

DRAFT Commercial Consolidators Guidance – for consultation

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1. Introduction

- 1.1. The Levy Rules provide for a particular class of scheme, those defined as Commercial Consolidators, to have their levy calculated using a different methodology to that used for other Schemes.
- 1.2. This Guidance seeks to assist trustees, sponsors and their advisors in gaining a broad understanding of the provisions within the Levy Rules for Commercial Consolidators¹. It is aimed primarily at those involved with establishing and running consolidator schemes. It is to be read in conjunction with TPR’s DB Superfunds Guidance², which sets out the standards TPR expects in the interim period before the legislative regime for consolidator schemes is in place and it 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. This Guidance will be regularly reviewed and updated from time to time.
- 1.3. The Commercial Consolidator Appendix of the Levy Rules provides for how the Risk Based Levy³ for consolidator schemes is calculated. This Guidance sets out the information that the Board requires and the matters of which the Board must be satisfied for the purposes of the definitions of “Recognised Buffer Arrangement” and “Acceptable Wind-Up Trigger”. Our focus is on buffer funds and winding-up triggers because it is these elements of consolidation arrangements which affect the point at which a consolidator scheme will enter a PPF assessment period and also the funding level of the scheme in such a situation. Buffer funds and winding-up triggers are therefore integral to establishing the risk to the PPF when calculating the Risk Based Levy.

¹ Commercial Consolidator Appendix

² <https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/db-superfunds>

³ Commercial Consolidator Appendix – Section 1 summarises the calculations with the approach specified in full in the following paragraphs.

- 1.4. A formal assessment of the appropriate levy will need to be undertaken at the point at which the levy becomes chargeable. However, we are prepared to carry out an initial assessment, alongside TPR's assessment of whether its expectations are met, in order that engagement is as streamlined as possible. This could include forming an opinion on the suitability of buffer fund arrangements and winding-up triggers for the purposes of our Levy Rules (subject to the circumstances remaining the same at the point of invoicing).
- 1.5. Our Levy Rules provide for a levy to be charged to Commercial Consolidators where a transfer in occurs after the start of the levy year and also provide that we can revise the levy we have charged following transfers in of new liabilities. Where we are considering revising a levy, we would (among other factors) have regard to any levies already paid in respect of the liabilities that have been transferred in to the Commercial Consolidator.
- 1.6. We have adopted a principles-based approach to our assessment of buffer fund arrangements and winding-up triggers, which we consider to be most suited to the initial stages of the development of the DB consolidation market, but we would expect to develop the principles over time and could develop standard forms in future years.

2. Definition of a Commercial Consolidator

- 2.1. For the purpose of calculating the Risk Based Levy, a Commercial Consolidator is a Scheme:
 - a) where one of the purposes of its establishment and/or the nature of the ongoing operation of the Scheme and/or of its surrounding arrangements is, in the opinion of the Board, to effect consolidation of Schemes' liabilities and/or to enable a return to be payable otherwise than to members; and
 - b) in respect of which the nature of the Scheme and/or the risk posed to the Board is such that in the opinion of the Board it is more appropriate for the Levy Rules applicable to Commercial Consolidators to apply than the Levy Rules that would otherwise apply.⁴
- 2.2. Any Scheme classified as a Commercial Consolidator under our Levy Rules will continue to be classified as such until the Board is satisfied that this definition should no longer apply to the relevant Scheme.
- 2.3. We would encourage any trustees or sponsors who think that their Scheme might fall within this definition of Commercial Consolidator to engage with us and with TPR. Note that there may be Schemes which would come within the definition of Commercial Consolidator that may be outside the definition of Superfund as defined by TPR. If that were to occur, and a Commercial Consolidator were to be outside the scope of TPR's

⁴ Rule C6.1(1)

assessment of Superfunds, we would be likely to have additional requirements for levy purposes beyond those set out in this Guidance. In that circumstance we would engage with the Commercial Consolidator regarding any additional requirements.

