1 Introductory remarks

1.1 In this submission we answer two specific questions posed in the inquiry terms of reference:

- How fair is the PPF levy scheme?
- What is the impact of the PPF levy scheme on businesses and scheme members?

1.2 We answer these questions specifically from the perspective of mutual employers (for example co-operatives, building societies and credit unions), because mutuals are currently experiencing some particular issues which we would like the Committee to be aware of.

1.3 To begin with we need to consider what fairness is in the context of the PPF levy. We assert that a fair PPF levy is one which accurately reflects the capacity of the business to meet its pension liabilities, including an accurate calculation of the risk of insolvency. A fair PPF levy is also one which treats all employers equally where appropriate, while appropriately taking account of any distinctive characteristics where these are relevant.

1.4 Unfortunately we must report that mutual employers subject to the PPF levy are not being treated fairly as per 1.3, and are being heavily penalised as result. There are two distinct issues mutual employers are currently struggling with:

- The calculation of mutual employers’ insolvency risk is deeply flawed due to a significant gap in data collection (see part 2)
- The PPF categories of employer (referred to as ‘score cards’) distinguish between larger and small, complex and simple, for-profit and not-for-profit, but take no account of highly relevant mutual characteristics (see part 3)

2 Missing mortgage age data

2.1 One of the most significant factors in an employer’s insolvency risk score in the PPF ‘universe’, and thus a key determinate in the overall levy payment, is ‘mortgage age data’.

2.2 The PPF rules for 2016/17, and now the draft 2017/18 rules, state that mortgage age data for employers must be collected from Companies House.\(^1\) While this is fine for all business and charities incorporated under the Companies Act, it is deeply problematic for mutual societies incorporated

\(^1\) See E2.2(C) http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/1617_Determination.pdf
under the Co-operative and Community Benefit Societies Act, the Building Societies Act, the Credit Unions Act and the Friendly Societies Act, because mortgage age data for these employers is held on the Financial Conduct Authority (FCA) Mutuals Register,\(^2\) and is not available through Companies House.

2.3 Because Experian, the PPF’s agent, is unable to collect data on charges on mutual societies’ assets, under PPF rules these businesses are given a scheme average 'neutral' mortgage age score as part of their overall insolvency risk. Mutual societies with PPF-eligible pension schemes are overwhelmingly prudent, stable and long established businesses, with typically few or no charges on their assets, so a scheme average neutral scoring for them is particularly distortive.

2.4 In practice this move to a neutral scoring is ascribing a higher overall risk of insolvency on the live scorecard of mutual societies, with their risk banding rising dramatically from 1 to 3, regardless of their actual financial position. As a result many of these mutual societies have seen their PPF levy double. This is resulting in unwarranted extra annual levy costs of over £40,000 for smaller co-operatives, to over a £1 million for the largest. **To reiterate: these are huge additional costs incurred solely because of the form of legal incorporation the employers use.**

2.5 For some mutual societies there are other factors in their risk scoring that have limited the negative impact of the neutral mortgage age scoring. But the fact still remains that the calculation of their levy is based on significantly incomplete data compared with the same calculation the PPF makes for companies.

2.6 We would like to make a distinction between this particular grievance and those of businesses who see their PPF costs rise as a result of how risk is calculated and ascribed in the PPF universe, which we recognise changes over time. Instead our grievance is that a sharp increase in costs has occurred as a direct result of how data is being collected for the PPF calculations. **The position of these employers has not become riskier by the PPF’s calculations; rather the data to make these calculations is not being collected.**

2.7 Co-operatives UK is currently working with seven large co-operatives which together have seen their levy payments increase by more than £2 million this year alone as a rest of this penalisation.

2.8 It is unfair for prudent and stable mutual societies to be downgraded in such a costly manner simply because they file the data Experian requires with the FCA rather than with Companies House.

\(^2\) See here: https://mutuals.fsa.gov.uk/
2.9 We have been working with the levy policy team at the PPF to try and secure a change in the scheme rules so that mortgage age data can be collected from the Mutuals Register in future. Disappointingly the PPF is so far unwilling to accept the Mutuals Register as a reliable source of mortgage age data. We do not believe he PPF has fully considered the scale of the extra costs being incurred by mutuals as a result of this policy, which we consider to be wholly disproportionate. This runs counter to established principles of better regulation.

2.10 Along with other mutuals we will be responding to the PPF consultation on its draft 2017/18 rules, setting out just how serious the penalisation for mutual societies has become. The consultation deadline is October 31 2016. However, without outside pressure we are not confident the PPF will reconsider our case. The final PPF rules for 2017/18 are not confirmed until December 2016.

3 Where do mutuals fit?

3.1 The PPF created a ‘not-for-profit’ scorecard because it found that employers such as charities, housing associations and others tended to be at lower risk of insolvency than other more profit-orientated entities. Employers on the not-for-profit scorecard pay lower levies. However most large mutuals, and all co-operatives we are currently working with, are on the more expensive ‘large and complex’ scorecard.

3.2 This is problematic because mutuals do not fit neatly into a ‘for-profit or not-for profit’ dichotomy. Some mutual societies, such as farmers’ co-operatives, are non-profit distributing and so could be classed as not-for-profit. But in all cases mutuals are very different from other profit distributing entities, such as PLCs, because by definition their mutual purpose takes primacy over the distribution of profits.

3.3 This is not to say that mutuals do not seek to trade at a surplus, for they do. But crucially so do most not-for-profit employers in the PPF universe. The difference is that mutuals are purposed and governed in such a way as to ensure that surpluses are used first to safeguard and develop the business, and are only distributed to members when it is prudent to do so. In mutuals the directors’ primary duty is to ensure the business works in the interests of members with stake in what the business does, rather than shareholders whose primary interests are in the return on investment the business can generate. Return on investment in mutuals is subject to de-emphasis.

3.4 Mutuals such as consumer co-operatives share some profits with their customers yet they have also demonstrated over many decades a marked degree of prudence and stability more in line with not-for-profit employers in the PPF universe.

4 Recommendations
4.1 We would like the Work and Pensions Committee to make two recommendations to the PPF:

- Change PPF rules so that mortgage age data is also collected from the Mutuals Register
- Create a new ‘Mutuals’ scorecard for mutual businesses which do not fit into the ‘for-profit or non-for-profit’ dichotomy

About Co-operatives UK

Co-operatives UK is the network for Britain’s thousands of co-operatives. We work to promote, develop and unite member owned businesses across the economy. From high street retailers to community owned pubs, fan owned football clubs to farmer controlled businesses, co-operatives are everywhere and together they are worth £34.1 billion to the British economy.

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