Consultation document

Changes to levy methodology for the 2021/22 levy year

Foreword

This consultation sets out our proposals for the calculation of 2021/22 levies. In developing these proposals, the impacts of COVID-19 have been foremost in our minds. It is clear that many scheme employers will have been significantly affected by the pandemic, with scheme funding also being impacted. From a PPF perspective, it means the risks we face have increased with the possibility of significantly higher claims.

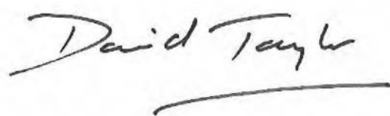
In this environment, setting an appropriate level for the levy is particularly challenging. The PPF's foremost responsibility is to ensure we can pay all our current and future members the compensation they are entitled to. At the same time, we are acutely aware of the cost of the levy to schemes and employers.

We are helped by having entered the pandemic in a robust financial position and with extensive hedging of our risks. This means, despite increases in risk, we are able to avoid the need for substantive short-term changes to our strategy. We are, in particular, able to leave the parameters which control how much levy we collect unchanged. This means once other changes are accounted for, notably an update in the way we calculate underfunding, we expect the 2021/22 levy to collect £520m. This is a £100m reduction on the equivalent figure for 2020/21.

We are also proposing only limited changes to our methodology for calculating individual scheme levies. In March, we published our Policy Statement confirming the basis of the insolvency risk model that will be used by Dun & Bradstreet (D&B). D&B have been scoring scheme employers since April this year and we are pleased that the model continues to perform well. We are not proposing any changes to the model but are publishing alongside this document the detailed rules giving effect to the move to D&B.

We have, however, carefully reviewed our approach to calculating levies for small schemes. Small schemes pay some of the highest levies as a proportion of liabilities and are most prone to significant fluctuations in annual bills. We also know they face barriers – including the costs of professional advice - in ensuring we have full information on the risk they present. We are therefore proposing an adjustment that would see the risk-based levy halved for the smallest schemes in our universe. We have also reviewed the level of the risk-based levy cap which applies to all schemes. The cap is currently set at 0.5% of scheme liabilities. We are proposing reducing this to 0.25% of liabilities.

Whilst these changes are modest in terms of the overall impact on the levy we collect, we believe they will provide material assistance to the schemes and employers with the most significant levies. I am looking forward to hearing stakeholder views on our proposals. We will publish our conclusions in the New Year.



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Executive Director and General Counsel

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1. Executive Summary

1.1. Introduction

1.1.1. This consultation document sets out our plans for the Levy Rules for 2021/22, and invites comments on them. The consultation will run from 29 September to 24 November. We expect to publish a response early in 2021.

1.1.2. Our document falls into two parts – part one focuses on areas which are influenced strongly by COVID-19 and how we plan to address those, and then part two picks up a range of other developments.

Our response to COVID-19

1.2. The impacts of COVID-19

1.2.1. It is clear that COVID-19 and the associated lockdown has had a very significant impact on many employers and schemes. Although current insolvency rates remain low, our view is that this reflects the impact of Government support schemes. As these come to an end we expect an increase in the level of insolvencies and a significant increase in claims on the PPF. However, there is of course considerable uncertainty about these ongoing economic impacts.

1.2.2. For 2021/22, however, we expect COVID-19 will only have a limited impact on levy bills. This is because our insolvency risk model which we use to score the majority of employers uses accounts information filed with Companies House. Only when accounts are filed covering the period of COVID-19 will they feed through into insolvency risk scores. For the majority of our employers this won't happen in time to impact levy scores used in the 2021/22 levies, the main effect will be seen in 2022/23 invoices. At that point, however, the effects could be substantial – with many employers seeing a worsening in their levy score. All else being equal this would lead to a rise in levy bills.

1.2.3. We are also focusing on how the pandemic may affect our insolvency risk model – theoretically, because COVID-19 has impacted a wide range of employers at the same time, it could make it more difficult to discriminate effectively between employers experiencing a limited, short term impact and those at genuine risk of insolvency. Findings for the first three months of lockdown (April-June 2020) suggest that the model is continuing to be predictive – though the limited number of insolvencies in the period (potentially due to the current range of Government support) means we must be cautious in interpreting the data. This will be an area we will be closely monitoring as new data becomes available ahead of consulting on our rules for 2022/23.

1.3. The scope of this consultation

1.3.1. The challenges presented by COVID-19 to employers, schemes and ourselves mean it would be wrong to treat this consultation as 'business as usual'. At this point we would

typically be looking to conduct a full review of our levy methodology and propose rules designed to remain unchanged for the next three-year period.

1.3.2. However, we think it is important to adopt a more flexible stance and be prepared to adjust our rules on an annual basis. The key reasons for this are:

- Most substantially, we think this offers us the best opportunity to support levy payers flexibly as the economic impacts of the COVID-19 pandemic unfold – as the focus in 2022/23 may quite appropriately be somewhat different to that in 2021/22.
- It will allow us to make an active choice on the level at which the levy is set in 2022/23 – when we will have more clarity on what the impact on our funding position has been – rather than automatically reflecting movements in scheme risk.
- The revision of the Pensions Regulator's scheme funding regime is expected to lead to changes to the asset information that schemes provide from 2022/23 on – so it would be better to delay our review of the existing asset class stresses.
- As set out in our Strategic Plan 2020, our new funding strategy will give a better picture of our long-term requirements – and the role of the levy - in time for setting the 2023/24 levy.

1.3.3. Our focus in this consultation is, therefore on setting an approach we think is most appropriate for 2021/22. We would envisage a return to setting the rules for a multi-year period – of three years or potentially longer – from 2023/24.

1.3.4. Given the immediate impacts COVID-19 is having on employers and schemes and to the risks we face, we have not sought to conduct a full review of our rules (which we believe to be working well). Instead our focus is on striking the right balance between the amounts we need to collect and recognising the costs of the levy to employers and schemes at a time when cash flows could be significantly constrained. These considerations are reflected in our decisions on the amount of levy we will seek to collect in 2021/22 (our levy estimate). However, we have also looked at what action we can reasonably take to support those (predominantly small) schemes facing the highest levies as a proportion of their liabilities. Our core policy proposals are to introduce a small scheme adjustment and to change the level of the cap on the risk-based levy.

1.4. 2021/22 levy estimate

1.4.1. If we made no changes to our Levy Rules for 2021/22 we estimate that we would collect £570m (a reduction on the levy estimate for 2020/21 of £620 million). This reflects that deterioration in insolvency risk scores and scheme underfunding is more than offset by the impact of updating the basis we use for our s179 valuations (ensuring we are in line with the latest insurance pricing). The policy changes set out below would reduce collection by a further £50 million, to £520 million.

1.4.2. As noted above, COVID-19 has changed the risks facing the PPF and, whilst there remains considerable uncertainty around the full extent of the impacts, there appears little doubt

that we will experience an increase in claims following employer insolvency. There is therefore a case for us to increase the amount we seek to collect in 2021/22.

1.4.3. However, we entered the pandemic in a strong financial position – both in terms of our balance sheet and the protection afforded by our hedging of risk - and this is helpful in avoiding the need for significant short-term changes in our levy strategy. This is particularly important as the effects of the pandemic are still emerging. We have therefore concluded that there is not a need to increase our levy collection by altering the levy parameters, for 2021/22, though we will monitor the position annually.

1.4.4. We are therefore setting our levy estimate as £520m for 2021/22. This is £100m lower than the equivalent figure for 2020/21.

1.4.5. As our impact analysis shows, we expect this to mean that the great majority of schemes (around 90 per cent of those paying a risk-based levy) will see a reduction in levy relative to their 2020/21 invoice.

1.5. Small scheme adjustment

1.5.1. Our analysis has shown that small schemes are far more likely to see the highest levies as a proportion of scheme liabilities. The Levy as a percentage of liabilities is three times higher for the smallest schemes (under £20m liabilities) than larger schemes (over £100m liabilities) and two times higher for medium sized schemes (£20-£100m liabilities) than larger schemes. This is justified if their risks are that much higher. However, we have considered the particular issues that small schemes face, and consider there are a number of ways it is likely that their risk may be overstated in our calculations (not least since they may have more restricted access to advice). We propose for schemes with less than £20 million of liabilities to apply a factor of 0.5 to their (uncapped) calculation. To avoid a cliff edge at £20 million of liabilities we also propose to taper away the reduction factor, so that a full levy is paid at £50 million liabilities. Although there are a significant number of small schemes, even in aggregate, the levy that they pay is limited – and so we do not intend to seek to recover the limited cost of this change through a higher levy on other schemes.

1.6. Risk-based levy cap

1.6.1. We have also reviewed the level of the cap on the risk-based levy, which is set to protect those with the highest bills relative to their liabilities. In recent years the number of schemes capped has reduced significantly – and the levies charged have risen (as liabilities have increased in the light of low gilt yields). As a result, we have concluded that we should reduce the cap to 0.25% of liabilities. This will protect a lower proportion of schemes – at 4 per cent of schemes - than we have done at some points in the past (where our aim has been to protect 5 per cent of schemes). This is because the small scheme adjustment is already reducing the number of smaller schemes with high levies as a proportion of liabilities. Setting the cap at 0.25% will mean that the schemes with the highest levies relative to liabilities pay around 100 times the levy, per pound of underfunding, compared with the lowest risks.

Other developments

1.7. Draft rules

1.7.1. Alongside this consultation document we are publishing draft versions of the Levy Rules where substantive changes have been made that will apply for 2021/22. Changes to documents where non-substantive amendments have been made primarily reflect year changes from 2020/21 to 2021/22 or the move from A8 to A9 assumptions. The amendments made to documents have also been summarised in section 12 of this document. We would welcome stakeholder comments on our published drafts and summarised changes.

1.7.2. We are also seeking views on whether any amendments to our contingent asset standard forms are needed, in general and in light of the Corporate Insolvency and Governance Act 2020. We do not see a strong case for changes at this point but are proposing a minor adjustment to correct an anomaly in the list of Nominated Jurisdictions for contingent assets following a proposal put forward by interested stakeholders.

1.8. Future levy years

1.8.1. We may make changes to the underfunding element of the calculation in 2022/23, to reflect conclusions of work with TPR on possible changes to asset classes and stresses. To ensure that schemes aren't asked for two sets of information we would expect to revise our approach at the same time as TPR.

