Pension Protection Fund

Consultation on contingent assets in the PPF Levy

October 2017

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1. Introduction

1.1 Background to this consultation

1.1.1 In March we issued our first consultation on our approach to calculating the levy over the next three year period (2018/19 to 2020/21). In that document we highlighted a specific doubt expressed about the interpretation of the wording in some of our standard form contingent asset agreements. We sought views on our proposal to update the wording and to ask trustees and guarantors/chargors to re-execute agreements on the new basis, in order for them to be taken into account in the levy from 2018/19 onwards.

1.1.2 We set out stakeholder comments and our conclusions in our September publication. After reviewing the wider policy underlying these agreements and in light of responses from stakeholders, we decided to consult further before finalising our approach. In particular, we are keen to understand how stakeholders – both trustees and guarantors/chargors - use these agreements in practice.

1.2 Scope of this consultation

1.2.1 This document sets out the changes we are proposing to make to our standard form agreements and the rationale for those changes. To support stakeholders in understanding and commenting on our proposed approach, we are also making available drafts of the amended forms. The changes address the issues identified but otherwise broadly preserve the existing framework and assume a continuation of the current system of levy credit.

1.2.2 We are seeking views on issues of some technical detail. To help inform that consideration, we have set out aspects of the general contingent asset framework for context, but it is not our intention to consider these more widely.

1.2.3 The scope of our review, and of this consultation, is to consider:

(1) The type of obligations that should be covered by the agreements; and

(2) The operation of the liability caps in the agreements, in particular the fixed cap, alongside other general improvements to the agreements.

1.2.4 Our review is focused primarily on Type A contingent assets (group company guarantees) and Type B contingent assets (charges). Type C contingent assets (bank guarantees) contain different wording that we are not currently seeking to substantially update.

1.3 Our intended next steps

1.3.1 We expect to publish the final version of the standard forms in January 2018. New contingent asset agreements entered into after the date of final publication of the new standard forms will be required to be on these new forms (as has previously been the case whenever a new standard form has been issued). For existing Type A and Type B agreements, we will not require re-execution in 2018/19, but are likely to require action to adopt the new standard forms to be taken for 2019/20. Existing contingent assets executed prior to the date of publication of the new forms will therefore continue to be able to be submitted for recognition in the levy for 2018/19.

2. Background to the contingent asset framework

2.1 Origins and evolution

2.1.1 From the first year of operation of the Risk-Based levy we have recognised group-company guarantees, charges, and bank guarantees[1] through the levy as respectively Type A, Type B and Type C contingent assets. Where they are robust, contingent assets can provide a real benefit to schemes and, indeed, to the PPF.

2.1.2 Our role in setting levy rules is primarily to price risk rather than to seek to influence particular behaviour. The inception of the contingent asset framework was, therefore, in order to reflect (in the levy) pre-existing behaviour in the market, in response to stakeholder request. Our aim has been to give appropriate credit for the risk reduction so as to ensure a level playing field between schemes with different contingent assets and those with none.

2.1.3 However, we are aware that the levy credit available and our standard forms have shaped the market. In particular, we believe that they have helped to encourage a growth in the number of arrangements and as trustees and their advisers have frequently observed, our regime has provided a helpful basis on which to put in place agreements they and sponsors can have confidence in.

2.1.4 The key features of PPF-compliant guarantees[2] are:

(1) They guarantee (on demand by the trustees) all obligations of the employer(s) listed in the guarantee in respect of the relevant scheme (on demand by the trustees), including ongoing contributions, recovery plan contributions, and statutory obligations on employer cessation events.

(2) They are intended to be irrevocable and indefinite. They should not be expressed as being in place for a limited period.

(3) On their terms, they are only able to be amended or released with the consent of trustees, and only then in limited circumstances relating to the overall funding position of the scheme.

(4) They contain caps on the liability of the guarantor, and these are set out in section 5 below.

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[1] Including letters of credit and surety bonds

[2] In this document, for ease of reading we use the terms "guarantee" and "guarantor" to generally apply both to Type A and Type B contingent assets when we are describing aspects of the framework or standard forms that apply to both.

2.1.5 We ensure that guarantees that we recognise meet these requirements, and achieve comparability between arrangements, through setting out standard form agreements, and requiring a legal opinion to confirm that departures from the standard form are not materially detrimental to the trustees. We then ensure that levy credit is fair, by assessing the strength of guarantors (for Type A contingent assets) and the appropriate value of charged assets (for Type B contingent assets).

2.1.6 Since the inception of the regime, we have developed the rules in response to experience and stakeholder feedback. In particular:

(1) From levy year 2010/11, we introduced a requirement that schemes provide evidence that the corporate benefit to the guarantor had been considered when putting in place the agreement.

(2) In levy year 2012/13, we formalised in our rules our expectation that the levy recognition for Type A contingent assets should be commensurate with the reduction in risk they offer, by requiring trustees to certify as to the guarantor's ability to meet the sum certified, and we took steps to test guarantor strength. In levy year 2015/16 onwards, we further evolved this principle by requiring trustees to certify the amount they were reasonably satisfied that the guarantor could meet (or any fixed cap in the agreement if lower).

