

PENSIONS ACT 2004, PART 2 CHAPTER 6

APPEAL TO PENSION PROTECTION FUND OMBUDSMAN

DETERMINATION BY THE DEPUTY PENSION PROTECTION FUND OMBUDSMAN

Applicant : High-Point Rendel (Trustees) Limited (the **Trustees**)
Scheme : High-Point Rendel Pension Plan

1. The Pension Protection Fund Ombudsman has received a reference of a reviewable matter, following a decision by the Reconsideration Committee of the PPF dated 11 January 2007.

RECONSIDERATION DECISION

2. The Reconsideration Committee decided:
 - 2.1. The reviewable matter to which the Applicant's request for reconsideration related is the PPF Board's (the **Board**) calculation of the pension protection levies for the Scheme in respect of the period 1 April 2006 to 31 March 2007.
 - 2.2. This calculation is a reviewable matter by virtue of paragraph 19 of Schedule 9 of the Pensions Act 2004.
 - 2.3. The Applicant has requested that the levy be re-calculated by reference to the Dun & Bradstreet (**D&B**) failure score for High-Point Rendel Holdings Limited.
 - 2.4. Under Section 175(5) of the Pensions Act 2004, before the beginning of each financial year, the PPF Board must determine, in respect of that year:
 - The factors by reference to which the pension protection levies are to be assessed;
 - The time or times by reference to which those factors are to be assessed;
 - The rate of the levies; and
 - The time(s) at which the levies become payable.

- 2.5. Under Section 175(2)(a)(i)-(ii) of the Pensions Act 2004, the factors by reference to which the risk-based levy is assessed must include:
- The difference between the value of a scheme's assets (disregarding any assets representing the value of any rights in respect of money purchase benefits under the scheme rules) and the amount of its protected liabilities; and
 - Except in relation to any prescribed scheme or scheme of a prescribed description, the likelihood of an insolvency event occurring in relation to the employer in relation to a scheme.
- 2.6. Under Section 175(2)(a)(iii), the factors by reference to which the risk-based levy is assessed may also, if the Board considers it appropriate, include one or more other factors, which the Board considers indicates one or more of the following:
- The risks associated with the nature of a scheme's investments when compared with the nature of its liabilities; and
 - Such other matters as may be prescribed.
- 2.7. At the time the Board made its Determination for the year 2006/07, the Pension Protection Fund (Risk-based Pension Protection Levy) Regulations 2006 (S.I. 2006/672) prescribed the following additional risk factors:
- (a) the nature of, and (b) any risks associated with, any arrangement 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.
- 2.8. This enabled the Board to determine that it would take into account the existence of certain contingent assets, when calculating the pension protection levies.
- 2.9. Section 175(2) does not amount to a free standing entitlement as regards the particular factors to be taken into account in respect of each individual

scheme. It is only where the Board has determined to take into account a particular factor, that it can be used to calculate the levies. Otherwise there would be no certainty for schemes before the start of the levy year, no guarantee of consistency of treatment between schemes and the Board would not have performed its statutory duty under Section 175(5).

- 2.10. Section 181 does not provide a free standing right to include other elements under Section 181(3), since that section relates to calculating the levy imposed under Section 175. The calculation required under Section 181(3) is the mechanical act of applying the calculation methodology to any particular case.
- 2.11. The Board is not entitled or obliged to take into account matters not provided for in its Determination.
- 2.12. Neither a declaration of scheme structure nor a participating employers form was filed on behalf of the Scheme by the relevant deadline. In these circumstances, the 2006/07 Determination required the Board to use the failure score of the employer with the most members when calculating the levy.
- 2.13. The employer with the most members specified in the scheme return dated 1 November 2005 was High-Point Rendel Limited.
- 2.14. High-Point Rendel Holdings Limited was not the employer with the most members and does not appear to be an employer in relation to the Scheme at all.
- 2.15. Had High-Point Rendel Holdings Limited entered into a Type A contingent asset guarantee in favour of the Scheme trustees, satisfying the requirements of the 2006/07 Determination, its failure score would have been relevant to the levy calculation. There is no suggestion that such a guarantee existed at the appropriate time and no certificate in respect of such a contingent asset was provided to the Board.
- 2.16. The Reconsideration Committee upheld the original calculation of the levies for the Scheme.

