PPFO-6992

Ombudsman's Determination

Applicant	Trustees of the Electrosonic Pension Scheme
Scheme	Electrosonic Pension Scheme
Respondent(s)	The Board of the Pension Protection Fund (the **Board**)

Summary of application

1. The Ombudsman has received a reference of a reviewable matter, following a decision by the Reconsideration Committee of the Pension Protection Fund (**PPF**) dated 22 October 2014. The referral concerns the decision, by the Board, not to recognise the Scheme's Type A contingent asset from Electrosonic Group OY AB for the levy year 2013/14.

Summary of the Ombudsman's Determination and reasons

2. The Board is not required to take any action because the Reconsideration Committee's decision was reached correctly.

Detailed Determination

Background

3. Schemes may take a number steps to reduce their risk-based PPF levy. One of these is to submit a contingent asset certificate. Part G of the PPF Determination for the levy year 2013/14 (the **PPF Determination**) set out the requirements for a contingent asset to be accepted. Further requirements were contained in the Contingent Asset Appendix to the PPF Determination. References to rules in the following document are to the rules contained in the PPF Determination.

4. A contingent asset may be one of three types: A, B or C. The Applicant submitted a contingent asset certificate for a type A contingent asset. This is a guarantee from a parent company or a relevant associated undertaking.

5. The Board rejected the contingent asset, under rule G2.3, on the grounds that there was insufficient evidence that the named guarantor (Helectron OY AB) would be able to meet its full commitment under the guarantee.

6. The Applicant submitted a request for a review on the grounds that:

   - The wrong company had been assessed by the Board. The correct company was Electrosonic Group OY AB.
   - The funds available to Electrosonic Group OY AB would be sufficient to cover the guarantee.

7. The Board's review committee issued a decision, on 23 July 2014, finding that the Scheme's levy had been calculated correctly. Its reasoning is summarised as follows:

   - Rule G2.3(2) stated,

     "(2) It must appear to the Board that:

     (i) the Contingent Asset reduces the risk of compensation being payable from the Board in the event of an insolvency event occurring in respect of an Employer in relation to the Scheme; and

     (ii) the reduction, if any, in a Scheme's levy that may result from the recognition of a Contingent Asset for levy purposes is reasonably consistent when compared with the level of that reduction in risk."

   - With regard to the Applicant's submission that the wrong guarantor had been named on the certificate, rule A2.3 made it clear that the Measurement Time for the submission of information relating to contingent assets for the levy year 2013/14 was 5:00 p.m. on 28 March 2013. Rule A2.1 provided that the Board would use the information which had been submitted as at the relevant Measurement Time. The information submitted as at 28 March 2013 stated

that the guarantor was Helectron OY AB. Therefore, the Board was required to assess the Scheme's contingent asset by reference to Helectron OY AB.

- Under rule B2, the Board had discretion to review a levy where it subsequently appeared to the Board that the information on which the levy calculation was based was incorrect in a material respect. Information is not incorrect for this purpose where it is correct and legitimate in itself but it would have been open to the person supplying it to supply some different or additional information which may have resulted in the PPF Determination being applied differently. The Board is under no obligation to review the amount of a levy simply because a scheme has been disadvantaged by the failure of those acting for it to supply the correct information at the proper time.

- They had considered the discretion arising under rule B2. They noted that no explanation had been given as to why Helectron OY AB had been named as the guarantor on the contingent asset certificate instead of Electrosonic Group OY AB. They had, therefore, concluded that the use of the rule B2 discretion would not be justified.

8. The Applicant requested a reconsideration. In its grounds for review, the Applicant agreed that the correct name of the guarantor was now Helectron OY AB. The Applicant said it had not, so far, provided information relating to this company, but had instead provided information relating to Electrosonic Group OY AB. The Applicant explained that Electrosonic Group OY AB (company registration number 17611297) had changed its name to Helectron OY AB on 30 December 2009. It said Electrosonic Holding OY AB (company registration number 22081307) had changed its name to Electrosonic Group OY AB, also on 30 December 2009. The Applicant said that "by accident" it had provided information for Electrosonic Group OY AB (which was the name on the original guarantee) but not for Helectron OY AB (which was the actual guarantor). It submitted accounts for Helectron OY AB as at 31 December 2013, but said they were in Swedish.

The reconsideration decision

9. The Board's reconsideration committee issued a decision on 22 October 2014. The committee's findings are summarised below:

- The Applicant agreed that the correct guarantor was Helectron OY AB and that it had failed to provide financial information relating to this company for the Board to assess the contingent asset.