(3) In levy year 2012/13, in response to stakeholders, we changed the levy calculation so that for Type A contingent assets, the guarantor's insolvency risk score was substituted only for those employers that had a weaker score than the guarantor.

(4) From levy year 2015/16, for Type A contingent assets we have applied an adjustment to the guarantor's levy band based upon the impact of the amount that it is guaranteeing would have on its gearing if it was called upon.

(5) We intend, from levy year 2018/19, to require a consultant's report on guarantor strength to be obtained before the largest Type A contingent assets can be certified, amongst other changes.

2.1.7 Throughout the evolution of the wider levy framework, whilst some changes have been made to the contingent asset levy rules to accommodate wider changes, the standard forms have been reviewed and updated but never fully replaced – meaning some contingent assets on the original 2006 standard forms have continued to be recognised in the levy.

2.1.8 The take-up of contingent assets has been significant as can be seen in the table below, showing the number of contingent assets recognised each levy year. We are aware that the contingent assets certified to us do not represent the total number of agreements entered into using our standard form as a basis, and that this consultation may be of interest beyond those schemes that currently benefit from contingent assets in the levy.

Table 1: Number of contingent assets by levy year

Levy Year	Type A	Type B	Type C
2006/07	107	13	15
2007/08	215	34	20
2008/09	362	62	29
2009/10	514	81	20
2010/11	628	100	19
2011/12	764	114	17
2012/13	716	126	7
2013/14	666	141	10
2014/15	624	133	13
2015/16	480	121	12
2016/17	446	128	11
2017/18	428	132	14

3. Why are we looking at the agreements now

3.1 Issue identified

3.1.1 Our general understanding has been that the contingent asset regime works well. We do not see a need for a wholesale review of the framework.

3.1.2 However, we have recently become aware that the wording of the cap in the standard form agreements requires our attention. It is possible to argue that the current wording in the Type A and Type B agreements means that *any* payments made (whether by the guarantor in the absence of a demand under the guarantee, the employer, another guarantor, or otherwise) in respect of the guaranteed obligations of the employer would erode the fixed cap (the "Cap Interpretation").

3.1.3 As we stated in our March and September consultation documents, we do not agree with this interpretation, nor do we think that this interpretation is likely to represent the understanding of trustees or guarantors, when putting guarantees in place and relying upon them. However, given the importance of these agreements to schemes and to the PPF, we remain of the view that we should amend the standard forms to put the matter beyond doubt.

3.1.4 However, consideration of this issue, alongside our intention to review the standard forms for any other changes that might need to be made at the same time, also prompted us to consider wider questions around the operation of the caps – in particular, whether payments made under the guarantee but outside of insolvency scenarios should erode the cap and if so, how we ensure appropriate levy credit is given (the "Cap Operation" question).

3.1.5 We think it is right to address both points at the same time, together with limited other changes, to avoid having to require a second re-execution in the near future.

4. The Cap Interpretation

4.1 Revised wording

4.1.1 In the existing wording of the Type A and Type B agreements, the cap sits within the definition of "Guaranteed Liabilities". The consultation draft moves the cap into a new capped recoveries clause to remove any doubt as to the intention of the parties; namely, that the fixed cap is not reduced as a result of any subsequent deficit top up payments made by the employer, the guarantor, or another guarantor.

4.1.2 The Cap Interpretation issue does not arise in relation to the Type C agreements (bank guarantees).

5. The Cap Operation

5.1 The liability caps in the Type A and Type B agreements

5.1.1 At present, the Type A and Type B agreements do not seek to distinguish between demands which are pre-insolvency or post-insolvency, and for that reason the agreements envisage demands being made in both circumstances. In light of how the contingent assets have operated since they were introduced, it is helpful to consider these two circumstances separately in order to understand whether changes would be appropriate to provide clarity for schemes and guarantors and protection for the PPF.

5.1.2 We have focused our consideration on Type A and Type B agreements. There are a range of differences between those types and Type C agreements including their broader design, the circumstances in which they can be called upon (and the mechanism for doing so), and the nature of the relationship between the parties to the agreement, which mean that the issues described in respect of Type A and Type B agreements do not arise in the same way for Type C agreements. We will consider the need to update the type C standard form in the light of conclusions about the Type A and Type B forms.

5.1.3 There are currently five types of liability cap in the Type A and Type B contingent asset agreements:

(1) Fixed monetary sum (called the "fixed cap");

(2) The amount of money required to bring the scheme to a specified percentage funding level (often 105 per cent) on a s179 basis (called a "fluctuating cap");

(3) Amount equal to the liabilities of the employer(s) were a s75 debt to become due (called a "fluctuating cap");

(4) Lower of (1) and (2); and

(5) Lower of (1) and (3).