3. Buffer Funds

- 3.1. A key feature of consolidation arrangements is the use of buffer funds, held outside the Scheme but available if funding falls, as a risk reduction tool.
- 3.2. We think it unlikely that buffer funds would meet the requirements of our contingent asset regime which need to be in a standard form. Where we are satisfied about the security of the arrangement, we will treat the assets in the buffer fund as Scheme assets for the purpose of the levy for Commercial Consolidators. Note the criteria set out in this Guidance for the recognition of buffer fund assets for levy purposes apply only to Commercial Consolidators, and not to Schemes that are charged a “conventional” levy.
- 3.3. It is not, primarily, our intention to place restrictions on the types of asset that can be held in the buffer fund. We will, however, require a high degree of certainty that, if needed, the assets in the buffer fund would be available to the Scheme and that robust provisions are in place to ensure the capital buffer is not subject to value leakage. We will also need to be confident that the level of investment risk within the buffer fund (that forms the basis of TPR’s assessment) will not be increased without an injection of additional capital if that is necessary in order to continue to meet TPR’s capital adequacy requirements.
- 3.4. How these concerns will be addressed is likely to vary from proposition to proposition. We will make our assessment of whether a particular buffer fund arrangement meets the requirements in order to be a “Recognised Buffer Arrangement” for the purposes of the Commercial Consolidator Appendix by reference to the following principles:
 - a) Buffer fund assets cannot be released outside of pre-defined circumstances (these circumstances should be in line with TPR’s expectations);
 - b) The risks within buffer fund investments cannot be materially increased after TPR’s initial assessment without an increase in capital if that is necessary in order to ensure that TPR’s capital adequacy requirements are met on a continuing basis;
 - c) Changes in buffer fund asset allocation cannot be made without consultation with Scheme trustees; and
 - d) There is a robust, legally enforceable mechanism for the assets of the buffer fund to transfer to the Scheme if there is a trigger event.
- 3.5. In order to allow an assessment of the extent to which these principles are met and therefore whether the Board is satisfied that the buffer fund arrangement meets the definition for a “Recognised Buffer Arrangement”, we would expect trustees to obtain

advice that the principles in 3.4 (a) to (d) are met and for this to form part of the Combined Opinion (see below in paragraph 5).

4. Winding up triggers

- 4.1. There may be a number of trigger events included in the governing documentation of a consolidator arrangement – for example, an event that triggers limits on the writing of new business or that triggers the transfer of assets from the buffer fund into the scheme (the ‘low risk funding trigger’⁵). From a levy perspective, we are particularly interested in the events that will trigger a wind up of the Scheme and, critically, how this will result in the employer undergoing a qualifying insolvency event (since the Pensions Act 2004 prescribes that it is employer insolvency that triggers a PPF assessment period). Arrangements that wind up the Scheme and only indirectly cause the employer’s insolvency at an uncertain date in the future are therefore not satisfactory.
- 4.2. Where a wind-up trigger is set at an appropriate s179 funding level (defined as a “Trigger Funding Level” in the Commercial Consolidator Appendix) and the Board is satisfied that the other conditions in the definition of “Acceptable Wind-Up Trigger” in the Commercial Consolidator Appendix are met, we will set a strike price for the calculation of the levy at below 100 per cent of s179 liabilities. This will be achieved using the factors for adjusting s179 liabilities as set out in paragraph 3 of the Commercial Consolidator Appendix. This discount reflects the reduction in risk to the PPF resulting from the wind-up trigger.
- 4.3. We will make our assessment of whether particular winding-up provisions meet the requirements in order to be an “Acceptable Wind-Up Trigger” for the purposes of the Commercial Consolidator Appendix by reference to the following principles:
 - a) the wind-up trigger has to take effect at a funding level equal to or in excess of what TPR deems acceptable. We expect the level to be at least 105% of s179 liabilities, unless otherwise agreed by TPR in consultation with the PPF in exceptional circumstances;
 - b) there must be adequate arrangements to monitor the s179 funding level with sufficient accuracy and frequency, which are consistent with TPR’s expectations for reporting and provide for more frequent assessments of the scheme’s funding position if the funding level approaches the ‘low risk funding trigger’;
 - c) once the wind-up trigger conditions are met, wind up must commence automatically i.e. wind up must not be at the discretion of any of the parties to the Commercial Consolidator arrangement if the trigger conditions have been met;
 - d) once the wind-up trigger conditions are met, Scheme wind up must commence immediately and there must be a mechanism in place by which the insolvency of the sponsoring employer will occur within an acceptable period, which we would generally expect to be no more than three months from the commencement of