- The Applicant submitted that, since the Board had correctly identified Helectron OY AB as the guarantor, it should have requested further financial information instead of rejecting the contingent asset. However, if the Scheme wished to rely on the contingent asset, the onus was on it to comply with the requirements set out in the PPF Determination.

- The Applicant submitted that the accounts it had now provided showed that the shareholder funds of the guarantor were approximately £10.2 million (after subtracting the shareholder funds for Electrosonic Limited) and this exceeded the deemed value of the guarantee (£7.1 million).

- They had considered these accounts, but had concluded that, as the guarantor's net profit (£0.6 million) would not be sufficient to meet the deemed value of the guarantee, the guarantor would be reliant on realising value from its net assets to meet its obligations under the guarantee.

- The guarantor's net assets were £12.6 million as at 31 December 2012, but included investments in the Group's undertakings. The guarantor's financial position was heavily dependent on the solvency of one of the Scheme's employers (Electrosonic Limited), which was also one of its subsidiaries. In the event of an employer insolvency event, the guarantor's net assets would be reduced by the value of Electrosonic Limited's net assets (£3.7 million). There would also be a negative impact of the market value of the remaining businesses.

- They had concluded that, in the event of Electrosonic Limited's insolvency, the guarantor would be unable to meet the deemed value of the guarantee from its other net assets.

- The information provided by the Applicant did not contain information about the funding available to the Group.

- Guidance published in December 2012 had stated,

  "5.4.1 It is intended that Type A guarantees with guarantors unable to meet the submitted certified value of their guarantee will, in general, be wholly rejected even where the contingent asset may be considered to have some value. If the Board were to partially recognise a contingent asset for less than the value (or not all the guarantors) that had been certified, this could encourage the use of under-resourced guarantors (e.g. listing a series of guarantors, of varying substance and levy rate) on the assumption that the scheme would get at least partial credit.

  5.4.2 The Board may, however, partially recognise a recertified or new contingent asset if all the circumstances justify it and if there has clearly been no intention to seek to gain an unfair levy advantage. However, schemes should not assume that the Board will exercise its discretion to partially recognise a contingent asset simply because the contingent asset is unchanged from the previous levy year. This will particularly be the case for levy year 2013/14 onwards, where schemes have had one year to familiarise themselves with the Board's requirement as to guarantor strength."

- They took the view that the Applicant had not demonstrated that there were circumstances to justify the partial recognition of the guarantee. Therefore, they had determined to reject the contingent asset in full.

Grounds for referral

10. The Applicant's grounds for referral are summarised below:

- The parent company's assets are £12.9 million. These reduce to £9.2 million if those of Electrosonic Limited are excluded. The actuarial valuation dated 31 January 2013 showed a shortfall of £7.1 million. There is, therefore, an excess of £2.1 million.

- The Board has said that there would be no excess because the market value of the group would decline in the event of an insolvency event. It disagrees. The remaining two assets of the group are: a property worth £7.5 million (as at 2010 and probably higher now), with a debt of £800,000 on it; and a subsidiary (Electrosonic Inc.) which is based in the USA and operates in different markets to Electrosonic Limited. Electrosonic Inc. has been consistently profitable and had net assets of $9.2 million (£5.75 million) as at 31 December 2012. On the basis of an average pre-tax profit of $2.4 million (for the two years prior to 31 December 2012), Electrosonic Inc. is valued at $14.4 million (£9 million). This demonstrates that the funds available to the parent company exceed the £7.1 million potential liability.

- In addition, the Applicant has received a guarantee from another employer involved in the Scheme; Helvar Limited. This company has guaranteed that they will contribute one-third of all costs which the Scheme incurs, including any liability which arises. Helvar Limited had net assets of £5.1 million as at 31 December 2013 and pre-tax profits of £3 million in 2013 and £2.6 million in 2012. It can, therefore, meet its obligation to cover one-third of any shortfall.

- Helectron OY AB may have to cover two-thirds of any shortfall; £4.7 million out of assets of £16.5 million.

- The Board did not ask any questions about the accounts despite having received the application for reconsideration on 14 August 2014 and saying they would respond by 22 September 2014.

Representations from the PPF

11. The Board's submission is summarised below:

- The conditions for acceptance of a contingent asset were set out in part G of the PPF Determination and the Contingent Asset Appendix. Paragraphs 25 to 27 of the Contingent Asset Appendix set out the certification and documentary requirements for a type A contingent asset. In particular, paragraph 26 stated,

> "The Certifier must confirm the Standard Confirmations and the following matters:
>
> …
>
> (2) The Certifier has no reason to believe that each Certified Guarantor, as at the date of the certificate, could not meet its full commitment under the Contingent Asset as certified …"

- The Standard Confirmations referred to above included a statement that the certifier was aware of guidance in relation to contingent assets published by the Board on its website.