Consultation question: we would be interested in views on whether there is value in continuing to offer all the different types of cap, given the limited use made of some cap types?

5.1.4 The guarantor guarantees all of the present and future liabilities of the employer to the scheme, but the relevant cap limits the amount of those liabilities that can be recovered from the guarantor. At any time the relevant fluctuating cap remains available to its full value (although the cap itself depends on the actual value at the relevant time of the s75 debt or s179 deficit, which of course fluctuates over time), and the guarantor's obligation to fund the scheme to the cap level continues, and is not directly altered by any payments that the guarantor might make pursuant to earlier demands under the guarantee.

5.1.5 We think this continues to be the right approach for a fluctuating cap, consistent with current levy credit. If a demand is made at a particular point in the scheme's lifetime so that the guarantor is required to pay an amount into the scheme, the cap going forward will be based on the ongoing deficit of the scheme; so if a payment is made then (all other things being equal and if the trustees are able to immediately apply the guarantor's payment against the deficit[3]) it reduces the deficit and hence the amount that might be paid under the fluctuating cap.

5.1.6 In relation to Type B contingent assets, the amount the trustees may apply against the scheme is the lower of (a) the net proceeds of enforcement of the relevant charged assets; and (b) the relevant cap. The analysis in the paragraph above applies equally to such element (b).

5.1.7 For the fixed cap, though, there are a number of possible approaches we could take when considering the Cap Operation in the new agreements.

(1) The agreement covers all the obligations of the employer(s), including ongoing payments as well as demands on insolvency. The fixed cap covers the aggregate of all payments so may be exhausted before insolvency.

(2) The agreement only covers demands in an employer insolvency, and the fixed cap attaches accordingly to these demands.

(3) The agreement covers ongoing demands and insolvency demands, and fixed cap covers both but renews on each demand made, so will be available in full on insolvency.

(4) The agreement covers ongoing demands and insolvency demands, but the fixed cap only attaches to insolvency demands.

(5) The agreement covers ongoing demands and insolvency demands, and there are separate fixed caps for (i) the aggregate of ongoing demands and (ii) for insolvency demands

5.1.8 There may be numerous other variants of options, but we focused our consideration on those identified above.

Option 1

5.1.9 Option (1) is not appropriate because such a guarantee is difficult to reconcile, on its terms, with the primary purpose of the contingent assets agreements, which is to protect the scheme in the event of employer

[3] If the guarantor is only able to pay part of the total liability due from the relevant insolvent employer (either because of the fixed cap, or because the guarantor itself is insolvent), the trustees are likely to hold the guarantor's payment on suspense, as per the terms of the guarantee, so that it can make a full claim in the employer's insolvency and thereby increase its overall recovery.

insolvency. In principle, such a cap could be completely used up by the time the guaranteed employer becomes insolvent. The legislative framework for recognising contingent assets enables us to consider, when setting the levy rules, arrangements which:

> "may reduce the risk of compensation being payable from the Pension Protection Fund in the event of an insolvency event occurring in respect of an employer in relation to the scheme".[4]

5.1.10 A guarantee with an inbuilt mechanism that could ensure that it is of no assistance in the event of an employer insolvency event occurring is both out of line with the critical core purpose of these agreements and, it might be argued, out of line with the legislation.

5.1.11 A cap that may not protect a scheme's position on insolvency would involve a fundamental reworking of our levy calculation for schemes with contingent assets (which might lead us to conclude that no levy recognition could be given). We have always required guarantees to be indefinite (i.e. they cannot be time-limited), because although the levy is charged annually, the levy estimate of how much we are seeking to collect each year is calculated to support the achievement of our longer term funding strategy. This strategy aims to establish a reserve that can deal with unexpectedly large claims in the future. It follows that a scheme whose risk is understated because of the recognition of a contingent asset that is subsequently unavailable will have effectively under-paid that contribution toward future risk. This principle applies in the same way to the risk that a cap is eroded before the employer is insolvent.

Option 2

5.1.12 We then considered Option (2), namely a guarantee that is only available on insolvency. We are aware, though, that the existing scope of guarantees (covering ongoing payments as well as obligations on insolvency) is of value to schemes, not necessarily because of the direct ability to make these demands, but because of the indirect ability of being able to use the existence of the guarantee to leverage contributions made outside the guarantee. We also recognise that, as a matter of fact, there may be situations where a scheme's outcome is improved by enabling the guarantee to be called upon prior to insolvency rather than only on insolvency (an example might be where the employer and guarantor are part of a wider group insolvency and where the scheme would have been better off receiving the money directly over a longer period than having a claim in the guarantor's insolvency).

5.1.13 More specifically, in terms of levy recognition, we would have concerns about recognising a guarantee if the scheme's position could have been undermined by the employer not making contributions that it was expected to,. Providing the trustees recourse to the guarantor in respect of the employer's pre-insolvency commitments reassures us that the sum available on insolvency is genuinely additional – rather than simply

[4] Regulation 2 of the Pension Protection Fund (Risk-based Pension Protection Levy) Regulations 2006

substituting for ongoing ordinary costs that have not been met (such as the normal costs of accrual, and recovery plan payments).