APPLICANT'S GROUNDS FOR REFERENCE

3. The Applicant submits:
 - 3.1. The Scheme was closed to new entrants and further accrual in October 2003.
 - 3.2. There are only 52 members out of a total of 831 members of the Scheme who currently still work for the group.
 - 3.3. The shareholders of High-Point Holdings Limited agreed to pay between £600,000 and £720,000 per annum into the Scheme to eliminate the deficit and, as at February 2007, have paid £200,000.
 - 3.4. If the shareholders are unable or unwilling to increase their support, the consequence of paying such a high levy will be to push the Company into administration/receivership.
 - 3.5. The 2006/07 levy represents more than 37% of the current employer's deficit reduction contribution for this year.
 - 3.6. This is a case where the PPF should be able to waive or reduce the levy in accordance with Section 181(8)(b).

MATERIAL FACTS

4. The Board issued its 2006/07 Determination (the **Determination**) on 30 March 2006. The Determination stated that the failure score which would apply to an employer was to be the failure score which D&B informed the Board that it had assigned to that employer. The Determination stated:

“For the purposes of this Schedule, the employer or employers in relation to a scheme shall be taken to be such undertaking or undertakings as have been notified as such by or on behalf of the trustees or managers of the scheme to the Board. Any notification of participating employers to the Board for this purpose shall be provided on or before 31 March 2006 in the form attached to this Schedule [a Participating Employers form] ... Where no such notification has been provided, the employer in relation to the scheme shall be taken to be the employer identified as the employer of the largest number of defined benefit members in the most recent scheme return ...”

5. The Determination further provided:

“The Failure Score which applies to an employer shall be the failure score which Dun & Bradstreet UK Ltd (“DBUK”) informs the Board that it has assigned to that employer, after taking such steps to identify or obtain data relating to that employer as the Board has required. For the avoidance of doubt, the failure scores to be provided to the Board are to be the normal failure scores which were or would have been assigned to that employer by DBUK in the ordinary course of its business as at 31 March 2006, save only that –

(a) ...

(b) ...

(c) This sub-paragraph applies in any case where DBUK informs the Board that it has decided, following representations made to it by or on behalf of the relevant trustees or managers or employer, that the failure score assigned to an employer as at 31 March 2006 was either too high or too low because it was based upon information which, as at 31 March 2006, was incorrect or incomplete by comparison with the information which should normally have been taken into account by DBUK in assigning a failure score at that date. In a case to which this sub-paragraph applies, the Failure Score shall be the higher or lower failure score which DBUK informs the Board ought to have been assigned to the employer as at 31 March 2006. For these purposes, the Board has instructed DBUK to give consideration to those, and only those, representations made to it not later than 28 days after the date shown on the original notification. In a case to which this sub-paragraph applies the Board will where necessary issue a revised notification of the amount of the levies in respect of the scheme;”

6. The formula for calculating the risk-based levy was set out in Part 3 of the Schedule to the Determination, as follows:

$$U \times P \times 0.8 \times 0.53$$

Where, U is based on the relationship between the scheme’s assets and liabilities and P is the PPF assumed probability of insolvency associated with the failure score which applies to the employer in relation to the scheme.

7. The Determination provided that, where the Board had not been provided with a Declaration of Scheme Structure form, P is applied as if the sole employer in relation to the scheme was the employer of the largest number of members.

