Pension Protection Fund

Consultation on the third PPF Levy Triennium – 2018/19 to 2020/21

Institute for Family Business Response

1. About Family Business

1.1 The Institute for Family Business (IFB) is a not for profit organisation, supporting and promoting the UK family-owned business sector through events, networking, representation, thought leadership and analysis.

1.2 We work closely with family firms to support them in growing enterprises for generations to come. A central part of our work is to provide educational resources and events designed to support business owners and those who work in family business. We aim to champion best practice within the family business community and help others to learn from these examples.

1.3 Family business is the backbone of our economy, and the bedrock of our communities. In the UK, family firms generate a quarter of GDP and employ over twelve million people. By their very nature, family businesses take a long term view, build on long-term stewardship of people and resources. Their commitment to passing something on to the next generation is locked into their corporate DNA.

1.4 The family business sector is extremely diverse. Family businesses come in all sizes, are found in all industries and across the whole country. Whilst the majority of family firms are small or micro businesses, there are over 17,000 medium and large firms. Family businesses are found in all parts of the UK. There are almost half a million family firms in the East of England, over one hundred thousand in Northern Ireland, and over three hundred thousand in Yorkshire.

1.5 Whilst family businesses generate a quarter of UK GDP[1], they recognise that success in business is about more than short term financial results. Success is about sustainable value creation. Family businesses perform better than non-family firms in non-financial metrics such as investing in their employees and in supporting communities.[2] And the best-run family businesses outlast others by a factor of two.[3]

2. Family Business and the Levy

2.1 The PPF Levy rating system transition from Dun and Bradstreet to Experian has raised particular issues for family businesses. The changes to factors and weightings have had significant impact on some family firms. The move away from factors such as age of business and information on Directors, to a focus on financial factors has arbitrarily skewed the results less favourably towards family firms.

2.2 Anecdotal evidence reported to the IFB has seen family businesses face large increases in their PPF Levy, some facing six figure increases. Family businesses are responsible and long term businesses, and their unique characteristics need to be understood and recognised in establishing levy contributions. It is

[1] Oxford Economics and IFB Research Foundation (2016) *The State of the Nation: The UK Family Business Sector 2015/16*
[2] M Institute and IFB Research Foundation (2012) *Sustainable Value Creation*
[3] Miller, D and Le Breton-Miller, I. (2005) *Managing for the Long Run: Lessons in Competitive Advantage From Great Family Businesses*

therefore important that the new model is reviewed to ensure it is accurately reflecting the insolvency risk of businesses of all ownership types, sectors, sizes and age.

3. Third Triennium Review

Question 1: Do you agree with the areas of the levy selected for review in the third triennium?
Question 2: Do you agree with the scope of the review of the PPF-specific model – that led us to rebuild five scorecards and propose recalibration of the three group scorecards?

3.1 By their very nature, family businesses take a long term view, built on long-term stewardship of people and resources. In our view, the current levy system is too focused on solely using financial metrics and that, particularly for multigenerational family businesses, this is not appropriate.

3.2 We are concerned that this review has gone further down that line of focusing purely on financial metrics, and has missed an opportunity to take a more rounded view by including consideration of the company's history, shareholding, attitude and ownership structure. These are all aspects which are considered in commercial risk scoring, which does not solely consider information in the accounts. Therefore it would be appropriate to include these within the levy model.

3.3 We believe there is scope to improve the scorecards to better reflect a whole business approach, which takes a broader consideration of business risk rather than simply relying on accounts. Particularly in multigenerational family owned firms, there is a case to make about the need to include non-financial information to accurately and appropriately measure risk.

Question 3: Do you agree with our conclusion that the re-built scorecards present sufficient benefits that they should replace the existing scorecards?

3.4 In our view the rebuilt scorecards may present some benefits, but they do not go far enough in updating the existing scorecards and the PPF should look at a more significant change to introduce more non-financial metrics into the system.

3.5 The new scorecards also seem to take the position that firms with lower turnover are at higher risk and more problematic. We do not agree that there is an inherent link between lower turnover and higher risk.

Question 4: Do you agree with our proposal to use public credit ratings in preference to the PPF-specific model?

3.6 We agree that it is important for the PPF to consider how public credit ratings could be used within the PPF model. However, we do not think that the current proposal is suitable particularly given the short term outlook of the rating agencies identified who focus on ratings in relation to short term lending. The proposals do not factor in the stability inherent in multigenerational businesses, something which we believe needs to be included in any updated system.

3.7 The proposal to use public credit ratings also only applies to certain types of businesses, including the largest firms. In our view if this is considered a necessary way forward for some types of businesses, it should be considered for all those who pay into the Levy to ensure that the riskiness of businesses is being effectively measured and rated. Multigenerational family firms have very different characteristics to other business types and a long term outlook which should be considered within the model.