Option 3

5.1.14 Given our view that pre-insolvency demands should not be able to erode the fixed cap, we considered whether the agreements should require the fixed cap to refresh each time a demand was made (Option 3). Although this would meet our expectation that the sum guaranteed would be available on insolvency, this formulation, particularly for a multi-employer scheme, would appear to substantially increase the guarantor's obligations on insolvency. Accordingly, we think it likely to be less attractive to those providing the guarantees than other satisfactory options.

Option 4

5.1.15 Another alternative is for agreements to cover all employer obligations but with a cap that only applies in the event of the employer insolvency (Option 4). This would preserve the full fixed cap on insolvency, but also provide schemes with the comfort of knowing that ongoing employer contributions were also guaranteed.

5.1.16 We consider this is the right option as a matter of principle, as it seems to us that the natural corollary of crediting the guarantee as insolvency support in the levy is to expect the scheme to be supported prior to insolvency (without the guarantee being affected).

5.1.17 We recognise that this formulation may not be one that is commercially commonplace, but we think it is in line with the practical usage of guarantees as we are not aware of formal demands generally being placed on guarantors for ongoing obligations.

5.1.18 Allowing a fixed cap to erode prior to insolvency would create a risk that the guarantor makes payments that the employer is able to make, meaning that the cap could be completely eliminated on insolvency and the scheme would be no better off from having the contingent asset. If the guarantor makes payments that the employer is *unable* to make, there is a similar risk that the effect of the guarantor's intervention is to defer the insolvency of the employer (and erode the cap while they are doing so), with the result that on the eventual insolvency, there would be increased PPF drift[5] and a reduced guarantee.

Option 5

5.1.19 The final option that we considered was for separate fixed caps in relation to ongoing liabilities and insolvency-related liabilities (Option 5). For similar reasons as set out above in relation to an insolvency only guarantee (option 2), we have reservations about the suitability of this option, as we would expect the pre-insolvency support to be sufficient to compensate for any shortfall in contributions from the employer – so that we can have confidence that the sum available on insolvency is genuinely additional to normal ongoing payments to the scheme – rather than substituting for

[5] "PPF drift" is where the continuation of a scheme means that the PPF liabilities increase by virtue of more members passing their normal retirement age and being entitled to a higher level of PPF compensation.

payments the employer was committed to make pre-insolvency. And practically, if guarantees are not actually being called upon pre-insolvency for wider reasons, there seems little benefit in introducing additional complexity in the form of a second cap for pre-insolvency claims.

Conclusion: Option 4 is the preferred option

5.1.20 Therefore, our position is that the fixed cap must remain available in full in the event of an insolvency event of the employer, whilst continuing to provide for the agreements to provide cover for other payments. The draft forms attached to this document give effect to that intention.

5.1.21 We would welcome stakeholder views on this assessment. We recognise that, to an extent, the caps are based on the commercial obligations that exist in the marketplace and we are keen to hear from those who want their agreements to operate differently.

Consultation question: do stakeholders agree that Option 4 offers a workable solution to ensuring that a guarantee on insolvency is additional to employer support pre-insolvency? Are there other approaches which would achieve that?

5.2 Multi-employer schemes

5.2.1 We think the above conclusion works well for a single-employer scheme (or a multi-employer scheme where only one employer is associated[6]) as there is only one situation in which the fixed cap can reduce.

5.2.2 The position is generally more complex for multi-employer schemes. We are clear that non-insolvency claims should not erode the amount available in a fixed cap on eventual insolvency. In principle, as with single employer schemes, it would seem reasonable that in multi-employer schemes with a discretion/requirement to create a segregated part on an insolvency, a demand after an insolvency should erode the fixed cap (for all the reasons set out above), assuming the money received is applied against the segregated liabilities. However, we recognise that there are particular issues that arise from the consideration of the operation of guarantees in multi-employer schemes, especially given the differences between types of schemes and the number of different scenarios that could arise. Given the complexity of these issues, we are particularly keen to receive stakeholder input to help us finalise our approach.

Partial segregation schemes

5.2.3 For a partial segregation scheme, on an insolvency event of an employer where a new segregated part is created which is then assessed for PPF entry, it would be consistent with the approach described under Option 4 above for the fixed cap to be reduced by the amount paid by the guarantor on that first insolvency, rather than the guarantor having to pay the amount of the cap on each insolvency. This is also broadly consistent with our current levy credit – which is limited to the value of the cap applied

[6] Guarantees must cover all associated employers. A guarantor could though only be associated with one employer in a multi-employer scheme

across the whole scheme[7]. In principle, the proposition that the fixed cap is able to reduce because some of the liabilities of the scheme have left the scheme, is reasonable.

