Pension Protection Fund

Consultation document

Levy rules 2024/25

Foreword

Welcome to the levy consultation for 2024/25.

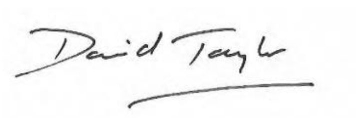
Our latest annual report shows the PPF is in a very strong financial position. In line with our funding strategy, published in September 2022, this means we have been able to substantially reduce the levy we charge, from £390 million in 2022/23 to £200 million in the current year, without compromising on the security we provide our members.

In 2024/25 we propose to continue this approach by reducing the levy to £100 million. This means that since 2020/21 we will have reduced the levy we charge by almost 85 per cent.

Our governing legislation places limits on how much can be charged and the extent to which the levy can be increased from year to year. This is intended to protect levy payers from sharp increases in the levy. However, it also effectively constrains how low we can allow the levy to fall without damaging our ability to respond to a funding challenge should one arise. We therefore plan to ensure the levy remains at or above £100 million in future years.

If our legislative framework was to change, as has been suggested in the recent DWP review of the PPF, we would reconsider our approach (depending on the exact nature of any changes and our funding position at the time). In the meantime, it is essential we charge a levy and retain the ability to manage our risks within the current legal framework.

A small increase in the levy scaling factor is needed to achieve a levy of £100 million in 2024/25, but we expect almost all levy payers to see their levy fall compared to the current year. However, because we anticipate the number of schemes paying a risk-based levy would otherwise continue to decline, more substantial changes are likely to be necessary to maintain a levy of £100 million in future years. This consultation seeks views on our limited proposals for 2024/25 but also on the options to maintain a levy of £100 million in the longer term.



David Taylor
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Contents

1. Key proposals 1
2. Executive summary 2
3. Policy context: Our legislative framework and the levy we charge 4
4. Towards a simpler levy 7
5. Levy for 2024/25 10
6. Levy options for future years - how to maintain a levy of £100 million 15
7. Customer service 21
8. Draft levy rules 2024/25 23
9. Next steps and key dates 26
10. Consultation arrangements 27
11. Comments on the consultation process 28
Appendix 1 - Insolvency risk 29
Appendix 2 - Impact analysis 30
Appendix 3 - Assumptions used to forecast levy collection 37

1. Key proposals

This document sets out our proposals and the underlying analysis for the 2024/25 levy rules. These rules will determine how levy bills to be issued in autumn 2024 will be calculated. The headline proposals are:

The Board's Levy Estimate, policy and levy parameters

- We intend to set the 2024/25 Levy Estimate at £100 million, which is a reduction of £100 million on 2023/24.
- The Levy Scaling Factor (LSF) will be set at 0.40 (2023/24 comparator 0.37).
- The Scheme-based Levy Multiplier (SLM) is to change to 0.000015 (2023/24 comparator 0.000019).
- The risk-based levy cap is to remain at 0.25 per cent of scheme liabilities.

More about our analysis and rationale for decisions, along with information about other subjects under consultation, can be found in the following sections of this consultation document.

2. Executive summary

2.1. Introduction

2.1.1. This consultation document sets out our plans for the levy rules for 2024/25 and invites comments on them. The consultation will run for seven weeks from 11 September to 5pm on 30 October. We expect to publish our consultation conclusions in December 2023.

2.1.2. The document also covers a range of further topics, including the future of the levy and proposals for 2025/26 and beyond. We would expect to return to these topics in future consultations rather than seeking to reach conclusions in our December response document.

2.2. Policy context

2.2.1. Section 3 sets out the policy context for our thinking on the ongoing requirement to charge a levy. It sets out the challenges of the legislative framework and the Board's conclusion that the lowest level at which the levy could safely be set is £100 million.

2.3. Towards a simpler levy

2.3.1. Alongside the question of how much levy needs to be charged, we have also reflected on the points set out in last year's consultation regarding the longer-term development of our levy methodology, and the responses received. Section 4 expands on our thinking on the next steps towards a simpler levy. It outlines our view that, whilst our aim of simplification in the long term remains, our main focus in the short term is to ensure stability and maintain a levy of £100 million. It details, and seeks views on, various areas we will look to consider in the coming years such as potential simplification of our approach to insolvency risk and our expectation that we will undertake a review of the systems we use to collect, manage, and manipulate scheme data.

2.4. Levy for 2024/25

2.4.1. Our plans for the levy rules for 2024/25 are laid out in Section 5. We will set the levy at £100 million (half of the 2023/24 estimate). We are proposing minimal changes to our methodology, focused solely on those needed to achieve the £100 million estimate. We plan to continue using A10 s179 assumptions rather than moving to A11 s179 assumptions. We are proposing a small change in the levy scaling factor (LSF), together with a small adjustment to the scheme-based levy multiplier (SLM) to keep the scheme-based levy within the legislative maximum of 20 per cent of the total levy. We expect that 99 per cent of all schemes will see a decline in their total levy under this proposal.

2.5. Levy options for future years

2.5.1. To achieve a £100 million levy in 2025/26 and beyond, given improvements in scheme funding, more intervention will be required. Without additional methodology changes, some schemes could see their levy increase significantly as the pool of risk-based levy payers diminishes. To this end, Section 6 seeks stakeholder views on different approaches to distributing levy at the £100 million level among schemes and the criteria we should use to assess options. This will help inform the proposals we set out in our autumn 2024 consultation (at this point we will also have more data to show how risk in the DB universe is in fact evolving).

2.5.2. The simplest option is to continue to increase the levy scaling factor. However, if bond yields remain at their current levels, we would expect the proportion of schemes paying a risk-based levy to fall. Due to the legal requirement that at least 80 per cent of the levy is risk-based, this means that most of the levy burden would fall on a minority of schemes. We believe it more appropriate to try and spread the levy burden across more schemes. We also consider that it would be reasonable to bring the reasons for charging a levy and the way it is distributed more into line. To achieve these aims we have considered different options including the inclusion of an additional factor which would scale-up a scheme's liabilities or increasing stress factors. We are keen to get your views on the merits of these options to achieve our policy aims, and whether there are any additional ideas we should consider.

2.6. Customer service

2.6.1. Section 7 summarises the steps we have been taking to improve customer service including updating our electronic invoicing process and continued improvements to the D&B portal.

2.7. Draft levy rules 2024/25

2.7.1. In Section 8 we set out the limited changes to the levy rules we are making. Due to the limited nature of proposed changes, we have provided detail about the proposed changes in the consultation rather than publish draft documents.

2.8. Other Information

2.8.1. Information regarding next steps, key dates, consultation arrangements and contact details for providing comments on the consultation process can be found in Sections 9, 10 and 11 respectively.

2.9. Appendices

2.9.1. Appendix 1 summarises the latest performance review of the PPF Specific Insolvency Risk model, operated by our insolvency risk partner, D&B.

2.9.2. Appendix 2 provides more detail on the impact analysis for Section 5: Levy for 2024/2025 and Section 6: Levy options for future years.

2.9.3. Appendix 3 sets out the key assumptions used to prepare the levy estimate.

3. Policy context: Our legislative framework and the levy we charge

3.1. Context

3.1.1. The PPF was set up by the Pensions Act 2004 to protect DB scheme members in the event a sponsoring employer becomes insolvent, and the scheme does not have sufficient funds to pay at least PPF levels of compensation. One of the key funding elements in the early years was the levy from DB schemes to help build a reserve to ensure that the PPF could withstand future claims. Over time, the contribution of investment returns to our funding position has increased, as the pool of assets that we invest has grown, and levies have become a smaller proportion of new funding.

3.1.2. The Pensions Act 2004 provided us powers to charge a levy – indeed it requires the Board to charge a levy annually – and it also sets the broad framework for how it is to be charged. The levy must be primarily risk-based: assessed by reference to the funding position of the scheme, the risk of insolvency of the scheme's sponsoring employer(s) and (if the PPF chooses to) the scheme's investment strategy and risk-reduction mechanisms.

3.1.3. The Pensions Act 2004 also sets limits on how much we can charge and how much we can alter that total from year to year. In particular:

- The amount we can increase the levy estimate from year to year is limited to 25 per cent. This would prevent us charging a levy again if we ever set a levy estimate of zero and constrains the speed with which the levy can be raised if reduced to a low level.
- The proportion of the levy estimate raised by the scheme-based levy (charged based on scheme size) is limited to 20 per cent of the total levy estimate.

3.1.4. Our funding position has improved over time, improving our financial resilience, and strengthening our reserves, which are held to meet longevity risk and claims (our priority 1 and 2 reserves). This means the additional investment returns and levy we receive will be contributing to further reducing risk to members (through priority 3 reserves). It is important to emphasise however that risks to our funding position remain, including the risk of outsized claims experience and longevity risk. This means that, while we have a high degree of confidence in our ability to maintain our financial resilience, we must be prepared to take actions to reinforce it should the need arise.

3.1.5. As a result, there is an increasing distinction between the amount of levy that we expect to need and the amount that we need to collect to be able to address a funding challenge. If it were not for the requirement to charge a levy, and the inability to set a higher levy in the future to respond to a funding challenge, the Board would expect[1] to be able to move to charging zero levy, only reintroducing the levy in the event of a significant challenge to its funding position.

3.1.6. We note that DWP's review of the PPF (the Titcomb review[2]) recommended reviewing the legislation around the levy, among a range of recommendations. We can see there is a case for

[1] Any decision to move to zero would be a future decision for the Board. However, the Board considers that, absent the legislative constraints, the existing level of funding and current level of claims risk would make a case for a zero levy.

[2] Department for Work & Pensions, Departmental Review of the Pension Protection Fund, 21 December 2022. Accessed at: https://www.gov.uk/government/publications/departmental-review-of-the-pension-protection-fund-ppf

that given how much the environment has changed since legislation was created. Such a review could explore not just the desirability of changes to allow a move to a zero levy (covering the current obligation to charge and the 25 per cent year-on-year restriction); but also changes to support a better distribution of the levy charge in an environment of significantly improved scheme funding (this issue is explored in more detail in Section 4).

3.1.7. The review also made reference to ensuring the shape of compensation available for DB benefits is understood by members. We note that there has been an increased level of comment about PPF compensation and the legislative requirements in relation to indexation and revaluation, reflecting the current economic environment. Any material change in these legal requirements would have an impact on the PPF's funding position, and potentially on the levy that we would need to charge.[3]

3.1.8. Changes to legislation are clearly a matter for Government. It is also worth noting that primary legislation would be required for which opportunities are extremely limited. The responsibility of the PPF Board is, therefore, to set an appropriate levy within the current legislative framework.

