Rt Hon Frank Field MP  
Chairman of the Work and Pensions Select Committee  
House of Commons  
Westminster  
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23 March 2017

Dear Mr Field

Defined benefit (DB) pension schemes report

This letter is to follow up on the Committee’s report on DB pension schemes, published on 21 December. We welcome the report and were happy to have been able to assist this important enquiry.

The report contained two specific recommendations relating to the PPF, both regarding the PPF levy. This letter seeks to update the Committee on how we have set about addressing both of these issues in our consultation, published today, on the levy rules for the next three year period starting in 2018/19. I have enclosed a copy for your reference.

The PPF levy

We welcome the Committee's support for the risk-based PPF levy, and we share the Committee’s desire that the levy is as reflective of risk as possible. Whilst the introduction of the PPF-specific insolvency risk model in 2015/16 has been broadly welcomed by our levy payers, and been shown to be more predictive of insolvency risk, we recognise there are clearly areas where we can continue to develop the model to better reflect the risk that some schemes and their employers pose to us.

Whilst we review and charge the levy annually, we aim as far as possible only to make significant changes to the levy rules at the start of each three year period (or triennium). This reflects our commitment to provide predictability and stability for our levy payers so they can plan ahead and best manage their levies. Hence, the consultation we have published today provides the opportune time to consider the recommendations you have made.

Recommendation 2 – re-examine how the levy framework could incentivise schemes to improve governance.

We agree that good scheme governance, which balances the interests of different groups of members, holds employers to account and effectively manages scheme investment strategy, is of critical importance to delivering positive outcomes for pension scheme members.

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We considered this in detail in 2010 when we were consulting on the rules for the three years 2012/13 to 2014/15. At that time, after careful analysis, discussion with our Industry Steering Group (comprising senior industry representatives) and consideration of consultation feedback, we identified significant practical barriers so did not progress the work further.

Since then, a number of stakeholders have continued to consider scheme governance, and following the publication of the Committee’s report, we have ourselves again been looking at this. Any such good governance discount would, in our view, need to be based upon objective and transparent criteria that are demonstrably associated with positive outcomes for members and that complement the levy model’s calculation of insolvency risk.

Whilst there appear to be significant legislative difficulties at present with incorporating governance into the levy framework, as set out in Section 10 of the consultation, we are keen to hear if stakeholders think there is now a case for incorporating a discount for good governance in the levy calculation. Specifically we are keen to receive evidence that might demonstrate how good governance reduces risks to the PPF and the precise elements of governance that are most critical in that context. We are also requesting views on how good governance could be measured for the purposes of recognition in the levy.

**Recommendation 12 – examine the effect of the levy framework on particular types of employer, including mutual societies and SMEs**

The consultation outlines proposals to revise how employers are allocated to scorecards, to introduce two new scorecards and to rebuild existing scorecards where predictiveness has been weaker. The aim of these changes is to improve predictiveness and ensure scorecards are better tailored to company size, resulting for example in SMEs and ‘not-for-profits’ paying levies that better reflect their risks. As a result of the changes we are proposing in the consultation, in aggregate, smaller employers would see reductions in levy.

Beyond the changes we are proposing with scorecards and improving the insolvency risk model, we still recognise that there are particular issues for the smallest schemes in engaging with the levy rules. Some of these were brought out by various stakeholders in written evidence (eg. PPF0019) and by members of the Committee in the oral evidence session on 2 November. The smallest schemes lack the resources to obtain more than the legal minimum of actuarial support – and so often receive little or no advice on levy issues. This can mean, for instance, that it is overly costly and complex for small schemes to take advice on risk reduction measures (such as certifying Deficit Reduction Contributions). We have proposed specific options to simplify the current approach to certifying Deficit Reduction Measures which, whilst available to all schemes in our universe, would be of particular benefit to small employers.

In addition, we have examined further options to simplify the levy system for small schemes. When considering these schemes, the options are limited by the legislation governing the levy. In particular, we cannot simply cease to charge a risk-based levy or charge on a different basis unless we believe the risk posed by small schemes merits that treatment. There are, however, some possibilities within the legislative framework, which we have set out in Section 8 of the consultation, together with the associated pros and cons. We are keen in particular to hear the views of small schemes on these, and other ways in which we could simplify and improve the system.
We have also considered the issue, raised variously with the Committee and directly with us by a number of stakeholders, regarding the calculation of the insolvency risk of mutual entities, and in particular the treatment of mortgage age data. As part of our approach to rebuilding scorecards, we propose to favour variables that can take into account a wider range of values. This has in particular resulted in the elimination of variables based on the age of secured borrowing from the new scorecards. This was a particular concern to mutual entities and the Committee.

**Engagement with levy payers**

We very much value input from our stakeholders. In developing the proposals contained in this consultation, we have again engaged with our Industry Steering Group. We have also organised a number of roadshow events across the country as well as webinars, to take place during the consultation period, so as to engage with as many of our levy payers (particularly small schemes) as possible. We encourage schemes and sponsors to participate in these events and share with us their views.

I hope this information is helpful. I would be more than happy to answer any further questions you or colleagues on the Committee may have on the consultation. I will write again to update the Committee after the consultation.

Yours sincerely,

Alan Rubenstein
Chief Executive

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1 Written evidence PPF0059; Oral evidence Q3410-3414

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