5.2.4 However, in the event of the creation of a segregated part, the debt that would be due from the employer to the scheme is the full s75 debt, irrespective of the drafting of the guarantee. Where the s75 debt of that employer is lower than the fixed cap, the trustees should therefore be able to claim that full amount from the guarantor. Where the s75 debt is higher than the fixed cap, the fixed cap will be claimed upon in full. This could mean that the first insolvency in a scheme significantly reduces (or even eliminates) the available fixed cap for subsequent insolvencies. From a member equity perspective, assuming the money received is all applied against the segregated part this could mean that scheme members in the earlier insolvencies, benefiting from a full s75 claim being paid by the guarantor, fare better than members of employers who become insolvent at a later date.

5.2.5 This effect arises in all of the caps apart from the full s75 cap (because in that scenario, the fact that an employer exits with its full s75 debt paid does not extract a disproportionate amount of the overall scheme cap) and is a consequence of a cap applying to the whole scheme rather than applying only to each employer.

Example: partial segregation scheme with fixed cap – potential for unequal treatment of members

S75 guarantee, with fixed cap of £10m applies to scheme with S75 deficit £50m

Employer 1 insolvency event

S75 debt of £9m arises and is claimed in full

Guarantor pays full s75 debt of employer – full scheme benefits secured for members

Remaining scheme is disadvantaged – as only £1m of cap remains with £41m s75 deficit

[7] i.e. if a CA is capped at £10m then the levy reduction is only in respect of a maximum of £10m of underfunding risk – not £10m per employer.

5.2.6 An alternate approach would be to aim for an apportionment of the cap between employers as they exit. This could, for example, be achieved by retaining the fixed cap on the overall scheme but by placing a separate s179-level cap on the individual insolvencies. We note, though, that where a scheme is funded between s179 level and full s75 level, it may not be desirable to place an s179 level limit on the amount that might be claimed under the guarantee, as to do so would prevent the members in that part from achieving the improved level of benefits that is potentially available to the rest of the scheme.

5.2.7 An alternative more way for the cap to work might be if it applied to each employer rather than to the whole scheme, as outlined below. This would make consideration of the caps simpler on second and subsequent insolvencies, as they would be unaffected by previous insolvencies.

5.2.8 The cap would allow, for example, for the situation where the guarantor is prepared to cover the full s75 / s179 of smaller employers, but only up to a cap for larger employers. However this would potentially give rise to equity issues, if it meant that member outcomes depended on the size of the employer (e.g., if all employers went insolvent on the same date and some members received full benefits and others PPF compensation, depending on the size of their particular employer).

5.2.9 Whether or not the cap were to apply to each employer, we are aware that trustees may not be legally required to pay monies received by the guarantor into the segregated part. It would seem most appropriate for trustees of schemes benefiting from levy credit to be required to do so, because otherwise the segregated part may transfer to the PPF with a deficit.

Consultation questions:

(1) ***In a partial segregation multi-employer situation, should the cap be applied in respect of the whole scheme, or should it be expressed as applying in respect of each employer's obligations on an insolvency demand?***

(2) ***If the cap were to be applied across the whole scheme, on the insolvency of an employer should the cap be allowed to be exhausted sequentially by insolvencies, or is there a case for requiring apportionment? How might apportionment be achieved?***

(3) ***If the fixed cap, or "lower of" cap, were applied across the whole scheme, should it erode on individual insolvencies?***

(4) ***Does the form of liability cap make a difference to the most appropriate solution?***

(5) ***Are there workable formulations of liability cap for multi-employer schemes that are not currently reflected in the agreement, such as an overall fixed cap for a scheme but s179 caps for individual insolvencies?***

(6) ***Should money from the guarantor in respect of a segregated part be required to be applied to that part? If so, how might this be achieved?***

Last man standing schemes

5.2.10 The position of a last man standing scheme (LMS)[8] also needs separate consideration. In such a scheme, in the event of an insolvency[9] of an employer, the pension liabilities in respect of that employer are, by operation of the scheme rules, met by the other employers, but a s75 debt will arise. Accordingly, the guarantor can be required to pay into the scheme at each insolvency, but a PPF assessment period will not commence until all the employers have become insolvent. In this situation, it might be argued that a fixed cap should not reduce once a payment on an insolvency is made, because the liabilities to which that payment relate have not left the scheme; if the cap were to reduce, the risk remains that in the event of the commencement of a PPF assessment period, the cap may have been reduced to nothing.

5.2.11 In this respect, an LMS scheme bears some similarity to a single employer scheme where payments prior to the insolvency that triggers PPF assessment should not reduce the cap – although we do observe that there is likely to be a significant difference (in terms of quantum) between a demand for an ongoing payment such as a missed recovery plan payment, and a demand for what will be the full s75 debt of an employer.