3.1.9. With this in mind, we have considered at what level the levy would need to be set to maintain a capability to revert to charging a material levy over a reasonable period, assuming the ability to raise levies by 25 per cent year on year. Any figure chosen is necessarily a compromise between the need to retain an ability to respond to adverse events and the possibility that the levies collected might not be needed. The Board has concluded that £100 million per annum is the lowest level at which we could safely set a levy. This would allow us to return to charging £400 million per annum (the amount we charged in 2021/22 before we started taking active steps to reduce the levy) over six years, whereas for example a £50 million levy would mean a nine-year period. It would also allow – across a ten-year period - for raising around £4 billion and so provides a degree of back up to the existing reserves (though scenarios that would significantly exceed such an impact are possible).[4]

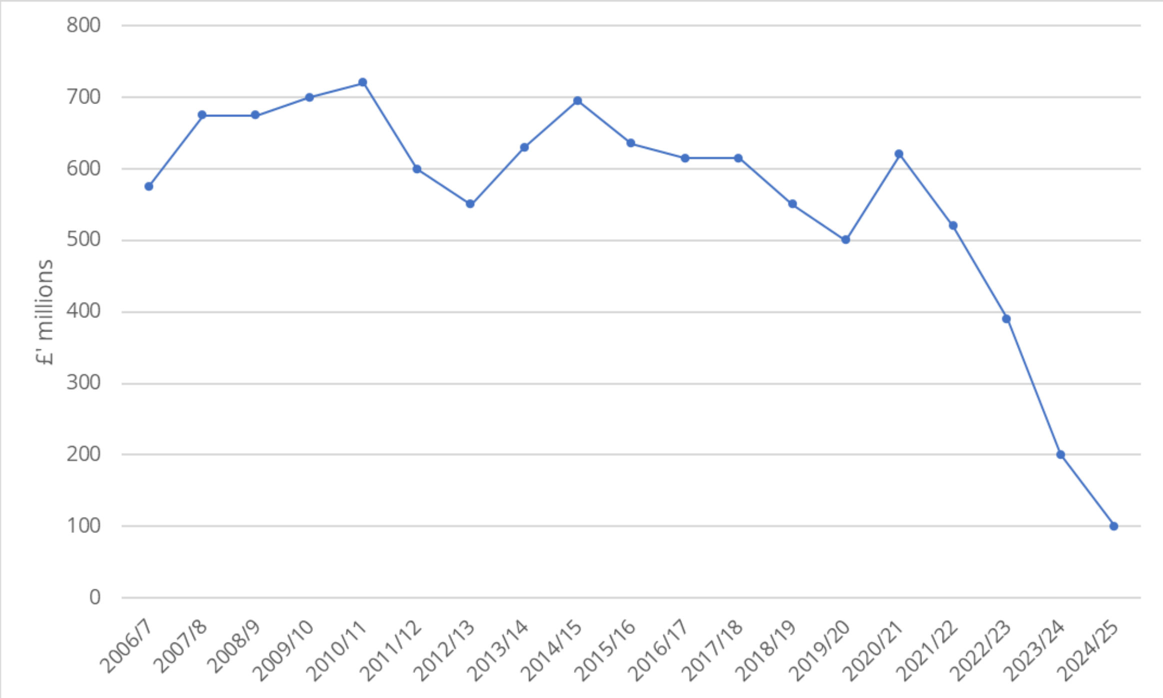
3.1.10. We intend to allow the levy to fall to this level immediately and are proposing to charge a levy of £100 million in 2024/25 – a 50 per cent reduction on our levy estimate for the current year and 75 per cent on 2022/23. In this way we aim to maximise benefit to our levy payers whilst maintaining the ability to use the levy in response to a funding shock. We intend to hold the levy at this level for future years unless there is a significant change in either the risks we face or our legislative framework. In essence this reflects the PPF pre-funding for future risks. Under a different legislative framework – one which allowed more significant increases in the levy charged – we would have less need to adopt this pre-funding approach. We set out more details in Sections 4 and 6.

[3] We have commented on this in more detail in our response to the Work and Pensions Select Committee –. Accessed at: https://committees.parliament.uk/writtenevidence/120650/pdf/

[4] We also note that the legislation allows for the Secretary of State to take powers to increase the maximum percentage increase. This would not be straightforward or certain, as it would require secondary legislation and a consultation process and would likely present the Secretary of State at the time with a difficult decision in light of competing stakeholder interests. The Board considers it would be inappropriate therefore for the Board to rely upon it being exercised.

3.1.11. To place the levy of £100 million in context, Figure 1 shows that the levy was at £700 million in 2014/15 and has been declining from the 2014/15 high. The 2024/25 levy estimate will be the lowest we have ever set.

Figure 1: Levy estimate from 2006/07 to 2024/25



Consultation question 1:

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

4. Towards a simpler levy

4.1. Introduction

4.1.1. In last year's consultation we introduced our initial thinking on the desirability of simplifying the approach we take to charging the levy, particularly in the context of a reducing levy.

4.1.2. We identified two key objectives for a revised methodology as being flexibility: that it is scalable and able to fit with the different potential circumstances and reasons for charging; and simplicity. We also detailed a number of supplementary objectives including compliance with legal requirements, an aim to avoid undue volatility in bills, that the design should be informed by stakeholder views and should align with behaviours expected by the Pensions Regulator, and to have regard to wider uses of data within the PPF and beyond.

4.1.3. In line with these objectives, our four key design principles were:

- Increased flexibility in the amount of levy we aim to collect.
- Increased flexibility to charge on the basis of the size of the scheme (scheme-based levy).
- Rebalancing the risk-based levy to emphasise underfunding and a lesser focus on employer insolvency (which was seen as a precursor for a simpler approach to the assessment of insolvency risk of scheme sponsors and a way to address volatility); and
- We should be open to using different approaches to how the levy is calculated depending on scheme size.

4.1.4. Last year we took a significant step towards rebalancing the risk-based levy to emphasise underfunding, place less focus on employer insolvency and minimise volatility by adjusting the levy rates that are applied for each levy band - so that a move from one band to the next, in isolation, has a more limited impact on schemes' levy bills.

4.1.5. As outlined in our December 2022 policy statement, we received strong support for our direction of travel. A number of responses, however, pointed to the support for, and familiarity of, the existing methodology. These responses raised a note of caution highlighting that there was no immediate desire for change from levy payers and that introducing simplification could impose costs on schemes at least on a transitional basis – and therefore that change should not be carried out in haste.

4.2. Next steps towards a simpler levy

4.2.1. Our aim of simplification in the long term remains, though as outlined in last year's consultation, some of the key changes - for example increased flexibility to charge on the basis of the size of the scheme (scheme-based levy) - require legislative change. We are also very mindful of the points raised by stakeholders that we should carefully consider the pace at which we introduce change, ensuring our approach is measured and proportionate.

Our intention in the short term, therefore, is to limit changes to those necessary to maintain a levy of £100 million, and in turn the ability to respond appropriately to a future funding shock.

4.3. Simplification in the near term

4.3.1. We will however continue to take steps towards a simpler levy at appropriate points in the future. One such point will be when we need to review or retender our existing contract with D&B for the provision of insolvency risk services (due to the procurement regulations we are subject to). Given this could potentially lead to relatively significant change even if we sought to maintain the status quo (such as when we transitioned from Experian to D&B previously) it presents an obvious opportunity to consider simplification of our approach.

4.3.2. We are likely to consider for example whether alternatives to our bespoke insolvency risk model might be more appropriate going forward such as either a very streamlined scoring model or use of off the shelf credit scores. Alternatively, if it can be proven to be predictive, use of covenant related information provided to TPR under the new scheme funding regime might be a possibility. Further simplification options that we will keep under review include measuring the risk of the employers that matter most to the survival of the scheme. In over 80 per cent of 'multi-employer' schemes there is a single dominant employer and so measuring only their risk could – now - be a sufficient reflection of the risk posed by the scheme as a whole.

4.3.3. In the meantime, we will continue to monitor the performance of our insolvency risk model to ensure it continues to perform satisfactorily (see Appendix 1 for more details on current performance) and will consider amendments where necessary. This could include considering whether our approach to schemes that file small accounts (and so where data is very limited) and our approach to industry wide schemes remain appropriate.

4.3.4. As part of simplification, we will also consider what if any changes to the approach we want to make in our use of credit ratings.

4.3.5. It is reasonable to anticipate that any further reduction in the role of insolvency risk would be guided by the result of any simplification in our insolvency model. For example, if we were to move to an approach with less granular information, such as mapping to covenant grades provided to TPR, it may be appropriate to put less emphasis on insolvency risk.

4.3.6. We also expect to undertake a review of the systems we use to collect, manage, and manipulate scheme data over the next few years. These are used for a range of purposes across the PPF including for the levy. This may include, for example, considering potential changes to our roll-forward approaches to ensure they remain fit for purpose, which may, in turn, impact our levy methodology. There may also be opportunities to make more use of data gathered for other purposes, rather than to continue to require the current range of levy specific information. However, if change requirements are identified, we don't anticipate implementation any sooner than levy year 2026/27 at the earliest.

4.3.7. Further steps towards our long-term design will be considered when the natural point arises, whether that be circumstances that necessitate it, such as system updates, contract expiry, or legislative change. In the interim we are proposing to focus on stability.

4.4. Alternative Covenant Schemes

4.4.1. Our proposals for the levy also naturally raise questions about what our future expectations are in relation to Alternative Covenant Schemes under our rules. This would include commercial consolidators (also referred to as superfunds).

4.4.2. One of the key differences between superfunds and other schemes is their ability to take profits (and for them to be payable to persons other than members). As such we believe it is important to ensure that there is not an expectation of cross subsidy between these schemes and conventional DB schemes[5]. We believe this is best ensured by charging any commercial superfund a levy that fully reflects the risk that they pose at that point in time – rather than scaling the charge to reflect our funding position (which could be seen as a benefit to the superfund based on historic levy contributions). We would expect therefore to continue to maintain a separate methodology for superfunds.

4.4.3. We will keep our existing Alternative Covenant Schemes levy methodology under review and consult on changes should they be necessary.

Consultation questions 2 and 3:

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

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

[5] Whether or not there is actually cross subsidy between conventional schemes and Superfunds will depend upon claims experience – as with an insurance policy where only some policy holders claim in any given year. An expected (or 'ex-ante') cross-subsidy would occur if we were to charge Superfunds less than the cost of their risk. This would amount to using existing PPF reserves to subsidise commercial Superfunds.

5. Levy for 2024/25

5.1. Summary

5.1.1. Due to the continued improvement in our funding position, we can continue to reduce the amount of levy we aim to collect for 2024/25. We are proposing to set our levy estimate at £100 million for this year. This is a reduction of £100 million compared to the 2023/24 levy estimate.

5.1.2. To maintain a levy of £100 million, significant change in future years is likely to be required. We want to ensure we take the time to gather stakeholders' views, and hopefully support, for a long term and lasting approach (see Section 6). Therefore, our overall aim is to limit policy change in 2024/25 whilst we are engaging with stakeholders.

5.1.3. For 2024/25 we can achieve £100 million with only minimal change, namely a small adjustment to the levy scaling factor (LSF). We will also need to make an adjustment to the scheme-based levy multiplier (SLM) to ensure, in line with legislation, that the proportion of the levy that is scheme-based (SBL) does not exceed 20 per cent. As a result of the desire to make limited changes, we are proposing to delay a review of the asset stress in the levy and the introduction of the A11 assumption in our output basis (i.e., to continue using A10 assumptions in our levy calculations). We are also proposing limited changes to the levy rules for this year; for more information, see Section 8.

