Pension
Protection
Fund

Policy statement

Levy rules 2023/24

13 December 2022

Foreword

I am delighted to introduce this policy statement and the conclusion of our consultation on the rules for the levy in 2023/24. Our proposals were met with strong support from respondents and I am pleased to confirm that we will be proceeding with them as consulted on:

- Our levy estimate is confirmed at £200m for 2023/24 which is around half last year's estimate.
- Our levy methodology changes will also go ahead, with halving of the increments between the levy bands, and a reduction in both the levy scaling factor by 23 per cent and the scheme-based levy multiplier by 10 per cent.
- Implementing the proposed asset and liability stresses which support the more detailed asset information the Pensions Regulator will be collecting from 2023.

As a result of the proposals 98% of schemes are expected to pay less levy in 2023/24, with the majority of schemes paying a risk-based levy seeing it fall by more than half.

As part of the consultation we also set out our plans for the future of the levy. I am grateful for the thoughtful comments we received on our proposals which we will reflect on over the coming months as we further develop our long-term plans for the levy.

Overall, our direction of travel was well supported. However, some respondents raised concerns that our proposals might mean larger and stronger schemes would be paying a proportionately greater share of the total levy bill. Given that levies for almost all schemes are now falling in absolute terms, this was primarily a concern in relation to a future scenario where the levy needs to increase substantially. I want to reassure stakeholders that we see this as genuinely unlikely. Our clear expectation is that levies will fall materially over time and the likelihood of our funding strategy requiring us to actively build funds is very low. We remain committed to the principle that those schemes that pose more risk, pay more levy. At the same time, it is right that the levy evolves to reflect concerns about volatility and complexity.

Some of the responses we received also raised questions about what would happen to any PPF excess reserves, echoing similar questions that were raised by stakeholders through our industry engagement. Ultimately what happens is a matter for Parliament as our governing legislation is silent on this issue. We will share the feedback from all our stakeholders (both business and members) with our sponsoring department – the Department for Work and Pensions.

We are grateful to all who have engaged with us - those who responded to our consultation, our Industry Steering Group and SME Forum and all others who have helped inform our approach.

David Taylor
Executive Director and General Counsel

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1. Key conclusions

On 29 September 2022, we launched the consultation on the Levy Rules for 2023/24. It closed on 10 November 2022 and we received a total of 25 responses. These were considered in determining the final Levy Rules.

We have now completed our consultation on the 2023/24 levy rules and are publishing our conclusions together with the levy rules for 2023/24. The headlines are:

Levy estimate
• We confirm the levy estimate is £200m.
Levy parameters
• The Levy Scaling Factor ('LSF') and Scheme-Based Levy Multiplier are confirmed as 0.37 and 0.000019 respectively, and the risk-based levy cap at 0.25 per cent of scheme liabilities. • Measures introduced in 2021/22 to support schemes through the pandemic with flexibility on payment terms stay in place.
Insolvency risk
• We are confirming the proposed change to the levy rates for levy bands 2 to 10, halving the band-to-band increase in the levy rate.
Asset stresses
• We are confirming the asset and liability stresses set out in the consultation document.

The Levy Rules that will govern the calculation of the levies for 2023/24, as specified in the Board's Determination under section 175(5) of the Pensions Act 2004, are published alongside this Policy Statement. Together with the Levy Rules, we have published guidance for schemes on how to meet the requirements of the Levy Rules, and to explain how we expect to make use of the areas where the Levy Rules provide us with flexibility.

The next section highlights the main themes arising from the consultation responses, our analysis, and next steps.

2. Proposals for the 2023/24 levy and direction of travel

2.1. Introduction

2.1.1. Our consultation published in September 2022 set out our thinking on our long-term approach to the development of the levy. This reflected our new funding strategy and our expectation of a material decrease in the levy in future (whilst recognising we must retain the capability to address funding challenges should they arise). The consultation document then set out specific proposals to change the 23/24 levy rules in keeping with our emerging long-term design principles.

Summary of our consultation document

Objectives

We set out two key objectives our future levy system must meet:

- **It must be flexible** – we expect the levy will be significantly lower than in recent years, but we'll need to retain the capability to raise it in the unlikely event that should be required in the future.
- **It should be simpler** – our levy methodology has developed over time to appropriately reflect the many different circumstances of individual schemes and employers. As the overall amount comes down, this level of sophistication can be reduced with benefits for schemes and us.

