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Chris Collins
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Dear Mr Collins

Consultation on the third PPF Levy Triennium – 2018/19 to 2020/21

I am writing on behalf of the Pensions Committee of the 100 Group of Finance Directors with regard to the above-named consultation.

The 100 Group

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent around 90% of the market capitalisation of the UK FTSE 100 Index, and in 2015 paid, or generated, taxes equivalent to 14% of total UK Government receipts. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including pensions, taxation, financial reporting, corporate governance and capital market regulation. The 100 Group represents companies sponsoring defined benefit (DB) pension schemes with assets of approximately £500bn and membership of 3.6m.

Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

General comments

Overall, we agree with the overall direction of the PPF's levy policy for the third triennium, in particular the proposal to use public credit ratings rather than Experian scores where these are available. This is something that the 100 Group has argued for since the introduction of the risk-based levy. We do however wish to raise some issues around the allocation of credit ratings to levy bands and the averaging of insolvency scores.

We have chosen not to respond to all the questions set out in the consultation, but rather to make a small number of key points in response to specific questions.

Question 4: Do you agree with our proposal to use public credit ratings in preference to the PPF-specific model?

Yes, the role of the rating agencies is to provide a long-term view of the strength of a company and so we agree that public credit ratings are a better guide to the health of large companies and corporate groups than Experian scores.

Question 6: Do you agree with our proposed basis of scoring where public credit ratings or industry scorecards are used?

The proposed mapping of credit ratings to insolvency scores is less favourable to companies at the mid-to-lower end of 'investment grade' than we might have expected. In addition, the consultation document notes that a small number of schemes with 'non-investment grade' sponsors will see a substantial increase in their levies. Whilst we recognise that the PPF has commissioned an external expert to advise on the translation from public credit ratings to one-year insolvency ratings and hence to levy bands, we think it would be helpful for the PPF to obtain a independent second opinion on this methodology given its potential significance for the distribution of the levy between schemes sponsored by rated entities and the very significant increase in levy for a small number of large companies.

In addition, the proposed model makes no explicit allowance for the significant support that the PRA's Recovery and Resolution Planning and MREL (Minimum Requirement for Own Funds and Eligible Liabilities) frameworks provide in reducing the likelihood of a default to the pension scheme for PRA-regulated entities with a credit rating. Whilst this will only apply to a proportion of rated entities, it seems worth investigating whether some allowance can be made.

Question 8: Do you think that we should move to a single point calculation of insolvency risk at 31 March?

No. The consultation document indicates that whatever approach is used for Experian scores would also apply to credit ratings. However, we believe that moving to a single point estimate could impact on rated entities differently from non-rated entities as there is a risk that a change in rating could come just before the insolvency risk is assessed (although the risk of a re-rating is one that rated companies carry across many areas).

We therefore believe that the existing averaging methodology should be retained as a better way of reflecting changing conditions, both for rated and for non-rated companies. Where there is a change in levy band, averaging provides a smoother transition (both on the way up and on the way down a levy band) and allows sponsors greater predictability over the levy.

Question 9: Do you have suggestions of improvements and simplifications that would particularly help smaller schemes?

We do not believe that different charging methodology should be used simply because a scheme is below a certain size (however measured). Any improvements or simplifications that are made to the levy calculation should be available to schemes of all sizes.

Question 10: Do you support our proposals to amend the approach for calculating certified DRC amounts?

Any simplification to the methodology is likely to be welcome, if it leads to a significant reduction in advice costs without having a substantial impact on the overall fairness of the methodology.

Question 15: Do you have any suggestions on the drafting of the current standard form Contingent Asset documentation? Do you foresee any practical difficulties in re-executing agreements?

Re-executing all contingent assets is likely to lead to an increase in advice costs for those schemes with contingent assets, at least for the 2018/19 levy year. Given that an increasing number of employers are likely to be considering providing contingent assets (in preference to paying excess contributions into the scheme which could lead to trapped surplus), it is important that the PPF should have simple guidelines for the valuation and review of contingent assets to ensure that excessive costs are not incurred.

Question 17: Do you have views and/or evidence on the extent to which good governance leads to a reduction in risk, of one or more of the factors allowed for in legislation, to the PPF? If so are there particular aspects of governance that should be focused on for the purposes of awarding any levy discount?

If a way could be found to incorporate good governance as a risk factor in the levy calculation, this would be likely in principle to improve the fairness of the levy, encourage good behaviour and reduce the actual risk to the PPF. We therefore agree that this is an area worth investigating further. We would expect that the inclusion of a good governance measure in the levy calculation would be likely to favour large well-run schemes.

However, we have considerable doubt about the practicality of finding an objective good governance measure that could be incorporated into the levy calculation. The Pensions Regulator already has responsibility for promoting good scheme governance and it may be better for schemes to have clarity that it is the Pensions Regulator not the PPF who is responsible for scheme governance.

We hope that you find these comments useful. Please do not hesitate to contact me if you would like to discuss any of the points raised.

Yours sincerely,

Alan Stewart
Chairman
The 100 Group Pensions Committee