. We have limited our response to answering questions that benefit from actuarial expertise. Members of the IFoA's Pensions Board, most of whom have experience advising trustees and/or sponsors, have overseen our response.

Q1. Do you agree with the areas of the levy selected for review in the third triennium?

2. The IFoA is not aware of any additional areas which should have been included as part of the levy review.

Q4. Do you agree with our proposal to use public credit ratings in preference to the PPF-specific model?

3. Yes. Given that the PPF's research suggests the proposed amendments to the methodology improve accuracy, we welcome the amendments.

4. There is a possibility that an employer may wish to use the system to its advantage by choosing to omit one of the three main credit rating agencies when looking for a rating. However, given the alternative uses of credit ratings, we expect the potential for this approach to be limited.

Q5. 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?

5. Given the likely improvements in accuracy, the IFoA agrees with this proposal. In particular, this will overcome the difficulty under the current model for some financial services companies which disclose no stock in their accounts.

6. Using an additional model may result in less transparency; therefore, there could be benefit for employers and trustees if the PPF could make its appeals process clearer in relation to this approach.

London 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel:** +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111
Edinburgh Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel:** +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313
Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel:** +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211
Beijing 6/F · Tower 2 · Prosper Centre · 5 Guanghua Road · Chaoyang District · Beijing China 100020 · **Tel:** +86 (10) 8573 1000 · **Fax:** +86 (10) 8573 1100
Hong Kong 2202 Tower Two · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +11 (0) 852 2147 9418 · **Fax:** +11 (0) 852 2147 2497
www.actuaries.org.uk

Q8. 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?

7. The IFoA recognises that scores will be more stable and should only change on submission of accounts. However, despite employers and trustees being comfortable with the averaging process; there is a benefit in a move to a single point estimate.

8. We note that such a change could create an opportunity for employers to maximise benefit from the system by choosing to submit accounts before, or after, 31 March each year depending on how favourable the resulting score would be. Although we recognise the PPF's assessment of this risk as low, a move from month-end averages to a single point calculation may encourage employers to time the filing of accounts for their benefit.

9. Whether the score is averaged or not, the frequency with which scores need to be monitored will decrease due to the enhanced stability of the framework. This will help reduce costs for schemes.

Q9. Do you have suggestions of improvements and simplifications that would particularly help smaller schemes?

10. Where the PPF levy is a significant cost, the cost of obtaining advice in relation to the levy can often be offset by future savings on the levy. This can be the case even for smaller schemes. The IFoA therefore believes there is no case for applying a different approach for small schemes from others, simply by virtue of their size. In particular, moving to an average insolvency risk band would represent a step backwards in the accuracy of the model.

11. Where smaller schemes genuinely present a lower risk, but are not reporting this to the PPF, there may be a case for making risk-reduction measures easier to access. The proposals to amend the approach for calculating certified deficit reducing contributions will go a long way towards addressing this.

12. There can also be cases where contingent security has been provided, but the relevant PPF certification has not been provided due to the onerous documentation needed. In these cases, we would expect it is a conscious decision based on the cost of so doing set against the levy saving. We also expect that the PPF has no appetite to change this process given the proportion of applications it currently rejects. However, if the PPF is seeking a further area for simplification for smaller schemes, this may be a starting point.

Q10. 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)?

13. The IFoA supports simplification of calculating certified DRCs. This may increase the likelihood of smaller schemes certifying. In stating this view, we have assumed that the increased number of certificates would have minimal impact on the PPF's systems.

14. Option (a) would remove one key barrier to certification. Investment expenses can dwarf DRCs. We believe it is difficult to justify including them while investment return assumptions are net of expenses. This is our preferred option, but we note there are still difficulties in certifying for schemes which remain open to future accrual.

15. Under option (b), there is a risk that the certified DRC could be overstated where a scheme is open to future accrual and the contributions paid in respect of future service are insufficient on the PPF basis. This is why we prefer option (a), but we note that the benefits of simplification and cost savings could outweigh this risk, particularly as there are fewer schemes now open to future accrual. Alternatively, option (b) could be used only where a scheme is closed to accrual.

16. The IFoA notes that if more certificates are submitted, the levy collected will need to be redistributed, but that this represents a fairer reflection of the risk to the PPF of each individual scheme.

Q13. Do you have views on the two proposed options where a guarantor is also a scheme employer?

17. We would support the first option of the two proposed in order to avoid changing the calculation process for all other schemes.

Q14. 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?

18. The IFoA supports this proposal because it more accurately reflects the level of risk reduction under such guarantees.

Q15. 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 re-execution?

19. The requirement to re-execute agreements dating back as far as 2006 represents an unexpected, and potentially significant, additional cost for schemes. We do not believe that this is justified simply by the PPF taking stock of its documentation. If there is a more pressing issue, we would welcome greater clarity from the PPF.

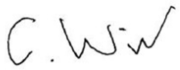
20. There may be a more pragmatic solution, for example a self-certification checklist on Exchange setting out changes to the terms, and inviting agreement to each.

Q17. 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?

21. The IFoA recognises that good governance does lead to a reduction in risk. However the reduction to the level of risk posed specifically to the PPF is likely to be negligible. Using the PPF levy to incentivise good governance seems a flawed approach. It would be impossible to structure such a discount in a meaningful, quantifiable way. Good governance should be core to a trustee board's role, rather than a tool to minimise the PPF levy.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely



Colin Wilson
President, Institute and Faculty of Actuaries