Pension
Protection
Fund

The 2016/17 Levy Policy Statement

December 2015

Foreword

This is our first year of calculating levy invoices using the new PPF-specific risk model. Almost all invoices have now been sent, bringing to an end the cycle of stakeholder engagement, development and implementation which began in 2013. For the next two years we aim to keep our rules as stable as we can. In line with this, our September consultation on the rules for 2016/17 proposed very little change.

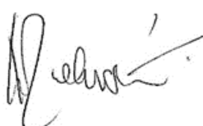
This approach was widely welcomed. Most respondents shared our view that the new model, which is statistically driven – based on experience of insolvencies amongst pension scheme sponsors - is a significant step forward. Overall, consultation responses and feedback on the first invoices using the new model suggest it is working well and that stability for schemes and employers is key.

The minor changes we have proposed were well supported - particularly the moves to reduce the burdens of certification for mortgage exclusions and asset backed contribution structures (ABCs). We have made some adjustments in response to helpful comments, including one instance (the exchange rate used in translating accounts to sterling) where we are deferring implementation to 2017/18 reflecting requests for a longer lead-in time.

Some respondents did raise concerns about how the model worked for their particular employer. Where there was strong evidence for a change, for example the use of interim accounts for new entities, we have amended the rules. In many cases however the impact of suggested changes across the whole base of levy payers is far from clear. We will examine these suggestions in more depth as part of our review of the framework for the next triennium, commencing with the 2018/19 year, on which work has already begun. We believe this is consistent with levy payers' firmly expressed desire for stability overall.

In advance of the next triennium we continue to consider whether any changes are necessary for 2017/18 to reflect the introduction of the new financial reporting standard FRS 102. We will be undertaking with Experian a detailed analysis of impacts as data becomes available. We will bring forward our conclusions as soon as we are able to.

Finally, now that the final rules for 2016/17 have been published, schemes are able to estimate what their invoice will be and assess the merits of putting in place and certifying risk reduction measures. This can both improve security for members and reduce bills, and is something the PPF is keen to encourage.



Alan Rubenstein
Chief Executive

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1. Introduction and Executive Summary

1.1 Introduction

1.1.1 On 21 September we launched our consultation on the Levy Rules for 2016/17. This document summarises the responses we received and our conclusions.

1.2 The Levy Rules (the Determination) for 2016/17

1.2.1 The Levy Rules that will govern the calculation of the levies for 2016/17, as specified in the Board's Determination under section 175(5) of the Pensions Act 2004, are published alongside this Policy Statement.

1.2.2 Together with the Levy Rules we have published six documents providing guidance for schemes on how to meet the requirements of the Levy Rules, Officer's certificates for certifying secured charges, ABC certificate and certain other matters. Further information is provided in section 4.

1.3 Summary of Responses

1.3.1 We received 43 responses to the consultation, which closed on 22 October 2015. These were considered by the Board in determining the final Levy Rules.

1.3.2 We have set out the key themes raised and whether we have made changes to the policy proposals that we consulted on. Generally, stakeholders continue to welcome the stability of rules delivered by our triennial approach and the PPF-specific model ('the model'). Where responses suggest changes to our approach, there is increasingly recognition that this may be a change for the start of the next triennium.

1.3.3 Overall, there was only limited criticism of the overall design of the model. The focus of such comments was primarily on themes previously raised in last year's consultations covering the move to Experian or more recently by individual stakeholders. Nevertheless, we have considered whether the points made ought to lead us to alter our policy.

1.3.4 The proposals we made for simplifying certain recertification arrangements were well received, and we are confirming these. We have made limited changes to the draft Determination published for consultation, resulting from the consultation, and we explain these within sections 2 and 3. In addition to this there are a number of minor changes intended to clarify how we are operating the rules – on which we set out more information in section 4. But, overall, we are delivering what we said we would, a set of rules that are very substantially unchanged from the previous year.

1.3.5 In addition to consulting on this year's rules, we invited comments on what we might do in 2017/18 to reflect the impact of the new accounting standard FRS 102, and on early ideas for the next triennium. Comment in relation to future years was limited. However, we will draw on what

has been received in the work now beginning to consider our approach for 2017/18 and the next triennium.

1.3.6 Alongside comments on policy, we have also received a number of comments on the operation of our web-based portal and the Experian customer service team. Stakeholders welcome the ability to track scores and understand the data that lies behind them, and indicate they have found Experian customer services to be easy to engage with. This is further backed up by our monitoring of the customer satisfaction scores that we are seeing and a 40 per cent decline in the number of appeals relative to 2014/15, suggesting issues are resolved before final scores are generated.

1.4 The Board's Levy Estimate

1.4.1 We announced in the consultation document that the Board had set a levy scaling factor of 0.65 and scheme-based levy multiplier of 0.000021 (both unchanged from 2015/16). The risk-based levy cap remains at 0.75 per cent of unstressed liabilities. We also announced that the Levy Estimate – the amount we estimated the draft levy rules would raise – was £615 million for 2016/17 (a reduction on our Estimate for 2015/16 of £635 million).

1.4.2 No comments were received on the Levy Estimate or the work done to develop it.

1.4.3 With no substantial changes in policy as a result of consultation, we are confirming the Levy Estimate made in September.

1.5 The measurement of insolvency risk

1.5.1 We have taken account of stakeholders' desire for stability and our intention to limit change within a triennium in our review of the Levy Rules.

1.5.2 We proposed some limited changes in September. Responses and conclusions are summarised below:

- The proposal to amend Rule E2.3(3) to make clear it would be possible to voluntarily submit full accounts for prior years for use in change variables (provided they were supplied for the previous three years) was supported and will be implemented.
- The proposal to move the date of translation of non-sterling accounts to the balance sheet date for the accounts drew a variety of responses. While most were in favour there were some concerns that this would apply to scores already produced. Although we do not as a matter of principle rule out making changes in the Rules that affect scores already produced (and in this particular example the change is not one that could have resulted in altered behaviour by schemes), we have concluded it would be better to introduce this change from 2017/18.
- There was general support for our proposal to increase the use of scheme averages, in preference to industry averages where possible. Some responses also suggested a change to the calculation approach

to one based on a weighted average. However, we were not persuaded that the scoring of an unscored (often small) company should necessarily be assumed to be in line with larger scheme employers (in terms of membership) rather than any other scored employers.

