

**PENSIONS ACT 2004, PART 2 CHAPTER 6**

**APPEAL TO PENSION PROTECTION FUND OMBUDSMAN**

**DETERMINATION BY THE DEPUTY PENSION PROTECTION FUND OMBUDSMAN**

**Applicant** : Trustee of Middlesex Group Limited Pension Fund  
**Respondent** : Pension Protection Fund (**PPF**)  
**Scheme** : Middlesex Group Limited Pension Fund, the Occupational Pension Scheme under which the appellant has benefit rights  
**Employer** : Middlesex Group Limited

1. The Pension Protection Fund Ombudsman has received a referral of a reviewable matter, following a decision by the Reconsideration Committee (**the Committee**) of the PPF dated 6 March 2007.

**RECONSIDERATION DECISION**

2. Mr Paul Foulds, a Trustee of the Middlesex Group Limited Pension Fund (**the Scheme**), requested the Committee to reconsider the PPF Board's calculation of the pension protection levies for the Scheme in respect of the period 1 April 2006 to 31 March 2007, as set out in an invoice to the Trustees of the Scheme dated 20 October 2006. This calculation is a reviewable matter by virtue of paragraph 19 of Schedule 9 of the Pensions Act 2004.
3. As well as asking the Committee to reconsider the calculation, Mr Foulds asked two further questions of the Committee:
  - How could it be equitable or sensible for the Trustees of the Scheme to pay the PPF levies, a large expense for them, which he considered would be better used to fund the Scheme?
  - How could it be sensible to have three methods of calculating pension scheme liabilities with large differences between them and how did that make sense in running a business and providing pensions for employees?
4. The Reconsideration Committee met on 6 March 2007 and decided that:
  - 4.1.1. Under Section 175(5) of the Pensions Act 2004 (**the 2004 Act**), 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.

4.1.2. A review or reconsideration of the amount of a levy was a review of the calculation of the levy in a particular case and not a review of the Board's Determination under Section 175 (5). The scope of the review should be whether the calculation in respect of the Scheme's levy invoice was carried out in accordance with the published Determination.

4.1.3. In response to the first specific question raised by Mr Foulds, the Board was required to impose a risk-based and a scheme-based pension protection levy in respect of all eligible pension schemes by virtue of Section 175 of the 2004 Act. Under section 181 of that Act the levy was payable to the Board by or on behalf of the managers of the trustees of the scheme. Therefore it was a matter of government policy that schemes were required to pay the levies. The Board must fulfil the statutory requirements imposed upon it by government.

4.1.4. In response to the second specific question raised, the Committee noted that:

- The fact that there were different actuarial valuations was not a reviewable matter, rather it was a matter of Government policy and not for the Committee to decide. The different valuation bases had different purposes and the assumptions used in them varied.
- The Determination provided for Minimum Funding Requirement (MFR) valuation data to be used to calculate the amount of the levies where no section 179 valuation had been supplied on or before 31 March 2006. In this situation, the methodology set out in Appendix 2 to the Determination was used to roll forward the MFR valuations given in the most recent scheme return to estimate the protected liabilities of the Scheme as at 31 March 2006. Schemes had the

opportunity voluntarily to submit a section 179 valuation, but where no such valuation was provided the Determination required the Board to use MFR data, being the only data that would be available for all schemes.

- The levy calculation for the Scheme, and in particular the roll forward of the valuation to 31 March 2006, had been checked and was correct.

5. The Committee concluded that the Board had correctly calculated the Scheme's risk-based levy in accordance with the Determination.

### **APPLICANT'S GROUNDS FOR REFERRAL**

6. Mr Foulds, in his capacity as a Trustee of the Scheme, referred his complaint to me on the grounds that:

6.1.1. it was not equitable or sensible for the Scheme to be required to pay the levies, which were a large expense for it and could be better used to fund the Scheme;

6.1.2. it was not sensible to have three different methods of calculating pension scheme liabilities, with such huge differences between each value;

6.1.3. Dun & Bradstreet (**D & B**) refused to adjust their calculation of the failure score of Middlesex Group Ltd (**the Company**), and would not disclose their workings so as to enable Mr Foulds to check the calculation of the failure score;

6.1.4. the failure score used in the calculation of the levies (62) did not match the failure score on D & B's report (67).