⁵ Please refer to TPR’s DB Superfunds Guidance for what is meant by the ‘low risk funding trigger’.

Scheme wind up. For example, the Scheme rules could provide for a contribution to become due from the employer immediately upon commencement of Scheme wind up without waiting for the section 75 debt to be calculated; and

- e) the ability to amend the wind up rule must be suitably constrained. Any ability to alter the wind-up trigger would need to be limited to changes that are required to meet evolving regulatory or legislative requirements.

4.4. In forming its view, the Board will have regard to TPR's guidance and expectations from time to time and, at a minimum, the wind-up trigger will have to meet any future requirements of a regulatory regime.

5. Requirement to provide a 'combined opinion'

5.1. In order to assess a buffer fund arrangement or wind-up trigger, applying the principles explained above, the Board will require a 'combined opinion' to be provided. We request that the trustees of a new Commercial Consolidator submit such an opinion to the Board at the same time as they notify TPR of their proposal and before any transfers into the consolidator are made so that we can undertake an initial assessment of the proposal (from a levy perspective) in conjunction with TPR. For this purpose, a 'combined opinion' means an opinion provided by a legal adviser and/or other advisers who are professionally qualified to opine on the relevant subject matter. It may be delivered in one document or in a series of documents (the "Combined Opinion").

5.2. The purpose of the Combined Opinion is to demonstrate to the Board that all of the PPF's requirements for a Commercial Consolidator have been met. The Board's expectation is that the opinion(s) will include input from the relevant advisory community and will clearly link the relevant elements of the Commercial Consolidator arrangement to the requirements set out in this Guidance and explain how those requirements are met.

5.3. The issues to be covered in the Combined Opinion include:

- a) the role of the Scheme trustees if changes to the buffer fund asset allocation are being considered;
- b) an explanation of the controls that are in place that would prevent the level of investment risk in the buffer fund from being materially increased without first ensuring that TPR's capital adequacy requirements are met on a continuing basis. We will want assurance that there is a robust framework in place to ensure this is the case. In particular, we will want to understand the controls that are in place to prevent investment risk being increased in scenarios where the Scheme's funding level is approaching the 'low risk funding trigger';
- c) the wind-up triggers contained in the Trust Deed and Rules including how any of the triggers relate to funding levels on a Section 179 basis;

- d) whether wind up is automatic or discretionary when triggered, and whether there could be a time lag between a wind-up trigger occurring and the commencement of Scheme wind up;
- e) an explanation of how the wind-up triggers lead to the insolvency of the Scheme employer and the time that could elapse between wind up being triggered and the employer's insolvency;
- f) an explanation of the link between Scheme wind up and payments out of the buffer fund;
- g) the restrictions on amending the Scheme wind up provisions;
- h) the measures in place for monitoring the s179 funding level of the Scheme (and any buffer fund); and
- i) the circumstances in which payments can be made from the buffer fund, including whether those payments are mandatory or discretionary.

5.4. The Combined Opinion should be capable of being read and understood without requiring reference to underlying documents. It should identify each of the relevant PPF requirements as listed in paragraphs 3.4 and 4.3 above, confirm whether the requirement is met and explain how the relevant provisions in the governing documentation meet that requirement (with citations of those provisions) including providing reassurance that an action triggered under one document cannot be frustrated by action/inaction at a subsequent stage.