5.2.12 We are also aware of the benefits to schemes in receiving money sooner rather than later (more generally, but specifically in the case of an LMS scheme where, as employers become insolvent, the liabilities fall to be met by the remaining employers). Calling on the guarantee on each insolvency event, or even calling on the entire guarantee on the first insolvency event, may well increase security when compared with the situation where the guarantee is preserved until the Qualifying Insolvency Event; if the scheme receives the money, it would, for example, be able to de-risk more quickly. We note that the position of an LMS scheme is substantively different to that of a partial segregation scheme – in particular, a call on the guarantee in an insolvency event of an LMS employer does not involve those assets leaving the scheme (although it does not involve the liabilities leaving the scheme either), and payments by a guarantor into a last man standing scheme on an insolvency would abate the remaining employers' obligations to fund the liabilities left by the insolvent employer.

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[8] i.e. a scheme to which Part 6 of the Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005 applies.

[9] As opposed to a Qualifying Insolvency Event as defined in s127 of the Pensions Act 2004

Consultation questions:

(1) ***What suitable protection can a guarantee offer an LMS scheme? Is it more beneficial to the scheme if:***

(a) ***The entire guaranteed amount is payable on the first insolvency?***

(b) ***The guarantee is apportioned between employers / insolvencies, either on a pre-fixed basis, or on a share of fund basis?***

The guarantee is preserved until a Qualifying Insolvency Event occurs.

(2) ***Should the position of LMS schemes differ where the guarantor is also a scheme employer?***

5.2.13 The analysis in this section highlights the difficulties in applying a cap concept that works for a single employer situation across to a multi-employer situation. We note, though, that it may not be optimal for there to be significant differences in agreement and levy treatment for single and multi-employer schemes, because a scheme's situation might change over time (for example, a group restructuring might mean that a guarantor is associated with different employers).

5.2.14 We welcome views, from all types of schemes, on the approaches that might provide suitable risk reduction to schemes whilst remaining commercially acceptable to guarantors. We would caution, though, that the multiplicity of possible scenarios and outcomes for multi-employer schemes will mean that some simplification of approach will be required in order to provide a workable standard form.

5.2.15 Given our intentions to seek stakeholder input before finalising the forms for multi-employer schemes, the draft standard forms that are being made available for consultation do not yet contain wording to seek to capture the Cap Operation in respect of multi-employer situations (although the rest of the wording of the agreements contains the necessary references to multi-employer schemes).

6. Ensuring appropriate levy recognition for contingent assets

6.1 Scope of review

6.1.1 The existing recognition for contingent assets is based upon the expectation that, in principle, the fixed cap is available on insolvency. In practice, that sum may be affected by the ongoing viability of the guarantor (or in the case of a Type B contingent asset, the value of the asset forming the security), and the value given in the levy builds in allowance for these. For Type A contingent assets, this is through substituting the insolvency risk of the guarantor for the employer's (where the guarantor's insolvency risk is more favourable), and for Type B contingent assets, by stressing the value of the asset.

6.1.2 In view of our preference for retaining the commitment to full value on insolvency, we have not considered significant change to the current levy recognition, and neither do we see the need to fundamentally revise the formulae. However, the principles underlying the standard form agreements and the levy credit we recognise should be aligned. If as a result of this consultation the final forms of agreement change, we may need to make consequential changes to levy credit in the Levy Rules.

6.2 Changes to the current framework

6.2.1 Whilst we are intending to make clear that guarantor payments prior to an insolvency do not erode a fixed cap, our view is that the coverage of such payments by the guarantor should not receive any separate levy credit. We consider this consistent with the view that to be genuinely additional, a guarantee of obligations on insolvency must be built on the base of a commitment to ensure ongoing obligations are met prior to insolvency.

6.2.2 We would also note that recognition of any pre-insolvency payments that are actually made could occur through deficit-reduction contribution certificates or improved scheme funding.

6.2.3 Any other changes to the current framework will be dependent on our final conclusions on how the agreements for multi-employer schemes will be structured.

6.3 Changes in contingent asset cover

6.3.1 Our position has always been that Type A and Type B contingent assets should be indefinite, i.e. should not be time-limited, and should not be released or amended except in limited circumstances. Consistent with this, we have included in the standard forms, since the second iteration in 2006, criteria to provide the guarantor with the opportunity to require that the agreement will be amended or released, in appropriately limited circumstances[10].

6.3.2 Alongside this, our levy rules explicitly provide for the possibility that a scheme amends or releases their contingent asset cover in a way that leaves the scheme worse off. In those circumstances, we may recalculate the levy disregarding the contingent asset (if the change is partway through the levy year). We also apply a year-on-year test so that if a scheme reduces contingent asset cover in this way, our intention is then not to recognise contingent assets in future years until the scheme's position is restored to how it was before the removal of the cover.

6.3.3 We are considering whether the amendment/release criteria in the agreements could be simplified. We are conscious that the existing criteria can be complex and may not be well-understood.