8. The Determination also provided for the calculation of U to take into account certain contingent assets. The permissible forms of contingent asset were guarantees given by associated companies, security over bank accounts, land or securities and letters of credit or bank guarantees.
9. High-Point Rendel Limited (**HPR Ltd**) is a wholly owned subsidiary of High-Point Rendel Group plc (**HPR Group**), which is in turn a wholly owned subsidiary of High-Point Rendel Holdings Limited (**HPR Holdings**).
10. According to the Scheme Return completed in November 2005, the Scheme was made paid up on 30 September 2003 and there were 829 members. Of these, 508 members were deferred members and 321 were pensioners. As at 1 August 2002, the Scheme was 86% funded on the Minimum Funding Requirement (**MFR**) basis.
11. The Scheme Return includes a section requiring details about scheme employers. The Principal Employer was stated to be HPR Group. The “Employer with the most members” was stated to be HPR Ltd, with 829 members. HPR Group was given on the return form as the employer with the fewest members (2). Details about HPR Holdings were not entered on the form. The question “How many other employers participate in the scheme as well as the employers mentioned above?” was not answered.
12. In October 2006, the PPF issued an invoice for £230,990.14. Of this, £224,698.58 represented the risk-based levy. In the explanatory notes accompanying the invoice, the PPF explained that the employer with the most members had been take to be HPR Ltd and that this company had a D&B failure score of 6, giving an insolvency probability of 0.070235.
13. The Trustees applied for a review, stating:

“HPR Holdings provides the bank finance for both [HPR Group] and [HPR Ltd].

HPR Holdings Limited signs a letter of support for both [HPR Group] and [HPR Ltd] for the purposes of the audited accounts.

The insolvency risk factor calculation is based on [HPR Ltd] but it should have been based on [HPR Holdings] which consolidates the accounts of both [HPR Ltd] and [HPR Group]. [HPR Ltd] cannot be viewed as a stand alone company for credit purpose but must be

viewed as a member of a Group. The strength of [HPR Ltd] is the strength of the Group. The D&B failure score for [HPR Holdings] is 81.”

14. The decision of the Board and the Reconsideration Committee was to find that the risk based levy had been calculated correctly, i.e. in line with the provisions of the March 2006 Determination.

WRITTEN REPRESENTATIONS

15. The PPFO has received written representations from both the PPF and the Applicant. These are summarised below.

The PPF

16. The PPF submits:
- 16.1. It has calculated the levies in accordance with the rules which were determined before the start of the financial year. Those rules have to be applied impartially to all schemes and neither it nor the Ombudsman has any obligation or power to depart from them.
- 16.2. The Determination is not a reviewable matter. The appropriate way to challenge the Determination was by judicial review at the appropriate time.
- 16.3. The Board has two quite distinct tasks to perform:
- (i) First, it has to make its determination under S175(5) of the Pensions Act 2004. In other words, it has to set out all the rules for calculating the levy. It is at this stage that the Board decides, amongst other things, whether and to what extent it considers it appropriate to take into account any risk factors mentioned in S175(3) of the Pensions Act 2004.
 - (ii) Secondly, it has to calculate the amount of the levy in respect of each scheme, as required by S181(3)(b) of the Pensions Act 2004.

It is the second task which is the reviewable matter.