1.8.2. We will also be monitoring the impact of the economic shock on insolvencies and the performance of our insolvency risk model over the next year, and will act in 2022/23 if we consider it necessary to do so, for example, to address performance issues. We may also bring forward changes in later years to different parts of the calculation if we consider that necessary in the light of the evidence available.

1.8.3. The worsening in insolvency scores that we predict means that, other things equal, the total levy estimate might be expected to rise in 2022/23. We will take a view next year on whether this would lead to an overall level of collection that we consider appropriate in the light of our funding position and probability of success at that time or alternately to lead to a collection that is either too high or too low. Stakeholders should not assume that, because the levy has fallen in 2021/22, we will necessarily restrain potential increases in 2022/23 (unless these exceed the legislative limit of 25 per cent increase). Rather, this will depend significantly on our claims experience over the next year, and the outlook for our funding position.

1.9. Responding to this consultation

1.9.1. We have made available two options to respond to this consultation via our website:

- The 'quick' submission option provides a summary of key proposals and gives the opportunity for respondents to give their views. It is designed to only take 10 to 15 minutes to complete.

- The ‘full’ version sets out all the questions we are asking in this consultation, allowing complete responses, along with free format text fields for additional views to be submitted. This can either be completed online, or respondents can download a template, complete it offline, and then upload it once complete (an e-mail summarising how to upload the completed submission will be sent to you when the template is downloaded). This new functionality reflects feedback received during our consultation in December. We hope it will be particularly helpful for stakeholders who collaborate with others on their response.

Our response to COVID-19

2. The impacts of COVID-19

2.1. Introduction

2.1.1. The COVID-19 pandemic, and measures to control it, are having a significant impact on many schemes and their sponsoring employers. From a PPF perspective this means the risks we face have increased – in particular the risk of a significant rise in the level of claims on us.

2.1.2. However, it is likely that the impact of these events on 2021/22 levy bills will be limited for most schemes. And indeed, COVID-19 will have a negligible impact on the amount we collect overall. This reflects that our methodology takes a five-year view of values for assets and liabilities – and that our measurement of insolvency risk will take time to reflect COVID-19 impacts.

2.1.3. By comparison, we may expect to see a greater reflection of impacts on levy bills in later years, though the extent of this is extremely uncertain.

2.1.4. We are also mindful that our insolvency risk model uses predictors of insolvency drawn from historic experience. COVID-19 represents a break from that experience and could mean that the performance of our model deteriorates. So far, the model continues to perform well but this will be an area we will continue to monitor closely.

2.2. The impact of COVID-19 on schemes and their sponsoring employers

2.2.1. We have continued to engage informally with a wide variety of stakeholders to assess the impact of COVID-19 on the schemes we protect. As might be expected, the impact varies significantly by sector. Some of the levy payers we have talked to have been little affected, or even seen a rise in sales, but many businesses will have seen a decline in turnover. In some cases, we know of businesses seeing a 90% or more decline in sales during the height of lockdown, though this has lessened since.

2.2.2. In this context, we are highly conscious that the levy is a cost for schemes and employers. Although the levy is, legally, a cost of the scheme, in many cases, arrangements between trustees and sponsors mean costs such as the levy must be met directly by the employer, or have to be reimbursed immediately.

2.3. Changes in the risks we face

2.3.1. The risk that we are facing is rising. Analysis that we have done suggests that insolvencies in 2020/21 may be of the order of twice their level in 2019 – though there is a high degree of uncertainty around the figures. Those insolvencies may also be more likely to affect

substantial businesses with schemes with substantial deficits than in a typical year. This could lead to claims significantly larger than we have previously seen.

2.3.2. The UK experienced a very significant decline in economic activity during lock down (ie, April 2020 – June 2020) and historically insolvencies show an upward trend when activity falls. Representing a break from historical experience the UK has witnessed a decline in the number of corporate insolvencies during lock down. The PPF in turn identified 13 qualifying insolvencies scored on of the PPF scorecards (ie, 52 on an annualised basis). This is also relatively low given the recessionary environment in the 2nd quarter of 2020 and reflective of the support mechanisms introduced by the UK. We believe that the (temporary) break with the historic relationship between recessions and insolvency count can be explained by the economic support package introduced. As these elements of this support package come to an end we expect the level of insolvencies to increase and with it to see a substantial rise in claims. This is factored into our analysis of the PPF funding position.

2.4. How will levies be affected by COVID-19

2.4.1. Despite the immediate impacts on schemes and employers, we do not expect COVID-19 to have a significant impact on 2021/22 levies.

2.4.2. Firstly, impacts on our assessment of underfunding will be limited. Valuations covering the period affected by COVID-19 will not be submitted for some time – and in any case our assessment adjusts valuations to reflect a five-year view of values for assets and liabilities. The main factors influencing our assessment of underfunding are:

- Our routine updating of our five-year view of asset and liability values to incorporate the current market conditions (which will replace values for 2016/17 with values for 2020/21); and

- That we plan to take account of improvements in terms in the buyout market – which show that it is cheaper to secure liabilities than previously allowed for through moving to a new valuation basis (A9) in the levy calculation.

2.4.3. As we set out later in this paper, in aggregate these very largely offset each other – and are expected if anything to show schemes as better funded than in 2020/21. For many schemes, the same is likely to be true, though the impacts will vary depending upon individual scheme circumstances. In aggregate we believe this points to levies charged being lower in 2021/22 than for 2020/21.

2.4.4. For our assessment of insolvency risk, the minority of companies that are assessed using credit ratings will already have seen the rating agency assess the expected impact of economic conditions on the score – but impacts have been limited and given the forward-looking nature of credit ratings there is no specific reason to expect further changes.

2.4.5. The majority of employers have insolvency risk measured using the PPF-specific model, which is now operated for us by D&B. This model uses company account information to assess risk – and so is essentially backward looking. Insolvency risk scores for 2021/22 will be calculated using the filed accounts available at the end of the months April 2020 to March 2021 – so the vast majority of employers will have their scores based on accounts that pre-date COVID-19.

2.4.6. Employers that do have accounts covering the period of COVID-19, will be scored using those for a part-year only. By contrast, we may expect more significant impacts on scores in 2022/23. Assuming the filing dates in 2021/22 and 2022/23 are the same as for 2020/21, we could expect results to feed in to insolvency risk scores as follows:

- A company with an accounts date in March 2020 (around 1 in 5 of employers) might typically start to see a monthly scoring impact between September 2020 and January 2021, once those accounts have been filed. We expect some of these accounts may show some impact due to COVID-19, and for any impact to be incorporated into a third of the 2021/22 levy scoring period on average, with a larger period of the 2022/23 levy year impacted.

- For companies with accounting dates of April 2020 to June 2020 (1 in 20 of employers), we expect COVID-19 to have a more significant impact on their accounts, and for this to affect between 1 and 3 scoring months of the 2021/22 levy year. Again, a larger period (9 to 12 months) of the 2022/23 levy year is expected to be impacted.

- Accounts, with an effective date of December 2020 make up half the population of employers in our universe. These accounts will typically start to be used to calculate levy scores between May and September 2021. Therefore, we would expect no impact to the 2021/22 levy, but a significant impact to the 2022/23 levy year.

2.4.7. There is considerable uncertainty about the extent to which scores will change once accounts data starts to feed through. It is, of course, likely to vary from company to company. However, overall, given the impact that COVID-19 has had on business revenues we anticipate the effects could be very significant. We carried out an exercise with D&B to model the changes to scores after a stylised stress was applied. (see box A below)

2.4.8. Based on our stress test, just under half of employers saw a change in levy band. Those who are projected to see a worsening in levy band - on average - experience a change of 2.2 levy bands as a result of the stress with roughly equal proportions for 1, 2 and 3+ band increases. The average level of change was generally speaking higher for those starting with a more favourable levy band, where a small change in insolvency probability can be sufficient to push a sponsor out of its current levy band. That said, levy rates are weighted

more heavily at the higher levy bands and therefore a change from band 2 to band 3 increases the levy significantly less than a change from band 9 to 10.

2.4.9. In aggregate – despite the uncertainties – our understanding of filing patterns and likely impact on financial accounts clearly suggests there is likely to be a significant deterioration of scores primarily for 2022/23 invoices. This could lead to a significant rise in levies, potentially exceeding the 25% year on year limit on the levy estimate. Rather than aiming to set rules that can cover this period now, we consider it more appropriate to adopt a more flexible, year by year approach. This will allow us to assess:

- the emerging pattern of movements in score in the light of other data such as insolvencies;
- the balance between a rise in levies implied by score changes and the amount the PPF needs to collect in aggregate, reflecting for example claims and our funding position.

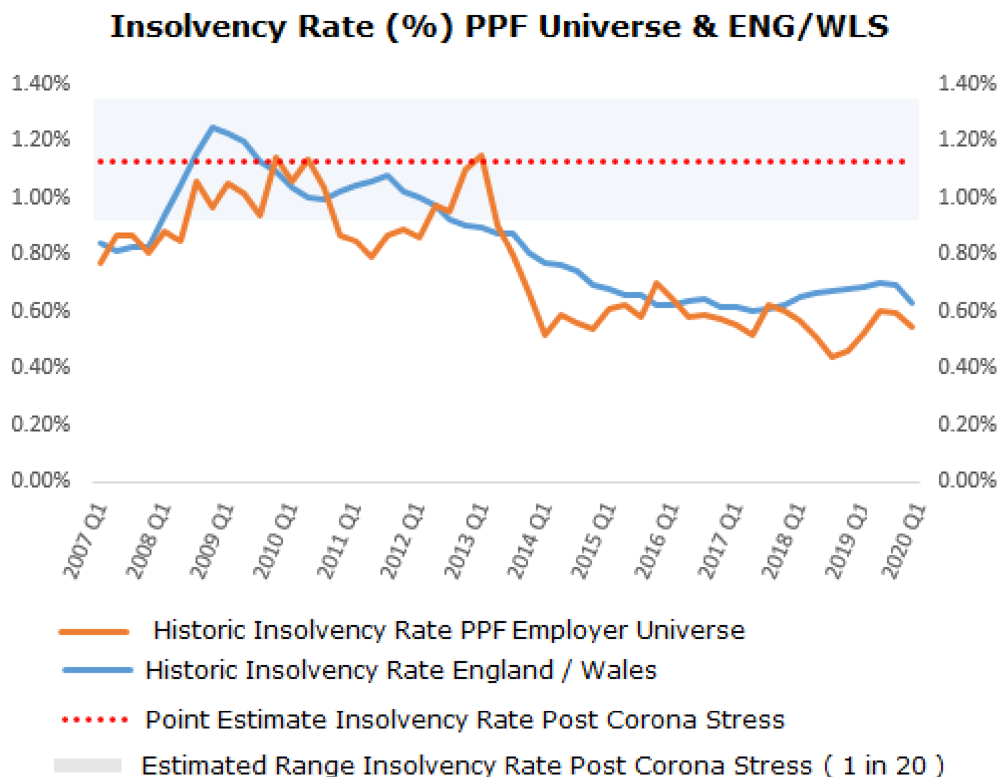
This could lead to either changes in calculation methodology or parameters such as the Levy Scaling Factor ('LSF').