6.3.4 We would welcome views from trustees in particular as to whether the current amendment/release criteria offer a valuable protection or negotiation point for trustees, and in particular whether trustees would feel they would be able in practice to navigate the criteria and formula set

[10] The first iteration of forms in 2006 did not contain any such criteria; the criteria were introduced in order to provide a mechanism to assist guarantors to remove/reduce their obligations in circumstances where the scheme's funding position had improved.

out in the schedule to the current templates (e.g. Schedule 2 in the form of Type A agreement) in order to consent to the amendment or release. We would also be interested to hear whether guarantors and prospective guarantors are reluctant to sign up to agreements because of the current amendment and release mechanism.

Consultation questions:

(1) ***Do the current amendment/release criteria offer a protection, or negotiation point, for trustees at present?***

(2) ***To what extent do trustees feel able to assess proposals put to them by guarantors?***

(3) ***Are guarantors (or prospective guarantors) deterred from signing up to agreements because of the current amendment / release mechanism?***

7. The proposed new standard form agreements

7.1 Type A and Type B contingent assets

7.1.1 As noted above, we are no longer proposing to require re-execution onto new forms for the 2018/19 levy year. The draft standard forms that we are making available for comment at this stage, and that we expect to publish in January, should be used for any new contingent assets entered into after the date of publication of the revised agreements (as has always been the case whenever a new form is issued).

7.1.2 As well as the change outlined above to address the Cap Interpretation, the following main changes are being made:

(1) Our Levy Rules require a guarantee to cover all employers associated with the guarantor, and previously, the schedule to the agreement required the guaranteed employers to be named. We have introduced a provision that the guaranteed employers will also include all employers from time to time that are associated with the guarantor. This should avoid the need for an amendment to be made to the agreement if the list of named employers needs to be changed.

(2) We have inserted wording to confirm that the fluctuating cap based on the s179 level is calculated as at the date the relevant employer suffered an insolvency event, and that the trustees are responsible for determining the new underfunding figure (which then allows the guarantor to pay the sum demanded of it). We have also confirmed that the cap based on s75 is calculated in line with the statutory requirements for timing.

(3) We have made it clearer that the benefit of the guarantees/charges will pass to any successors to the trustees that originally execute the agreement.

(4) We have relaxed the requirement that the representations given by the guarantor (as to various matters including its legal capacity to enter into the agreement) are deemed to be repeated on a daily

basis. The wording now requires that they are deemed to be made when the agreement is executed, and then every year thereafter.

(5) We have updated the drafting of some of the provisions, such as the covenants, representations, gross up clauses, and set-off clauses to make the drafting of the agreements more consistent.

(6) In the Type B(i) and Type B(iii) draft it is now clearer that the trustees have practical and exclusive control over the cash and securities accounts that are the subject of the charge.

7.2 Type C contingent assets

7.2.1 We are also making available forms for Type C contingent assets, for any new agreements that are entered into after the date those new forms are published.

7.2.2 The Type C agreements do not contain the wording that is affected by the Cap Interpretation. The following main changes are being made:

(1) As with Types A and B, we have made it clearer that the benefit of the guarantees/charges will pass to any successors to the trustees that originally execute the agreement.

(2) We have made general clarificatory improvements to the drafting of some of the provisions, in particular including a new definition of the available amount under the agreement to more clearly set out its maximum limit.

7.3 Levy year 2019/20 onwards

7.3.1 The new standard forms that we are making available as part of this consultation contain a number of improvements, as outlined above (as has previously been the case when new versions of the standard form have been produced). We would encourage schemes to move onto the new versions, to take advantage of these.

7.3.2 Our expectation is that for 2019/20 our contingent asset requirements will be updated to require Type A and Type B contingent assets that are certified (or re-certified) for that levy year to give effect to our proposals in relation to the operation of any cap. For Type C contingent assets, we would be interested in views as to whether the issues described in respect of multi-employer schemes affect Type C contingent assets in the same way as they might for Type A and Type B – for example, the issue of equity between members of multi-employer schemes were the Type C guarantee to be called upon.

7.3.3 More broadly, we consider that the revised agreements provide a more secure basis for trustees and employers to plan, as they give greater clarity about obligations. We would therefore encourage scheme trustees to discuss with employers and guarantors how to update their agreements.

7.4 Options for achieving re-execution

7.4.1 We are hopeful that the longer time-frame for moving onto the new agreements gives trustees and guarantors ample opportunity to engage with the need to re-execute, and with the wording of the new standard forms. We do recognise that re-execution involves some effort for schemes and guarantors.

7.4.2 We have heard a variety of stakeholder views about the practicalities of re-execution. Some have asked if we can enable the process to be as minimal as possible, for example by allowing forms of amendment that have the same legal effect as full re-execution but which may be easier for guarantors to become comfortable with. Others have said that it is easier not to have a choice of methods, as that would involve schemes needing to take advice.

7.4.3 Our current proposal is that we will require re-execution onto a new form for Type A and Type B contingent assets (and will recognise re-execution that is effected in legally acceptable ways such as via a deed of amendment and restatement that appends the new form as the restated obligations). For Type B contingent assets, we regard full re-execution as the only viable option because the legal complexities in effecting amendments of documents that create security are likely to create difficulties for schemes. For Type A contingent assets, we have considered whether to produce a shorter form of new agreement that only includes key changes, which would have been a suitable approach if we were seeking only to resolve the Cap Interpretation, but given that the agreements incorporate more changes to reflect the Cap Operation considerations, we think that is less likely to be workable. We would be prepared to hear views, though, from stakeholders about any particular practical difficulties they might anticipate in re-executing.