We also want to ensure the levy is fit for purpose, more stable for levy payers, transparent and predictable – all elements our stakeholders tell us are critical.

This has led us to **four design principles**:

- Increasing flexibility on the amount of levy we aim to collect
- Increasing flexibility to charge on the basis of size of scheme (e.g. scheme-based levy)
- Reducing levy sensitivity to changes in insolvency risk which reduces volatility and increasing the emphasis on underfunding
- Applying different approaches to how the levy is calculated depending on scheme size.

Our proposals for 2023/24 form the first step to our future levy plans:

- Reduce the levy estimate to £200m down from £390m in 2022/23
- Halve the band-to-band increase in levy rates - reducing the cliff edges and volatility.
- Reduce the risk-based levy scaling factor by 23% to 0.37 and the scheme-based levy multiplier by 10% to 0.000019 so all eligible schemes see a reduction in their levy bills.
- As a result, 98% of schemes are expected to pay less levy in 2023/24.

2.2. Summary of responses

2.2.1. We received 17 responses for our full consultation, 16 of which answered questions related to the 23/24 levy proposals.

2.2.2. In addition, we also asked in our short form consultation: do you agree with our proposals? We received seven responses and five respondents said they were supportive of our proposals, with one disagreeing and one neutral response.

Future direction of travel

2.2.3. We received strong support for our direction of travel with many respondents highlighting that they agreed with our proposed direction of travel for the levy. This included reducing the emphasis on insolvency risk and being able to adjust the levy for schemes of varying sizes. For example, one respondent noted:

"We support the principle that schemes that pose more risk pay more levy…that said, the rebalancing of the risk-based levy to emphasise underfunding with a reduced focus on employer insolvency seems sensible and would likely introduce greater predictability in future levies making budgeting by schemes easier." (PLSA)

And another respondent noted:

"We agree that it is sensible to reduce the administrative burden on small schemes and that a simpler method could be adopted for these schemes."

2.2.4. However, some responses expressed concern that this could mean larger schemes and those with stronger sponsors, paying a larger proportion of the levy – particularly were the PPF to increase the levy in future. We reflect on these points below.

2.2.5. We also invited stakeholders' views on what the priorities should be for simplification of the levy methodology. We received suggestions from 20 respondents. Suggestions included reducing the complexity of the credit scoring model and a reduction in the volume of paperwork relating to the annual rules and guidance, and taking a tiered approach to levy requirements depending on scheme size.

2023/24 proposals

2.2.6. There was strong support for our 2023/24 proposals – with 80 per cent or more of responses supporting each proposal. The table 1 below summarises responses.

Table 1: Responses to consultation on proposed 2023/24 changes

Question	Agree	Disagree
Do you agree with our proposal to reduce the cliff-edges between levy bands?	81%	19%
Do you agree with our proposal to reduce the Levy Scaling Factor?	100%	0%
Do you agree with our proposal to reduce the Scheme Based Levy Multiplier?	100%	0%

2.2.7. As we set out in our consultation document, as a first step towards a future levy system, we proposed to reduce the emphasis on insolvency risk by halving the increments between levy bands. A number of those agreeing with the proposal to place less emphasis on insolvency risk in our calculation – through reducing the cliff edges for levy bands - cited the advantages in terms of reducing volatility and stakeholder concerns. For example:

"The cliff-edges have historically been a major challenge for many clients and will be well received by the majority of schemes. Clients have expressed their concern in the past in relation to the cliff edges with some historically seeing a 50%+ change in levy/value for a movement between a single band at certain points of the scale." (Advisor).

"[cliff edges are] an unwelcome consequence of statistical models and potentially small changes in data which on the face of it would appear immaterial." (Advisor).

2.2.8. All respondents agreed with our proposal to reduce the levy scaling factor and scheme-based levy multiplier. Reasons given include it is fair to spread the benefits of lower levy across the universe including to those schemes that are better funded. For example, one respondent highlighted the following with regards to the levy scaling factor:

"Given that the PPF has undertaken a funding review and has calculated that levy collections can be significantly lowered, this appears to be the simplest and most effective way to help achieve this." (Advisor).