1.5.3 The most common criticism (in 12 responses) was of a perceived lack of flexibility resulting from including a fully documented system of scoring in our published rules. This leaves companies that consider that they have a good reason for a seemingly poor result in their accounts unable to have their circumstances individually considered, for example arguing that an exceptional item affecting profitability should be excluded. Typically, responses proposed more discretion, either for Experian or through the appeals process (one response suggesting that the Levy Rules themselves should be within scope for an appeal), but without a clear view on how this would operate.

1.5.4 Our view is that the lack of flexibility is an inevitable corollary of published rules – and indeed we flagged this point ahead of the introduction of the model. It is a feature that overall is widely welcomed, and we recognise that this approach makes it particularly important to ensure that the fixed rules we use have a firm statistical basis and are as robustly reasonable as possible. Our view as set out in section 2 remains that introducing wide-ranging discretion would require an undesirable degree of subjectivity into assessment, and a level of individual engagement that would be impractical to operate in a system which seeks to limit costs to the sector as a whole. We have therefore made only limited changes to broaden the scope of reviews, namely:

- Clarifying (as in the consultation draft of the Levy Rules) that the Board's discretions under Part B of the Levy Rules remain available for any insolvency-risk issues that are not able to be dealt with under the Experian appeals process;
- Extending the scope of the Experian appeals process so that where information relating to mortgages was unavailable to Experian at the relevant measurement time, it may still be taken into account where that lack of availability was not because of the trustee, employer, ultimate parent or subsidiary (as the case may be); and
- Clarifying that where the obligations secured by the refinance mortgage must be used to satisfy an earlier mortgage, that requirement need not be on the face of the loan document itself if other satisfactory contemporaneous evidence is provided.

1.5.5 A small number of stakeholders assert that certain categories of entity are poorly treated, principally:

- Smaller employers – particularly, but not exclusively, where they are on the scorecard used for all ultimate parents (the "large and complex" scorecard).
- Companies that operate without substantial debt (a group that overlaps with the above group) and who feel the model should recognise this through a variable measuring gearing.

1.5.6 We received a number of comments in relation to the exclusion of mortgages and charges. These included suggested changes to the

approach on refinancings and also from entities where Experian is not able to obtain information on the existence of secured charges, and which are therefore given a neutral score on the "mortgage age" variable.

1.5.7 We set out in section 2 why were not persuaded that changes should be made in relation to these issues, except to a limited extent in relation to the issue of mortgage certification. Central to our view has been that the outcomes the model predicts are in line with our experience, and that a substantive re-casting of the model is a significant endeavour most reasonably carried out periodically, and with the opportunity for broad engagement with stakeholders.

1.5.8 On mortgage certification, we continue to believe self-certification is not generally desirable or appropriate. However, one consultation response identified that some entities may be able to demonstrate conclusively that they could have no secured borrowing by pointing to legal prohibitions on borrowing. We have therefore amended the Levy Rules to allow for this situation.

1.5.9 We are also confirming that, in line with our consultation proposal, we have made limited changes to the rules governing re-finance mortgages to ensure that arrangements which are a genuine re-finance but where a delay in recording the release of a charge, or other like circumstance has occurred, fall within our rules for exclusion.

1.5.10 One further change we are making is to allow interim accounts to be submitted, where an entity has only been trading for a short period and Experian would otherwise therefore be unable to score the entity.

1.5.11 Now that the Levy Rules have been finalised, we will update the scores that are shown on the Portal, for scores from April 2015, to be on a basis consistent with these rules. The main change will be the recognition of rolled-over mortgage exclusion certificates indicating an investment grade credit rating. If, once Portal scores have been refreshed, a score does not reflect a certificate that is likely to mean that the PPF is not expecting to recognise that certificate for next year.

1.6 FRS 102

1.6.1 We had a number of responses to our call for evidence on the impact of the new accounting standard FRS 102. There was little detailed information supplied and agreement that this will largely affect scores in 2017/18, though there may be a few early adopters. There was a range of opinion on how many schemes will be affected – most seemed to think significant impacts are likely to be limited to a subset of those on two of the scorecards.

1.6.2 We have carried out some initial work with Experian to test impacts – but limited data has meant this is inconclusive. We are looking to conduct further analysis, with Experian, through additional data capture, for a substantial proportion of accounts filed in the coming months, to analyse prior year comparative figures. The prior-year comparative figures (which will have been restated on an FRS 102 basis) will enable us to see what impact the standard is having. While the effect of reporting a

pension scheme's deficit (or surplus) has drawn most attention in responses, we will also want to understand other impacts too.

1.6.3 We will bring forward proposals on the appropriate handling of the transition as soon as we are able to.

1.7 Issues not related to the measurement of insolvency risk

1.7.1 We received a limited amount of feedback on some issues not related to the measurement of insolvency risk. In particular the suggestion of a lighter touch approach to recertifying asset backed contribution arrangements was welcomed. We have extended the guidance, to cover this.

1.7.2 In addition, since the consultation document was published we have carried out a range of actions to improve the assessment of group company guarantees, including running a series of interactive seminars on assessing the strength of guarantors attended by around 150 trustees and advisers. While we do not rule out making further changes in relation to certification in future, no changes have been made for 2016/17.

1.8 Third Triennium

1.8.1 We indicated in the consultation document that we will start looking ahead to the third triennium in 2016. We received a limited number of suggestions for areas to be reviewed in the next triennium and we will add these to those we have already identified.

1.8.2 When considering the extent of changes to the model we will weigh the strength of the case for change against the benefits stakeholders see in stability of rules.

2. PPF-specific model

2.1 Introduction

2.1.1 Most of the comments received in our consultation related to aspects of the model. We had proposed making some very limited changes in 2016/17, and our conclusions on these, and other points made by a number of stakeholders, are set out below.

2.2 General model issues

2.2.1 In the consultation document we highlighted some areas that had been raised by stakeholders and which we had considered further but concluded that changes would not be put forward for 2016/17. We have received further comments on some of these issues and on other issues and have reviewed them again.

2.3 Use of interim accounts for new employers

2.3.1 We received five responses that raised concerns about the absence of data on which Experian can base scores for a new employer until its first set of accounts have been filed. This can arise where there is a transfer of a franchise, following a company merger or on certain corporate transactions.

2.3.2 One of the options which had been considered and rejected in the past was the use of the accounts information from the predecessor company. The reason this was rejected was that the new company will not always match the predecessor (for example franchises may be offered on a different basis). Given that the starting point under the legislation is to assess the insolvency risk of the scheme employer (not its predecessor or a similar employer), we would need a very clear basis on which we could regard another company's risk as representing the true risk of the entity being scored.