5.5. The adviser(s) providing the Combined Opinion must accept a duty of care to the Board of the Pension Protection Fund. In addition, the Board must be able to rely on the Combined Opinion and there must be either no exclusion of liability or a liability cap that is at a level that the Board considers to be reasonable in the circumstances. We would not expect the cap to be lower than £5m, but there may be circumstances in which a higher minimum cap is appropriate. A suggested form of wording for the duty of care statement is as follows:

"We accept a duty of care to the Board of the Pension Protection Fund (the "PPF") in relation to our advice and acknowledge that the advice may be relied upon by the PPF for the purpose of calculating the PPF levy for [name of scheme]. We do not purport to exclude liability to the PPF, whether arising pursuant to the Pensions Act 2004 or otherwise.

We confirm that we have taken into account the Board's Determination, Commercial Consolidator Appendix and Commercial Consolidators Guidance for the [xxxx e.g. 2021/22] Levy Year and The Pensions Regulator's DB Superfunds Guidance when preparing this Opinion.

We confirm that we are independent of any investor in, and the trustees and the employer of, [name of scheme]".

6. Annual information requirements

- 6.1. We require certain information to be provided at least annually⁶, or more frequently if that is consistent with TPR's expectations for reporting. We will make prudent assumptions when calculating the risk-based levy in accordance with the Commercial Consolidator Appendix if that information is not available. The current information requirements reflect our understanding of the consolidator arrangements that have to date been presented to the PPF. We recognise that the market is developing and as the consolidator proposals develop, our information requirements may also evolve.
- 6.2. Currently we expect all Commercial Consolidators to supply the following information in respect of each Scheme within 3 months of the Board confirming that the Scheme meets the definition of a Commercial Consolidator and thereafter by midnight on 31 March immediately prior to the start of each levy year, or as otherwise notified to the Scheme by the Board. We expect the information to be updated at least annually:
- a) s179 valuation;
 - b) a bespoke investment stress calculated using the approach set out in our Investment Risk Appendix, covering both the Scheme assets and buffer funds; and
 - c) the granular asset breakdown and sensitivities to interest rates and inflation which underlie the bespoke stressed value of the Scheme assets and buffer funds.
- 6.3. For the purposes of b and c above, it is our preference that the buffer fund assets are not amalgamated with the Scheme assets and that the information for each is provided separately. All information should be calculated consistently at a single effective date.
- 6.4. Where s179 valuations are not updated annually we will apply a 5% per annum factor to Scheme liabilities to reflect the understatement of risk for older valuation submissions.⁷
- 6.5. The Levy Rules provide for Rule B1 to apply in cases where any items of information that we require are not provided. Where Rule B1 applies, the calculation of the Levies would be performed in such manner and by using such assumptions as in the opinion of the Board is prudent and reasonably practicable, and best gives effect to the general approach laid down by the Levy Rules.

7. Value extraction

- 7.1. In accordance with TPR's Guidance on DB Superfunds, there should be no extraction of profit from the Scheme or the buffer fund unless members' benefits are bought out in full. TPR has said that it will review its position regarding profit extraction within three years of its Guidance on DB Superfunds being published.

⁶ See section 2 of the Commercial Consolidator Appendix

⁷ Commercial Consolidator Appendix section 3 - Factors to reflect understatement of risk for older valuation submissions

- 7.2. We expect Commercial Consolidators to adhere to TPR's expectations regarding profit extraction. If TPR's expectations change in the future, we recognise the possibility that Scheme or buffer fund assets reported to the PPF may be paid out in accordance with arrangements for distributing surplus capital to investors. It is not the PPF's intention to prevent this occurring if permitted by TPR. However, we expect that value extraction would only occur if TPR's capital adequacy tests could continue to be met following the extraction in respect of a particular levy year.
- 7.3. Our Levy Rules allow for a consolidation vehicle to supply valuation information net of value extraction that may occur in the forthcoming levy year. This allows us to calculate the annual Levy based on the value of assets that will remain available to the Scheme throughout the year regardless of any value extraction.

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