5.2. Levy estimate

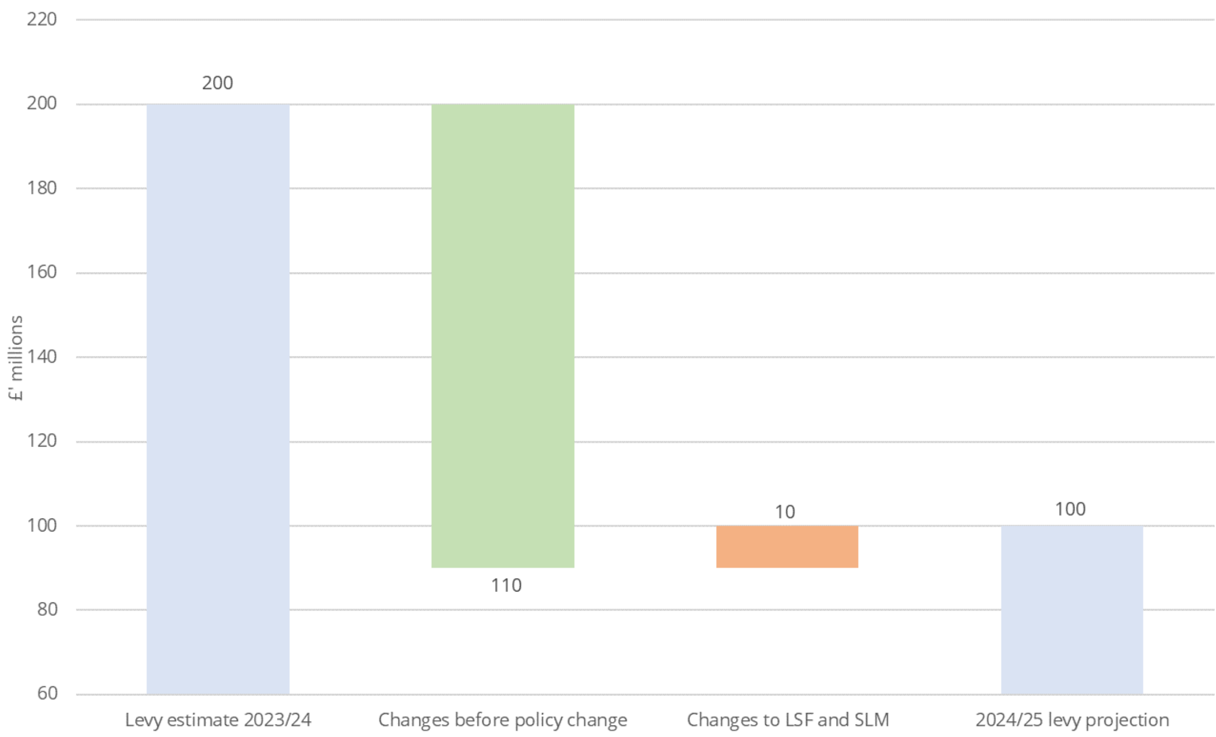
5.2.1. We made a levy estimate of £200 million for the 2023/24 levy. Over the past year, scheme funding has continued to improve. The PPF 7800 index estimates that the number of schemes in surplus in our universe increased to 4,652 at the end of June 2023 (91 per cent of schemes) from 3,814 schemes in surplus at the end of June 2022 (74 per cent). There were an estimated 479 schemes in deficit at the end of June 2023 compared with 1,317 schemes in deficit at the end of June 2022.

5.2.2. Our PPF insolvency risk model continues to perform well (see Appendix 1). For 2023/24 levy collection we saw a reduction in insolvency risk compared to the previous year, which may have reflected a recovery in company financials after COVID impacts unwound. For 2024/25, we have assumed there will be limited changes to universe insolvency risk.

5.2.3. The increase in bond yields since the calculation of the 2023/24 levy estimate of £200 million, along with a small impact from other data changes, reduces the amount of levy we would expect to collect in 2024/25 by over £100 million. This results in a projected 2024/25 levy collection under unchanged rules of around £90 million (see Figure 2). Policy changes are therefore needed to meet the £100 million required.[6]

[6] The assumptions used to calculate the levy estimate are set out in Appendix 3.

Figure 2: Change from 2023/24 levy estimate to 2024/25 levy estimate



5.3. Key policy proposals

5.3.1. To achieve a levy of £100 million we are proposing to increase the LSF to 0.40 for 2024/25 from 0.37 in 2023/24. In addition, we are required to make a small adjustment to the scheme-based levy multiplier to keep the scheme-based levy within legislative requirements. Therefore, we are proposing to adjust the scheme-based levy multiplier to 0.000015, compared to 0.000019 in 2023/24. As a result, the scheme-based levy will be 20 per cent of the total levy.

5.3.2. This option means that almost all (around 99 per cent) schemes will see a reduction in their levy. Schemes that pay a risk-based levy (RBL) will typically experience an overall reduction in risk-based levy with the exception being a small minority of schemes who see their risk alter due to the individual circumstances of the scheme and sponsor (e.g. a significant deterioration in the sponsor's insolvency risk score). Scheme-based levies will also fall.

5.4. Whether to move to A11 valuation basis

5.4.1. The PPF s179 assumptions are updated from time to time to take account of changes in buy-out pricing. Most recently, as a result of consultation, they were updated from A10 to A11 in May 2023. New assumptions are used as new valuations are carried out over the following years so that, at any time, valuations reported by schemes are a mixture of those on an 'old' and 'new' basis. We expect one-third of schemes to provide new valuations each year.

5.4.2. The valuation information provided is transformed as part of our levy calculation on to a consistent basis. There is a choice for the PPF about when to implement the new valuation basis in our levy methodology – i.e., whether to transform older valuations to the latest A11 basis or to retain the A10 basis that we are using in the 2023/24 levy, meaning that we will transform any valuations completed on the A11 basis (likely to be few in number) back to A10.

5.4.3. If we were to implement A11 in 2024/25, this would, all else being equal, reduce levy collection by around £20 million and reduce the pool of risk-based levy payers by around 20 per cent. Maintaining a levy estimate at £100 million with a split of £80 million RBL and £20 million SBL would therefore require the LSF to increase to 0.50, a further increase of 25 per cent.

5.4.4. We think there are good reasons to delay using A11 as our output basis. Implementing now would increase the levy burden of those still paying a risk-based levy on the A11 valuation basis - due to the higher LSF that would then be required (and we want to explore options with stakeholders that limit the extent to which this happens – see Section 6). In addition, as A11 was only introduced in May 2023, no scheme would have been required to report on A11 at the measurement time, and the great majority of schemes will still have a valuation based upon A10 (or older) assumptions.

5.5. Whether to update stress factors to reflect recent volatility

5.5.1. We considered updating our asset stresses for 2024/25, particularly in the light of the very significant volatility in interest rates seen over the last year. An update would have resulted in the interest rate stress increasing. Were this to happen, all else being equal, this would be likely to reduce the funding level of schemes and increase levies.

5.5.2. However, consistent with our desire to limit change for 2024/25, and to allow the opportunity to engage with stakeholders to determine the role that stresses will play in our longer-term approach (see Section 6), we have decided not to make a change to the stresses this year. In the meantime, we will continue to monitor volatility.

5.6. Asset class implementation

5.6.1. TPR and PPF have been reviewing the implementation of the asset class changes (the introduction of more detailed information for larger schemes) in the 2023 scheme return. As a result, both organisations are considering updating the guidance on Exchange to clarify the preference for schemes to report their exposure primarily via the asset mix, only using the more detailed risk factor stress impact methodology for particularly complex arrangements that can’t be adequately described in the asset mix. While discussions are still ongoing about the possible changes, we wanted to give stakeholders an early indication of possible changes to the asset class guidance for next year.

5.7. Data for credit ratings

5.7.1. For our credit-rated scorecard we access and obtain data from three providers, S&P, Fitch and Moody’s. Using three providers has a cost, and, due to the declining levy charged based on ratings, the high degree of overlap between the three agencies, and the good performance of the PPF model we have reviewed the costs of operating the scorecard. We are currently in commercial negotiations with the providers, and depending on the outcome of those we may reduce the number of providers we use to two for the 2024/25 levy year. In the event that we do so, we envisage that only around 10 per cent of the entities currently scored using a credit rating (i.e., just over 50 employers and a similar number of ultimate parents) would be scored using the PPF-specific model instead. As this is yet to be finalised we are not yet in a position to provide full clarity for stakeholders. We will provide an update as part of the policy statement and contact the schemes affected by the change.

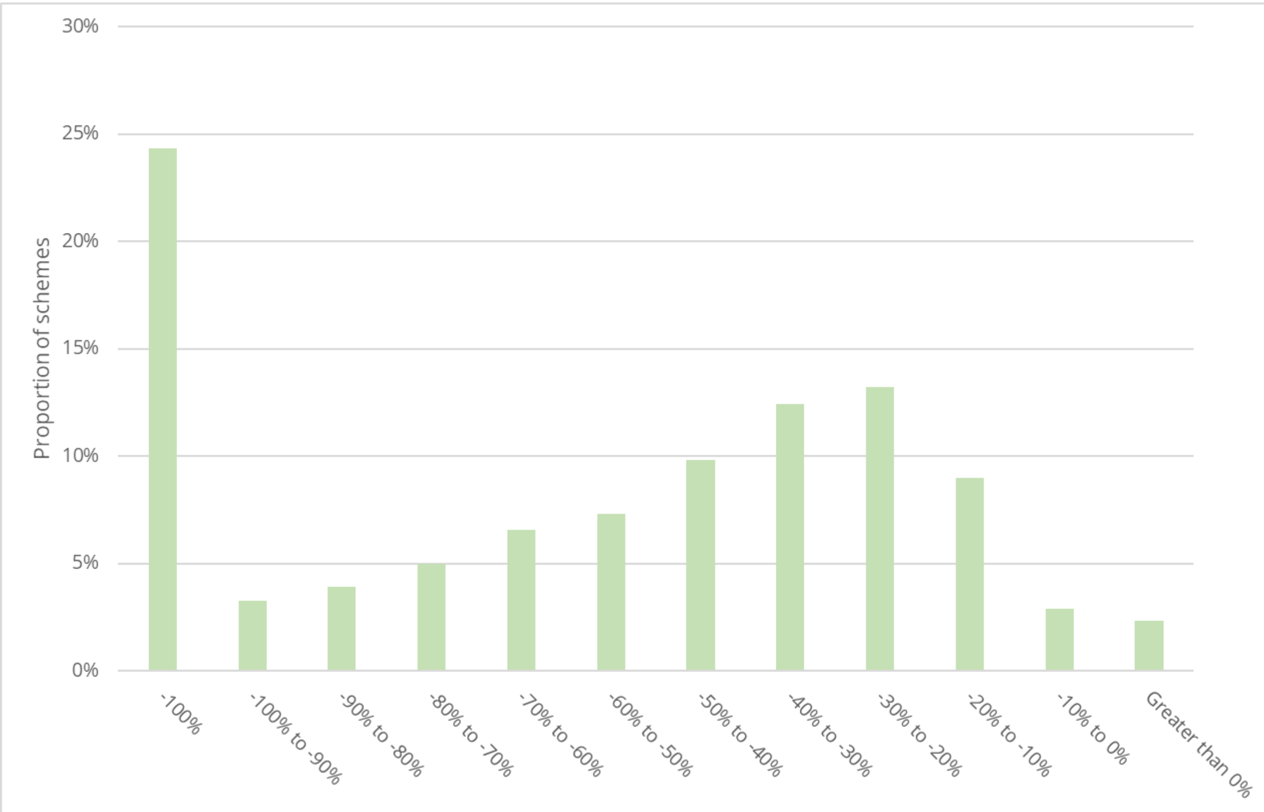
5.8. Impact assessment for 2024/25 levy proposals

5.8.1. We have carried out an impact analysis to show the projected impact on levy bills for 2024/25 levy based on the known changes in the environment (including economic market data and information on insolvency scores to end-June 2023). We set out a summary of the impact assessment below with further detail available in Appendix 2. The great majority of schemes are projected to see a fall in levy compared to 2023/24.

