ASSOCIATION OF CONSULTING ACTUARIES

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31 October 2017

Chris Collins
Chief Policy Adviser
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon, Surrey
CR0 2NA

Dear Chris

Combined Third Triennium Policy Statement and 2018/19 Consultation Document

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation issued on 27 September 2017.

We are generally comfortable with most of the changes proposed, though note that the proposed levy band changes continue the recent trend towards further shifting the cost of the PPF levy to the strongest employers. There will be significant increases in the levy for some strong employers which is counter to the stability message that you put out.

Our comments on the specific questions raised in the consultation are set out in the Appendix.

We hope that you find these of assistance and would be happy to discuss them further if that is helpful. Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague Kevin Rowe who prepared this response on 0113 203 5897 (kevin_rowe@jltgroup.com).

Yours sincerely

David Everett

David Everett
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

Sent by e-mail to: consultation@ppf.gsi.gov.uk

APPENDIX

The third PPF levy triennium – 2018/19 Consultation Document

Chapter 10: The Levy Scaling Factor and Levy Estimate

1. Do you have comments on the approach to calculating the LSF?

We welcome the proposal to reduce the overall levy amount and thus the reduction in the LSF. We also welcome the intention to keep the LSF constant over the triennium.

2. Do you agree with our proposal to reduce the Risk-Based Levy cap?

Yes, particularly having noted that you expect the revised cap to apply to a similar number of schemes as before. We would comment further though that this must mean a further redistribution of the levy to the strongest employers, on top of the changes to levy bands previously consulted upon.

Chapter 11: Levy Bands and Rates

3. Do you have any comments on the proposals for levy bands and levy rates?

We welcome the testing of the levy band structure against Moody's data, and are comfortable with your conclusion that no changes are required to the bands.

However, the proposed changes to levy rates do appear to increase the amount that stronger employers must pay relative to the weaker, in particular the significant increase in levies for employers in bands 1 and 2, even after taking into account the reduced LSF of 0.48.

Over the years what the levy rate represents has changed. It was a distressed five year insolvency risk; in 2012/13 it became the amount financial market participants would charge to cover insolvency risk; in 2015/16 it was a combination of the expected insolvency rate plus a risk margin. Over this period the levy rate associated with band 1 has consistently been brought closer to the other levy bands.

It is not now clear what the levy rate represents. If it is a means to achieve a defined policy aim (such as stronger employers paying more), then that could be reasonable, but should be clearly stated. If it is intended to theoretically represent a company's risk to the PPF, we suspect it is no longer doing so.

Research from Deutsche Bank (see figure 54 on page 32) shows the difference between an A rating (band 1) and a BBB rating (band 3). This is both in terms of the implied default rates that are priced into debt issuances (the figures on the left hand side of the table) and the insolvency rates during a stressed five year period (the "Worst" figures on the right hand side of the table. By any measure the difference between band 1 and band 3 is considerably more than the difference in the proposed levy rates (0.28% and 0.35% respectively).

We would reiterate the point that the strongest employers, who already pay a substantial portion of the total levy, are enabling reduced levies to be delivered for all others.

We note however that you also conclude that the LSF will fall further if this change proceeds, mitigating the increase to some extent.

Chapter 15: Block Transfers

4. We would welcome stakeholder comments on our proposed rule changes and our draft guidance

In principle we welcome the move to allowing "Exempt Transfers".

However, given the requirement for legal advice to allow a Self-segregation transfer the change does not appear to materially reduce the amount of work required by schemes compared to the existing block transfer regime.

The approach taken for One-to-One transfers is simpler and represents an improved option for schemes in this position.

5. We would welcome suggestions on improvements that could be made to the supply of data following bulk transfers.

The ability to be able to enter data on both transferring and receiving schemes in advance of a transaction (perhaps with as assumed effective date for the transfer) would give schemes more flexibility in completing the work associated with these procedures, and potentially give PPF/tPR more timely information post transaction.

Draft levy rules

Finally we have some comments on the draft levy rules as follows:

Transformations appendix

In our response to the consultation on the 2017/18 levy we said the following:

> "We would appreciate if the PPF could review the approach taken to rolling forward LDI assets in the draft transformation appendix as there is no explicit category for these types of investments and they tend to get entered into the scheme return as "cash" as there is no better alternative. This then gets rolled forward using cash returns rather than reflecting what the underlying asset has actually done and may explain why new valuations received by the PPF often show better asset returns than expected. Whilst we acknowledge that the option is available for schemes to submit bespoke stress tests, a number of smaller schemes are now investing in pooled LDI funds and such schemes do not necessarily have the resources to be able to submit a bespoke stress test, as compared with larger schemes who have bespoke liability hedging arrangements. We would therefore request that the PPF looks into this further."

We remain of this view.

Insolvency risk appendix

In paragraph 4.12 you say the following:

> "The value obtained at paragraph 4.10 is multiplied by the Adjustment Multiplier which applies to the relevant Scorecard as set out in Table 3 below:"

We think that the reference to paragraph 4.10 should in fact be to paragraph 4.11.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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