6.2. Mr Foulds submitted that, as he was unable to independently verify the calculation used to arrive at the score, the Trustees were being asked to approve a payment he believed might well be incorrect. Approval of such a payment might breach his fiduciary duties as a trustee of the Scheme. He also said that the levy was unreasonably high given the low probability of the failure of the Company and represented an unreasonable burden on it.

**RELEVANT LEGISLATION**

7. The 2004 Act provides, so far as relevant to the reference to me:

7.1. **“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 eligible schemes.  
 In this Chapter "pension protection levy" means a levy imposed in accordance with this section.

(2) For the purposes of this section-

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

- (i) 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,
- (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 a scheme, and
- (iii) if the Board considers it appropriate, one or more other risk factors mentioned in subsection (3), and

(b) a scheme-based pension protection levy is a levy assessed by reference to-

- (i) the amount of a scheme's liabilities to or in respect of members (other than liabilities in respect of money purchase benefits), and
- (ii) if the Board considers it appropriate, one or more other scheme factors mentioned in subsection (4).

(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.

(4) The other scheme factors referred to in subsection (2)(b)(ii) are-

(a) the number of persons who are members, or fall within any description of member, of a scheme;  
 (b) the total annual amount of pensionable earnings of active members of a scheme;

(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 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.

(6) Different risk factors, scheme factors or rates may be determined in respect of different descriptions of scheme.”

## 7.2. “Valuations to determine scheme underfunding

(1) For the purposes of enabling risk-based pension protection levies (within the meaning of section 175) to be calculated in respect of eligible schemes, regulations may make provision requiring the trustees or managers of each such scheme to provide the Board or the Regulator on the Board's behalf-

(a) with an actuarial valuation of the scheme at such intervals as may be prescribed, ...

(2) For the purposes of this section, in relation to a scheme-  
"an actuarial valuation" means a written valuation of the scheme's assets and protected liabilities prepared and signed by the actuary;

"the actuary" means-

(a) the actuary appointed under section 47(1)(b) of the Pensions Act 1995 (c. 26) (professional advisers) in relation to the scheme, or

(b) if no such actuary has been appointed-

(i) a person with prescribed qualifications or experience, or

(ii) a person approved by the Secretary of State.

(3) Regulations under this section may prescribe how-

(a) the assets and the protected liabilities of schemes, and

(b) their amount or value,

are to be determined, calculated and verified.

(4) Subject to any provision made under subsection (3), those matters are to be determined, calculated and verified in accordance with guidance issued by the Board.

(5) In calculating the amount of any liabilities for the purposes of a valuation required by virtue of this section, a provision of the scheme rules which limits the amount of the scheme's liabilities by reference to the value of its assets is to be disregarded.

(6) In this section references to "assets" do not include assets representing the value of any rights in respect of money purchase benefits under the scheme rules.”

## 7.3. “181 Calculation, collection and recovery of levies

(1) This section applies in relation to-

(a) the initial levy imposed under section 174 in respect of a scheme, and

(b) any pension protection levy imposed under section 175 in respect of a scheme.

(2) The levy is payable to the Board by or on behalf of-

(a) the trustees or managers of the scheme, or

(b) any other prescribed person.

(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 in respect of the scheme of the amount of the levy in respect of the scheme and the date or dates on which it becomes payable.”

7.4. Reviewable matters are listed in Schedule 9 to the 2004 Act. From Schedule 9:

“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).”

**MATERIAL FACTS**

8. The Board issued its 2006/07 Determination (**the Determination**) on 30 March 2006. The Determination set out the factors and times by reference to which the pension protection levies were to be assessed, and the date on which levies became payable.

9. Paragraph 2 of Part 1 of the Schedule to the Determination provides:

“Save where otherwise stated, all the matters referred to in this Schedule shall be assessed, measured or quantified in accordance with the factual position as it existed at 31 March 2006.”