Box A: Stress test on impact of COVID-19 on scores

The stress we specified was applied to all companies and reflected:

- A decrease in revenues consistent with that seen for the S&P 500;
- A move from profit to loss;
- A decrease in cash; and
- An increase in liabilities as a result of new borrowings

The resulting expected insolvency rate for the PPF Universe as a whole was 1.13%[1], compared against 0.55% over the period April 2019 – March 2020. Such an insolvency rate would be consistent with that observed following the 2009 financial crisis, and with rating agency expectations at the time of modelling for the default rate for their non-investment grade universe to peak in the first quarter of 2021 at the levels seen in 2009. Applying a wider (1-in-20 year) confidence interval around the point estimate gives in adverse circumstances an insolvency rate of 1.35% (and in more favourable circumstances 0.92%). At the close of August 2020, the annualized insolvency rate had climbed from 0.55% over the period April 2019 – March 2020 to 0.78% (not seasonally adjusted).



In the analysis we were not able to model different sectors differently, though we recognise that impacts differ by sector. The results appear reasonable in aggregate given the resulting insolvency rate, but until actual insolvencies are observed it's unclear whether the stress applied captures the risk fully, or indeed overstates it.

3. The scope of our review

3.1. Focusing on 2021/22

3.1.1. In 2012/13, following consultation with stakeholders, the PPF launched the New Levy Framework. An important feature of the new approach was a commitment to minimise changes to our Levy Rules over a three-year period. This was part of a drive to provide stability for levy payers, ensuring that changes in levy bills over the 3 years would only reflect changes in a scheme's own risk (ie, changes in the scheme's underfunding position or in the insolvency risk of its sponsoring employer) and not changes in our calculation methodology or deliberate action by the PPF to increase the amount of levy collected.

3.1.2. Stakeholders have confirmed that they value this stability in the rules – though we think that equally stakeholders seek stability of outcome.

3.1.3. 2021/22 would be the start of the next three-year period over which we would typically aim to hold rules steady. However, as noted in the previous section COVID-19 has introduced significant uncertainties. In particular, we may see significant changes in our assessment of insolvency risk over the coming years. If we attempted to set rules for a multi-year period now that may lead to automatic and substantial increases in levies charged in subsequent years. Equally, the impact of COVID-19 is still emerging – and it is not until mid to late 2021 that we expect to have sufficient evidence to judge whether any changes to our insolvency risk model are necessary.

3.1.4. Other factors are also of relevance. We expect the Regulator's new scheme funding code to take effect in 2022. To support that change we are working with the Regulator to improve the information they collect on scheme asset allocation that is likely to be available for use in the calculation of levies from 2022/23. We expect there to be at least some changes in asset information gathered, and that this will require us to consider the set of asset stresses used.

3.1.5. We therefore consider that it will be important to maintain flexibility over this period to react to issues as they arise. Our focus therefore has been on identifying the appropriate changes for 2021/22 rather than seeking to set rules now that can last for 3 years. Moving to a yearly basis for setting levy policy for the next few years will allow us to take a judgement each year on whether claims experience and our future probability of success in achieving self-sufficiency require a change in the amount we collect – rather than being tied to an automatic increase in levies charged if our methodology indicates an increase in risk, which may not then crystallise. It will also allow us to change how we calculate levies if that is needed to better support schemes – for example in tackling an increase in volatility of levies.

Consultation Question: Do you have any views on our approach for the Levy Rules for 2021/22 and 2022/23 being set on an individual, year by year, basis?

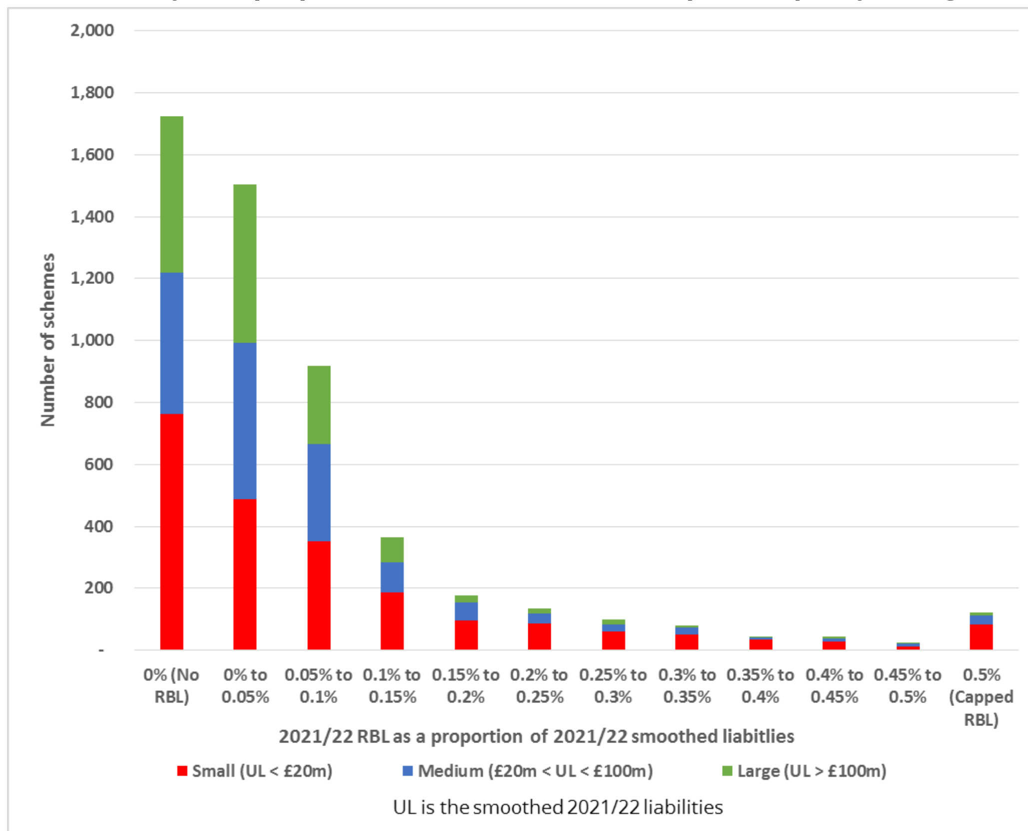
3.2. Scope of our review

3.2.1. As noted above, 2021/22 would mark the start of the next period over which we would normally seek to hold rules steady and so we would typically be conducting a full review of our rules and potentially introducing relatively significant change.

3.2.2. We have, of course, already conducted a full review of our insolvency risk model as part of the move to D&B. The evidence shows the model continues to perform well. We do not, therefore, see the case for changes to the model additional to those implemented following our March Policy Statement.

3.2.3. In terms of the wider aspects of our methodology we have looked to prioritise stability in approach – recognising that our levy payers are likely to be fully focused on dealing with the challenges presented by COVID-19. We have, however, looked carefully at concerns stakeholders (particularly SME employers) have raised with us about the impact of the levy on their costs. This is obviously an area that is likely to be a more significant concern over the next few years given the impact of COVID-19 on employers and the potentially significant changes in individual levies.

3.2.4. Firstly, it is important to stress that for the vast majority of employers the levy is a small cost by relation to the size of the scheme and to other pension costs and wider expenses. The levy is currently capped at 0.5% of scheme liabilities but most schemes pay a levy that is less than 0.1% of liabilities.



3.2.5. We noted, however that amongst those paying higher levies relative to size of scheme a high proportion were small and medium sized schemes[1].

3.2.6. We also looked at levy payments relative to recovery plan payments to provide a sense of how significant the levy is as a pension cost (where suitable data existed[2]). Around three quarters of schemes investigated had levy amounts which were less than 10% of recovery plan payments and only 1% where the levy was equal to recovery plan payments. Again, disproportionately those with high levies relative to recovery plan payments were smaller schemes.

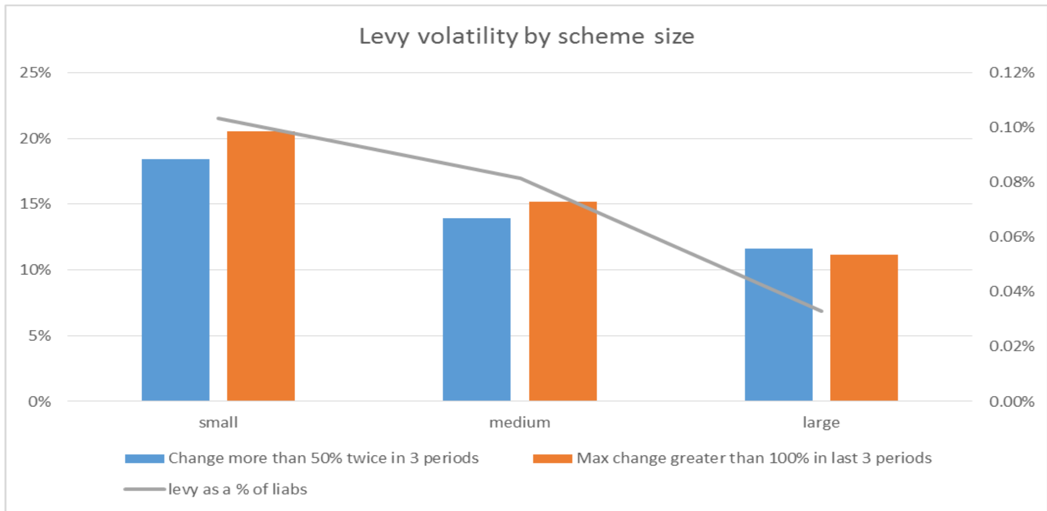
3.2.7. We have also considered the impact of the levy on schemes and employers in positions of distress. Insolvencies and administrator statements since 1 April 2020 have been reviewed as part of our analysis, and in no case was the PPF levy mentioned as a contributor to insolvency, although in a minority of cases, costs of supporting the pension scheme after new valuations were cited. This reflects our previous pre-COVID-19 analysis of administrator statements in 2017/18.