- The decision to reject the contingent asset was based on the view that the guarantor would not be able to meet its commitment in full in the event of Electrosonic Limited's insolvency. The deemed value of the contingent asset amounted to £7.1 million and there was no evidence that the guarantor had resources amounting to £7.1 million. It did not appear to the Board that the contingent asset reduced the risk of compensation being payable in the event of Electrosonic Limited's insolvency or that a reduction in the Scheme's levy was reasonably consistent when compared with the level of reduction in that risk (rule G2.3(2)).

- The Applicant's request for a review of the levy calculation was based on an assertion that the Board had erred in identifying the guarantor. However, the guarantor considered by the Board was the guarantor identified on the contingent asset certificate. Since there was still no evidence that the guarantor could meet its full commitment, the review committee upheld the levy calculation.

- In the request for a reconsideration, the Applicant accepted that the Board had correctly identified the guarantor and supplied accounts to support the assertion that the guarantor could meet it full commitment under the guarantee. The reconsideration committee concluded that the guarantor had net assets of £12.6 million, but these would be reduced in the event of Electrosonic Limited's insolvency. The reduction being Electrosonic Limited's assets (£3.7 million) and a general deterioration in the value of the guarantor's remaining businesses.

- The Applicant accepts that, in the event of Electrosonic Limited's insolvency, the net assets of the guarantor would be reduced by an amount equivalent to Electrosonic Limited's net assets. However, the Applicant asserts that Electrosonic Limited's insolvency would not have an adverse effect on the guarantor's other assets: a property and shares in an American company. The Applicant also seeks to rely on a purported guarantee from another company, Helvar Limited.

- At each stage of the Applicant's challenge to the levy calculation, the Applicant has produced different evidence which was not available to the Board or the relevant committee. Such evidence should not be taken into account by the PPF Ombudsman when determining whether the reconsideration committee reached its decision correctly. The PPF Ombudsman's decision should be based on the same evidence which was put to the reconsideration committee.

- Without prejudice to the above, they believe the Applicant's evidence supports the reconsideration committee's conclusions for the following reasons:

    - The Applicant has not provided an independent valuation of the guarantor's interest in the American company. In any event, this interest is taken into account in the calculation of the guarantor's net assets appearing in its accounts. It would not be appropriate to ascribe a different value to the guarantor's interest in the American company for the purposes of considering whether the guarantor could meet its commitment in full.

    - It is not the case that the American company would not be affected by Electrosonic Limited's insolvency because Electrosonic Limited is both a supplier to and a customer of the American company. Electrosonic Limited's insolvency would, therefore, reduce the value of the guarantor's interest in the American company.

    - There is no evidence that the guarantor has an interest in the property referred to above. The valuation provided by the Applicant states that the property is owned by another company which is not listed as a subsidiary of the guarantor. The Board could not rely on this valuation because it was produced for the sole use of this other company.

    - There is no evidence that the debt secured against the property amounts to £800,000.

    - There is no evidence that the value of the property has increased since 2010. There are a number of reasons why the value of property may have decreased in the interim. For example, buildings falling into disrepair or being destroyed by fire.

    - Electrosonic Limited's insolvency would have an impact on the value of the property. It pays the greater part of the rent and, as with any investment property, a large proportion of the capital value of the property is attributable to the rental income. The loss of rental income from Electrosonic Limited would be of particular effect because the property has been configured in accordance with its specific needs, meaning re-letting would be more difficult .

    - The agreement with Helvar Limited does not meet the requirements for a contingent asset: it was not notified to the Board before the Measurement

Time, and it only obliges Helvar Limited to contribute one-third of the Scheme's expenses.

Conclusions

12. Under section 175 of the Pensions Act 2004, the Board is obliged to calculate a risk-based levy in respect of all eligible schemes. For the purposes of section 175,a risk-based levy is a levy assessed by reference to the difference between the value of a scheme's assets and the amount of its protected liabilities, and,

> "**if the Board considers it appropriate**, one or more other risk factors mentioned in subsection (3) …" (my emphasis)

13. Subsection (3)(b) refers to "such other matters as may be prescribed". These were set out in the Pension Protection Fund (Risk-based Pension Protection Levy) Regulations 2006 (SI2006/672) (as amended). They are (a) the nature of and (b) any risks associated with "any arrangements which the Board considers 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".