While another highlighted the following benefit of reducing the scheme-based levy multiplier:

"it seems fair to share the total reduction in levies collected amongst all schemes, including the 45% of schemes that currently only pay a scheme-based levy." (Advisor).

Concerns raised by stakeholders

2.2.9. The minority that expressed reservations or argued against those changes, or our overall direction of travel can be summarised into the following categories:

- Arguing against shifting the risk-based levy to focus more on underfunding – because the levy should reflect the full range of insolvency risks if it is to be fair. Four responses suggested an alternative method of reducing cliff edges by creating more levy bands. This is highlighted by a respondent:

  "In our view an additional priority in the simplification considerations should be fairness - a recognition that well managed larger schemes with good covenants, which represent less risk to the PPF, should not necessarily take on a greater proportional funding burden." (Scheme).

- Concerns about shifting the burden to larger schemes that might be implied by the role we envisage for the scheme-based levy or the prospect of charging differently for different sizes of schemes. For example:

  "In general, we support the proposal to move to a simpler basis for assessing the levy. However, this is tempered by a concern that this will lead to larger, but well-funded, schemes bearing the greatest proportion of any future levies." (Advisor).

- One response asked whether there was sufficient consideration given to the risk of schemes open to new members in our approach.

- Two respondents also raised questions about our funding position and what would happen to the "surplus".

2.2.10. A number of responses we received also emphasised the support for, and familiarity of, the existing levy approach amongst levy payers generally. These responses raised a note of caution highlighting that introducing simplification could impose costs on schemes at least on a transitional basis. For example:

"As a general observation, we believe there is logic to not making significant changes to the Rules given they are well understood by the industry." (PLSA).

2.3. PPF response

2.3.1. We welcome the strong support our proposals for the 2023/24 levy rules received. The comments and notes of caution around our future direction of travel and simplification possibilities will be valuable as we further develop our thinking. We note concerns about the impacts should the levy rise in future - first and foremost we want to reassure levy payers this is unlikely to happen.

2.3.2. Our future of levy plans provide for the possibility that levies might need to rise in the future, were our funding position to be substantially challenged. We regard being prepared for such an eventuality as what a responsible Board should do. That does not mean we regard the eventuality as likely.

2.3.3. To provide some context, our modelling[1] suggests we have only a 1 in 10 chance of our reserves being less than £10bn in five years' time (with a similar probability of such a decline over 10 years). The point at which the Board might decide it needed to take action to actively build reserves would depend upon a range of factors including the level of risk in the universe at the time, and where we are in our life-cycle, but it is reasonable based on current risk levels to expect that it would be lower than £10 billion. It is also worth noting that, as our funding strategy outlines, in the unlikely event of the situation occurring, we would review the level of investment risk we take, so that we would not necessarily respond through raising the levy.

2.3.4. Some stakeholders raised concerns that our proposals meant we were shifting away from our risk reflective approach and that this might undermine the fairness of the levy. Fairness is an elusive concept, and we are aware that opinions amongst our stakeholders differ widely in respect to what a fair levy looks like. As a result, it is a concept we typically do not seek to evaluate directly. We remain strongly committed to the principle that schemes that pose more risk, should pay more levy and this will continue to inform our thinking as we develop our future proposals. However, we remain of the view that it is right to reduce the sensitivity of the levy to changes in insolvency risk (and as a result increase the emphasis on underfunding risk). This supports a move to a simpler levy – important as the overall value of the levy falls – and, critically, addresses volatility in material levy bills.

2.3.5. As noted above, addressing the volatility of levies caused by movements in insolvency risk was very strongly supported in responses. This includes those who noted that, inevitably, there will be rough edges in any insolvency risk model, making it difficult to justify big jumps in levy following only small changes in assessed risk. In addition, in the light of the forthcoming DB Funding Code it is timely to increase the focus on the second critical aspect of our risk, underfunding, in the levy calculation.