2.3.3 We do however recognise that the absence of data for a brand new entity does not allow for the most accurate assessment of insolvency risk. We are therefore extending the rules to allow audited interim accounts to be voluntarily submitted by employers (providing they cover at least one month's trading activities).

2.4 FRS 102

2.4.1 In the consultation document we highlighted that the introduction of the reporting standard FRS 102 could affect the accounts of employers within multi-employer schemes where those accounts do not already reflect their pension deficit. This could be where they have previously used the option of accounting on a defined contribution basis. However the impact

was likely to be less significant where the defined contribution option was not used or where the pension deficit information was included because the employer is an ultimate parent company. We also noted the potential impact on trend variables where the calculation would include data on two different accounting bases. We asked schemes and advisors to provide information on the expected range and extent of impacts arising from the change.

2.4.2 We received thirteen responses touching on a number of aspects of this issue. There was generally a recognition that this was an issue that could have an impact on scores from 2017/18, though with a desire for early clarity on action. Most responses covering the option to account on a defined contribution basis indicated this was widely adopted, though one said that it was quite rare for all employers in a multi-employer scheme to account on a defined contribution basis, and that because FRS 102 only requires at least one employer to account on a defined benefit basis they thought the impact in this respect would be very limited. However even in this situation it was argued that those that are affected would be significantly so – and therefore some kind of adjustment should be allowed.

2.4.3 The types of adjustment suggested included:

- allowing companies to re-state N-3 accounts (in full or part) on an FRS 102 basis; and
- allowing the first set of accounts on an FRS 102 basis (in full or part) to be re-stated on a UK GAAP basis.

2.4.4 The examples of the impacts provided directly by stakeholders or by representatives were limited. Experian have been able to identify a small number of cases where defined benefit pension scheme sponsoring employers have moved from UK GAAP to IFRS. Our examination of these cases, though numbers are very limited at this stage, does not appear to indicate that any particular areas are most affected. Experian have also investigated a relatively large number of employers that do not sponsor defined benefit pension schemes and have moved from UK GAAP to IFRS. This showed that key financial data showed a range of improvements and worsening results, with most financial metrics changing by 5% or less.

2.4.5 We are looking to conduct further analysis through Experian capturing prior year information for accounts to allow a fuller comparison to be carried out and inform whether an adjustment is justified. Data is only likely to start to be available in the months after February 2016. This is because that is when the first accounts with a December 2015 year end are typically filed - though companies can file as late as September and a significant proportion of companies take advantage of that flexibility.

2.4.6 Some respondents asked us if we could indicate the form of any adjustment by 31 March 2016 so that employers and schemes would be able to anticipate the effect it would have on their scores from April 2016. While we do not expect to have sufficient data available to decide an appropriate response on that timescale, we will bring forward our conclusions as soon as we are able to.

2.4.7 If the evidence supports an adjustment it is likely to be one that allows re-statement of part or all prior accounts information on an FRS 102 basis or a smoothing of the relevant variables.

2.5 Mortgage Certificates

2.5.1 A number of scorecards include a variable measuring the age of the most recent mortgage or secured charge. As set out in our 2015/16 Policy Statement, we allow certain mortgages and charges to be excluded from the calculation of the mortgage age variable. These are mortgages in favour of the pension scheme, refinance mortgages, rent deposits, mortgages meeting our test of immateriality, and any mortgage from entities with an investment grade credit rating (CRA Certificates).

2.5.2 We had a number of comments from stakeholders on the design of the mortgage certificates themselves, and accordingly will be making some minor changes to them, so they are easier to use.

Carry-forward of 2015/16 certificates

2.5.3 In our September consultation, we proposed that refinance mortgages, pension scheme mortgages, rent deposit mortgages and credit rating exclusions for which certificates were provided (and accepted) for 2015/16 should continue to be excluded for future levy years with no need for recertification for 2016/17. The only mortgage type that we proposed needed recertifying annually was immaterial mortgages, on the basis that the amounts used for the purpose of calculating immateriality might vary from year to year.

2.5.4 Most respondents supported the proposal without reservations, and commented positively about the reduced administrative burden. One respondent thought that we should also roll forward immateriality certificates, and suggested Experian should be able to assess materiality from the employer's most recent accounts. However, there is no straightforward way for Experian to establish whether or not a charge has changed, and in particular whether borrowing under (for example) a revolving credit facility has increased.

2.5.5 Therefore, we are confirming that we will carry forward all mortgage certifications that were accepted for the 2015/16 levy, except for those for immaterial mortgages which will need to be certified annually.

2.5.6 We will review the credit ratings of all those employers/guarantors for which we have accepted CRA certificates (either for the first time in 2016/17 or carried forward) by the deadline of the end of March 2016. This check will test that the credit rating for the entity concerned is still at an Investment Grade level at the end of March 2016. If it has fallen below this level at 31 March 2016 the benefit of the certificate will be withdrawn for all Monthly Scores counting for 2016/17 levy.

2.5.7 Clearly, at that point, it will be too late for schemes to take action to deal with the impact of a withdrawn certificate. So, while it remains the responsibility of schemes and employers to monitor their scores, and where relevant the rating of any certified entity, we have carried out an

early review of 2015/16 CRA certificates, and will be including or excluding them from scores available on the portal shortly. Schemes and employers will therefore be able to see whether, on the basis of the information we currently have, it is anticipated that the certificate will be recognised – and the impact it has on scores since April.

2.5.8 The checks we have carried out have indicated that (absent future changes) the CRA certificates should continue to be applied in the great majority of cases. Certificates we have dis-applied are those where there has been a loss of investment grade status (either for the entity itself or within the wider group), or certification was flawed, and we consider a new certificate should then be supplied if mortgages are to be excluded.

2.5.9 We will aim to contact the schemes affected by the non-recognition of CRA certificates and they may wish to take appropriate action - for example, certifying to exclude the charge under one of the other bases, if applicable.

Private Credit Ratings

2.5.10 In the consultation document we invited stakeholders to provide evidence on the extent to which it would be possible to draw the conclusion that any charges where the chargor had a private rating were unlikely to be predictive of insolvency risk.

2.5.11 We received six responses with mixed views. While some said they would welcome an extension of the credit rating exclusion, others were doubtful of the arguments made for extension. Demand for such an extension was also very limited.