10. Paragraph 14 of Part 3 of the Schedule set out the formula for calculating the risk based levy (see paragraph 12 below) and paragraph 26 gave details of how the employer’s failure score was to be arrived at. Paragraph 26 provides, as relevant:

“The Failure Score which applies to an employer shall be the failure score which [D & B] 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 [D & B] in the ordinary course of its business as at 31 March 2006, save only that –

.....

(c) This sub-paragraph applies in any case where [D & B] 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 on 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 [D & B] in assigning a failure score at that date. .... For these purposes, the Board has instructed [D & B] to give consideration to those, and only to 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.

.....”

11. On 20 October 2006, the PPF issued its invoice to the Scheme:
  - 11.1.1. The Scheme based levy was calculated at £1,911.34.
  - 11.1.2. The risk based levy was calculated at £46,876.02.
12. The risk based levy was calculated according to the formula:
$$U \text{ (Underfunding risk)} \times P \text{ (Probability of Insolvency)} \times \text{Levy Scaling Factor} \times \text{Percentage risk based}$$
13. The Applicant accepted the figures in the formula except for P.
14. The Company’s insolvency probability figure (P) was 0.014, which was in turn based on D & B’s failure score for the Company of 62. (The higher the failure score, the lower the risk of failure – so a score of 62 means a lower risk of failure than, say, a score of 52).
15. The Applicant took steps to find out what information about the company D & B had taken into account in giving it a failure score of 62. The Applicant obtained a copy of D & B’s Comprehensive Report as at 8 December 2006, which showed a failure score of 67. He appealed to D & B, as he was entitled to do, against the score of 62.
16. The Applicant also requested a review of the Scheme’s levy invoice issued on 20 October 2006, writing formally to the Complaints Officer on 12 December 2006. He said:

“My company manufactures precision components for the aerospace industry and was founded by my father in 1945, we remain a family owned business.

In the 1950s my father started our final salary scheme as he believed that our employees should have a decent pension in retirement.

His far sighted vision has now turned into an administrative nightmare.

Ten years ago we closed our scheme to new members and have changed the benefit structure for future service most recently in April 2004 when the scheme members were contracted back into the state scheme and the accrual rate for future service reduced to 1/120<sup>th</sup>.

Earlier this year the triennial valuation at April 2005 was prepared by the scheme actuary which showed a deficit on an ongoing basis of £1,229,000 and an FRS17 deficit of £1,567,000. The scheme actuary has updated the valuation at 6 April 2006 and the deficit on an ongoing basis has reduced to £270,000 and the FRS17 deficit has increased to £1,797,000.

A schedule of contributions has been agreed between the Company, Trustees and Actuary which eliminates the deficit over 10 years and funds up future service liabilities.

On 23 October 2006 we received your PPF levy invoices for the current year and were shocked to discover that you require £48,787.36 for immediate payment. On the same day I e-mailed you to query this invoice and also Dun & Bradstreet to query our failure score.

We have always funded the scheme in accordance with [the] actuary's recommendations and have taken steps to try to make the scheme affordable and keep the scheme open. How can it possibly be equitable or indeed sensible that we are now required to pay your levy which for us is a large expense and could be much better used to fund our scheme. In addition could you please explain how it can be sensible to have three methods of calculating pension scheme liabilities with such huge differences between each value and how this makes any sense in the real world of running a business and providing pensions for our employees...."

17. The reviewable matter was reviewed by the Board and was the subject of a Notice of Decision under section 207 of the Pensions Act 2004, dated 12 January 2007.

17.1. The PPF Board noted that the Applicant had not identified any specific errors in the calculation of the levies, nor any factual inaccuracies in the data used for the purposes of that calculation from the scheme return of 3 August 2005. The review of the amount of the levies had therefore been carried out by checking that the appropriate data had been used in calculating the levies. But, the Board noted, it was not entitled or obliged to depart from the Determination in calculating the amount of the levies; it was the calculation under section 181(3)(b) which was a reviewable matter.