2.3.6. Two responses suggested we could increase the number of levy bands as an alternative way to reduce cliff edges. As we set out in our consultation document, demonstrating statistically that each successive band is higher risk than the preceding bands is already difficult, so increasing the number of bands would undermine the validity of distinctions in risk level. This would mean some levy payers paying higher levies than others without there being a statistical justification for the differences. In addition, the proportion of employers seeing a levy band change would rise – so that an increasing proportion of schemes would see levies vary year on year. This would mean we would not meet one of our Future of Levy objectives which is managing volatility of the levy.

2.3.7. In respect of the scheme-based levy, we consider that as risk, and the total levy collected, falls, there is a case for the proportion of the levy that is scheme-based rising.

[1] Our modelling assumes that compensation is based on the current legal position. Were this to change then that might affect our funding position.

This is because there are costs associated with running the protection system for example those associated with investment management and provision of member services that aren't related to scheme risks and therefore shouldn't just fall to risk-based levy payers. For the avoidance of doubt, we do not expect scheme-based levies to rise from current levels (and indeed they will be lower in 2023/24 than in 2022/23), but they might form a higher proportion of a lower total levy.

2.3.8. We also consider that there may be a case for using the scheme-based levy more extensively in response to a funding challenge – though this would depend on the circumstances at the time. This flexibility is important because the proportion of schemes that pay a risk-based levy has fallen significantly and can be expected to decline further over time[2]. Charging a high levy (essentially to recover a sunk cost rather than due to future risk) using the risk-based levy could concentrate the costs on a minority of schemes still underfunded on a s179 basis. We would also note, in the context of our current reserve position, that if we were to face a funding challenge due to claims, then it will very likely be the failure of sponsors of large schemes that caused that challenge (by comparison, small schemes[3] might represent over a third of our universe, but their combined underfunding is less than 2 per cent of the risk we face).

2.3.9. For the purpose of calculating the PPF levy we treat open schemes as we do other schemes. The levy assesses risk over a one year time horizon and whether a scheme is open to future accrual or closed does not make a substantial difference to risk over this period. However, we would note that the factors that might be expected to reduce the proportion of schemes that are paying a risk-based levy may apply less strongly to open schemes: if they are not maturing they are less likely to be targeting low dependency and adopting a low risk investment strategy, and may be amongst the pool of schemes that remain underfunded on a s179 basis. The flexibility to use a scheme-based response to a funding challenge might therefore avoid these schemes meeting an undue share of any increased levy in the future.

2.3.10. We received strong support for seeking legislative change to increase flexibility in relation to setting the levy estimate. Two respondents highlighted that they would prefer the levy to be decreased as quickly as possible – making achievement of this flexibility a priority.

2.3.11. Our level of reserves, and what should happen to them if they turned out not to be needed to meet compensation, was highlighted by two respondents in this consultation. While the PPF presently has substantial reserves it will be many years before it is certain whether they are required or not. We recognise that different stakeholders have different views on what should happen to any PPF excess reserves. Some stakeholders have suggested that money should be paid back to schemes – pointing to their contribution to the PPF's reserves and indeed that they remain on risk

[2] Five years ago, 82% of schemes paid a risk-based levy. By 2022/23, only 60% of schemes paid a risk-based levy and this is likely to fall further in light of funding improvements and in light of TPR's anticipated revised funding code.
[3] Here defined as schemes with fewer than 100 members.

if PPF funding falls. Other stakeholders – including one responding to this consultation - argue reserves should be used to improve members' compensation (and indeed that levy should be maintained at current levels to fund it).

2.3.12. The Pensions Act 2004 is silent on what would happen to any PPF excess reserves, should they arise. Therefore, there is no legislative mechanism to return funds to levy payers (or, generally, to redesign PPF compensation). Ultimately what happens to the PPF excess reserves is a decision for Government and is likely to require legislative change. We will share the feedback we have received from all stakeholders to DWP as our sponsoring department.

Levy estimate

2.3.13. We proposed a series of measures which, combined with trends across the PPF universe for improvements in scheme funding, was expected to lead to our collecting £200 million for 2023/24 – a reduction of nearly 50 per cent on our 2022/23 levy using data at the end of July.

2.3.14. Our approach to our funding strategy and to the levy are long-term in nature. While there have been market movements in recent months, we can reassure stakeholders that we have no need to adjust our proposals and are confirming the levy parameters on which we consulted.