2.5.12 Our approach to the extension of mortgage exclusions has been a cautious one. The evidence Experian gathered indicates that a recent mortgage is strongly correlated with a heightened risk of insolvency. We therefore only extend the scope of exclusions, particularly a wide ranging exclusion such as for public credit ratings, where there is clear evidence to do so. We are therefore not extending the credit rating exclusion at this time.

Immaterial mortgages

2.5.13 We proposed one change to the immaterial mortgage regime – that the definition be amended so that charges over bank accounts can be excluded as being immaterial – using the amount that was required to be deposited as the measure of immateriality.

2.5.14 Respondents were generally supportive of this approach and we confirm that we will allow charges over bank accounts to come within the class of charges that can be certified for immateriality.

Refinance mortgages

2.5.15 We proposed a refinement to the timeframe for entering into a refinance mortgage. The rule for 2015/16 was that the refinance must take effect

not later than 14 days after the original mortgage is released. While this rule clearly limits the time period between mortgages where the original mortgage is released before the refinance, it did not restrict the time period between mortgages to 14 days where the original mortgage was released *after* the refinance. We originally proposed a change that clarified this, and a further extension of the rules for cases where the refinance mortgage must be used to discharge the original mortgage (which clearly demonstrates the connection between the two mortgages), so that the refinance mortgage:

- became effective at the same time as, or no more than 14 days after, the original mortgage was released; or
- became effective no more than 14 days before the original mortgage was released; or
- became effective more than 14 days before the original mortgage was released, and the refinance mortgage states on its terms that it must be used to discharge (in whole or in part) the obligations secured by the original mortgage.

2.5.16 We also proposed that the definition of refinance mortgage be broadened to cover new mortgages that are a restatement or confirmation of the existing lending, with no changes to or extension of their terms, without the existing mortgage needing to be released. There was general support for this broadening of the definition and we are now confirming this in the Rules.

2.5.17 As to the 14 day period, one consultancy respondent had not come across difficulties in meeting the current definition, but some respondents wanted the broadening to go further. However, there was no clear proposal for an objective alternative rule. One respondent suggested that the PPF should be able to use a discretion to take an ad hoc approach to accept arrangements as refinances where the circumstances justify it. We do not intend to proceed with this approach – it would give rise to undesirable uncertainty about what the Levy Rules are.

2.5.18 Instead, we have considered how best to reflect our policy intentions in the Rules whilst seeking to introduce limited additional flexibility for cases where the 14 day period could not be met but through no fault of the trustees, employer, ultimate parent or group subsidiary (as the case may be). We have concluded that the intent can be reflected more simply than we had expressed in consultation. Our policy intention remains that where the original mortgage was discharged before the refinance mortgage was entered into, a 14 day period remains required because a longer period is likely to be evidence that the transaction is not, in reality, a refinance – and that the relevant documentation for these purposes is not the entering into of the underlying loan agreement, but the security interest taken by the lender. It may well be that the loan agreements are entered into more than 14 days apart but our rule is aimed at the dates on which the security taken by the lender(s) are entered into / discharged.

2.5.19 However, where the refinance mortgage was entered into before the original mortgage was discharged, the key issue is not the time period between the two, but, rather, whether the refinance is in fact used to

discharge the original lending. Therefore, we no longer see the need for a 14 day restriction where the refinancing security interest is entered into before the original mortgage is discharged, so long as the refinancing is used to discharge the original mortgage.

2.5.20 We have therefore reverted the levy rule so that the timing requirement remains that the refinance mortgage became effective not later than 14 days after the original mortgage was released, and have clarified that the refinance mortgage means the security interest.

2.5.21 For those schemes where the refinance mortgage was entered into more than 14 days after the discharge of the original mortgage, we have sought to meet stakeholder concerns by introducing some flexibility via an extended scope of the Experian appeals process. Where information relating to mortgages was unavailable to Experian at the relevant measurement time, it may still be taken into account where that lack of availability was not because of any action or inaction on the part of the trustee, employer, ultimate parent or subsidiary (as the case may be).

2.5.22 For those schemes where the refinance mortgage was entered into before the discharge of the original mortgage, we had originally proposed a further way of meeting the timing requirement where the refinance mortgage states on its terms that it must be used to discharge (in whole or in part) the obligations secured by the original mortgage. Two respondents asserted that companies may be unable to comply with the rules because their charges were entered into before the Experian regime. One suggested that if the refinance mortgage did not state on its terms that it was to be used to discharge the original mortgage, then a letter of confirmation from the lender might be supplied instead. We recognised that the evidence of the new lending being used to discharge the original borrowing may not need to appear on the face of the documentation itself in order to satisfy us, but note that the definition of Original Mortgage already includes a requirement that its discharge is funded by amounts secured by the refinance mortgage. In order to keep the rules as simple as possible while continuing to achieve our aims, we have therefore not replicated this requirement within the definition of Refinance Mortgage, but have instead made it clear in the mortgages guidance that this test may be met by evidence in the loan agreement or by analogous contemporaneous evidence.

2.5.23 We have also made the following changes to the Levy Rules, as refinements to reflect the development of our policy as a result of our experience over the last year.

2.5.24 Where a refinance mortgage is put in place to replace more than one older mortgage, the refinance mortgage can be excluded by submission of a certificate, but the most recent original mortgage (for mortgage age purposes) will then be taken to be the most recent of the group of original mortgages. The new arrangement will need to satisfy the other elements of the refinancing test relative to the charges it replaces, where appropriate in aggregate. The required 14 day period between discharge of original mortgage and entering into of refinance mortgage must be satisfied by reference to the earliest of the original mortgages to be discharged.

Mortgage age scores for non-corporate entities

2.5.25 In relation to non-corporate entities the only change proposed in the draft Levy Rules was in relation to entities that were registered at Companies House but were not required to file charges at Companies House. This clarification had been proposed because we had become aware of some entities that were receiving a zero score for mortgages but in reality may well have charges that Experian are unable to retrieve. The change in the Insolvency Risk Appendix therefore gave these types of entities a neutral score consistent with our general policy, as their mortgage information cannot be verified from what they filed. Schemes affected will see this reflected in scores on the portal shortly.

2.5.26 No responses were received on the specific change that we had proposed for 2016/17. Several responses repeated suggestions that entities who did not file any information at Companies House (such entities currently receiving a neutral score for mortgage age) should be able to certify that they had no charges and thereby obtain a zero instead of a neutral variable.