- 16.4. There are provisions in the Determination which allow for the risk-based levy to take account of support from an associated company of the scheme employer. These only apply where certain types of contingent assets have been put in place, in a manner which is the subject of detailed rules. This is to ensure that the benefit of those assets is indeed available to the trustees of the scheme if required. Contingent assets, means assets that generate a cash flow into the scheme contingent upon an insolvency event occurring in relation to the scheme employer. For example, a parent company guarantee.
- 16.5. The making of the Determination followed extensive consultation and it was made very clear to trustees and employers what they would have to do if they wished to have the financial strength of a parent company taken into account.
- 16.6. Neither HPR Holdings nor any other associated company of HPR Ltd has provided a contingent asset in accordance with the terms of the Determination.
- 16.7. Based on information provided by the Applicant, there appear to be two employers in relation to the Scheme: HPR Ltd and HPR Group. The Scheme appears to be a “multi-employer scheme” as defined in S307 of the Pensions Act 2004.
- 16.8. Section 175(2)(a) is amended by The Occupational Pension Schemes (Pension Protection Levies) (Transitional Period and Modification for Multi-employer Schemes) Regulations 2006 (see Appendix) to provide for the use of the employer with the most members for the 2006/07 levy year.
- 16.9. The only mechanism for the Board to have a complete list of employers of a scheme and information about the scheme structure, thus enabling it to calculate a weighted average, was via the Declaration of Scheme Structure and Participating Employers forms.
- 16.10. There is no suggestion that HPR Holdings is an employer in relation to the Scheme (as defined in S318 of the Pensions Act 2004 or the Pension Protection Fund (Multi-employer) (Modifications) Regulations 2005).
- 16.11. Section 175 requires the likelihood of an insolvency event to be considered in relation to the employer in relation to the scheme; not in relation to some

associated company of that employer. “Employer” is as defined in S318 of the Pensions Act 2004.

- 16.12. No Declaration of Scheme Structure or Participating Employers form was submitted in respect of the Scheme.
- 16.13. Deficit reduction contributions, made at the appropriate time, are taken into account but this is irrelevant to the question of insolvency risk.
- 16.14. The levy is a liability of the scheme; albeit that it may be recovered from an employer. The legislation requires a risk-based levy. The calculation of the levy cannot depend upon whether a particular company says it is unable to afford a particular amount.
- 16.15. The problem for this particular group of companies arises from the fact that it either failed to consider putting a contingent asset in place in one of the accepted ways or decided not to.
- 16.16. Section 181(8)(b) does not, itself, confer a power of waiver. Section 181 simply provides that Regulations may be made relating to waiver. The actual powers arise under the Pension Protection Fund (Waiver of Pension Protection Fund Levy and Consequential Amendments) Regulations 2007, which came into force on 30 March 2007. No application for a waiver has been made and, in any event, the above Regulations do not provide for a waiver to be granted in the circumstances of this case.

Supplementary Statements by the Applicant

- 17. The Applicant further submits:
 - 17.1. The strength of HPR Ltd is the same as HPR Holdings.
 - 17.2. By applying rigid rules, the PPF has calculated a risk-based levy of £224,698.58. If the failure score for HPR Holdings were to be used, the risk-based levy would be £60,000.
 - 17.3. HPR Holdings are already paying £600,000 into the Scheme; this represents 50% of its profits for the year ended 31 July 2006.

- 17.4. If HPR Holdings has to increase its contribution to cover the levy, it will represent 70% of its profits, which is not sustainable.
- 17.5. The consequence of applying the levy rules in this way is to increase the risk of the Scheme entering the PPF.
- 17.6. The circumstances surrounding the HPR Group are probably exceptional. HPR Ltd has had large historic write-offs of work-in-progress and debtors over the last three years which has depressed its credit score. The credit score for HPR Holdings is 81 and for HPR Ltd it is 8, when they are essentially the same group of assets and liabilities. The levy for 2006/07 is £224,698.58, which represents 1.2% of the shortfall of the assets over the PPF liabilities; in addition to the £600,000 which HPR Holdings is paying into the Scheme. The levy for 2007/08 will be £561,709, which will represent 3% of the shortfall. This does not reflect the actual amount of risk.
- 17.7. The risk-based levy is based on a credit score from D&B, which is meant to reflect the chances of the Company going into liquidation. The credit score for HPR Holdings was 81 and that for HPR Ltd was 8. The only asset of any value held by HPR Holdings is its shares in HPR Ltd. Thus, if HPR Ltd goes into liquidation, so does HPR Holdings; therefore, the credit ratings should have been the same. This has now been reflected in the revised credit score for HPR Ltd of 86 for 2007/08.
- 17.8. If HPR Holdings had provided a parent company guarantee for HPR Ltd, they would effectively be pledging their shares in HPR Ltd to guarantee HPR Ltd, which may be financial assistance and illegal under Section 151 of the Companies Act 1985. A parent company guarantee would not have given any greater security to the PPF.
- 17.9. D&B's methodology can be flawed when dealing with small companies. In 2006, HPR Ltd had a County Court judgment registered for £10,600, which reduced the credit score from 37 to 6; this has now been cleared. In addition, HPR Ltd do not have many suppliers because the majority of its costs are payroll. The credit score is influenced by supplier feedback and, as a result, a