14. The Board may, therefore, take account of a contingent asset in calculating the Scheme's risk-based levy, but it is not obliged to do so.

15. The conditions under which the Board was prepared to consider a contingent asset were set out in the PPF Determination; in particular, in rule G2. Rule G2 applied if a contingent asset certificate, together with satisfactory hard copy supporting documents, had been supplied before the relevant Measurement Time. The relevant Measurement Time for the submission of the Scheme's contingent asset certificate was 5:00 p.m. on 28 March 2013. The Applicant had submitted a contingent asset certificate by the relevant Measurement Time. It was appropriate, therefore, for the Board to consider whether it should take account of the contingent asset (the guarantee) in calculating the Scheme's risk-based levy.

16. The problem lies in the fact that the information supplied by the Applicant in relation to the contingent asset was incorrect/incomplete. The Board assessed the contingent asset by reference to the company name given in the guarantee; Helectron OY AB. In requesting a review of the decision to reject the contingent asset, the Applicant asserted the Board had referred to the wrong company. The Applicant said the Board should have been assessing the contingent asset by reference to Electrosonic Group OY AB. The Applicant subsequently agreed that the guarantor was Helectron OY AB (formerly known as Electrosonic Group OY AB). The Applicant also agreed that the financial information it had previously supplied did not relate to Helectron OY AB but to Electrosonic Group OY AB (formerly known as Electrosonic Holding OY AB). It subsequently submitted accounts for Helectron OY AB (in Swedish).

17. The requirements for submitting a contingent asset were set out in the Contingent Asset Appendix. Amongst other things, the contingent asset certificate was required to give the full name and company registration number for each guarantor. This was, presumably, an attempt to avoid the kind of confusion seen in this case.

18. It cannot be said that the Applicant complied with the requirements set out in Part G of the PPF Determination and/or the Contingent Asset Appendix. It is reliant on the Board being able/willing to consider the additional financial information it has supplied after the Measurement Time.

19. There is scope under rule B2 for the Board to correct the data used to calculate the Scheme's levy. In the particular circumstances of the Scheme's contingent asset certificate, either rule B2.1(1), (2) or (3) might be said to apply. However, the PPF Determination made it clear that the Board was under no obligation to correct the data used to calculate a levy.

20. The Applicant has argued that the Board did not seek any further information itself. There is provision for the Board to do so within the PPF Determination (rules B3.1 and G2.4). However, the Board is under no obligation to seek further information in respect of a contingent asset. The submission of a contingent asset is an option made available to schemes wishing to have their PPF levies reduced. It behoves those responsible for taking up this option on behalf of the Scheme to make sure that they comply with the requirements set out by the Board.

21. The Board have made the point that, at each stage of the challenge to the levy calculation, the Applicant has submitted new and different data. That is true. However, to some extent that is the nature of an appeal process. The Board argues that the Applicant's referral should be considered only by reference to the evidence which was before the reconsideration committee. Having said that, the Board has, itself, been prepared, at each stage, to consider the evidence presented by the Applicant. It has reached the view that the evidence does not cause it to change the decision to reject the contingent asset. It has given its reasons for doing so. In view of this, I need not give further consideration to whether or not the evidence before me should be restricted and I make no finding on that point.

22. It is for the Board to determine whether the contingent asset reduces the risk of compensation being payable in the event of an insolvency event occurring in respect of an employer in relation to the Scheme. Despite the confusion about the company name, the Board has made its decision by reference to its assessment of the ability of the guarantor to meet its commitment in full in the event of a relevant insolvency event. In doing so, it may place such weight as it considers appropriate on any of the evidence presented to it.

23. The Applicant disagrees with the Board's assessment. However, it has not pointed to any error or omission of fact on the part of the Board. The Applicant simply disagrees with the Board's assessment of the likely impact on the guarantor itself, of the

insolvency event. This is insufficient to find that the Board's assessment could be said to be perverse.

24. The Applicant has also suggested that the Board should consider a property and an agreement with another company to cover Scheme expenses. Neither of these pieces of evidence were presented to the Board prior to the relevant Measurement Time. The Board is under no obligation to consider them at this late stage. It has nevertheless done so and given cogent reasons why it does not consider them to be relevant to its decision.

25. I find that the reconsideration committee's decision was reached correctly and there is no further action required by the Board.

Anthony Arter
Pension Protection Fund Ombudsman

26 May 2016