2.5.27 The reason for the neutral variable is that it is not possible to verify the accuracy of mortgage information for an entity which is not required to file mortgage information at Companies House. One suggestion was that we could use filed accounts for this purpose. But this would mean that a newly-created charge may take some months (or years) to be reflected in the accounts, depending on the reporting requirements of the type of entity in question. During that time period, if we treated the previous set of accounts as representing the accurate mortgages position and that previous set contained no mortgages, the entity would be benefiting from a zero mortgage score when in fact they should be receiving a score that represents their very recent charge.

2.5.28 The responses favouring allowing non-corporates to certify that they have no charges were largely for a one-way certification allowing entities to benefit from having no mortgages. If we were to allow all entities to certify as to their mortgage position, we would still need an assumption for those that do not provide mortgage information. The fairest approach (to prevent entities from gaming by deciding whether or not to report their mortgage position) would be to apply the least favourable score as the default, and to enable entities to certify against that position. This would be an administratively heavy burden on schemes, though, not least because it would place an onus to certify on the majority of overseas entities – and it would still not deal with the issue of verification.

2.5.29 It therefore remains the case that there is no clear way in which we could allow all non-corporate entities to certify that they have no charges, and it is our confirmed policy not to make a general change on this front for 2016/17.

2.5.30 The one area, though, on which we are persuaded by respondents that we should make a change, is where it is clear that an entity has no power to grant security over its assets. This type of entity is the one clear case that cannot self-select to only certify to improve their score – as they will

not have any charges anyway, so our identified area of concern (of schemes self-selecting to certify) does not arise.

2.5.31 We have therefore included in the final Levy Rules for 2016/17 a provision enabling a mortgage to be excluded where the Board is satisfied that the entity does not have the power to grant security over its assets. These entities will be able to provide evidence that they can have no mortgages and therefore receive a zero score for mortgage age. There is no set form of certificate for this because the types of evidence might vary, but the Mortgage Guidance provides some assistance as to what might be acceptable, including that we will require a letter from a legal advisor.

2.6 Voluntary submission of accounts

2.6.1 In the draft Levy Rules we included a change that confirmed that when full accounts are voluntarily submitted to Experian the three preceding years can also be provided to allow the N-3 calculations to be carried out but this can only be done if full accounts for all three years are provided to Experian.

2.6.2 This change was welcomed by eight of the nine responses on this. The one opposing the change suggested that the change would allow schemes to pick and choose the type of accounts to be submitted. The requirement to submit all three prior year accounts, and the existing rule that once an employer has opted to submit accounts voluntarily it will remain scored on a full scorecard in future, provide protection against the risk of gaming. We are therefore confirming the change we highlighted in the consultation.

2.7 Non-Sterling Currency Exchange Rates

2.7.1 We proposed moving away from a single date for the conversion of all non-sterling currency accounts of 1 April (preceding the relevant measurement time). Instead we proposed using the balance sheet date of the most recent accounts to convert both those accounts and the accounts from three years prior (used in the trend variable calculations).

2.7.2 All but one of the responses favoured the change, but most also requested that we delay implementation as the change would affect scores that schemes and employers had been monitoring and planning around this far into the year.

2.7.3 We have concluded that we should implement the change proposed, but to delay implementation until April 2016 (i.e. for levy year 2017/18). Experian will update scores in the portal based on the new rule in April 2016, with the draft rule change included in the 2017/18 Draft Determination published with our consultation.

2.8 Scheme and Industry Averages

2.8.1 Scheme and industry average scores can be used for unscored employers providing certain conditions are met. We asked for comments on our proposed change to the calculation of scheme averages, focussing on the

number of scheme members in scored employers (rather than the number of employers scored), in determining the point at which a scheme average can be used for unscored employers.

2.8.2 Most responses supported our proposed approach to extending the use of scheme averages for unscored employers. Some responses suggested that the scheme average calculation should be a weighted average.

2.8.3 Although we understand the instinctive view that a weighted average calculation might be more appropriate than a straight average, we have decided to maintain the proposal as set out in the consultation document. We do not think that the scoring of an unscored (often small) company should necessarily be assumed to be in line with larger scheme employers (in terms of membership) rather than any other scored employers. And we consider that the greater significance of the larger employers is already adequately reflected through the weighted average calculation of the insolvency risk (IR) itself.

2.8.4 With respect to calculation of industry averages we floated the possibility that a more flexible approach might be taken to formation of the groups of employers to be averaged by varying the number digits of the relevant SIC used (from one to four) and we will consider this for a future year.

2.9 Issues previously considered: scoring of smaller companies / borrowing / scorecards for sectors

2.9.1 As in previous consultations, we received a limited number of comments which focus on the design of the model generally, or of specific scorecards.

2.9.2 The scoring, on the Large and Complex scorecard, of smaller companies, or of the impact of a potentially immaterial subsidiary or parent to a score, was raised by a few respondents. In our Policy Statement of 2015/16 we confirmed that we had reviewed the scoring of smaller companies (particularly their scoring on the Large and Complex scorecard). In particular we looked at insolvency rates (by size of business) that the model predicted and compared it to actual experience of insolvency. Among around 680 employers with a turnover of less than £20 million on the scorecard, over the six years used for modelling, the expected level of insolvencies was 78 and the actual number 84. This demonstrates that the model is not over-estimating the risk of smaller entities.

2.9.3 We do not propose any change to the scoring of companies on the Large & Complex Scorecard. There is a correlation between size and insolvency risk and also we have found no evidence of a relationship between an ultimate parent's score and how material its subsidiaries are to a group. We tested this by looking at the average scores of entities where the ultimate parent accounts for varying proportions of the group's results. We found average scores were broadly consistent whether the ultimate parent was a small, average, or very large contributor to the group results.

2.9.4 We received a small number of responses challenging the use, operation or exclusion of particular variables for individual employers or groups of employers. In a number of cases these were issues we had previously looked at.

2.9.5 In particular, some questioned the omission of gearing as a variable in its own right within the model. Experian's approach to model building is to seek to identify predictive variables and then to consider whether adding a variable improves predictiveness. This will mean that where a variable is predictive, but is less predictive than another variable that tests a similar aspect of the accounts, it is likely that only the more predictive variable will be included.

2.9.6 In the case of gearing, there is no dispute that it is a predictive measure. However the impact of borrowing can also be measured by testing the age of the most recent secured charge. The evidence from employer insolvencies shows mortgage age to be more predictive, and so consistent with the prioritisation of predictiveness as the primary success criterion for the model, mortgage age was selected. For scorecards that include the mortgage age variable, adding gearing as well would not have offered a significant improvement in predictiveness.