[1] we have defined small schemes as those with smoothed liabilities less than £20 million, medium schemes as those with smoothed liabilities between £20m and £100m, and large schemes as those with smoothed liabilities greater than £100m

[2] We used data on schemes with four years recovery plan information - around half of all schemes

3.2.8. However, we do recognise that – even with the existing cap on the risk-based levy - for a small minority of schemes the levy appears a more substantial impact and that there is a case to consider action in relation to those with the highest bills relative to the size of the scheme – particularly in the light of the pressures on employers over the next year.

3.2.9. Volatility of levy bills due to changes in an employer's insolvency risk scores has also been identified as a particular concern by SME employers and smaller schemes. Even if the levy payment itself is manageable unexpected increases in bills can cause cash flow issues. Our analysis identified that levies for the smallest scheme are generally twice as volatile as those of the largest schemes.



3.2.10. We have therefore focused our review on exploring appropriate changes to our methodology to support schemes facing the biggest levy bills as a proportion of their liabilities. The subsequent sections set out our two core proposals – the introduction of a small scheme adjustment; and changes to the level of the risk-based levy cap. We also propose to carry forward the COVID-19 payment easement introduced for 2020/21 invoicing.

3.3. Insolvency risk model performance

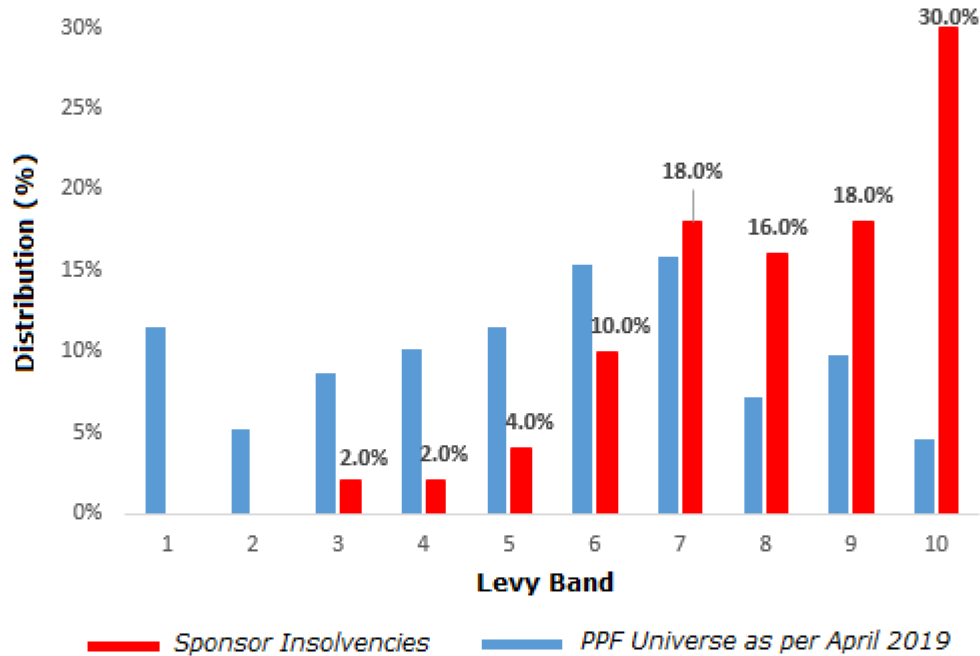
3.3.1. Recognising the unique challenges lock down presented, we are encouraged that the PPF-specific model scorecards continued to perform strongly during lock down (ie, April 2020 – June 2020) in their ability to discriminate between solvent and insolvent employers. The ability to discriminate is measured using the so-called Gini coefficient which during lock down stood at 75.2%, a level considered strong (but the level of confidence around it is obviously wide given the small number of observations available).

3.3.2. However, we are conscious that some unique challenges still lie ahead. As a result of COVID-19 employers might experience a decrease in revenues, a move from profit to loss, and an increase in liabilities as a result of new borrowings. Using financials capturing the impact from COVID-19 could result in credit scores generated becoming

more concentrated in higher risk buckets, making it potentially more difficult to discriminate between solvent and insolvent sponsors. We have therefore recalculated the Gini Coefficient using insolvency scores incorporating the impact of our stress test (see section 2 for details of the stress test). This resulted in a Gini Coefficient of 65.5%, a small decrease from 75.2% (as we expected) but which has no impact on our conclusion that the ability of the model to discriminate during lock down was strong.

3.3.3. To monitor scorecard performance, in addition to looking at performance metrics we also review available information on employers which have entered into insolvency. Better understanding what has contributed to an employer's insolvency helps assess if the scorecards are still using the best information available to the PPF to assign scores. In particular we are interested in any insolvencies which our scorecards at the start of the new levy year suggested were not among the weakest in our universe (ie, those scored as Investment Grade (levy band 1 to 4) and Strong Non-Investment Grade (levy band 5 and 6)). We look for common factors which could help explain the insolvency events having occurred and could be incorporated in our scorecards.

3.3.4. We identified 10 employers which as at April 2019 were judged to be less likely to become insolvent but did so over the following 12-month period. In all but 2 instances, were we able to establish that the company was loss making at the time of insolvency (which is supportive of a profit-based variable being included for credit scoring, which is currently indeed the case for all scorecards using full financials). We also satisfied ourselves that for this group of 10 employers a worsening in levy band could be observed where new financials were filed post April 2019, and such financials captured loss information not available as at April 2019. In other words, the direction of the change movement in levy band was consistent with what one would expect when new information revealing a loss becomes available for credit scoring.



3.3.5. We remain conscious that some unique challenges to the credit scoring model still lie ahead and we have identified a number of distinctive milestones when we want to look at the performance of our scorecards more closely. Our first milestone for 2020 was of course lock down itself and our next milestone for 2020 is the period coming out of lock down (ie, July 2020 – November 2020). Looking at 2021, our first milestone is the period directly following the end of the UK's post-Brexit transition period (ie, January 2021 – March 2021). Monitoring the performance of the model around these three distinctive phases we have identified above will allow us to identify underperformance at an earlier stage and might allow us to attribute underperformance to a specific phase.

Consultation question: Do you agree with our proposal to not make any changes to the PPF-Specific model in light of COVID-19 for 2021/22?

4. Levy Policy for 2021/22

4.1. Introducing a small scheme adjustment

4.1.1. As part of our review of the levy for 2021/22 we identified the particular impact of the levy on smaller schemes as an area to review. Small schemes – c. 2,200 schemes with liabilities below £20 million - see levies that are higher (as a proportion of scheme liabilities) and vary more from year to year than larger schemes. Even collectively, the levies that are charged to small schemes represent only a small proportion of the total levy collection – and historically we have seen less engagement in our consultations from smaller schemes with the result that we have been less aware of the issues they face (though this is changing with initiatives such as our SME Forum).

4.1.2. The inevitable complexity of the levy - if it is to measure risk across widely differing schemes appropriately - can mean that it is hard for a small scheme to ensure that its risk is accurately reflected. Examples can include some / all of:

- Payments made into the scheme, that reduce the deficit and could be certified as deficit-reduction contributions (DRCs) may not be certified because the cost of doing so exceeds the benefit in terms of saving. We've sought to make DRCs easier to certify, but are still aware of schemes that could certify and don't
- Risk reduction measures such as guarantees or asset backed structures may be in place but it isn't cost-effective to ensure they are in a PPF compliant form and certified
- Information submitted about scheme assets may not be sufficiently detailed to ensure low risk assets are recognised and treated appropriately
- Valuations, which for some larger schemes are carried out annually (and typically result in a reduction in deficits) will only be carried out every three years, and may be more likely to need to use assumptions where it is not cost-effective to assess accurately. Given the obligation not to understate liabilities this may mean small scheme valuations have more of a tendency to be overstated
- Less resource to check bills and less likely to receive advice from scheme actuary on measures to reduce levy
- Many employers to such schemes may file smaller company accounts, which contain less information, and may make insolvency scores less accurate

4.1.3. It isn't practical to ascertain the extent to which each of these – or other factors – may lead to differences in levy, but we consider it reasonable to believe that cumulatively there is likely to be an impact.

4.1.4. We therefore propose to introduce an adjustment to the levy calculation to reduce the levy for small schemes based on the smoothed liabilities used in the levy calculation. A factor of 50 percent will apply to those with below £20 million of liabilities. This would be applied before the cap on the RBL. In order to avoid a cliff edge, where schemes would

see a significant rise in levy at the £20m threshold, we propose to taper the reduction away, so as to charge a full levy at £50m liabilities. A reduction of this level will reduce the levy we collect by around £10 million.

4.1.5. In addition to addressing affordability, we are looking to improve the information given to all schemes to help them manage their levy. This will particularly help smaller schemes that may receive more limited advice. But, as well as receiving greater warning we appreciate that the simple fact of a significant increase can be very difficult, particularly for SME employers/schemes to manage.

Consultation question: do you agree with our proposal to introduce a small scheme adjustment?