- 17.2. The Scheme fell within the definition of ‘eligible scheme’ provided in section 126(1) of the 2004 Act, and it was not open to the Board to consider exempting the Scheme from the levies on the general grounds raised by the Applicant. As to the Applicant’s request for an explanation of why it was sensible to have three methods of calculating pension scheme liabilities, it was simply noted that occupational pension schemes were obliged to conduct these valuations. The Board did not consider this point to be relevant in deciding whether the Determination had been correctly applied in calculating the levy invoice which had been issued to the Scheme.
- 17.3. Having checked that the data contained in the Scheme return dated 3 August 2005 were those used to calculate the levies for the Scheme, the Board was satisfied that the amount of the invoice dated 20 October 2006 was correctly calculated. The amount of the pension protection levy for the Scheme, as notified in the invoice dated 20 October 2006, was therefore correct.
- 17.4. In relation to the failure score used by D & B, the Board noted that, if the Applicant’s appeal against this were to be successful, such that the revised failure score resulted in a reduction in the levy, a credit note would be issued in respect of the invoice dated 20 October 2006. A new invoice for the revised amount would then be issued. However, in relation to the review itself, the Board concluded that the data supplied in the scheme return dated 3 August 2005, were those used in calculating the Scheme’s levy invoice, which complied with the terms of the Determination.
18. On 15 January 2007, D & B informed Mr Foulds that the failure score had been reviewed in some detail and they confirmed that it was correctly calculated as at 31 March 2006. They continued:
- “There is clearly some confusion on how the D & B Failure Score works and specifically the constraints we are working within, with regard to how it interacts with the [PPF’s] Risk Based Levy.
- “Our score of 62 is derived using statistical models based on hundreds of thousands of historical insolvencies. The weighting attributed to each of these elements in the models is determined by the statistical importance of these elements to failed businesses.

Although you may not consider some of these elements to be significant enough to justify a score of 62, statistically speaking they are, and so the underlying scores reflect this.”

There followed a list of the main significant factors which it was said had negatively contributed to the Scheme’s score, and the letter concluded,

“If you feel that any of the elements we have used were inaccurate, then I would be prepared to change them and recalculate the Failure Score retrospectively.”

19. Mr Foulds was dissatisfied with both D & B’s response, and the Board’s decision, and indicated he would be challenging both.
20. On 26 February 2007, D & B responded to Mr Foulds’ appeal. They told him they had corrected three factual inaccuracies within their report (relating to a charge to an investor, the resignation of the company secretary and a branch closure), but that these would not have had an impact on the failure score. The Global Scoring Group at D & B had reviewed the 31 March 2006 score, and had confirmed it had been calculated correctly. The PPF had asked D & B not to make exceptions for individual cases unless there were data inaccuracies or facts used in the scoring models available but not reflected at the time. D & B could not see any new grounds for appeal in Mr Foulds’ letter, and the failure score of 62 would therefore stand.
21. Mr Foulds asked D & B to provide a detailed copy of the calculations and assumptions used in arriving at the score so that he could check the calculation. D & B told him that they could not fulfil his request: they did not disclose detailed workings of their scores as this was commercially highly sensitive. The failure score was calculated using a range of demographic, financial, payment and public record elements and the weighting attributed to these elements in the models was determined by the statistical importance of these elements to failed businesses.
22. On 19 March 2007, the Reconsideration Committee gave notice of its decision dated 6 March. Its conclusions are set out at paragraph 4 above.
23. Mr Foulds then referred the matter to me.