2.9.7 Table 1 shows the relative predictive power of gearing[1] compared to that of the age of the most recent mortgage. As the chart shows the age of the most recent mortgage was the most predictive and so was included, but gearing was not.

2.9.8 We are not therefore proposing to include gearing as a variable for any scorecards. However, as part of the work we do for the third triennium we will review both the suitability and calibration of the factors used to assess insolvency risk.

[1] Equity Gearing = Shareholders Funds Divided by Total Assets, Debt Gearing = 100 * (Long Term Group Loans +Long Term Director Loans +Long Term Hire Purchase +Long Term Leasing +Other Long Term Loans) /(Total Shareholders' Funds –Intangible Fixed Assets)

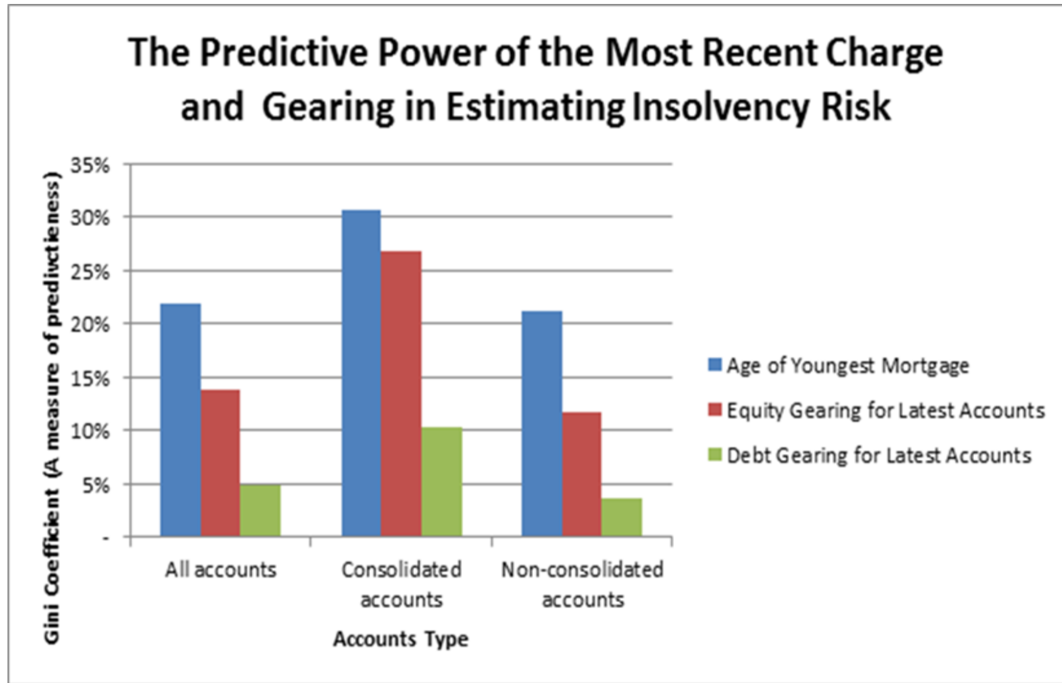

Table 1: Predictive Power of Most Recent Mortgage Charge and Gearing

2.9.9 More generally the variables used within the model have been selected based on their correlation with the historic insolvency experience of the sponsors of defined benefit pension schemes. Because of the interlocked nature of the variables, forcing a variable to be included would require the whole scorecard to be rebuilt. This would entail significant disruption and see some employers' scores worsen as well as others improve, without evidence to support the change, or an opportunity to engage with stakeholders.

2.9.10 Within the work for the third triennium we will review whether we are using the right variables – which may include considering alternatives to the 'most' predictive model if that offers sufficient advantages when considered in the light of other significant criteria. This would also be the appropriate point to reconsider the case for any sector-specific issues (for example, whether there is a case for taking a sector-specific approach in relation to regulated entities, or mutuals).

2.10 Not For Profit Scorecard definition

2.10.1 We did not propose, in our 2016/17 Levy Consultation Document, making any change to our levy rules in relation to not-for-profit ("NFP") entities. As we are entering the middle year of the second triennium, and mindful of the changes we introduced to this area as part of our move to Experian in 2015/16, our intention has been to keep the rules as stable as possible for the coming year.

2.10.2 We did not receive many responses which raised NFP issues as part of this year's consultation. A few responses suggested that the current drafting of Rule E3.1(8) should be widened to allow for private members' clubs to be treated as NFP entities for scoring purposes. We have not

seen persuasive evidence that the risk private members clubs pose is necessarily different to entities established on a profit-seeking basis.

2.10.3 We do not propose making a change to our rules for 2016/17 to accommodate these entities within our NFP regime at this time.

2.11 Customer service and the PPF/Experian Portal

2.11.1 Alongside the introduction of the PPF Specific model and the move to Experian we introduced the PPF/Experian Portal (the Portal) as part of the drive to improve our customer service. The Portal provides schemes and employers with the opportunity to monitor scores on an ongoing basis and to see the data that has been used in the calculation of their score. There is also the option to download a tool that can show the impact of changes to the data.

2.11.2 We have seen a very high take up of the monitoring opportunities offered by the Portal with around 92 per cent of employer scores having been monitored through it or the other services Experian offer and the stakeholder response has been overwhelmingly positive. One stakeholder noted that as a result of the Portal and the fully published scoring methodology "very few employers should have found their 2015/16 invoice surprising".

2.11.3 This enhanced ability for schemes and employers to understand scores (and address any issues before they are finalised) has directly contributed to a significant reduction in the number of insolvency score appeals by comparison with previous years. With invoicing almost complete, we have seen around 40 per cent fewer appeals than in 2014/15 (this, after excluding a large group of 2014/15 appeals connected to a single error in calculation). In the context of a substantial change in methodology – which inevitably means some schemes see a large change in their levy – the limited number of appeals is striking.

2.11.4 The PPF and Experian customer service teams have also received positive feedback with callers noting

- the fast and efficient service;
- that the advisor they dealt with was very helpful, friendly and gave them the information they needed; and
- that it was a very prompt, informative service.

2.11.5 These anecdotal comments are consistent with the findings of our customer satisfaction surveys, showing a good overall level of satisfaction.