small number of suppliers who provide negative feedback can have a disproportionate effect when they are only a small part of the overall costs.

- 17.10. D&B appear to previously misunderstand the relationship between HPR Holdings and HPR Ltd. Subsequent to the Trustees' appeal, D&B appear to have acknowledged this because they have re-rated HPR Ltd in 2007. It would be unjust for D&B not to adjust the 2006 score to take account of their newly acquired understanding of the businesses' inter-relationship, which has not changed over the period in question.
- 17.11. It cannot be right that the pension fund should suffer a large and excessive levy when in deficit because D&B had a formulaic process that did not fully take into account the situation at that time, but which, with hindsight, they now do.
- 17.12. They only became aware of the factors which influence the D&B score during the course of the appeal and did not have the opportunity to take action any earlier, in accordance with the regulations.

Further Response by the PPF

18. The PPF submits:

- 18.1. In the absence of an arrangement such as a legally enforceable guarantee, a parent or holding company bears no responsibility for the liabilities of its subsidiaries.
- 18.2. Statute requires the Board to base its levy on the insolvency risk of the employer (as defined). It is the employer which will bear the legal liability to make up any deficit in the scheme and whose insolvency might trigger a claim on the PPF.
- 18.3. The Board would be required to take into account the financial strength of HPR Holdings if there had been an enforceable parent company guarantee in place.
- 18.4. The Board took the decision to use the D&B failure score as its measure of insolvency risk for all companies because it has neither the expertise nor the

resources to consider the financial risk for each company on an ad hoc basis. The D&B methodology applies in a standardised way to all relevant companies and, therefore, provides a measure which is fair and consistent.

- 18.5. The Board does apply “rigid rules” because this is what the Pensions Act 2004 requires it to do. To do anything else would be unfair between schemes.

CONCLUSIONS

19. This is a reviewable matter by virtue of paragraph 19 of Schedule 9 of the Pensions Act 2004.
20. The reviewable matter in question is the amount of the risk-based levy required of the Scheme in the financial year 2006/07.
21. The risk-based levy has been calculated by reference to the D&B failure score for HPR Ltd. The Board’s Determination for the year 2006/07 provided that, in the absence of a Declaration of Scheme Structure or a Participating Employers form, the factor P should be determined by reference to the employer of the largest number of defined benefit members in the most recent scheme return. HPR Ltd did not submit a Declaration of Scheme Structure or a Participating Employers form. The employer identified as having the largest number of members in the Scheme on the Scheme return for November 2005 was HPR Ltd. P, therefore, fell to be calculated by reference to the failure score for HPR Ltd.
22. The Board has calculated the risk-based levy in accordance with the provisions of its March 2006 Determination. The Board is not, therefore, required to take any action.
23. HPR Ltd have argued that its D&B failure score does not give a true picture of the actual risk to the funding of the Scheme. There were steps HPR Ltd, with its other group companies, could have taken to enable the Board to take account of those other companies’ failure scores. For whatever reason, those steps were not taken. I conclude, therefore, that the amount of the risk-based levy for the year 2006/2007 has been correctly calculated and no direction is required.
24. I have noted the Trustees’ submissions concerning the revision of HPR Ltd’s failure score by D&B for 2007/08. The arguments they now seek to put forward represent a

significant departure from those originally raised with the Reconsideration Committee and, latterly, with me. I do not consider it appropriate to extend the scope of the reference to me in this way and believe that it would be more appropriate for the Trustees to raise this matter with the Board in the first instance to allow them to consider the new matters raised.