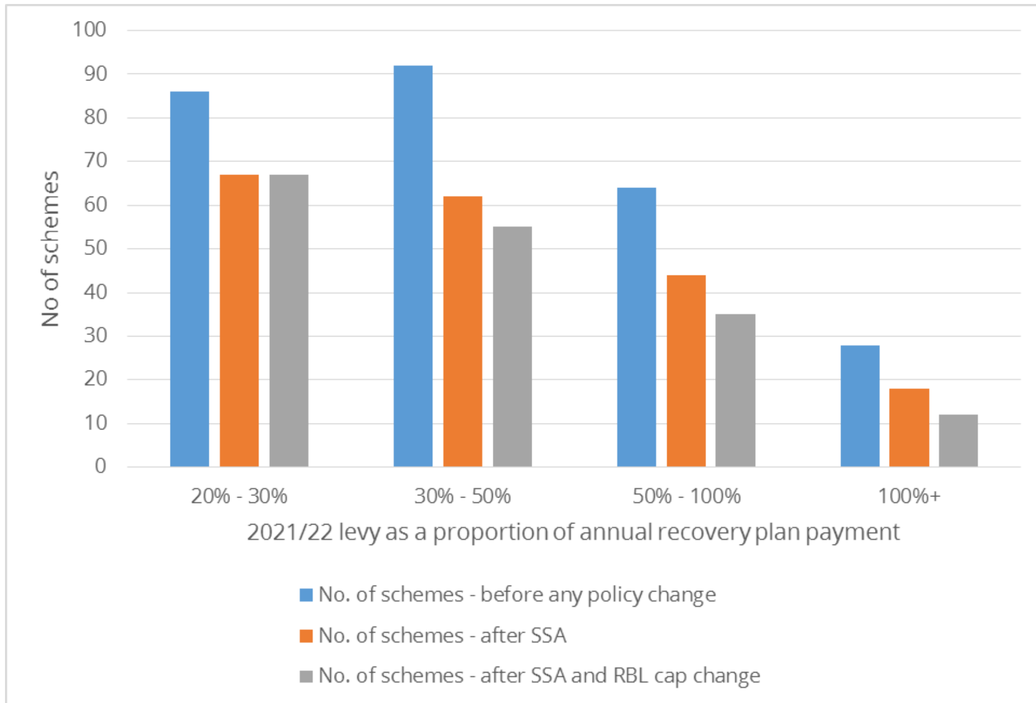
4.2. Reducing the cap

4.2.1. We are also proposing changes that will seek to reduce the impact of increased levy charges for the schemes in most difficulty by reducing the risk-based levy cap - which limits the maximum risk-based levy schemes can be charged.

4.2.2. Currently the cap reduces levies for under 3% of schemes and for 21/22, before accounting for the small scheme adjustment (SSA) described above, this would fall to 2%. Including the impact of the SSA we project this will fall below 1%. Every three years we typically review the level of the cap, so that it captures around 5% of schemes, though the SSA could be considered to reduce the number of schemes that need protecting. So we would ordinarily be considering adjusting the cap downward to 0.35% or 0.3%, all else being equal. Financial pressures on scheme sponsors over the next 12 to 18 months due to COVID-19 makes a case for reducing the cap further, although once the immediate pressures of COVID-19 have receded, we may consider the level of the cap again.

4.2.3. Our proposal is to halve the rate from 0.0050 (0.5%) of unstressed liabilities to 0.0025 (0.25%). We estimate that this will result in an additional 152 schemes seeing their levy capped and will reduce our estimate of the levy we will collect by £40m.

4.2.4. We identified that smaller sized schemes in particular appear to generally be closer to the risk-based levy cap and are more likely to be affected by affordability issues. The combined effect of reducing the cap to 0.25% and the small scheme adjustment would reduce the number of schemes for which the levy is a high proportion of recovery plan payments. (as shown in the below table).



4.2.5. Reducing the cap to 0.25% will support sponsors in either improving their resilience, or in strengthening the funding of schemes (e.g. by returning to making payments after deferral). A cap at 0.25% still leaves the great majority of schemes paying the full levy their risk entails, capping 4% of schemes. It will mean that the highest levies relative to liabilities are around 100 times the level of the lowest, per pound of underfunding risk.

Consultation Question: Do you agree that we should reduce the risk-based levy cap from 0.5% to 0.25% of unstressed liabilities?

4.3. Support with payments

4.3.1. We announced earlier in the summer that we were introducing additional payment flexibility for the levy we are invoicing this autumn (the 2020/21 levy) – to help schemes with sponsors impacted by COVID-19.

4.3.2. Based on stakeholder feedback, and on what we're permitted to do by legislation, we have developed policy which introduces a new payment plan option – available for the invoices we are currently issuing (2020/21). Affected schemes or their sponsoring employers can submit a notification form via our website – within 28 days of receiving their invoice – explaining how they have been negatively affected by COVID-19 and request an extension to payment terms. If approved, we will waive any interest charges that would have normally accrued due to late payment for up to 90 days (as long as payment is made within those 90 days).

4.3.3. Where schemes/employers need longer than 90 days (or there are other reasons why they would face particular difficulties paying on time) applications can be made under the existing payment plan process.

4.3.4. Our policies, FAQs and forms relating to payment plans and our new COVID-19 easement can be found on our website at ppf.co.uk/levy-payers/pay-your-levy/help-paying-your-levy

4.3.5. This flexibility was introduced to address concerns about cash flow availability in the short term – given declines in turnover during the lockdown period. We would expect that such concerns will have receded over the next year, but would be interested in views on the merits of extending the flexibility to cover the 2021/22 levy on which we are consulting now.

Consultation question: Do you think the easement measures for COVID-19 impact should be extended to the 2021/22 levy year?

5. How much levy we will aim to collect

5.1. Introduction

5.1.1. This levy year is the first after the fixed period for Levy Rules ended. If we made no changes to our Levy Rules for 2021/22 we estimate that we would collect £570 million (a reduction on the levy estimate for 2020/21 of £620 million). This reflects that likely deterioration in insolvency risk scores and scheme underfunding is expected to be more than offset by the impact of updating the basis we use for our s179 valuations to ensure we are in line with the recent insurance pricing.

5.1.2. The policy changes set out below would reduce collection by a further £50 million, to £520 million. It should be noted that there is always a significant degree of uncertainty about how close the total levy invoiced will be to our estimate, given the range of assumptions we have to make about information we do not yet have. This is particularly true for 2021/22 given the particular circumstances. Further detail on the process we have followed to make our estimate is included at Annex A.

5.2. Levy Estimate

5.2.1. We have reflected carefully on the level at which we should set our levy target (the levy estimate) for 2021/22.

5.2.2. In setting our levy target, an important consideration is the expected level of future claims and its impact on our funding strategy. This has generally been reasonably steady from year to year. However, this year, the level of expected future claims has increased. The main reason for this increase has been the impact of COVID-19. Although the exact impacts and when they will emerge is unclear, particularly because there is considerable Government support to help employers avoid insolvency, it is clear that there is a significant increase in risk.

5.2.3. Taken in isolation, this might make a case for acting to increase the levy we collect – for example by increasing the Levy Scaling Factor ('LSF'). We are however mindful of the high degree of uncertainty about projections at this stage – and conscious of the pressure that schemes and their sponsors are likely to be under as they seek to recover from the effects of the current economic shock.

5.2.4. We will be publishing our annual report later in the year. We are close to finalising our results and, whilst subject to audit, they show that we're still in strong financial health. Our investment strategy is designed to be low-risk and over the year the value of claims received was low. For these reasons we've been able to maintain a positive funding level.

5.2.5. We have therefore concluded that there is not a need to increase our levy collection by altering the levy parameters, for 2021/22, though we will monitor the position annually.

5.2.6. Considering all of this, we are setting our levy estimate as £520m for 2021/22. This is £100m lower than the equivalent figure for 2020/21.

6. Impact assessment

6.1. Impact summary

6.1.1. We have carried out an impact analysis to show the impact on levy bills for 2021/22 of the changes that we propose to make to levy methodology, and the impact of known changes in the environment (including available market data and information on insolvency scores to July 2020):

- The introduction of a small scheme adjustment (SSA) for which those schemes with liabilities up to £50 million will be eligible, and
- A reduction in the RBL cap from 0.5% to 0.25% of liabilities.
- In addition, we show the impact of moving from the information used for 2020/21 levies to estimated 2021/22 levies.

6.1.2. The overall picture is that 89 per cent of schemes paying a risk-based levy are expected to see a levy that is lower in 2021/22 than 2020/21. The key features seen are:

- The introduction of the SSA is expected to reduce 2021/22 levies for the 65 per cent of small schemes that pay an RBL by 46%, with a lower benefit for medium schemes, leading to a reduction in total levy collection by £10 million.
- The proposed change in the RBL cap from 0.5% to 0.25% is expected to further benefit small to medium sized schemes and benefit a lower number of large schemes, with a reduction in total levy collection of £40 million.
- The introduction of a new valuation basis, reflecting the impact of improvements in pricing of buyout market on our assessment of scheme funding, has led to schemes being assessed as better funded. Schemes that are close to fully funded see the largest relative decrease in levy. (note: those schemes that are further from fully funded may see larger reductions in levy in absolute terms).
- Movements in insolvency scores for individual companies observed to July 2020 lead to an expected increase in levy for a small proportion of schemes from 2020/21 to 2021/22. In practice, actual scores - being collected between April 2020 and March 2021- may alter this picture.

6.2. Background

6.2.1. The starting point for the analysis is the neutral estimate of the 2021/22 levy on current Levy Rules, before any changes to policy, of £570 million. The majority of schemes paying a higher RBL as a proportion of liabilities are small or medium sized schemes.

6.3. Small scheme adjustment

6.3.1. We conducted analysis of the characteristics of schemes by scheme size (based on 2019/20 levy invoices) illustrating the differences in the level of levy bills.

	Small (£0 - £20m)	Medium (£20m-£100m)	Large (£100m+)
No. of schemes	2,437	1,572	1,409
Total 2019/20 Levy	£20m	£60m	£483m
Average Levy	£8k	£38k	£343k
Levy as a proportion of liabilities	0.11%	0.08%	0.04%

6.3.2. The table illustrates that smaller schemes have levies that are on average, a higher proportion of liabilities.

6.3.3. The introduction of the SSA will apply to schemes with smoothed liabilities up to £50 million. Based on our 2021/22 levy calculations, we expect 61 per cent of schemes to have liabilities less than £50 million and be eligible for the small scheme adjustment.