3.8 If there is a need to consider public credit ratings rather than the PPF-specific model we believe that this is a significant change which requires more consultation, and should be considered for all business types.

Question 5: Do you agree with our proposal to use industry scorecards for regulated financial institutions that are not themselves rates, in preference to the PPF-specific model?
Question 6: Do you agree with our proposed basis of scoring where public credit ratings or industry scorecards are used?
Question 7: Do you agree that we should seek an alternative approach for employers that cannot be assessed by reference to financial information alone? Do you have any comments on our draft rule?

3.9 The PPF has identified large complex firms, and regulated financial institutions, as types of entities which might require an alternative approach than the standard PPF model.

3.10 Having accepted that not all businesses can be treated in the same way when assessing riskiness, we believe there is a strong case to update the PPF model to include consideration of certain measures which better reflect the entirety of a family business and reflect the role that the long term outlook, history and shareholding have on the stability and sustainability of that business and its defined benefit pension scheme. The PPF should develop a model for all employers which does not rely on assessing them through financial information alone.

Question 8: Do you think that we should move to a single point calculation of insolvency risk at 31 March? If not do you consider that a change should be made to the number of insolvency risk scores that are averaged?

3.11 We do not support a move to a single point calculation of insolvency risk at 31 March. We believe this system would be open to manipulation.

Question 9: Do you have suggestions of improvements and simplifications that would particularly help smaller schemes?

3.12 We support efforts to reduce the complexity and bureaucracy associated with the Levy. The PPF should work with the TPR to view the whole administrative burden on smaller schemes and seek to identify ways to reduce these overall.

Question 10: Do you support our proposals to amend the approach for calculating certified DRC amounts? If so, which factors do you consider should be used to allocate schemes between the two options (a) and (b) (which could include applying a single option to all schemes)?

3.13 We support option (b), which in our view would go some way towards reducing the administrative burden and bureaucracy which schemes encounter.

Question 11: Do you have views on the proposed requirement for a guarantor strength report to be held by trustees at the time of Type A contingent assets? Do you have views on the proposed threshold of £100 million and are there any alternatives we should consider?

3.14 In our view the threshold should be at least £100 million, and no lower.

Question 13: Do you have views on the two proposed options where a guarantor is also a scheme employer?

3.15 We do not believe that either measure addresses the PPF concerns in a proportionate way, and believe that the PPF should consider additional options for this.

Question 15: Do you have any suggestions on the drafting of the current standard from Contingent Asset documentation? Do you foresee any practical difficulties in re-executing agreements? Do you have views on issues to consider in setting a timeframe for re-execution?

3.16 Given the cost and time involved in changing such agreements, in our view it should only occur where there is an overwhelming need, and significant proof of a problem.

Question 17: Do you have views and/or evidence on the extent to which good governance leads to a reduction in risk, in one or more of the factors allowed for in legislation, to the PPF? If so are there particular aspects of governance that should be focused on for the purposes of awarding any levy discount?
Question 18: Do you have proposals for the identification and measurement of good governance sufficiently linked to a reduction in risk for the PPF that meet the broad aims of avoiding a tick box approach, avoid administrative burdens and are not designed to be widely available? Do you have suggestions on who should administer such a process and how?

3.17 A long term outlook is at the heart of family business. Shareholders in family businesses view their role as that of a steward, with an obligation to pass the business on to the next generation in a stronger state than they found it. They feel a sense of responsibility not only to future generations of their own family, but also to the legacy of their forebears, their employees, and the community in which they are based.

3.18 Good governance within successful family businesses has two components – family and corporate governance. Family businesses have an in-built natural tendency to approaching corporate stewardship in ways that ensure that the pursuit of good financial performance supports their long term objectives and values, rather than harming them.

3.19 Family governance and procedures will vary depending on the specific characteristics of each individual family business, but there are common structures. It is essential that families have the flexibility to introduce these structures as best suits the unique requirements of their family and business, to best meet the needs of their employees and community.

3.20 Family businesses manage corporate governance in a way which is most appropriate to their own unique circumstances – circumstances which can vary significantly even within the family business community, let alone the wider private business environment. Some choose to adopt those parts of the FRC or other codes which are appropriate to their business.

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3.21 It is essential that if the PPF is going to consider introducing a corporate governance element to the levy model that they do so only after fully considering the many different types of businesses which fall under the levy system, and the many different characteristics of their corporate governance.

3.22 The PPF must not introduce a system which simply transplants an existing code for listed companies (i.e. the FRC code) into a model which also includes private companies, SMEs and others. This would carry with it the possibility of a number of unfavourable unintended consequences, and would lead to incorrect conclusions.

3.23 We would welcome the opportunity to discuss this further with the PPF, to ensure that they have the fullest understanding possible of the unique characteristics of family business before moving forward with this work.

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