2.11.6 However, we know there remain areas we can improve on, including ensuring that we offer a fully joined up service and that queries are always dealt with in a timely fashion. In the run up to the next invoicing cycle we will work with stakeholders to identify changes that will help us deliver an excellent level of service.

2.11.7 We are also refreshing Portal scores for the period from April 2015 onward, so that they are on the basis of the finalised 2016/17 Levy Rules.

This will particularly affect those entities that certified mortgage exclusions in 2015/16, and now see those certificates carried forward.

3. Issues not related to the measurement of insolvency risk

3.1 Asset Backed Contributions (ABCs)

3.1.1 Respondents broadly welcomed our proposed light touch approach for recertifying ABCs. Several commented that this approach was a welcome move, which in particular would ease the administrative burden on schemes through the ability to use an updated valuation rather than commissioning a fresh valuation.

3.1.2 A number of respondents suggested that the Board's duty of care requirement should be supplemented by a legal agreement between the Board and the relevant adviser directly. However we considered that introducing the requirement to enter into such an agreement would create a further, and unnecessary, step in the certification process for schemes.

3.1.3 We consider that our current requirement to use standard form duty of care wording remains the most straightforward means of ensuring that all ABCs are assessed on a uniform basis, while also providing a readily understandable format for schemes and advisers. We were not therefore persuaded that a change to this approach would be appropriate.

3.1.4 A number of responses, while welcoming the proposed light touch approach to recertification, queried the situations in which this would be appropriate. In doing so, we received a number of helpful suggestions as to when a light touch approach could be used. We have updated the 2016/17 ABC Guidance to include material on example situations where we consider a light touch approach may be suitable. However it must ultimately be for the professional valuer to decide whether a new or an updated valuation is required, based on their view of the ABC asset's value since the last valuation.

3.1.5 We have also updated the ABC Guidance to make clear that, on a recertification, it is acceptable for trustees to use a previously obtained piece of legal advice, provided that the legal position underlying the ABC arrangement has not changed since the date the arrangement was previously certified.

3.1.6 A number of respondents suggested that the professional valuer should be able to value the ABC asset as being "no less than £X…" rather than certifying a specific figure. We consider that this approach is reasonable, and have updated the ABC Guidance to confirm that the valuer may make a prudent estimation of value, provided that the valuation clearly sets out the basis for this approach and otherwise complies with our requirements.

3.2 Contingent Assets

3.2.1 We received comparatively few responses to our 2016/17 levy consultation in relation to contingent assets. This is perhaps unsurprising,

as we signposted our intention to keep our rules around contingent assets consistent with those of the 2015/16 levy year.

3.2.2 One respondent highlighted the change which we made to our standard form Type C(ii) contingent asset agreement in 2015/16 in order to allow for insurers to be the provider under these arrangements. They suggested that we should consider making an equivalent change for Type C(i) contingent assets.

3.2.3 We have considered the points raised, and concluded that our standard form Type C(i) agreement should be revised to allow an insurer as the provider. We have updated the existing references to "Issuing Bank" in the standard form agreement with "Issuer" to reflect this, and have also made the necessary changes to the 2016/17 Contingent Asset Appendix.

3.2.4 We highlighted in our 2016/17 levy consultation document that we would be running a series of interactive seminars during September and October 2015 in relation to assessing the financial strength of Type A contingent asset guarantors.

3.2.5 Consultation responses were very positive about both the seminars and the additional information provided by us to schemes in January 2015, which has now been incorporated in part into the 2016/17 Contingent Asset Guidance.

3.2.6 We were also encouraged both by the level of attendance and engagement displayed by attendees, whom we thank for their participation, and are hopeful that trustee awareness of what is expected for certification will have been further enhanced through the sessions. We will consider whether similar sessions may be appropriate in future levy years.

3.2.7 Our review of contingent assets for 2015/16 has now completed, and has resulted in a lower level of rejections than for 2014/15, but one that remains above the levels we would hope to see. In particular we would emphasise the importance of trustees asking probing questions. The key issues coming out of the reviews were:

- It is essential to consider in detail what the knock-on effect of the employer's insolvency will be on the rest of the group.
- trustees must understand the impact of the employer insolvency and of the guarantor having to pay out on:
  - Inter-company balances
  - Pooled cash funds
  - Group-wide banking arrangements.
- Trustees should look behind intra-group arrangements such as trade terms and the ownership/licencing of intellectual property to consider the impact on the recoverable amount from the guarantee.
- When considering the value of companies that might be sold to satisfy the guarantee liability, care must be taken when selecting valuation multiples to ensure they properly reflect the circumstances the guarantor faces in having to dispose of the entity

in a short period with the possibility of a distressed disposal perception.

3.2.8 The best source of advice on what we are looking for remains our guide to assessing guarantor strength – which will be re-issued shortly with updated references on our website. A number of respondents also raised specific points regarding the levy calculation methodology for guarantors. In the interests of stability, we are going to consider these points as part of our overall review for the next triennium.

3.3 SORP and reporting of annuities

3.3.1 We will be proceeding as set out in the consultation document, i.e. for levy year 2016/17 the s179 'non-accounts' annuity proportion will be set to zero for any schemes with an asset breakdown date on or after 31 December 2015.

3.3.2 Two respondents suggested changes to this approach to address potential differences between the value of annuity policies as they will appear in scheme accounts and the value calculated as a part of the s179 valuation. We consider that the valuation of such assets is primarily a matter for the Trustees and their auditors. We don't propose to make any changes for 2016/17, particularly as the number of affected schemes is expected to be very small, but we may consider again in later levy years.

3.4 Main data deadline on 31 March

3.4.1 We confirm that the deadline will be extended to midnight on 31 March 2016. Please note that Experian telephone support will close at 5.30pm that evening, as normal. Our Levy Customer Support Team will be available to answer queries until midnight.

3.5 Re-invoicing of incorrectly declared Associated Last Man Standing (LMS) schemes for prior years

3.5.1 The consultation document included information about our plans to re-invoice schemes in certain circumstances where they had incorrectly identified themselves as Associated Last Man Standing Schemes (LMS). We appreciate that re-invoicing will be unwelcome, but believe it is necessary, to ensure that schemes have paid the right levy. This will avoid schemes that correctly identified their structure being disadvantaged. We will aim, however, to carry out re-invoicing in a measured and considerate fashion – recognising that schemes will have certified in good faith.

3.5.2 We did not include this as a consultation issue as no change was proposed to the rules, but we wanted to give schemes early warning that we would be writing to them to confirm the position in past years and giving them an opportunity to provide evidence that they met the terms of the certification on Exchange in the relevant levy years.