6.3.4. The impact of the SSA will only affect those schemes with a non-zero risk-based levy who are not capped both before and after the adjustment, and we expect it to impact approximately 41 per cent of schemes, with a reduction in total levy collection of £10 million. The impact of the proposed small scheme adjustment on those schemes affected is as follows:

	Total	Small	Medium	Large
Proportion of schemes affected	41%	65%	43%	0%
Reduction in levy across affected schemes)	34%	46%	25%	-

6.3.5. The reduction in total levy across all affected small schemes is 46%, being less than 50%, due to the fact that the SBL component of the calculation is not reduced, and a number of small schemes will see a lower than 50% reduction in RBL due to being capped prior to the application of the SSA, and becoming uncapped after the application of the SSA.

6.4. Risk-based levy cap

6.4.1. The implementation of the SSA reduces the number of schemes capped by the current RBL cap from 123 to 45. The reduction in the levy cap from 0.5% to 0.25%, after the implementation of the small scheme adjustment increases the number capped to 197, with a reduction in total levy of £40 million.

6.4.2. The impact of the proposed policy changes affects the number of schemes capped as follows:

	Total	Small	Medium	Large
No. of schemes capped – current policy	123	84	27	12
No. of schemes capped – after SSA, before cap change	45	16	17	12
No. of schemes capped – after SSA and cap change	197	84	70	43

6.4.3. The impact on levy as a proportion of recovery plan payments can be seen as follows:

Levy as a proportion of recovery plan payments	**20% - 30%**	**30% - 50%**	**50% - 100%**	**100%+**	**Total**
No. of schemes – current policy	86	92	64	28	270
No. of schemes – after SSA and cap change	67	55	35	12	169
Change	-19	-37	-29	-16	-101

Note: these figures should be viewed with caution as they are based on a sample of around half of schemes. It is likely that some of the schemes we do not have sufficient data on have recovery plans.

6.5. Change in levy from 2020/21 to 2021/22 after policy options

6.5.1. After the implementation of the two proposed policy options, the proportion of schemes seeing various changes in total levy from 2020/21 to 2021/22 is as follows:

Proportionate change in levy	**Proportion of schemes**			
	Total	**Small**	**Medium**	**Large**
-99.9% to -50%	43%	69%	31%	15%
-50% to -25%	26%	23%	33%	24%
-25% to -10%	12%	3%	15%	25%
-10% to -5%	4%	1%	5%	8%
-5% to 0%	3%	1%	3%	7%
0% to +5%	1%	0%	1%	3%
+5% to +10%	1%	0%	2%	2%
+10% to +25%	3%	0%	3%	6%
+25% to +50%	3%	1%	3%	5%

+50% to +100%	2%	1%	2%	3%
Greater than +100%	1%	0%	2%	2%

Note: Table excludes schemes with zero RBL

6.5.2. Smaller schemes see a greater reduction in levy than large schemes. The small proportion of schemes seeing an increase are driven by changes in insolvency risk.

6.5.3. We can see that the schemes that see the greatest reduction in levy moving to 2021/22 after the policy changes, are those schemes that are closest to fully funded on a s179 basis (reflecting the impact of our change in basis to A9).

Proportionate change in levy	**Proportion of schemes**						
	2020/21 underfunding as a proportion of 2020/21 liabilities						
	0% to 5%	5% to 10%	10% to 15%	15% to 20%	20% to 25%	25% to 50%	50% or more
-99.9% to -50%	73%	65%	55%	47%	48%	39%	35%
-50% to -25%	17%	19%	26%	20%	25%	28%	29%
-25% to -10%	5%	8%	13%	19%	13%	13%	10%
-10% to -5%	2%	1%	1%	2%	2%	5%	6%
-5% to 0%	1%	0%	0%	2%	1%	3%	8%
0% to +5%	1%	1%	1%	2%	1%	1%	1%
+5% to +10%	0%	0%	0%	2%	2%	2%	2%
+10% to +25%	0%	1%	2%	3%	3%	3%	2%
+25% to +50%	0%	3%	1%	2%	2%	3%	3%
+50% to +100%	1%	1%	0%	1%	1%	2%	2%
Greater than +100%	0%	0%	0%	0%	1%	2%	1%

Note: Table excludes schemes with zero RBL

6.6. Basis of analysis

6.6.1. The starting point for this analysis is the data that will be used in the calculation of 2020/21 levy invoices. The neutral estimate of the 2021/22 levy estimate of £570 million before policy changes allows for a number of assumptions on market data, submitted scheme level data including s179 valuation data, and insolvency scores up to, or as at 31 March 2021. For the purposes of this analysis the effect of these assumptions is assumed to be spread across the universe, weighted by the uncapped risk-based levy component of the calculation.

6.6.2. Recovery plan payment data has been incorporated where the recovery plan data details at least 4 years of payments from the start of the recovery plan, with the annual figure used in the analysis taking the average of the second and third year recovery plan payments. This was designed to limit the risk that unrepresentative figures from the start or end of a recovery plan were used in the analysis. A limitation on this analysis is that the period of the recovery plan payments differs from scheme to scheme and may not cover the same period as that used for the levy figure (which is the projected 21/22 levy).

Other developments

7. Move to D&B

7.1. Engagement with D&B

7.1.1. We consulted last year on changes to the model we use to measure the insolvency risk of scheme employers, the PPF-Specific model – and introduced our new partner D&B. Following the consultation, we set out our conclusions in a Policy Statement. The model has now been operating for only a few months, and we are not proposing to make any further changes to the method under which it calculates insolvency risk.

7.1.2. We are however still encouraging employers and schemes to engage with their scores, in order to ensure that correct information is being used to generate them. We set out in our consultation in December that there were some employers who self-submit accounts, and those accounts could not be migrated from Experian to D&B. It is important the self-submitted accounts are filed with D&B to ensure accurate scores are being generated.

7.2. Ultimate parent identification

7.2.1. Through our continuous monitoring, we have identified - for some complex, international company structures – that there can be frequent changes in the ultimate parent identified as a result of D&B's approach to building corporate linkages. While this has not been raised as a concern by any schemes or employers, we are analysing the extent to which this occurs, and whether it is problematic for the purposes of levy calculations.

Consultation question: If you've had any experiences in relation to this particular scenario, we'd like to hear your views.

7.3. The rules

7.3.1. Alongside the publication of this consultation, we have published the updated Insolvency Risk Appendix which reflects the move to D&B as our insolvency risk partner and the changes to methodology set out and confirmed in our consultation in December and Policy Statement in March respectively.

8. Measurement of underfunding

8.1. Stress factors

8.1.1. We have carried out a high-level review of the current stress factors and conclude that they remain broadly reasonable for continued use in 2021/22. Although some of the factors could potentially be changed slightly to align with updated market experience, our priority is to maintain a stable approach pending the comprehensive review of asset classes, the indices used to adjust asset values to a common valuation date and stress factors.

8.1.2. We propose to update the output basis for transforming and rolling-forward s179 valuations from version A8 to A9 of our assumptions guidance. A9 is the current version applicable to schemes carrying out s179 valuations, and reflects improvements in buyout pricing over recent years. Consequently, we are able to assess schemes as being generally better funded and thereby reduce overall levy collections.

8.2. Investment review

8.2.1. We are carrying out a joint review with TPR of the asset information which schemes are required to submit, in order to support the new defined benefit funding regime and the associated requirements for schemes to better understand, measure and report their investment risk. This was covered in paragraph 371 of TPR's consultation document 'Defined benefit funding code of practice', dated March 2020, as set out below:

We are working with the PPF on revising the existing asset class information that we will require schemes to submit. We are keen to ensure that schemes should only need to submit one set of asset class data and we recognise that there is merit in expanding/amending the asset classes used to provide a better insight into the level of investment risk. This objective is shared by both the PPF and TPR and, with this in mind, we plan to issue a joint consultation on amending the scheme asset class information.

8.2.2. Work continues between our two organisations to develop an integrated set of asset class proposals for the joint consultation referred to above. We aim to implement any resulting changes to the scheme asset class information in time for the 2022/23 levy year.

8.2.3. Linked to this exercise, we also propose to review the market indices used to roll-forward the various classes of asset holdings under our transformation methodology, as well as the asset stress factors, liability stress factors and risk factor stresses. We also expect to introduce these changes for levy year 2022/23.

9. Customer service improvements

9.1. Making the PPF website a better resource for customers

9.1.1. In our December 2019 consultation, we set out a number of improvements we have made to our corporate website – ppf.co.uk – to improve the online resources available to those who interact with the levy. One of the improvements introduced the ability to respond to our consultations using simple online forms, a 'quick' version for those who are short of time, and a 'full' version for those looking to submit a more detailed response.

9.1.2. Feedback received in relation to the new functionality was very positive. However, there were some suggestions for improvement which we have aimed to address in this consultation.

9.1.3. The main point raised by stakeholders was that it is difficult for several individuals to collaborate on a 'full' consultation response when it is solely online, which led to a number of responses being submitted by email. While email responses have been a standard in previous years, digesting and synthesising the information contained within into a usable format for review is a very time-consuming process – mainly due to there being no format standards.

9.1.4. In response to this, we have introduced the ability to download an offline version of our full consultation that can be completed and then uploaded to our website when complete. The downloadable document is in editable PDF format and is designed to work in conjunction with our consultation document, setting out clear areas where consultation questions can be responded to.

9.1.5. There is still the ability to respond online without downloading the editable PDF document, and the 'quick' version of the consultation will be available online too.

Consultation question: Do you have any feedback on the newly introduced functionality for consultation responses?

9.2. New PPF functionality to support the invoicing process

9.2.1. A common request received by the Levy Customer Support team is for invoices to be sent in electronic format. These requests are usually processed on an ad-hoc basis by our Levy Customer Support Team.

9.2.2. In early 2020, we undertook a feasibility study to understand what we could do to develop functionality that would allow us to issue electronic invoices by email and provide an option for schemes to opt for paperless levy invoicing. The study concluded with a viable solution that we have now introduced.

9.2.3. Starting this year (invoices being issued from September 2020), we will be issuing paper invoices addressed to the scheme trustees – as usual, and also sending electronic PDF invoices to scheme contacts listed on TPR's Exchange database. We have also introduced

a paperless invoicing consent form on our website that allows scheme trustees, or authorised scheme managers to opt to receive only electronic invoices.