5.8.2. Figure 3 shows the expected change in risk-based levy from 2023/24 to 2024/25 for all schemes that paid a risk-based levy last year. The key features seen are:

- 98 per cent of schemes paying a risk-based levy are expected to see a risk-based levy that is lower in 2024/25 than 2023/24, with an average reduction in risk-based levy of over 40 per cent.
- A small number of schemes will see risk-based levy increase, such as where there has been a significant worsening in the sponsors' insolvency scores.

Figure 3: Change in risk-based levy from 2023/24 to 2024/25 on proposed policy



5.8.3. Our analysis has focused on schemes paying a risk-based levy for whom changes in levy may be considered material. However, over 60 per cent of schemes are projected to pay only a scheme-based levy for 2024/25. We expect that all schemes will see a decrease in scheme-based levy due to the reduction in the SLM, and generally decreasing liabilities for levy purposes, though it is possible that some schemes will see an increase due to particular features of the scheme. Schemes are expected to see, on average, a reduction of over 25 per cent in scheme-based levy. As a result, we expect 99 per cent of schemes to see a reduction in their levy.

Consultation question 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?

6. Levy options for future years - how to maintain a levy of £100 million

6.1. Summary

6.1.1. In recent years, improved scheme funding has reduced the amount of levy we collect and meant that fewer and fewer schemes have paid a risk-based levy each year. Without changes to the levy methodology, these two trends are likely to continue.

6.1.2. One option to maintain levy collection at £100 million is to adjust the levy scaling factor. However, as this would be shared among a declining pool of risk-based levy payers, these schemes would each have to pay increasingly large proportions of the levy.

6.1.3. We believe it is important to consider ways to ensure that the risk-based levy reflects the changing context for charging a levy and continues to be paid by a substantial proportion of levy payers. We therefore present two additional options to maintain a levy of £100 million:

- increasing investment stresses by considering worse economic scenarios, or
- introducing an additional factor on the liabilities.

It is possible that we may need to use more than one option in future years to maintain the levy at £100 million or alternatively develop additional policy proposals.

6.1.4. We want to share and seek views on our proposed longer-term design principles and options. The input we receive will be used to help shape our proposals for 2025/26 and later years. These will be consulted on in the normal way in the autumn preceding each levy year and will take account of the most up-to-date information available at the time – which means that the proposals we consult on will almost inevitably differ from those explored below.

6.2. The policy challenge

Our changing risks

6.2.1. Our levy methodology largely relies on an assessment of current underfunding and investment risk, with limited stressing. Those schemes that are in surplus under this assessment do not pay a risk-based levy. As a result, the risk-based levy is currently only charged to schemes that pose a funding risk now or under relatively limited downside scenarios. The number of schemes in this situation is declining.

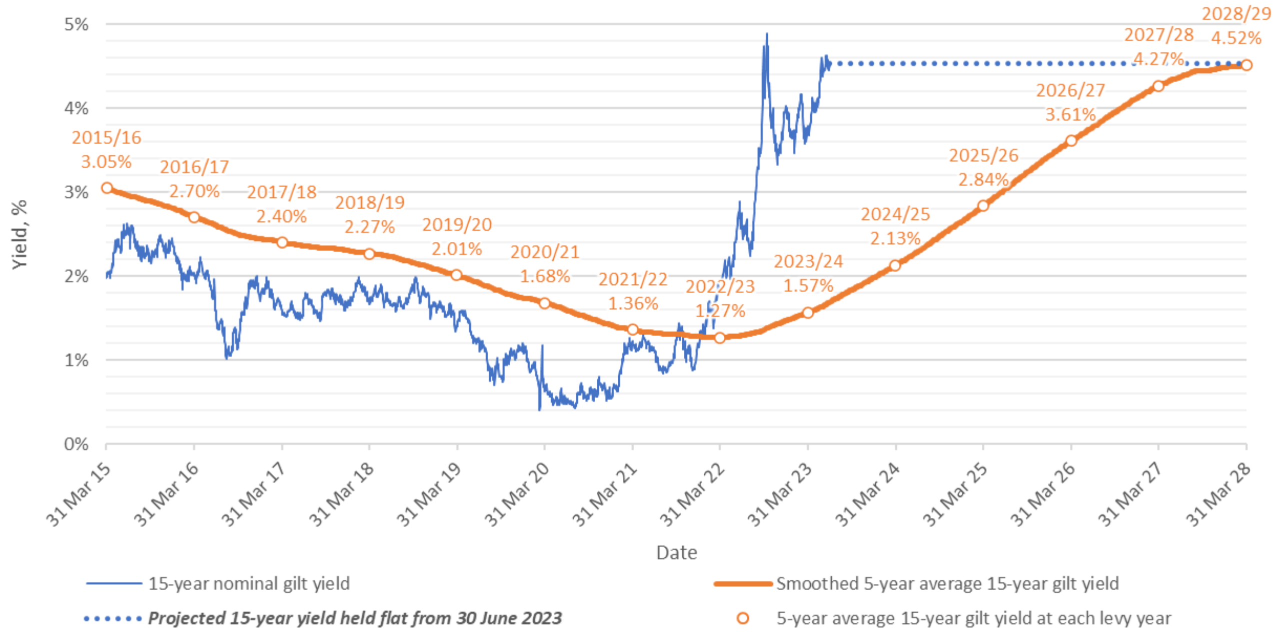
6.2.2. Given the PPF's current funding level, the levy we collect from now on would provide resources to deal with the possibility of very high claims, or other large funding shocks that may arise at some point in the future.

6.2.3. In these low-likelihood, high-impact future scenarios, schemes that are not currently underfunded may still lead to claims on the PPF. We therefore believe there is merit in adapting our methodology to reflect the changing role of the levy in guarding against this risk.

6.3. Decline in number of risk-based levy payers

6.3.1. Given the uncertainty over how risk in the universe of schemes we protect may evolve in the future, we do not make formal estimates for levy collection in future years. However, if current market conditions persist, the smoothed bond yields we use for calculating the levy will gradually increase over the next few levy years, as periods when bond yields were low are replaced by more recent periods with higher yields in our smoothing calculation. This is illustrated in Figure 4.

Figure 4: Bond yields and impact of our smoothing methodology



6.3.2. Increases in the smoothed bond yields used in the calculation of the levy would lead to a reduction in the measured liabilities of schemes. This would mean that fewer schemes are assessed to be underfunded, so the pool of schemes paying a risk-based levy (RBL) would shrink over time.

6.3.3. As a result, without methodology changes, the levy quantum could fall throughout the period from 2024/25 to 2027/28, and the proportion of schemes paying an RBL could reduce significantly. We have produced a stylised example to illustrate this point, in Appendix 2.

6.3.4. We could therefore need to take additional measures each year to raise the levy to £100 million. In practice, the extent of adjustments that we need to make will only become clear in the run-up to setting the levy rules for each year.

Consultation question 5:

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

6.4. Existing mechanisms - levy scaling factor

6.4.1. At present, one lever to adjust the amount of levy we collect is the levy scaling factor (LSF). Increasing the LSF would mean that the levy burden will fall on a declining number of less well-funded schemes. The additional levy payable from the increase in LSF could be substantial for some of these schemes. To illustrate the point, our example highlights some schemes may even end up paying significantly more levy in future years than they did in 2023/24, despite the overall quantum of levy reducing from £200 million in 2023/24 to £100 million from 2024/25 onwards.

6.4.2. This option will also not extend a risk-based levy charge to cover a greater proportion of those schemes that are not currently underfunded but still pose some risk to the PPF.

6.4.3. We may therefore need to consider what other policy interventions we could undertake, rather than increasing the LSF.

6.5. Criteria to assess different options

6.5.1. To assess the different potential changes to our methodology, we consider the following criteria:

1) Reflection of risk: How well would the levies reflect the remaining risk that schemes pose to the PPF in the new environment?
2) Flexibility: Is it a one-off adjustment to the methodology, or can it be scaled to requirements? For example, is it a factor that can be increased or decreased as needed in future years?
3) Alignment with long term principles for the levy: Does the option align with our future levy objectives, including simplification and increased focus on scheme funding?

Consultation question 6:

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

6.6. Assessment of the options

6.6.1. As well as the existing option of increasing the LSF, we have identified two additional policy options that address the policy challenge and the criteria we describe above: introducing a factor on liabilities or amending the stressing methodology. A quantitative comparison of all three options is provided in the 'Summary of distributional analysis' at the end of this section and more detail in Appendix 2.

6.7. Introduce an additional factor to scale up liabilities

6.7.1. Under this option, we would increase schemes' liabilities by a fixed factor before calculating underfunding. This approach was used in the early years of the PPF, when changes were made from year to year in the liabilities factor to manage levy distribution.

6.7.2. If we introduced an additional factor on liabilities, schemes would be assessed as less well-funded. The reduction in funding level would be consistent across all schemes, irrespective of their size or existing funding level. Schemes that remain overfunded after the factor is applied would not pay a risk-based levy. Schemes that move from overfunded to underfunded as a result of applying the additional factor would see smaller levy increases, relative to their size, than schemes that were already underfunded prior to the application of the factor.

6.7.3. This option fits our criterion to ensure the levy is risk-reflective, as it would mean some currently overfunded schemes would pay a risk-based levy, reflecting that our risk is not just from schemes that are currently underfunded. However, we also recognise that it does not take account of hedging and how that may influence schemes' likelihood of claiming in stress scenarios (for example, following a significant move in interest rates and/or inflation).

6.7.4. It is a good fit for our criterion on flexibility, as the factor could be increased or decreased every year as required to maintain a levy of £100 million amid changing conditions.

6.7.5. It also aligns reasonably well with our long-term objectives for the levy, as it is both relatively simple and increases the focus on funding rather than insolvency risk. And while our long-term vision anticipates greater flexibility to use the scheme-based levy (particularly if we need to collect a material levy where claims risk is low), this requires legislative change. As a result, a liability factor may potentially be needed in the long-term if legislative restrictions on the scheme-based levy remain.

Consultation question 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?

6.8. Changing the stressing methodology

6.8.1. To assess investment risk, we currently stress the assets and liabilities to reflect a one-in-six chance of a downside scenario. As the levy is now being charged to provide resources that protect against more extreme scenarios, we could align the charging methodology with that objective by increasing the severity of the stresses. For the purposes of this consultation, we have explored increasing the stress factors to two standard deviations.

6.8.2. This change would be risk-reflective, as it reflects the more extreme adverse scenarios against which we are aiming to protect with future levy collection. It also reflects appropriately on the difference in risks posed by different schemes: well-hedged schemes would see a limited change in their levy, while schemes with growth-seeking portfolios would see their levies increase by more, better reflecting the risk they might pose in a more severe adverse scenario.

6.8.3. We considered if such a change might influence investment strategies. However, the additional levy charged under this measure would be small compared to the expected excess return from growth-seeking assets[7], so we do not expect this policy to affect investment decisions.

