XPS Pensions

Briefing

January 2020

The PPF consults on new D&B insolvency risk scores

In brief

- D&B to replace Experian for insolvency risk scoring from April 2020
- Existing scorecards to be recalibrated
- Some further changes proposed based on stakeholder feedback
- Scores for larger employers are expected to worsen, increasing levies
- Analysis suggests one in five schemes could be expected to see an increase in their levy
- 7% of employers could be expected to see levy increases in excess of 50%
- Some scores will change purely due to different data interpretations

Next steps

- Check you can access the new D&B scores via the D&B score portal
- Review the new scores and understand the potential impact on levies
- Check the data used by D&B and see if any supplementary information could help the scores
- Consider responding to the consultation

On 18 December 2019, the Board of the Pension Protection Fund (PPF) issued a consultation proposing changes to how insolvency risk scores will be calculated for the 2021/22 levy and beyond.

Background

Part of the PPF levy calculation is based on the insolvency risk of a scheme's sponsoring employer(s). For the last 6 years, this has been calculated by Experian, based on the PPF's agreed methodology.

In early 2019 the PPF announced that Dun & Bradstreet (D&B) would take over as insolvency risk provider from April 2020. This latest consultation sets out the PPF's proposals for changes to the existing insolvency risk methodology. A further consultation on the other elements of the levy calculation for the 2021/22 levy and beyond is planned for mid-2020.

What changes are being proposed and what is the likely impact?

The PPF is not proposing wholesale changes to its existing methodology. It is happy that the existing methodology is working well and so D&B will be largely using the same approach.

Scorecard recalibration

The main change proposed is to recalibrate the existing PPF model scorecards, so that they provide a better fit with actual insolvency experience.

In assessing the performance of the existing model the PPF has found, when compared to actual insolvency experience, that each scorecard either under- or over-predicts the level of insolvencies. It is suggested that the proposed recalibration helps eliminate the smaller and not-for-profit entities subsidising the largest employers. Even if the PPF continued to use Experian it would have recalibrated the scorecards in line with recent experience anyway.

Impact: The recalibration will impact all organisations measured by the PPF model scorecards. Larger employers on Scorecard 1 can expect to see a worse score, with two-thirds seeing an increased levy band and higher levies. Some smaller employers and not-for-profits can expect to see a score improvement.

D&B's collection and interpretation of data

Another change impacting scores will come from D&B's approach to collecting and interpreting data and how this may differ to Experian's approach. Experian's general approach is to collect accounting data exactly as presented in the accounts. D&B's approach can involve adjusting certain items, based on supplementary information such as that included in the notes to the accounts. D&B believe this approach leads to a more consistent treatment of the accounting data across companies.

D&B will also use a different approach to determine an organisation's ultimate parent company and to determine consolidated accounting figures when financial information on an ultimate parent company is not available. The PPF encourages stakeholders to check they are satisfied with D&B's interpretation of the ultimate parent and to provide feedback as part of the consultation.

Experian does not currently differentiate between data that is zero or an unknown. D&B believe it is possible to differentiate the two with confidence and will do this.

Impact: All organisations on the PPF model could potentially be impacted. Whether the impact is negative or positive depends on the circumstances. It is important to check the data D&B are using for scoring and that their interpretation of the accounts and corporate structure is correct.

Other PPF model changes proposed

The recalibrated scores allowing for D&B's data interpretation represent the PPF's '*baseline*' scores going forwards. The PPF is also proposing the following additional changes based on past feedback from stakeholders:

- For group entities, the *mortgage age* variable is to be removed and replaced by a *cash by current liabilities* variable.
- The *creditor days* variable is to be capped at 60 days to remove extreme model values.
- For regulated financial institutions the *creditor days* variable will be given a neutral value reflecting the fact that these entities don't have trade creditors.

Non-PPF model changes

Some organisations' insolvency risk is measured by public credit ratings, or alternative industry specific scorecards instead of the PPF model. The PPF has confirmed:

- Public credit ratings (where available from S&P, Moody's and Fitch), have been shown to have been highly predictive and will be retained.
- The S&P credit model that is used for around 70 large financial institutions listed on the Bank of England's Bank or Insurer list will no longer be used post March 2020. Going forwards these organisations are to be scored using the PPF model instead.

Impact analysis

The PPF has carried out some impact analysis, firstly by looking at how the changes could lead to levy band changes and secondly by looking at how the changes could have impacted on the levies payable for the 2019/20 levy.

The analysis is caveated to the extent that some score changes could be due to '*gaps*' in the data used to calculate the new D&B scores rather than anything else. This is because D&B does not currently have access to all the supplementary information Experian had, such as self-submitted accounts.

The PPF's analysis allowing for all changes shows that:

- Two-fifths of employers are expected to remain in the same levy band. As noted above, the largest employers on Scorecard 1 are likely to see a worsening in scores due to the recalibration. More organisations on the other seven PPF model scorecards will see an improvement in the levy band rather than a worsening.
- One-third of schemes would have seen a similar levy amount if the new D&B scores had been used for the 2019/20 levy. Almost half would have seen a lower levy and one in five would have seen an increase (mainly those on Scorecard 1).
- 7% could have seen an increase in levy of over 50% (but some of these could be due to 'data gap differences').

The new D&B PPF score portal and other news

At the same time as launching its consultation, the PPF has given trustees and sponsors access to a test version of its new score portal that will show '*live*' D&B scores (those based on the recalibrated scores) and '*consultation*' D&B scores (that allow for all changes).

There will be a 'web-chat' function for queries to supplement the existing email and phone options, and score alert emails will be introduced to notify users of score changes. A score analyser function that will help users identify why live scores have changed is being considered.

Users can access the new score portal via https://levy.ppf.co.uk/login. Initial access will be granted to trustees as well as other individuals who have delegated access to the existing Experian score portal. Sponsors will need to register to view scores.

Actions for Trustees and advisors

The consultation closes on 11 February 2020. Trustees should check they can access the new scores, understand the reasons for any changes in scoring and consider whether supplementary information such as self-submitted accounts should be provided to D&B to fill any 'data gaps'.

XPS Pensions has a specialist PPF Solutions Team who can help you understand the score changes ahead of the new D&B scores being put in place in April 2020. We can also advise you on all other areas of the levy calculation and steps that may be taken to reduce the PPF levy payable.

For further information

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