9.2.4. Electronic invoices will be sent to the Levy Contact email address listed on TPR's Exchange database in the first instance, with a contact hierarchy in place where a Levy contact is not present as follows:

Contact	**Priority**	**Condition**
Levy Contact email address	1	n/a
Scheme Contact email address	2	In the absence of a Levy Contact email address
Trustee email address(es)	3	In the absence of both a Levy Contact and Scheme Contact email address

9.2.5. We have carefully considered cyber security as part of implementation to ensure that electronic communication is safe. All electronic invoices will be issued using a system provided by Mimecast. Mimecast is a cybersecurity provider that helps thousands of organisations worldwide make email safer and bolster cyber resilience.

9.2.6. The introduction of Mimecast's secure messaging system does mean that there are some necessary steps - when an electronic invoice is received - to ensure that the recipient of the email can implement maximum security. The first time an electronic invoice is received, two emails from 'postmaster@ppf.co.uk' will be sent, one to notify that a secure message has been received; and one requesting that a password to access secure messages is set. Once a password is set, this can be used for all future secure electronic invoices sent.

Consultation question: If you have received an electronic levy invoice, do you have any feedback on the service?

10. Contingent assets and nominated jurisdictions

10.1. The Corporate Insolvency and Governance Act 2020

10.1.1. In view of our desire to limit changes at a time when stakeholders have other priorities, we have not undertaken a general review of Levy Rules relating to contingent assets. However, the changing environment, and in particular recent legislative changes may mean that we should make changes next year.

10.1.2. The Corporate Insolvency and Governance Act 2020 came into force on 26 June 2020, and introduced a new moratorium and restructuring plan. We have considered whether any changes need to be made to our standard form contingent asset agreements to ensure that the agreements continue to work from a technical perspective, following the introduction of these new procedures. We have concluded that no such changes are required.

10.1.3. We have also considered whether the PPF contingent assets still deliver, in principle, the expected level of risk-reduction for the PPF, following the introduction of these new procedures. Although the legal agreements that underpin them have a degree of specialisation, they are in essence based on the general practice for banking guarantees at the present time, we haven't seen evidence to support any change, and so we do not propose to make any changes to the standard form contingent asset agreements and/or the levy credit given to contingent assets for the levy year 2021/22, as a result of the new legislation. However, we will be monitoring both the use of the new procedures and whether others are changing analogous legal agreements and reviewing whether similar changes should be made to our standard form contingent asset agreements. Should we have evidence that these new procedures could alter the level of risk reduction provided by contingent assets, or that practice in drafting guarantees is evolving, we will reassess our position.

Consultation question: We would be interested to receive comments on points that we should consider in time for the 2022/23 Levy Rules and are also seeking views on whether any changes should be made in light of the Corporate Insolvency and Governance Act?

10.2. Nominated Jurisdictions

10.2.1. We have addressed one issue raised by a stakeholder, which may allow for additional valuable contingent assets to be put in place.

10.2.2. One of the requirements for contingent assets to receive levy recognition is that 'Acceptable Financial Institutions' (e.g. banks) are domiciled in a Nominated Jurisdiction. These jurisdictions are specified in the rules – and include the European Union (EU) and the Organisation of Economic Co-operation and Development (OECD). We have identified that Liechtenstein, despite being a member of the EEA and subject to EU financial services regulation, currently falls outside the nominated jurisdictions. The other two countries that are in the EEA but not the EU (Iceland and Norway) already qualify by virtue of their OECD membership.

10.2.3. Liechtenstein, as an EEA member, achieves close regulatory alignment with EU countries by being part of the single market. Key pieces of EU financial services legislation are cross-applied to EEA countries like Liechtenstein through the EEA Agreement. We regard it as an anomaly that Liechtenstein is the only EEA country that is not covered and therefore think it is appropriate to expand the definition of Nominated Jurisdiction to include all members of the EEA. We will also update the definition of Nominated Jurisdiction within our standard form contingent asset agreements to allow for Liechtenstein to be included. Contingent asset agreements which have already been executed will continue to be suitable for levy recognition if they were executed using the standard form in force at the time of execution and there is no need to re-execute on the new forms.

10.2.4. These amendments will be made in time for the publication of final rules for 2021/22.

11. Responding to market developments

11.1. Consolidators and other endgame solutions

11.1.1. We continue to engage with stakeholders exploring options for 'DB endgame solutions' and how these arrangements could impact both the PPF and scheme members. As well as consolidator vehicles, we are aware that a range of approaches are being developed as a search for an endgame solution for schemes, albeit these are at an early stage of development. We will monitor market developments and may consider a targeted consultation on the introduction of a 'hybrid' levy methodology, for arrangements which have consolidator characteristics, but for which our existing methodology may not provide the most appropriate levy as there is an element of continuing conventional covenant to consider.

11.1.2. We would welcome thoughts at this stage on how these vehicles could be captured in our rules, but for 2021/22 we will maintain our current rules for levying these types of arrangements whilst the market is developing. This means that arrangements which fit within our definition of a Commercial Consolidator will be subject to the provisions of the Commercial Consolidator Appendix, while our standard methodology will apply to other arrangements

11.1.3. To assist schemes and their advisors in gaining a broad understanding of the provisions within the Levy Rules for Commercial Consolidators we have produced Commercial Consolidator Guidance that will be published alongside our final rules. This draws heavily on the material previously published in our 2019/20 Policy Statement[3]. TPR has also produced its Superfunds Guidance, which sets out the standards TPR expects to be met before legislation is in place. This follows on from the DWP consultation on the Consolidation of Defined Benefit Pension Schemes which set out proposals for a future regulatory regime for commercial consolidators. If there are schemes or sponsors that are proposing to proceed with transactions, we would encourage them to discuss their plans with TPR and us.
Consultation question: Do you have any views on how we might amend the Levy Rules to capture 'DB end game solutions'?

11.2. Credit rating realignment

11.2.1. Feedback during our consultation in December 2019 suggested that stakeholders were in favour of the PPF recalibrating the mapping of credit ratings to levy bands, in line with our recalibration of the D&B scorecards.

11.2.2. In our Policy Statement, we committed to reviewing the mapping and to set out a precise basis under which we would propose to recalibrate. When adjusting the mapping we

[3] Published in December 2018

must both recalculate the Long Term (LT) average default rates and recalculate the ratio of insolvency to default. Our proposal is to recalibrate as at the 31st December 2020. For the LT average default rates this will allow us to capture the more favourable default experience in the years prior to the current recession as well as the default experience during the current recession. For the ratio of insolvency to default this will allow us to capture the insolvency experience over 2020 from UK companies having defaulted on or before the 31st December 2019.

11.2.3. Recalibrating as at the 31st December 2021 would allow us to capture the insolvency experience of UK companies having defaulted in 2020 but also result in further postponing the recalibration which we believe is not consistent with stakeholder feedback. We also note that to date only five UK based companies have been classified as having defaulted by the public credit rating agencies. While this is a relatively high number for a single year, it is less material in the context of the 80 data points collected up to the 31st December 2019. As such we don't believe that the ratio of insolvency will see a material shift as a result.

Consultation question: Do you agree with our proposals to recalibrate the credit rating to levy band mapping as per the 31st December 2020?

12. Draft Levy Rules 2021/22

12.1. Introduction

12.1.1. In contrast to previous consultations, and following stakeholder feedback, we have moved away from publishing a full suite of draft documents this year. Instead we are only publishing the draft Determination and Appendices where substantive change has been made.

12.1.2. The main changes to the Levy Rules have been to reflect:

- the move to Dun & Bradstreet Limited (D&B) as our Insolvency Risk partner and the changes to the measurement of insolvency risk consulted on last year; and
- the policy proposals set out in this consultation.

12.1.3. Drafting changes can be found in the Determination and Appendices published alongside this consultation document, but a summary of the changes is also set out below. Other changes to the rules simply relate to date changes and the move from A8 to A9 of our assumptions guidance. These will be published when the Determination is finalised.

12.2. The move to D&B

12.2.1. The D&B Insolvency Risk Model started generating monthly scores in April 2020, these scores will be used to calculate levy invoices that will be issued in 2021.

12.2.2. Different credit scoring companies use different approaches in areas such as how and when data is collected and the approach to the identification of specific data fields. One particularly important difference is that D&B distinguish between zeros and missing data within employers' accounts whereas Experian did not (and therefore treated both the same in their calculation of insolvency risk scores). We have redrafted the scorecards to reflect this difference. More generally, scorecards have been recalibrated (so coefficients will have changed) and in a limited number of cases the variables used have been changed or amended. All these changes were set out in the conclusions on our first consultation.

12.2.3. The classification of Accounts types is now based upon the D&B business as usual process, and not based upon the UK Companies House Account Type as previously. D&B use a data driven approach to scorecard categorisation (so in broad terms where profit and loss data is absent then categorisation is normally to a small scorecard, and where such data is present, to a full account scorecard), rather than relying on the categorisation assigned by Companies House. We have amended the definitions of Full and Small Accounts so that Full Accounts are those that show a Turnover or Pre-Tax Profit figure and Small Accounts are those accounts that do not. Since the SME Accounts definition relied on Companies House indicator types and also seemed very similar to the new definition of Small Accounts we have decided to delete the definition of SME Accounts and use Small Accounts instead where it is referred to in the Determination. SME Accounts were used for the categorisation of *Group Small* and *Independent Small* employers which now refer to Small Accounts. **See the Definitions and Rule E3.1(6) and (7) of the Determination**.

12.2.4. The Mortgage Age variable has been replaced with Cash by Current Liabilities. The Mortgage Age variable was included in the following scorecards: 03 (Part of a group with £50m+ turnover), 04 (Part of a group with turnover £10m-£50m) and 05 (Part of a group with turnover under £10m).

12.2.5. Another variable where there have been changes since last year's Levy Rules is Creditor Days. This variable was included in the following scorecards: 01 (Non-Subsidiaries £30+ or Large Subsidiaries), 02 (Non-Subsidiaries <£30M) and 05 (Part of a group with turnover under £10m). The cap on creditor days has been set at 60 days (previously 365 days) and we have set a neutral creditor days score for companies previously scored on the S&P Credit Model. **This is reflected in the treatment of the Creditor Days variable in the relevant Scorecards in the Insolvency Risk Appendix**.