7.5 Intended position for contingent assets that are not re-executed for 2019/20

7.5.1 Whilst ultimately the question of levy treatment for 2019/20 will be a matter for the 2019/20 levy rules, our firm intention is that Type A and Type B contingent assets that are not re-executed before the end of March 2019 will not be credited in the levy.

7.5.2 We think this approach is reasonable given that we are providing schemes with early sight of the new standard forms and an opportunity to comment on them, and providing ample time for schemes and guarantors to take the required steps.

7.6 Future development of contingent assets

7.6.1 Given our view that the contingent asset system is working well we have focused this consultation on the specific issues we feel need addressing (Cap Interpretation and Cap Operation). It is our intention not to require schemes to undertake a second re-execution exercise in the near future, but schemes should be aware that our policies and requirements will continue to evolve with time.

8. Questions for consultation

8.1.1 We would be interested to receive comments from stakeholders – including trustees and those offering guarantees – on the proposed standard form agreements, and on the following questions

8.1.2 A question on the current range of liability caps

(1) we would be interested in views on whether there is value in continuing to offer all the different types of cap, given the limited use made of some cap types?

8.1.3 Questions on the current operation of the contingent asset framework

(1) The existing standard form agreements allow trustees to make (i) pre-insolvency demands and (ii) post-insolvency demands. In practice, are both sets of obligations being enforced?

(2) To what extent does the existence of a guarantee/charge lead to guarantors/chargors supporting schemes or employers in order to avoid the contingent asset being called upon?

(3) To what extent might contingent assets be put in place in situations where "real" assets such as cash contributions might have been available to the scheme instead?

8.1.4 A question on our proposed option for the cap

(1) Do stakeholders agree that Option 4 (i.e. that the agreements cover all employer obligations, with a cap that only applies in the event of the employer insolvency) offers a workable solution to ensuring that a guarantee on insolvency is additional to employer support pre-insolvency? Are there other approaches which would achieve that?

8.1.5 More technical questions about multi-employer schemes

(1) In a partial segregation multi-employer situation, should the cap be applied in respect of the whole scheme, or should it be expressed as applying in respect of each employer's obligations on an insolvency demand?

(2) If the cap were to be applied across the whole scheme, on the insolvency of an employer should the cap be allowed to be exhausted sequentially by insolvencies, or is there a case for requiring apportionment? How might apportionment be achieved?

(3) If the fixed cap, or "lower of" cap, were applied across the whole scheme, should it erode on individual insolvencies?

(4) Does the form of liability cap make a difference to the most appropriate solution?

(5) Are there workable formulations of liability cap for multi-employer schemes that are not currently reflected in the agreement, such as an overall fixed cap for a scheme but s179 caps for individual insolvencies?

(6) Should money from the guarantor in respect of a segregated part be required to be applied to that part? If so, how might this be achieved?

(7) What suitable protection can a guarantee offer an LMS scheme? Is it more beneficial to the scheme if:

  (i) The entire guaranteed amount is payable on the first insolvency?

  (ii) The guarantee is apportioned between employers / insolvencies, either on a pre-fixed basis, or on a share of fund basis?

  (iii) The guarantee is preserved until a Qualifying Insolvency Event occurs?

(8) Should the position of LMS schemes differ where the guarantor is also a scheme employer?

8.1.6 Questions about the amendment/release criteria in the agreements

(1) Do the current amendment/release criteria offer a protection, or negotiation point, for trustees at present?

(2) To what extent do trustees feel able to assess proposals put to them by guarantors?

(3) Are guarantors (or prospective guarantors) deterred from signing up to agreements because of the current amendment / release mechanism?

8.1.7 Question on our intention to require re-execution for 2019/20

(1) Given the extended timescale for re-execution, do you anticipate any practical difficulties in achieving re-execution onto the new standard forms?

9. Consultation Arrangements and Key Dates

9.1 Contingent asset consultation

9.1.1 This additional consultation runs from 19 October to 21 November 2017.

9.1.2 Please ensure that your response reaches us by the deadline. Submissions may be made by email or post, using the details below.

Email: consultation@ppf.gsi.gov.uk

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

9.1.3 Please 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.

9.1.4 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 information for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication.

9.1.5 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 website of the Ministry of Justice at:

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

9.1.6 A summary of responses and the Board's final Determination and confirmed policy are planned to be published on the PPF website at:

http://www.pensionprotectionfund.org.uk in December 2017.

9.2 Comments on the Consultation Arrangements

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

Richard Williams
Head of Corporate Affairs
Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon, Surrey
CR0 2NA

Email: Richard.williams@ppf.gsi.gov.uk