3.5.3 We did receive a number of questions and comments about how we intend to conduct this exercise.

3.5.4 We have now identified these schemes that may have erroneously described themselves as LMS in previous levy years, and will be contacting them shortly. First we plan to contact the schemes that responded to the Regulator's e-mail of April 2015, advising us that they no longer believed they met the LMS definition for 2015/16. Later in the year we plan to contact the remainder of schemes that, by midnight on 31 March 2016, have not confirmed on Exchange that they have appropriate legal advice that supports their LMS certification.

3.5.5 We will not be including schemes that are in an assessment period or have become ineligible in this exercise. In addition, we will not be re-invoicing where it is not economic to do so.

3.5.6 Our communication on this will be with the schemes affected, recognising that this is an issue that affects a limited number of stakeholders and that individual circumstances will vary. Schemes where we decide not to take action due to the limited sums involved will also be notified.

4. Final Levy Rules 2016/17

4.1 Publication of final Levy Rules

4.1.1 Today we are publishing the final Levy Rules for 2016/17 including all the appendices and guidance.

4.2 Documents being published

4.2.1 Together with the Levy Rules we have published six documents providing 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. These are:

- Guidance on Asset Backed Contributions
- Guidance on Bespoke Investment Risk Calculation
- Guidance on Block Transfers
- Guidance on Contingent Assets
- Guidance on Deficit Reduction Contributions
- Guidance on Officer's certificates certifying secured charges and certain other matters

4.2.2 In addition we are publishing Officer's certificates for certifying secured charges, the ABC certificate and certain other matters alongside this document.

4.2.3 We are not publishing the Levy Practice Guide for 2016/17 at this stage as we have in past years; but we plan to do so in the coming months. Publishing this later will allow us to better reflect our intentions for the 2016/17 year, for example by allowing us to reflect on issues arising from levy reviews over the next few months.

4.2.4 We have removed material from the Levy Practice Guide which informs schemes on actions they should take ahead of deadlines (in particular material on DRCs is now in Guidance on DRCs), so that what remains will be a statement of our approach to exercising the discretions available to us under the Levy Rules. This Guide should help schemes to better understand how the reviews process can be expected to operate, rather than being needed to inform reporting of scheme/employer information ahead of the measurement time.

4.3 Clarifications

4.3.1 We have made a number of minor drafting changes with the intention of clarifying how we expect the rules to operate. These are not intended to substantively alter how we applied the rules from levy year 2015/16.

4.3.2 This includes:

- how we deal with satisfaction of a charge being delayed by conditions outside of the entity's control (Rule E7.5 (1) (b));

- the ONS data source used as a basis of categorising entities as Public Bodies (Rule A1.1 Public Bodies definition)
- how we roll forward property and hedge fund assets in the Transformation Appendix (the asset return roll up factors definitions table).
- clarifying the position where an ABC is entered into after the most recent s179 valuation and is not purchased from scheme assets (Transformation Appendix).

5. Next steps for schemes and key dates

5.1 Introduction

5.1.1 This chapter outlines next steps and key dates for the calculation of 2016/17 levies. As confirmed in section 3 of this document we are revising the main deadline on 31 March to include all submissions and hard copy documents (to the PPF) up to midnight, rather than 5.00pm as has been the case in past years. Electronic submissions to Experian can also be made up to midnight.

5.2 New certificates and re-certifications

5.2.1 Schemes will be able to submit new certificates for 2016/17 for the exclusion of mortgages (from the mortgage age variable), for ABCs, and for contingent assets. Mortgage certificates successfully submitted for 2015/16 in respect of rent deposit deeds, pension scheme mortgages, re-financing and public credit ratings do not need to be re-submitted. New certificates will be required for schemes claiming mortgage exclusions on the basis of immateriality or where a credit rating has not been able to be carried forward.

5.2.2 All mortgage exclusion certificates, notifications and evidence relating to insolvency risk scoring (for example employee numbers or evidence – including legal advice that the entity is prohibited from having a mortgage) should be submitted to Experian. ABC and contingent assets certificates/re-certification should be submitted to the PPF.

5.3 Confirmation of scheme structure (LMS)

5.3.1 As usual scheme returns on Exchange will include confirmation of the scheme's structure. This year, if a scheme selects the LMS option they will be prompted to answer a further question about whether they have received external legal advice confirming their scheme's status. As explained in section 3, those schemes that respond that they have legal advice that they are LMS will not be written to as part of the re-invoicing exercise for schemes previously identifying themselves as LMS.

5.4 Key dates

5.4.1 For 2016/17 we will use information from the annual scheme return that is submitted via the Pension Regulator's Exchange system to calculate levies.

5.4.2 The Regulator has recently written to schemes explaining that the next update of Exchange is due to be in late January. This will mean that some of the changes we cover in this Policy Statement will not yet be reflected. In particular the new button allowing schemes identifying themselves as LMS to confirm legal advice on scheme status has been received is not

yet active. In addition the helptext on asset breakdowns and the measurement time on contingent asset certificates will not be up to date.

5.4.3 We will also use other data submitted to either the PPF or Experian as follows.

Item	Key dates
Experian Score Measurement Date	Last business day of each month from April 2015 to March 2016
Deadline for filing of or submission of data **to Experian** to ensure impact on Monthly Experian Scores	One calendar month prior to the Score Measurement Date
Submit scheme returns **on Exchange**	By midnight, 31 March 2016
Reference period over which funding is smoothed	5-year period to 31 March 2016
Contingent Asset Certificates to be submitted **on Exchange** and with hard copy documents as necessary **to PPF**	By midnight, 31 March 2016
ABC Certificate to be sent **to PPF**	By midnight, 31 March 2016
Mortgage Exclusion (‘Officers’) Certificates and supporting evidence to be sent **to Experian**	By midnight, 31 March 2016
Deficit-Reduction Contributions Certificates to be submitted **on Exchange**	By 5pm, 29[2] April 2016
Certification of full block transfers to be completed **on Exchange** or sent to PPF (in limited circumstances)	By 5pm, 30 June 2016
Invoicing starts	Autumn 2016

5.4.4 The ABC certificate can be found on the PPF website and the Mortgage Exclusion (Officer’s) Certificates are available on the PPF/Experian portal.

[2] The consultation document incorrectly referred to 5pm on 30 April 2016, which is a Saturday