[7] The current one standard deviation stress means that a scheme that invests in equities may pay a higher levy than if invested in bonds. For an underfunded scheme with a measure of insolvency risk of 0.34% (levy band 4), the change to a two standard deviation stress would mean that this extra levy (from investing in equities versus bonds) may increase by around 0.04 per cent of assets. By contrast, the 2023 Long-Term Capital Markets Assumptions by J.P. Morgan Asset Management assumes a 7.4 per cent return on Developed World Equity.

6.8.4. We think this would be better seen as a long-term methodology change, rather than simply a response to the current challenge of dealing with a falling levy quantum. As a result, it would be less appropriate to change the approach yearly for managing quantum, and so does not – on its own – fit well with our flexibility criterion. It would be necessary to supplement this change with one of the other two options, i.e., increasing the LSF or introducing a factor on liabilities. This change would align well with our future of levy vision in that, by using existing factors, it does not add complexity, and it serves to emphasise the importance of funding risk.

Consultation questions 8 and 9:

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?

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?

6.9. Other options we considered

6.9.1. We also considered and rejected applying a taper to scheme funding, extending the smoothing period, and delaying the introduction of A11 further, as they were a poor fit to our criteria.

6.9.2. We rejected changes related to our insolvency risk methodology as they do not address the issues identified, which are primarily funding related. In addition, we are minded not to reverse the changes we made last year which aligned our approach to insolvency risk with the long-term direction of the levy. We have also excluded scaling up levy rates[8], as this would produce a similar outcome to changing the LSF but be less transparent.

6.10. How we envisage the options could work together

6.10.1. We believe there is merit in reviewing and making a long-term change to the asset and liability stress factors to reflect the more extreme adverse scenarios for which future levy may be required. This could be implemented for the 2025/26 levy year. However, this change may not be sufficient to raise the total levy to £100 million in that year – and the gap to £100 million may widen in subsequent years.

6.10.2. We therefore believe other options may also be required for 2025/26 and beyond. This could include increasing the LSF, introducing a factor on liabilities, or both.

6.10.3. We would welcome stakeholder views on the options, sequencing and whether there are other ideas we should consider to ensure a risk-reflective approach to the levy in future years.

Consultation question 10:

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

[8] Employers have their insolvency risk assessed and are placed in one of ten bands – from 1 (lowest risk) to 10 highest), each of which has a levy rate associated with it. The levy rate, or for a multiemployer scheme the weighted average of rates, is included in the levy calculation.

Summary of distributional analysis for 2025/26 (stylised example)

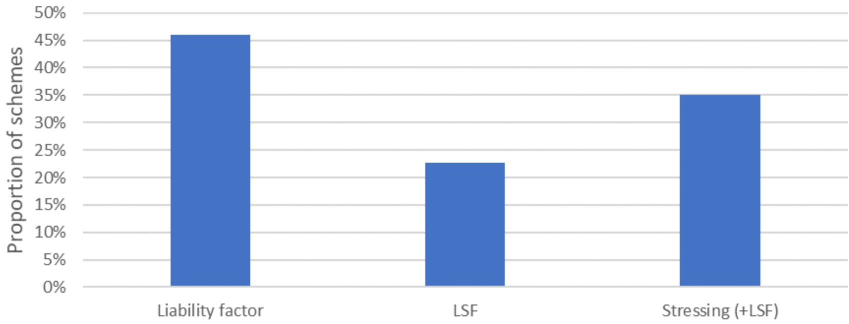
We provide a high-level summary of how the policy options listed above would change the distribution of the risk-based levy in 2025/26, based on our stylised example. For this stylised example, we assume that market conditions remain static from 30 June 2023 onwards, and the relative rate of risk reduction assumed in the 2024/25 levy projections continues to 2025/26. We assume that A11 applies as the output basis in 2025/26.

All options result in an additional cost to schemes, when compared to the cost of levy if the levy were allowed to fall below £100 million with no change in methodology. However, the distributional impact of each option is different. Further detail about the distributional analysis is in Appendix 2.

To charge £100 million of levy in our stylised 2025/26 example, the liabilities would have to be scaled up by an additional 18 per cent, or the LSF would have to be increased from 0.40 to 1.07. Alternatively, the asset and liability stress could be increased to two standard deviations, but this would need to be combined with another measure as well to reach £100 million total levy – e.g. a smaller increase in the LSF from 0.40 to 0.46.

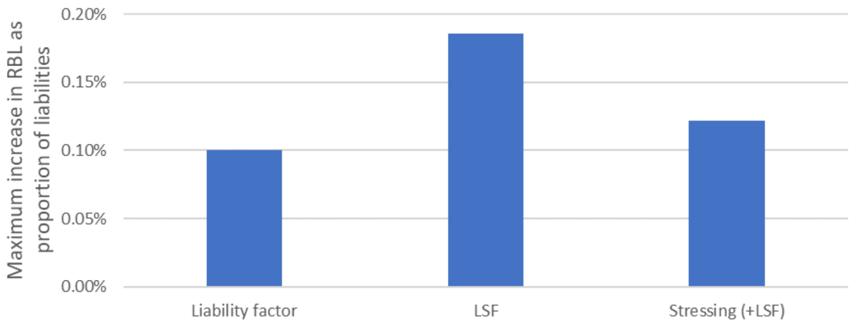
An increase in the LSF would not change the pool of risk-based levy payers in 2025/26, which would be a little under 25 per cent of schemes. By comparison, around 45 per cent of schemes would pay a risk-based levy if we introduced the additional factor on the liabilities, or around 35 per cent of schemes if we recalibrated the asset and liability stress factors (Figure 5).

Figure 5: Number of schemes paying a risk-based levy, by policy option



The inverse is true for the level of increase to risk-based levies from each of the options compared to if the levy was allowed to fall below £100 million. Under the LSF option, the pool of risk-based levy payers is smallest, and those schemes see the largest increases in risk-based levy. If we introduced a factor on liabilities, the pool of risk-based levy payers is largest, and they see the smallest increases in risk-based levy per scheme. The increased asset and liability stressing option falls somewhere between the two. Figure 6 shows the maximum increase in risk-based levy, as a proportion of liabilities, for any scheme under each policy option (when compared to their risk-based levy if none of the illustrated 2025/26 policy options were adopted, allowing the levy to fall below the £100 million required).

Figure 6: Maximum increase in risk-based levy as proportion of liabilities, by policy option



7. Customer service

7.1. Introduction

7.1.1. This section summarises the steps we have been taking to improve customer service.

7.2. Electronic invoicing

7.2.1. Since September 2020 (the 2020/21 levy), we have sent electronic PDF invoices to scheme contacts listed on the Pensions Regulator's Exchange database, as well as paper and electronic versions to scheme trustees.

7.2.2. From 2023/24 levy year if you opted to only receive the levy invoice by email - you would have done this on the Pensions Regulator's Exchange system – the levy invoice will be sent by email to the scheme trustee(s) and to the PPF Levy Contact (this is a new contact on the Regulator's Exchange system).

7.2.3. Our electronic invoices are issued using a system provided by Mimecast – to ensure that they remain secure. Mimecast offers a secure messaging service that helps many organisations worldwide make email safer and bolster cyber resilience. Our invoices will originate from the address 'noreply@mail.ppf.co.uk'. However, if you are in any doubt about the legitimacy of an invoicing email, please do contact us at information@ppf.co.uk to confirm – as several levy payers did last year.

7.3. Continued Improvements to our scores portal

7.3.1. We introduced, with effect from November 2022, multi-factor authentication (MFA) to ensure that portal access remains secure without requiring frequent changes to passwords. MFA is a two-step verification process that enhances information security by using one-time security codes to keep information secure.

7.3.2. The verification process is done either by mobile number or email. A security code will be sent to either your email account or your mobile phone from D&B. This code will need to be entered on the device you are accessing the portal on.

7.3.3. If you choose to use a mobile phone number to receive your security code, your password for the portal will no longer expire. If you choose to use email, the password you set will expire automatically every 180 days.

7.3.4. We have also published a set of six 'how to' short videos to help you manage your portal access, reset your portal password, check your insolvency scores, use the what if tool, set up email alerts and log in for new users of the PPF score portal. The videos can be found on the insolvency risk scores section of the PPF levy website at ppf.co.uk/levy-payers/what-levy-and-who-has-pay-it/insolvency-risk-scores.

7.4. Support with payments

7.4.1. We announced in our policy statement for the 2022/23 levy year that we would continue to offer our COVID easement throughout 2022/23 and 2023/24 - to help schemes with sponsors impacted by COVID-19 by giving them longer to pay.

7.4.2. In 2022/23 we received fewer than five applications for a COVID easement plan. And with the UK back to broadly pre-covid activity levels, we do not expect the accounts on which we base insolvency risk scores for the 2024/25 levy to be impacted by COVID. As a result, we will be no longer offering this option for 2024/25 levy year.

7.4.3. Where schemes/employers need longer (or there are other reasons why they would face particular difficulties paying on time) applications can be made under the existing payment plan process.

7.4.4. Our policies, FAQs and forms relating to payment plans can be found on our website at ppf.co.uk/levy-payers/pay-your-levy/help-paying-your-levy.

7.5. Levy projections

7.5.1. Levy payers - particularly from small schemes – in the past have suggested the provision of a levy projection (providing insight into their likely levy charge ahead of time) could be valuable. This was noted in the recent DWP led review of the PPF where a recommendation was made that *"The PPF should seek to provide a levy calculator for schemes and their employers via its website, so that they can work out what their risk-based levy charge will be in pounds and pence. If it is not feasible to provide this, then it should explain clearly why this is the case."*[9]

7.5.2. Prior to undertaking any development in this area, we have over the past two years trialled the provision of manual estimates with a number of small schemes to assess demand for the service. The take up and feedback we have received has been very limited, though the few schemes who did respond said they found the levy projections useful.

7.5.3. Our view is that the reduction in the value of the levy charge, alongside action to tackle volatility, has significantly reduced the value of early estimates for many. In addition, the provision of estimates at any scale would require significant changes to our systems, because providing early estimates based on partial data can be more complex than generating the final invoice. We consider this is not justified particularly as we are expecting to reshape our levy methodology and IT systems over time. We are not therefore considering any further work specifically in this area. We will, however, keep the interest in estimates in mind as the levy and the systems that support it are reshaped in the future.

[9] Department for Work and Pensions, Departmental Review of the Pension Protection Fund, 21 December 2022. https://www.gov.uk/government/publications/departmental-review-of-the-pension-protection-fund-ppf

8. Draft levy rules 2024/25

8.1. Introduction

8.1.1. The main changes to the levy rules will be to reflect:

- The policy proposals set out in this consultation.
- Minor clarifications to the rules taking account of stakeholder feedback.
- Minor changes taking account of recent court judgments or wider legislative changes.

8.1.2. Due to the limited number of proposed changes we are not planning on publishing the draft Determination or Appendices or Guidance. Instead we have provided more detail about the proposed changes in the consultation below. The Determination, Appendices and Guidance will, as usual, be published alongside the final policy statement.

8.2. Other changes

Data for credit ratings

8.2.1. As we mentioned in Section 5, we are considering whether to change the number of providers we have for credit ratings. We envisage this would require us to make some small amendments to the relevant definitions in the Determination and update the Insolvency Risk Appendix accordingly.

Special Category Employers

8.2.2. Special Category Employers (SCEs, see Rule E3.1(11) of the Determination) are employers who are either part of government, the Crown or established by legislation, and present a low risk to the PPF. This is relevant for a very small number of employers in our universe (in 23/24 32 employers met the Special Category Employer status)".