12.2.6. As advised in the March 2020 Policy Statement we determined to cease using the S&P Credit Model. It has not been used since April 2020 and employers have transferred to the relevant D&B scorecard. References to the S&P Credit Model have been deleted from the Rules and Insolvency Rules Appendix. It was necessary to create a new definition of Financial Institution to identify those employers who were previously scored on the Industry-Specific scorecard using the S&P Credit Model and who would now get the neutral creditor days score. The definition refers to entities on the Bank of England Bank List or the Bank of England Insurance List. **See the Definitions section of the Determination**.

12.2.7. Use of 2007 Standard Industry Classification (SIC) Code. This is used to calculate an industry average for where an employer has not filed accounts and a Scheme average could not be used. The Experian model used 1992 SIC Codes but D&B's normal course of business is to use 2007 SIC codes so the definition has been updated to reflect that. D&B's practice is to use the US SIC Code 1987 for those non-UK employers who don't have a UK classification. **See the Definitions and Rule E.5.4(2) in the Determination**.

12.3. Small scheme adjustment

12.3.1. This consultation proposes the introduction of a Small Scheme Adjustment (as explained in section 4.1 of this document). **See paragraph C2.3 of the Determination.**

12.4. Risk-based levy cap

12.4.1. This consultation proposes to reduce the risk-based levy cap from 0.50% to 0.25% (as explained in section 4.2 of this document). **See paragraph C3.1 of the Determination.**

12.5. Exempt Transfers

12.5.1. Exempt Transfers. During consideration of a Scheme transfer an apparent 'loophole' in the current requirements for self-segregation applications was identified. The parent scheme had completed its latest s179 valuation by the 15-month deadline but never entered the results on Exchange, due to an administrative oversight. The rules are clear that we can reject an application in a 1-to-1 case under these circumstances, but those provisions don't currently carry over to self-segregation cases. We have therefore amended the wording in the Transfer Appendix for 2021/22 so that we can treat self-segregation and 1-to-1 applications consistently. **See paragraph 19.2(c) of the Transfers Appendix**.

12.5.2. We identified an issue this year that if the scheme updates the membership information by reducing it to zero in the transferring scheme/section this leads to the scheme becoming non-registrable and prevents the entry of data on the transferring/parent scheme/section. In particular, this course of action removes the scheme's ability (and effectively the requirement) for it to update its s179 valuation details. We have seen at least one case this year where the transferring scheme's action in this respect meant that the updated s179 valuation which would normally have fallen due for submission by 31 March was not provided. This could be viewed as a means for schemes to avoid carrying out a new s179 valuation without prejudicing their exempt transfer application, and also leads to us migrating out-of-date s179 valuations. We have amended the Levy Rules to remove this anomaly and included additional wording in the Levy Rules to clarify that we will reject exempt transfer applications (both self-segregation and 1-to-1) where a scheme or its advisers takes action on Exchange which results in a 'non-registrable' status and the consequent inability of the scheme to update its s179 valuation details results in failure to submit a new s179 valuation which would ordinarily have been required by the start of the levy year. **See Rule F4.2 in the Determination.**

12.6. Contingent assets

12.6.1. Rules about re-execution of Contingent Asset documentation. In Levy Year 2018/19 we introduced new rules to require re-execution of our forms for certain types of Contingent Asset -Type A and B Contingent Asset of Sub Type (a), (c) and (e) (those containing a fixed monetary sum). We have introduced a new rule to make it make it clear that if a scheme has already satisfied the Re-execution Requirement in a previous levy year, they don't have to re-execute the documentation again. **The amendment is in paragraph 4(16) of the Contingent Asset Appendix**.

13. Next steps and Key Dates

13.1. Next Steps

13.1.1. We expect to publish our final rules for the 2021/22 levy year in January 2021, reflecting a move from the normal publication in December each year. This decision has been taken to allow stakeholders longer to engage with our consultation.

13.2. Key dates

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

Item	Key dates and times
Closing date for the 2021/22 consultation	24 November – 5:00pm
Publication of final rules and Policy Statement	End January 2021 (expected)
Scheme returns and electronic contingent asset certificates to TPR	31 March 2021 - Midnight
ABC certificates and special category applications to us	31 March 2021 - Midnight
Send hard copy contingent asset documents to us (or method of submission/deadline specified on our website)	31 March 2021 – 5.00pm
Start of 2021/22 levy year	01 April 2021
Deficit-reduction contributions certificates to TPR	30 April 2021 - 5.00pm
Send exempt transfer applications to us	30 April 2021 - 5.00pm
Certify full block transfers with TPR	30 June 2021 - 5.00pm
Publication of Mean Scores	July 2021
Invoicing starts	Autumn 2021

14. Consultation Arrangements

14.1. The consultation runs from 29 September 2020 to 5pm on 24 November 2020. Please ensure your response reaches us by the deadline. Submissions can be made online:

www.ppf.co.uk/levy-payers/help-shape-our-rules

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

- The 'quick' submission allows respondents to review a summary of key proposals set out in our consultation, and the opportunity to give their views. It is designed to only take 10 to 15 minutes to complete. This version is designed for those who may not have time to respond to our consultations in full.

- The 'full' version sets out all the questions we are asking in this consultation, allowing complete responses, along with free format text fields for additional views to be submitted. This version of submission can either be completed online, or via an offline template which can be downloaded and once complete, uploaded via our website. The offline submission is new functionality we are introducing as part of this consultation following feedback from stakeholders. We hope this will aid collaborative submissions where input is needed across an organisation or range of stakeholders.

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

14.4. Under the Freedom of Information Act 2000 (FoIA), all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal data for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication.

14.5. If this is not the case, the respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with FoIA obligations and general law on this issue. Further information can be found on the GOV.UK website:

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

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

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

15. Comments on the Consultation Process

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

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

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

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1. Annex A - Assumptions used to derive 2021/22 levy estimate

1.1. Assumptions

1.1.1. We have arrived at the 2021/22 estimate after making assumptions about data which will not be known until April 2021 or later. This includes both assumptions which reflect the usual annual cycle of the levy, and assumptions about the specific circumstances at this time.

1.1.2. Assumptions are needed because we produce the estimate well in advance of having all the data that will be used in levy invoice calculations. Much of the data we will use for invoicing will be provided up to the end of March 2021 (scheme return data, contingent asset certifications/re-certifications and monthly insolvency risk scores); other information (about DRCs and block transfers) can be provided up to the end of April and June 2021.

1.1.3. In setting our assumptions we have adopted the same approach as we took for 2020/21. This is to look at trends in recent years and at market data. It is always difficult to judge the setting of individual assumptions, but taken together we consider that these assumptions provide a balanced view of the factors that may affect the total levy.

1.1.4. Existing scheme data, together with our assumptions, is used to estimate the impact on levy invoices of various factors, the most material of which being scheme funding and insolvency risk. Our assumptions for each for each of these areas are set out below.

1.2. Scheme Funding

1.2.1. Each year the funding risk of schemes changes as a result of market movements, new accrual and payments to reduce deficits. The assumptions for market movements are particularly important as these include the gilt yields used to discount liabilities, as well as the indices used to value assets.

1.2.2. In addition, as we have reached the end of the current three-year period for levy, we are proposing to update the assumptions basis for the calculation of liabilities from A8 to A9. The result of this move in isolation is a reduction in scheme underfunding, and a reduction in 2021/22 levies.

1.2.3. Counter to this is the impact of the roll forward of the underfunding. Underfunding risk is calculated based on smoothed market conditions over a period of five years. For the 2021/22 levy, this will be the five-year period up to 31 March 2021.

1.2.4. The 2021/22 five-year averaging period will not include the period 1 April 2015 to 31 March 2016, which was included in the 2020/21 averaging period. In the period 1 April 2015 to 31 March 2016, gilt yields were generally higher than in the period since 31 March 2016. As a

result, in isolation, the 2021/22 five-year smoothed position is expected to increase underfunding, and hence the levy estimate, relative to 2020/21.

1.2.5. The combined impact of the change from A8 to A9 and the roll-forward of the underfunding is a decrease in underfunding, and a reduction in 2021/22 levies of £15 million.

1.2.6. In addition, we also reflect our experience that when new valuations are submitted, these have historically shown an improved funding position, relative to the previous valuation rolled forward to the new date. For the 2021/22 levy estimate, consistent with our approach last year, we assume the impact will be in line with the average for the last three years, giving a reduction in 2021/22 levies of £45 million.

1.3. Insolvency risk scores

1.3.1. The insolvency risk scores for the 2021/22 levy estimate are initially estimated from the monthly scores for the period from April 2020 to July 2020 which incorporates the impact of the move in insolvency risk provider to D&B, the changes to the scorecards, and insolvency risk experience observed to July 2020. We then allow for expected movements to March 20201, and expected subsequent appeals.

1.3.2. We have also considered the impact of COVID-19. For employers that are credit-rated, the credit rating agencies updated their ratings earlier this year to factor in the impact of COVID-19. These recent ratings are taken into account in the April 2020 to July 2020 scores. For employers that are not credit-rated, where the insolvency risk is based on analysis of company accounts, we have used a different approach. Based on analysis of previous filing dates, we are expecting that a relatively low proportion of employers will have monthly scores incorporated into 2021/22 mean scores that are affected by COVID-19. Based on our analysis, we expect an increase levy for 2021/22 of £10 million due to COVID-19, noting that the impact will be expected to be much higher in 2022/23.

1.4. Risk Reduction Measures

1.4.1. We have assumed that deficit-reduction contributions (DRCs), contingent assets and asset backed contributions will have a similar levy impact as they have had in 2020/21.

1.5. Conclusions on levy estimate

1.5.1. The 2021/22 levy estimate taking into account the assumptions in this section, on current policy, is £570 million.

1.5.2. Taking into account the proposed introduction of a Small Schemes Adjustment (£10 million) and the proposed reduction to the RBL cap from 0.5 per cent to 0.25 percent (£40 million), gives a levy estimate of £520 million. It should be noted that there is always a significant degree of uncertainty about how close the total levy invoiced will be to our

estimate, given the range of assumptions we have to make about information we do not yet have. This is particularly true for 2021/22 given the particular circumstances.