2.4. Next steps

2.4.1. Based on the strong support for our 2023/24 levy proposals we will proceed as planned. This includes halving the increments between levy bands, and the proposed reductions in the levy scaling factor and scheme-based levy multiplier. As a result, 98% of schemes are expected to pay less levy in 2023/24. The majority of schemes that pay a risk-based levy are expected to see their risk-based levy decrease by more than half.

2.4.2. As part of our work on Future of Levy we will reflect on the suggestions we have received for simplification and the broader comments made.

3. Other policy development

3.1. New asset classes and associated stress factors

3.1.1. The consultation document set out that we are updating our asset and liability stress factors as the Pensions Regulator is planning to introduce the updated asset categorisation, which TPR and the PPF jointly consulted on last year, for the 2023 scheme return. To inform our approach we commissioned an independent review of our overall system of stress factors.

3.1.2. We received 16 responses on the full consultation to our questions on asset stresses. The majority of respondents supported our proposed asset stresses. Table 2 below sets out the questions we asked and a summary of the active responses.

Table 2: Responses to consultation on proposed stress factors

Question	Agree	Disagree	No opinion
Do you agree with our proposals for UK equities?	69%	6%	25%
Do you agree with our proposals for Private Debt?	62%	13%	25%
Do you agree with our proposals for Diversified Growth Funds?	69%	6%	25%
Do you agree with our proposals for Absolute Return Funds?	69%	6%	25%

3.1.3. There were several key themes emerging from consultation responses which we have summarised:

- Respondents emphasised the need for updated helptext for the new asset information on the Scheme Return to be made available as soon as possible, to help in preparing for the upcoming submission process.

- Some respondents raised the question of whether the recent extreme market movements we have seen would require us to revisit the proposed stress factors for some asset classes. One respondent also highlighted that some schemes reporting as at 30 September 2022 could see their asset allocation deviating significantly from their long-term investment strategy.

- Several respondents requested further explanation on where we had made allowance for the diversification benefit among some growth asset sub-classes.

- One response recommended a less penal stress factor for Private Debt as, in their experience, investments are typically at more senior debt levels, albeit they acknowledged the presence of additional liquidity risk and, of course, a lack of publicly available data.

3.2. PPF response

3.2.1. We agree it is important that schemes have sufficient guidance and information to accurately breakdown their assets into the required groupings. Schemes have been able to access the Regulator's updated helptext files since early December. We would also note that the updated categorisation is unchanged from that which we communicated jointly with TPR in October 2021.

3.2.2. We have considered the recent experience of volatility caused by recent market events. However, given that the proposed stress factors are based on data analysed over a long period of time – including, for example, both the global financial crisis in 2008 and COVID-19 more recently – we concluded that the stress factors proposed remain appropriate.

3.2.3. Where asset allocations have been distorted from long-term investment strategies, which could be the case for 30 September 2022 scheme year-ends, we would not expect that to necessarily lead to a significant levy impact; in addition, attempting to introduce some type of adjustment in arriving at the stressed asset value would risk being subjective.

3.2.4. In deriving stress factors for the growth asset classes, we have maintained the previous approach of allowing for the benefits of diversification from global developed market equities. However, we have not allowed for any diversification benefit for diversified growth funds and absolute return funds, on the basis that the stress factors for those classes are not entirely market-based. We note also that respondents generally agreed with the proposed stress factors for these classes.

3.2.5. On Private Debt, the feedback we received demonstrated that there is in practice a range of funds and risk profiles schemes use to access this class. We would note that even where that exposure is obtained at senior debt levels, those funds are not publicly traded and are less liquid. In striking an appropriate balance reflecting the range of private investments and based on the professional advice we received, we concluded that the stress factor derived from the third-party data we referred to was appropriately representative.

3.3. Transformation Appendix and Block Transfers

3.3.1. We noted in our consultation document that the presentation of the asset breakdown and the asset roll-forward formulae in the Transformation Appendix were dependent on the ultimate presentation of the asset breakdown within Exchange. We highlighted that the final version of the Transformation Appendix might therefore incorporate some presentational adjustments from the consultation version, depending on how TPR's system build evolved over the following months.