8.2.3. We have considered SCE status in light of the Subsidy Control Act 2022. The 2022 Act is the UK's new subsidy control regime, replacing (following the UK leaving the European Union) the EU state aid regime in the UK.

8.2.4. We are satisfied that the SCE regime is not a 'subsidy scheme' under the Act and the levy advantage derived from granting employers SCE status is not a 'subsidy' for the purposes of the Act because it is not specific. This is because SCE status does not involve more favourable treatment of enterprises in a comparable situation, with reference to the risk of making a claim on the Board. We also take a similar view in respect of the Northern Ireland Protocol.

8.2.5. Therefore, we can simplify our SCE processes as follows:

- We will not require employers to confirm whether their SCE status constitutes a subsidy (or state aid, for example in respect of the Northern Ireland Protocol).
- We will remove the de minimis (or minimal financial assistance) approach. This is because our approach has shifted to the advantage derived from the levy being non-specific. Therefore, we will no longer need to check amounts of subsidies received by SCEs.

8.2.6. To effect this policy update, we plan to delete Rule E3.1(11)(a)(ii) and (b)(ii) of the Determination.

8.2.7. Stakeholder views on this updated and simplified approach are welcomed.

Treatment of ABCs on termination/surrender

8.2.8. We made a small change to ABC rules last year to enable sale proceeds to be included as Coupon Payments on termination of an ABC. We have reviewed how the rule has operated in practice this year alongside other queries we received. As a result, we are proposing to clarify in the Guidance that no legal opinion is required for the ABC Certificate if the ABC has terminated and there are no future payments. The underlying principle for us is that the legal opinion is needed to support the ABC value – in that it speaks to committed future payments.

8.2.9. We will also clarify – through the ABC Guidance - how we expect schemes to capture the strip out basis for U for s179 ABC Value on termination of an ABC Arrangement - the value in the s179 Scheme Accounts (or if not available any other value determined by the Board at that time).

8.3. Rule changes

We also propose to make the following changes:

Determination

(a) Amend definitions of Credit Rating Agency and Investment Grade to reflect operational decisions on providers as required.

(b) Amend Rule C1.2 of the Determination to reflect the change to the scheme-based levy multiplier (refer to 5.3.1 of this consultation for further information).

(c) Amend Rule C2.2 of the Determination to reflect the change to the LSF (refer to 5.3.1 of this consultation for further information).

(d) Amend Rule 3.1(11) of the Determination – to delete Rule E3.1(11)(a)(ii) and Rule 3.1(11)(b)(ii) - to reflect the proposed updated approach regarding Special Category Employers, as outlined in Section 8.2 above.

(e) Rule C5 - minor changes to the Alternative Covenant Guidance to take account of changes in asset stress approach, to reflect updates following the Pensions Regulator's August 2023 revised DB Superfunds Guidance, and to improve the clarity of some of the paragraphs.

Transformation Appendix

(f) As noted in Section 5.4 of this consultation document, version A11 of the s179 valuation assumptions came into force for valuations with effective dates on or after 1 May 2023. We have therefore extended the Transformation Appendix to specify A11 as an additional potential input basis, so that any s179 valuations carried out on this basis can be transformed back to the output basis, A10.

(g) We are also updating the Transformation Appendix to incorporate the notional cash-based rollforward index for holdings in absolute return funds which was publicised on our website earlier this year and which will apply in the calculation of 2023/24 levy invoices. For reference the formula is below.

Ca+Ret(Date1,Date2):

Ca+Ret(Date1,Date2) = CashPlus TRI@Date2 ÷ CashPlus TRI@Date1
where CashPlus TRI@DateX = 1 + CashPlusreturn%(BaseDate, DateX),

CashPlusreturn% will be estimated by rolling up the Bank of England base rate plus 3.5 percentage points from BaseDate to DateX, and
BaseDate = 1 November 2004

Insolvency Risk Appendix

(h) We will also, as required, update the Insolvency Risk Appendix (for example, table 4 and Annex 1: Assignment of CRA Ratings) to take account of operational changes regarding credit rating providers, as outlined at paragraph 8.2.1 above.

Consultation question 11:

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

9. Next steps and key dates

9.1. Next steps

9.1.1. We expect to publish our final rules for the 2024/25 levy year in December 2023, along with our policy statement which finalises our proposals for change following feedback to this consultation.

9.2. Key dates

9.2.1. The following table sets out the proposed key dates in the coming year, as reflected in this consultation and our draft determination:

Item	Key dates and times
Closing date for the 2024/25 consultation	30 October 2023 – 5:00pm
Publication of final rules and Policy Statement	By end of December 2023 (expected)
Scheme returns and electronic contingent asset certificates to TPR	31 March 2024 - Midnight
ABC certificates and special category employer applications to us	31 March 2024 - Midnight
Send contingent asset documents to us	02 April 2024 - 5.00pm
Start of 2024/25 levy year	01 April 2024
Deficit-reduction contributions certificates to TPR	30 April 2024 - 5.00pm
Send exempt transfer applications to us	30 April 2024 - 5.00pm
Certify full block transfers with TPR	30 June 2024 - 5.00pm
Publication of mean scores	July 2024
Invoicing starts	Autumn 2024

10. Consultation arrangements

10.1. Timing and responding

10.1.1. The consultation runs from Monday 11 September 2023 to 5pm on Monday 30 October 2023. Please ensure your response reaches us by the deadline. Submissions can be made online: www.ppf.co.uk/levy-payers/help-shape-our-rules

10.1.2. There are two versions of online submission available to you, 'quick' and 'full':

- The 'quick' submission allows respondents to review a summary of key proposals set out in our consultation, and the opportunity to give their views. It is designed to take only 10 to 15 minutes to complete. This version is designed for those who may not have time to respond to our consultations in full.
- The 'full' version sets out all the questions we are asking in this consultation, allowing complete responses, along with free format text fields for additional views to be submitted. This version of submission can either be completed online, or via an offline template which can be downloaded and once complete, uploaded via our website.

10.1.3. Please ensure you state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear whom the organisation represents and, where applicable, how the views of members were assembled.

10.1.4. Under the Freedom of Information Act 2000 (FoIA), all information contained in the response, including personal information, may be subject to publication or disclosure.

10.1.5. The respondent should limit any personal information which is provided or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with FoIA obligations and general law on this issue. Further information can be found on the GOV.UK website:

https://www.gov.uk/make-a-freedom-of-information-request

10.1.6. A summary of responses and the Board's final confirmed policy will be published on the PPF website at:

https://www.ppf.co.uk/

11. Comments on the consultation process

11.1. The consultation is being conducted in line with the Cabinet Office's Consultation Principles:

https://www.gov.uk/government/publications/consultation-principles-guidance

The Board would welcome feedback on the consultation process. If you have any comments, please contact:

External Affairs
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon, Surrey
CR0 2NA

Email: externalaffairs@ppf.co.uk

Appendix 1 - Insolvency risk

1.1. The PPF-specific insolvency risk model

1.1.1. Our insolvency risk model, which was originally developed in collaboration with Experian, continues to be operated by our insolvency risk partner, D&B. The model assesses the likelihood of a scheme's sponsoring employer to become insolvent at the end of each month. The average score for the year is then calculated and the scheme is placed in one of 10 levy bands (levy band 1 being the lowest risk).

1.1.2. We recognise that every business is different and as such every sponsoring employer is assessed on their specificities (in terms of size, subsidiary/independent, for profit/not for profit) which fall under one of eight scorecards.

1.1.3. The review of our model continues to give us confidence that it remains fit for purpose even though we recognise that no scorecards can fully reflect the unique characteristics of every company.

1.2. Model performance review

1.2.1. During the year to March 2023, the credit scoring model the PPF uses to calculate levy invoices continued to perform well and remains fit for purpose.

1.2.2. The Gini coefficient is our core metric and measures how well the PPF scorecards discriminate between solvent and insolvent sponsors. Measured on a scale of 0-100 per cent the PPF scorecards scored a high 81.6 per cent, performing more favourably than public credit ratings assigned by Moody's and in line with public credit ratings assigned by S&P and Fitch. This result shows that the discriminatory power of the insolvency risk scoring undertaken for levy invoicing purposes has been robust under very challenging and different economic scenarios.

1.2.3. None of the insolvencies were in entities that had been scored investment grade. As a matter of best practice, we have however reviewed all insolvencies with the most favourable credit assessment to understand the reason. There were two insolvencies that met this criterion, but both reflected very individual circumstances without wider application.

1.2.4. A second performance metric we consider is the PPF scorecards' ability to predict the insolvency count correctly. To do this, we compare the predicted insolvency rate, based on the scores that companies had at the start of the year, with the actual number of insolvencies - and see if the actual number is reasonably close to the expected number.

1.2.5. The expected insolvency experience for the period April 2022 - March 2023 was higher than observed the insolvency count. However, the insolvency count has shown some upward momentum and our expectation continues to be that the insolvency count will increase to levels more in line with the historical average. We will continue to monitor this.

Appendix 2 - Impact analysis

1.1. Introduction

1.1.1. This section provides more detail on the impact analysis for Section 5: Levy for 2024/2025 and Section 6: Levy options for future years.

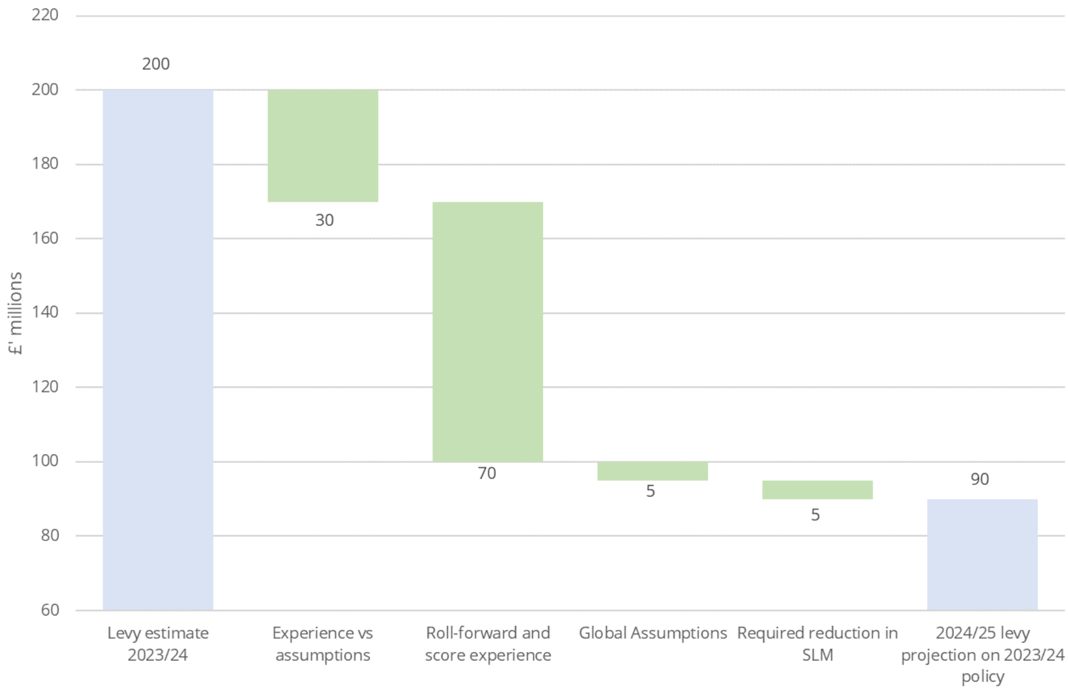
1.2. Change in expected levy collection, before and after policy changes for 2024/2025 levy

1.2.1. We have analysed the change from the 2023/24 levy estimate to the expected 2024/25 levy collection, based on the policy changes set out in Section 5 to maintain the levy at £100 million.