CHARLIE GORDON

Deputy Pension Protection Fund Ombudsman

10 August 2007

APPENDIX

The Pensions Act 2004

“175 Pension protection levies

- (1) For each financial year falling after the initial period, the Board must impose both of the following –
 - (a) a risk-based pension protection levy in respect of all eligible schemes;
 - (b) a scheme-based pension protection levy in respect of all schemes.

...
- (2) For the purposes of this section –
 - (a) a risk-based levy is a levy assessed by reference to –
 - (i) the difference between the value of the scheme’s assets (disregarding any assets representing the value of any rights in respect of money purchase benefits under the scheme rules) and the amount of its protected liabilities,
 - (ii) except in relation to any prescribed scheme or scheme of a prescribed description, the likelihood of an insolvency event occurring in relation to the employer in relation to the scheme, and
 - (iii) if the Board considers it appropriate, one or more other risk factors mentioned in subsection (3) ...
- (3) The other risk factors referred to in subsection (2)(a)(iii) are factors which the Board considers indicate one or more of the following –
 - (a) the risks associated with the nature of a scheme’s investments when compared with the nature of its liabilities;
 - (b) such other matters as may be prescribed.

...

- (5) The Board must, before the beginning of each financial year, determine in respect of that year -
- (a) the factors by reference to which the pension protection fund levies are to be assessed,
 - (b) the time or times by reference to which those factors are to be assessed,
 - (c) the rate of the levies, and
 - (d) the time or times during the year when the levies, or any instalment of levy, becomes payable.

...”

“181 Calculation, collection and recovery of levies

...

- (3) The Board must in respect of the levy -
- (a) determine the schemes in respect of which it is imposed,
 - (b) calculate the amount of the levy in respect of each of those schemes, and
 - (c) notify any person liable to pay the levy ...

...

- (8) Regulations may make provision relating to –
- (a) the collection and recovery of amounts payable by way of any levy ...
 - (b) the circumstances in which any such amount may be waived.”

“307 Modifications of this Act in relation to certain categories of scheme

...

“multi-employer scheme” means an occupational pension scheme in relation to which there is more than one employer.”

“318 General interpretation

...

“employer”

(a) in relation to an occupational pension scheme, means the employer of persons in the description of employment to which the scheme in question relates.”

“Schedule 9

Reviewable Matters

...

19 The amount of the initial levy or any pension protection levy payable in respect of an eligible scheme determined by the Board under section 181(3)(b).”

The Pension Protection Fund (Risk-based Pension Protection Levy) Regulations 2006 (S.I. 2006/672)

“2 Matters prescribed for the purposes of assessing the risk-based pension protection levy

For the purposes of section 175(2)(a)(iii) of the Pensions Act 2004 (pension protection levies – other risk factors), the prescribed matters 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.”

The Occupational Pension Schemes (Pension Protection Levies) (Transitional Period and Modification for Multi-employer Schemes) Regulations 2006 (S.I. 2006/566)

“4 Modification of section 175 of the Act for the financial year beginning on 1st April 2006: non-segregated schemes

- (1) This regulation applies to a non-segregated scheme for the financial year beginning on 1st April 2006.
- (2) Section 175 of the Act shall be modified so that it shall be read as if –

...

for paragraph (a) of subsection (2) there were substituted –

- (a) “a risk-based pension protection levy is a levy assessed by reference to –

...

(iii) the likelihood of an insolvency event occurring -

(aa) where, on or before 31st March 2006, the Board has received sufficient information to assess the likelihood of an insolvency event occurring in relation to each employer in relation to the scheme and such an assessment would reduce the amount of the risk-based pension protection fund levy which would otherwise be payable, in relation to each employer in relation to that scheme; or

(bb) in all other cases, in relation to the employer who on 31st March 2006 has most members of the scheme or, where two or more employers have most members, each of those employers ...”