3.3.2. TPR have kept us appraised of developments in this area, as a result of which it has been necessary to make some slight amendments to the Transformation Appendix. In particular, the final version of the Transformation Appendix published today reflects the intermediate sub-totalling of bond allocations on Exchange for schemes submitting asset breakdowns in accordance with the requirements of Tier 2 or Tier 3. Specifically, the sum of the allocations across the 'headline' sub-categories (i.e. before splitting by duration) and the allocations by duration (where applicable) within each sub-category must each total 100 per cent. For ease of reference, this relates to paragraphs 3.2, 4.4.3 and 5.7 to 5.11 of the Appendix.

3.3.3. We confirm that these amendments are purely to ensure that the calculation outputs rising from the application of the Transformation Appendix continue to reflect our policy intention and are consistent with the inputs on Exchange.

3.3.4. We have also included a provision to take account of the asset class changes in the Block Transfers Guidance and Appendix. For ease of reference this relates to paragraphs 3.42-3.56 in the Block Transfers Guidance. We have also made a minor change to the Block Transfers Appendix, part C.

3.4. Asset Backed Contributions (ABCs)

3.4.1. In response to a stakeholder query, we have made a small change to the Rules to enable the Board to take account of payments made to a scheme in exchange for the scheme trustee's interest in an ABC Arrangement ceasing (eg by sale or other arrangement). This will allow such payments to be included in the calculation of ABC payments where it is appropriate to do so.

3.4.2. In order to implement this change for 2023/24, we amended the Levy Rules and ABC guidance. We have also made a small change to the ABC Appendix and Certificate regarding Deficit Reduction Contributions to reflect appropriate treatment for option Beta certification.

4. Customer service

4.1. Insolvency Risk Portal

4.1.1. Based on stakeholder feedback, we have introduced a range of improvements to the insolvency risk portal managed by Dun & Bradstreet.

4.1.2. The most significant change is the introduction of multi-factor authentication (MFA). MFA is a two-step process using a security code, which is sent either to your email account or your mobile phone, to access the portal. If you choose to use a mobile phone number to receive your security code, your password for the portal will no longer expire. This will address perhaps the most significant point of user feedback on the portal – frustration with frequent password expiry. If you choose to use email, the password you set will expire automatically every 180 days.

4.1.3. We've also introduced a report that you can download in a PDF format. This will display either the latest score or the mean score and the data used to generate that score.

4.1.4. The current alerts function has been improved making it more visible and making it easier to set alerts when a score changes. Once you've logged into the portal, select 'set alerts' at the top right of your screen where you can then choose whether to receive an email notification when a levy band changes, when a score changes or both. You can stop email notifications by following the same steps and unchecking the tick box labelled 'I want to receive email notifications.'

4.1.5. We've re-introduced a webchat service which will enable users to receive answers to common queries as well as engage with an agent using an onscreen chat service.

4.1.6. All these improvements have been introduced based on stakeholder feedback so please let us know what you think by completing the surveys that are offered when you visit the insolvency risk portal.

4.2. Scheme return changes and electronic invoicing

4.2.1. The Pensions Regulator has also introduced some changes to the scheme return, including the addition of a new contact field for the receipt of electronic levy invoices. Please ensure this field is completed with the correct email address for the recipient of the levy invoice. There is also a new field to consent to receiving electronic levy invoices. If this box is ticked the scheme will only receive an electronic invoice; however if it is left unticked the scheme will receive a hard copy as well as electronic invoice.

5. Key dates and next steps

5.1. Key dates for 2023/24

5.1.1. The following table sets out the key dates in the coming year:

Item	**Key dates and times**
Scheme returns and electronic contingent asset certificates to TPR	31 March 2023 - Midnight
ABC certificates and special category applications to PPF	31 March 2023 - Midnight
Start of 2023/24 levy year	01 April 2023
Send contingent asset documents to PPF	03 April 2023 – 5.00pm
Deficit-reduction contributions certificates to TPR	28 April 2023 - 5.00pm
Send exempt transfer applications to PPF	28 April 2023 - 5.00pm
Certify full block transfers with TPR	30 June 2023 - 5.00pm
Publication of Mean Scores	July 2023
Invoicing starts	Autumn 2023