1.2.2. Before allowing for the proposed policy changes, the projected 2024/25 levy is £90 million. The change from the 2023/24 levy estimate of £200 million to this figure is made up of (Figure 1):

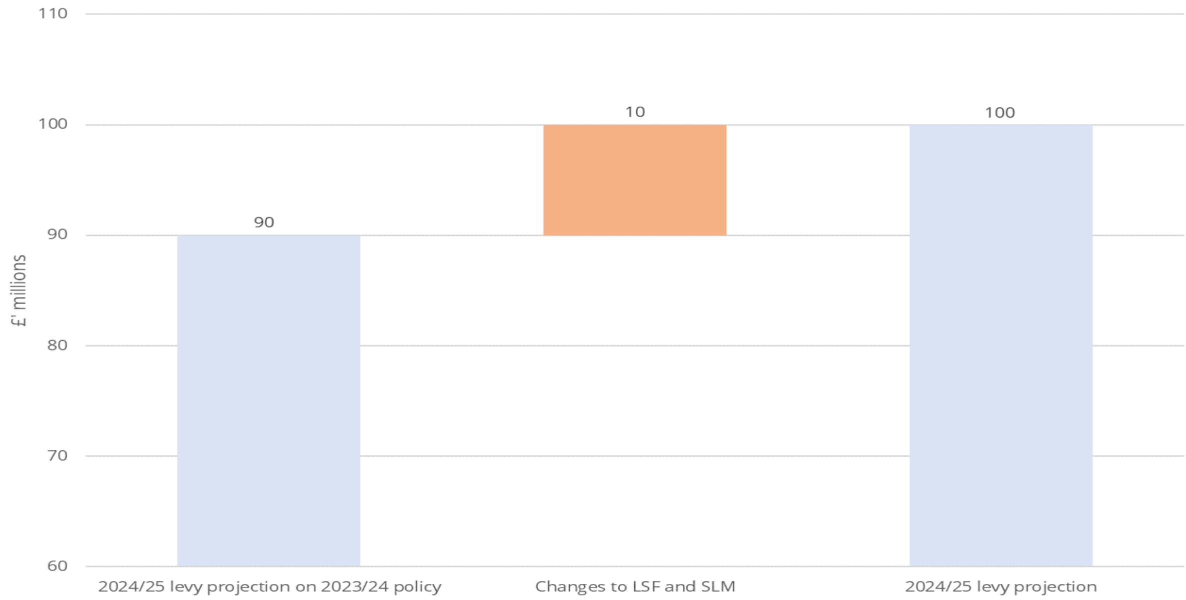
- Incorporation of 2023/24 invoicing scheme and employer data, and actual market data to 31 March 2023, to replace the assumptions made in the 2023/24 levy estimate. This leads to a reduction in levy of £30 million. Most of this impact is due to the increases in yields between the calculation of the 2023/24 levy estimate and 31 March 2023.
- The change in the measurement date from 31 March 2023 to 31 March 2024, moving the five-year smoothing period for the roll-forward output forward a year; and to a far lesser degree, incorporation of insolvency score movement between March and June 2023. This reduces expected levy collection by £70 million.
- Assumptions about schemes' risk reduction measures (as described in Appendix 3) over the 2024/25 levy year. This reduces expected levy collection by £5 million.
- Reduction in the scheme-based levy multiplier (SLM) to 0.000014 to reduce the scheme-based levy to no more than 20 per cent of total levy. This reduces levy by £5 million.

Figure 1: Change from 2023/24 levy estimate to 2024/25 levy projection on 2023/24 policy



1.2.3. The proposed policy changes in aggregate increase the expected 2024/25 levy collection by £10 million. This is reached by changing the LSF to 0.40 to raise the risk-based levy to £80 million, and then setting the SLM to 0.000015 so that the scheme-based levy constitutes 20 per cent of the total levy of £100 million (Figure 2).

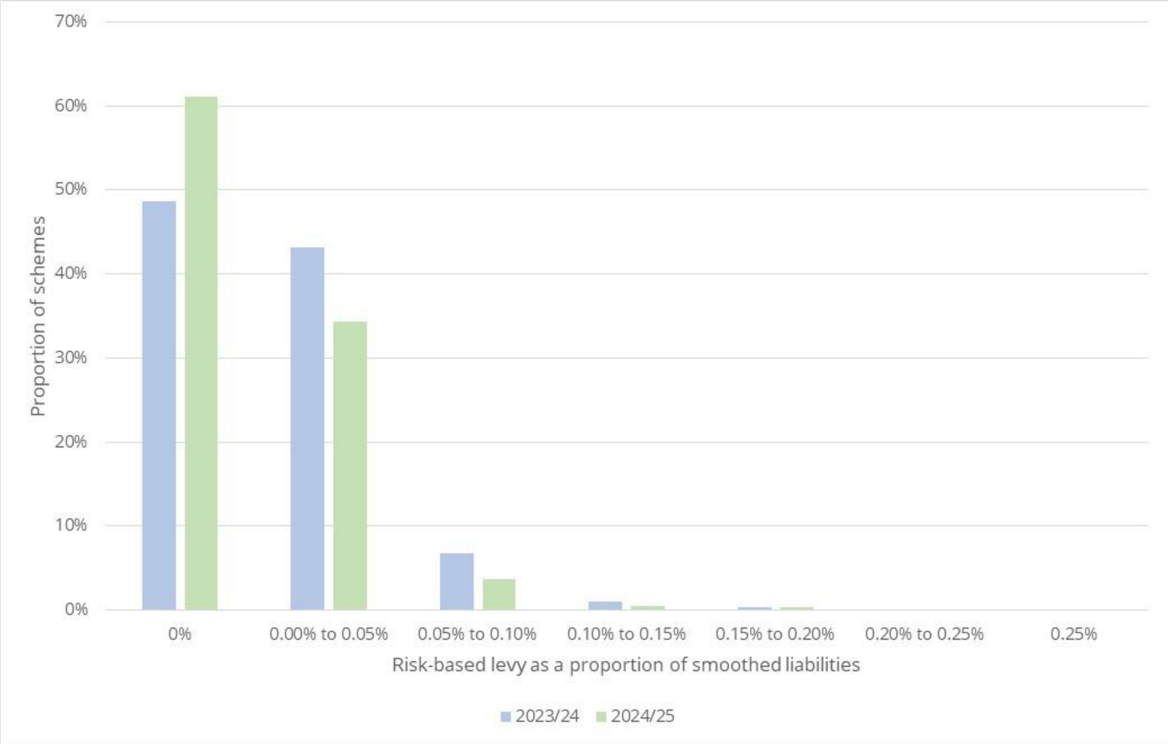
Figure 2: Impact of proposed policy on 2024/25 levy collection



1.3. Impact of policy changes on levy for 2024/2025

1.3.1. 98 per cent of schemes paying a 2024/25 risk-based levy are expected to see a reduction in risk-based levy from 2023/24 to 2024/25. The average reduction in risk-based levy for these schemes is over 40 per cent. The relative affordability of levy bills (measured as the risk-based levy as a proportion of smoothed liabilities) will generally improve across the universe, with c. 95 per cent of schemes paying a risk-based levy less than 0.05 per cent of smoothed liabilities (Figure 3). It is expected that no schemes will have the risk-based levy cap applied in 2024/25.

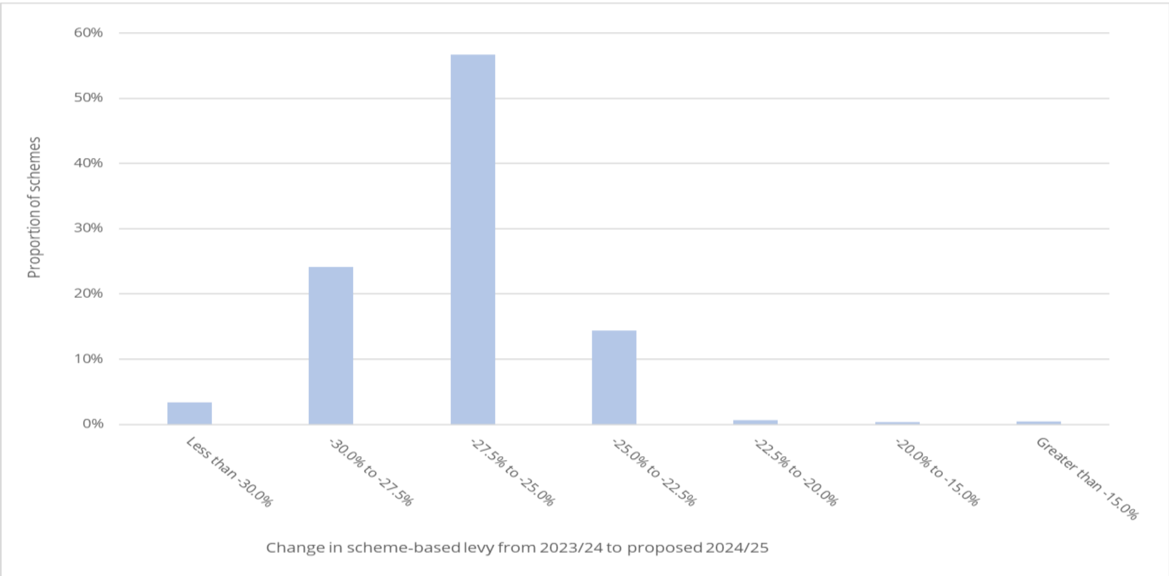
Figure 3 Impact of proposed policy changes on distribution of relative affordability of risk-based levy



1.3.2. Where a scheme sees an increase in risk-based levy, this will generally be because of the removal of the 2022/23 adjustment, or an increase in insolvency risk.

1.3.3. The reduction in the scheme-based levy multiplier from 0.000019 to 0.000015 will reduce scheme-based levies by over 20 per cent. Combined with the expected reduction in smoothed liabilities, we expect all schemes to see a fall in scheme-based levy, with more than four in five schemes seeing a fall in scheme-based levy of more than 25 per cent (Figure 4).

Figure 4: Impact of policy changes on scheme-based levy

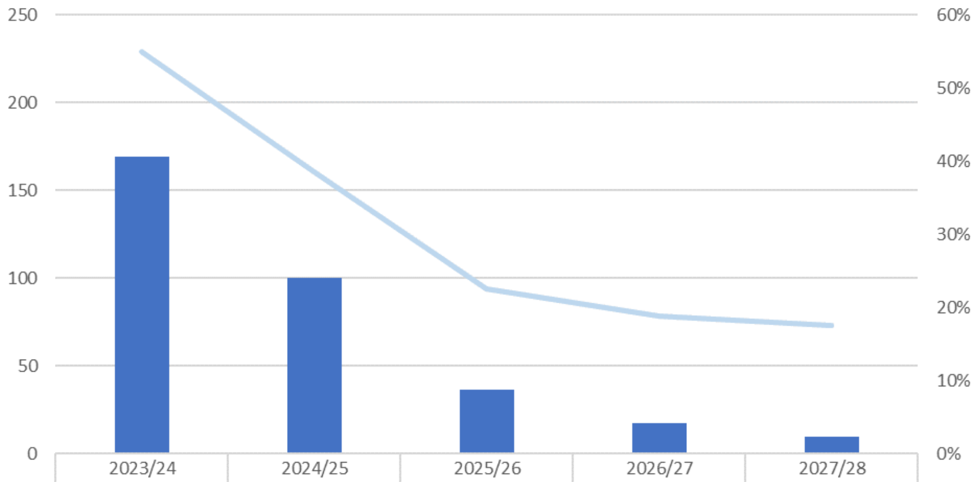


1.4. Impact analysis of policy options for future levy years

1.4.1. This section provides more detail about the distributional impact of the three main policy options set out in Section 6 using our stylised example. In this high-level stylised example, we assume that market conditions remain static from 30 June 2023 onwards, the relative rate of risk reduction assumed in the 2024/25 levy projections continues to 2027/28, and that A11 will apply as the output basis from 2025/26 onwards. The stylised example represents only one specific way that experience could play out, and so the actual impact and level of the levy factors required would, in reality, deviate from those presented below.

1.4.2. Due to improvement in yields, fewer schemes are assessed to be underfunded, so the pool of schemes paying a risk-based levy (RBL) would shrink over time. In the stylised example, without methodology changes, the levy quantum could fall from £100 million in 2024/25 to £10 million in 2027/28, and the proportion of schemes paying an RBL could decline from 39 per cent in 2024/25 to 18 per cent in 2027/28 (Figure 5).

Figure 5: Possible direction of quantum and proportion of schemes paying a risk-based levy[10]



	2023/24	2024/25	2025/26	2026/27	2027/28
Quantum, £ millions	169	100	37	17	10
Proportion of schemes paying an RBL	55%	39%	23%	19%	18%

1.4.3. As detailed in Section 6, to achieve a total quantum of £100 million of levy in our stylised 2025/26 example, the liabilities would have to be scaled up by an additional 18 per cent, the LSF would have to be increased from 0.40 to 1.07, or the asset and liability stresses could be calibrated to two standard deviations combined with a smaller increase in the LSF from 0.40 to 0.46.

1.4.4. The different policy options have different distributional impacts as demonstrated in Figures 6 and 7. In Figure 7, each of the 100 squares in each chart represents 1 per cent of schemes, with the colour of the square representing the mean average increase in RBL as a percentage of liabilities across the 1 per cent of schemes contained in the square.

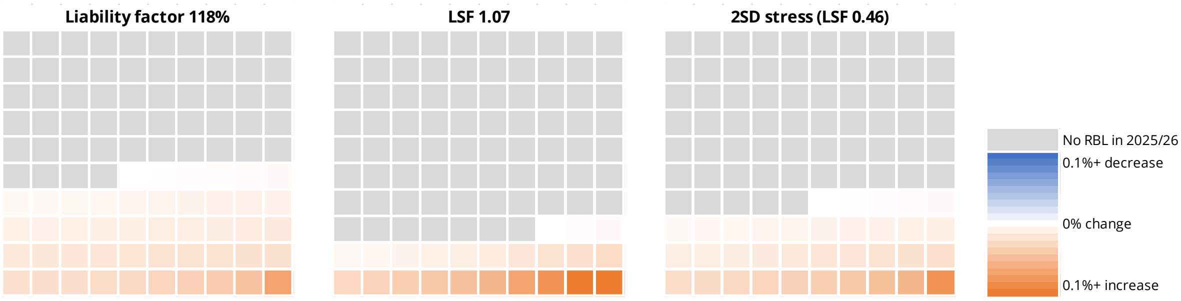
[10] The graph in Figure 5 was originally published showing the 'Proportion of schemes paying an RBL' in 2025/26 as 27%, this has now been corrected to 23%.

Figure 6: Impact of policy changes on scheme-based levy

Policy option	Factor	Number of schemes paying RBL	Median increase in RBL*	Maximum increase in RBL*	Proportion of RBL paid by top 10 RBL payers
Liability factor	118%	2,310	0.014%	0.100%	35%
LSF	1.07	1,140	0.025%	0.186%	45%
Stressing (+LSF)	2 s.d. (0.46)	1,760	0.015%	0.122%	40%

*relative to the RBL that would be payable in 2025/26 with no policy changes, and expressed as a percentage of scheme liabilities

Figure 7: Change in scheme's risk-based levy as proportion of liabilities: 2025/26 policy options as compared to no methodological change in 2025/26



1.4.5. If we increased the levy scaling factor, around 260 schemes would experience an increase of at least 0.05 per cent in their risk-based levy as a proportion of their liabilities, with around 75 schemes seeing an increase of more than 0.10 per cent. If we changed the stressing methodology, around 110 schemes in this example would experience at least a 0.05 per cent increase in their risk-based levy as proportion of their liabilities, with around 10 schemes seeing an increase of more than 0.10 per cent. In comparison, around 50 schemes would see an increase of 0.05 per cent or more in the risk-based levy as a proportion of their liabilities if we introduced an additional factor on the liabilities.

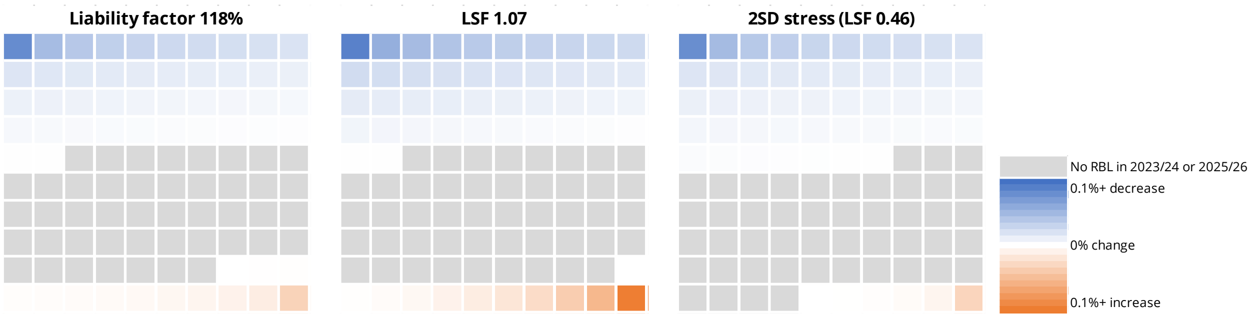
1.4.6. The distributive impact of the three options is therefore that the pool of risk-based levy payers would be widest in in the liability factor option and narrowest in the LSF option, with the increased stress factor option lying between the two. Correspondingly, the liability factor option would see the top levy payers experiencing the lowest increases in risk-based levy, while the top levy payers under the stress factor option would see higher increases, and higher still under the LSF option.

1.5. Impact on levy of the proposed options versus 2023/24

1.5.1. We have also considered, within our stylised example, how each scheme's 2025/26 risk-based levy under each policy option compares to the risk-based levy that they will pay in 2023/24.

1.5.2. The proposed policy changes from 2025/26 onwards are designed to keep the levy at a minimum of £100 million. As the scheme-based levy can only constitute up to 20 per cent of this figure, we aim to maintain the risk-based levy at £80 million. As this is materially lower than 2023/24 risk-based levy, most schemes who pay a risk-based levy in 2023/24 will see a reduction in, or even the removal of, their risk-based levy. However, under each policy option there is a minority of schemes that would see their risk-based levy increase. Figure 8 displays the distribution of changes in risk-based levy between 2023/24 and 2025/26 under each policy option for each percentile of schemes in a similar way to Figure 6 above.

Figure 8: Change in scheme's risk-based levy as proportion of 2025/26 liabilities: 2025/26 policy options as compared to 2023/24



1.5.3. The number of schemes experiencing reductions in levy between 2023/24 and 2025/26, and the level of reduction in levy as a proportion of liabilities for those schemes, is fairly consistent between the three options. However, the number of schemes experiencing an increase in levy, and the extent to which those schemes' levies increase as a proportion of their liabilities, varies significantly between the three policy options.

1.5.4. If we were to introduce an additional factor on liabilities, around 13 per cent of schemes in our stylised examples may experience an increase in risk-based levy between 2023/24 and 2025/26. However, the level of increase in risk-based levy would generally be fairly low, with only around 3 per cent of schemes seeing their risk-based levy increasing by more than 0.01 per cent of their 2025/26 liabilities.

1.5.5. The LSF option would see a smaller proportion of schemes – around 11 per cent – experiencing an increase in risk-based levy under our stylised example. However, the extent of these increases would be greater than under the liability factor option, with more than half of the 11 per cent seeing increases of more than 0.01 per cent of liabilities, and around 2 per cent seeing increases of more than 0.05 per cent of liabilities.

1.5.6. Under the option to calibrate the asset and liability stress to two standard deviations, the picture is quite different. Here, only about 6 per cent of schemes see any increase in risk-based levy, and the scale of those increases as a proportion of liabilities is typically very small as well. In this case, only around 1 per cent of schemes experience increases of more than 0.01 per cent of liabilities.

1.5.7. The following broadly describes which types of schemes are more likely to experience an increase in RBL between 2023/24 and 2025/26 under each policy option:

- Levy scaling factor: schemes that are very poorly funded.

- Liability factor: schemes that are close to fully funded.
- Increasing the asset and liability stress: schemes with a low level of matching in their investment strategy, especially if also poorly funded.

Appendix 3 - Assumptions used to forecast levy collection

1.1. Introduction

1.1.1. Each year, we are required to set an estimate of overall levy collection. We do that by modelling each scheme's expected underfunding and sponsor insolvency scores to arrive at a scheme-level estimate and combine that with the more general trends and impacts we anticipate.

1.1.2. As set out in Section 5, we have proposed changes to the levy rules, in particular an increase in the LSF from 0.37 to 0.40, and a reduction in the SLM from 0.000019 to 0.000015. The following subheadings set out our methodology and analysis on these movements that have led to our forecast for levy collection of £100 million for 2024/25.

1.1.3. We have arrived at the 2024/25 collection after making assumptions about data that will not be known until April 2024 or later.

1.2. Risk reduction

1.2.1. We have retained assumptions that deficit-reduction contributions (DRCs) and new s179 valuation filings will continue to lead to improved funding levels, and hence, a reduction to levy, assuming that the relative reduction in levy from these measures is in line with that observed in 2023/24. For risk-reduction measures such as contingent assets, ABCs, and liability hedging investment strategies, given the expectation of increasing funding levels, and the proposed decrease in total levy collection, we have assumed that the change in levy from these measures is broadly neutral to that observed in 2023/24.

1.3. Insolvency scores

1.3.1. For 2024/25 levy collection, we have seen aggregate changes in insolvency risk decreasing the total levy relative to 2023/24. The total net impact of changes in insolvency scores relative to 2022/23 implies that the deterioration in scores seen due to accounts adversely impacted by COVID-19 has now been reversed.

1.3.2. Considering this reversal, and the policy implemented in 2023/24 to reduce the sensitivity of levy to changes in insolvency score by reducing the relative increases in levy rates between levy bands, the estimate of levy collection assumes that in aggregate, insolvency risk for the remainder of 2024/25 remains broadly flat to the insolvency risk data to June 2023 monthly scores.