**WRITTEN REPRESENTATIONS**

24. Mr Foulds' original submissions are summarised in paragraph 6 above.
25. The PPF responded that:
- 25.1. The Board had calculated the levies in respect of the Scheme in accordance with the rules which were determined before the start of the financial year, following a statutory process. Those rules then had to be applied impartially to all schemes, and neither the Board nor the Ombudsman had any power to depart from the rules on an application for review made by an individual scheme.
- 25.2. The Scheme was an eligible scheme in respect of which levies were payable to the PPF. The levies in respect of the 2006/7 financial year consisted of a Scheme based levy and a risk based levy. The calculation of the risk based levy depended in part upon the likelihood of an insolvency event occurring in relation to the scheme employer (assessed by reference to its failure score).
- 25.3. The Board was required to impose a risk based and a scheme based levy in respect of all eligible pension schemes by virtue of section 175 of the 2004 Act. Under section 181 of that Act, the levy was payable to the Board by or on behalf of the managers or trustees of the scheme. Therefore it was a matter of law that the Board was required to determine, and that schemes were required to pay, the levies.
- 25.4. Where the scheme was a single employer scheme, which this Scheme was, the Determination required the calculation of the risk based levy to be based upon the deemed insolvency risk of the employer in relation to the scheme, which in this case was Middlesex Group Limited. The system for calculating the risk based levy required an assessment of the assumed probability of insolvency for the relevant employer, based on the failure score provided to the Board by D & B. This score was based on the financial position of the relevant company as at 31 March 2006 – a lower failure score meant a higher risk of insolvency. The failure score for Middlesex Group Limited at the relevant time was 62.

- 25.5. The Board had identified four grounds of complaint by Mr Foulds:
- 25.5.1. that it was not equitable or sensible for the Scheme to pay the PPF levies when the money would be better used to fund the Scheme;
  - 25.5.2. that it was not sensible to have three different methods of calculating scheme liabilities;
  - 25.5.3. that D & B had refused to adjust its failure score and would not disclose its workings;
  - 25.5.4. that the failure score used in the calculation of the levies did not match the score in their report.
- 25.6. The PPF submitted that the first three grounds were not truly grounds for review. As to the first ground, a consideration of whether the levies were equitable or sensible was beyond the Board's, or my, powers of review: the imposition of the levies was a matter of law. As to the second ground, the fact that there were different methods of actuarial valuation was not reviewable; it was largely a matter of Government policy. Schemes had the opportunity to submit a section 179 valuation, but where (as here) they did not do so, the Determination requires the Board to use MFR data, being the only data which will be available for all schemes. As to the third ground, the fact that the Board had determined to use D & B failure scores as a method of determining the probability of insolvency, was not a reviewable matter and was beyond the scope of the Board's, and my, powers of review.
- 25.7. As to the fourth ground, the PPF had contacted D & B about the Applicant's appeal against the failure score of 62. The failure score was recalculated daily based on the most up to date data available to D & B on that day and changed if necessary. D & B had explained that the failure score on 20 March 2006 was 62, while on 3 October 2006 it increased to 67, and on 26 February 2007 it changed to 62 again. Hence, at 31 March 2006, the score was 62, and at 8 December 2006 it was 67.
- 25.8. In calculating the levies in respect of a particular scheme, the Board had no power to do anything other than to apply the rules set out in the Determination. The same rules had to be applied impartially to all

schemes. In this respect, the Ombudsman was in the same position as the Board.

- 25.9. The Board's determination under section 175(5) of the Pensions Act 2004 required it to use the D & B failure score and, D & B having gone through their internal appeals process referred to in the Determination, the Board was satisfied that the score was correct. The Board did not have discretion to depart from the Determination or interfere with D & B's analysis.
- 25.10. As to the decision of the Board to use D & B, the Board had to choose an appropriate method of measuring insolvency risk, as required by the 2004 Act. It consulted on its proposal to use a market-based solution, and on its proposed selection criteria. D & B's model represented the most appropriate method – it was chosen after a thorough selection process, compliant with European law. It would have been prohibitively expensive for the Board to seek to employ its own insolvency assessment staff to perform in-house assessments of approximately 40,000 employers. The Board acknowledged that employers might wish to understand the precise manner of calculation of their D & B failure score. However, compared to possible alternative providers, D & B had been willing to be quite transparent about the quantitative factors that determine their insolvency risk measure, including the relative weightings of various areas. No other provider was willing to be more transparent, and some had a qualitative element to their insolvency risk assessment.
26. Commenting on the Board's response, Mr Foulds said that he did not take issue with much of it, but the calculation of the failure score remained a matter of contention. He was being asked to clear for payment a charge which he had no means of verifying. He said:
- “In a process which I would have thought that both the Pensions Regulator and the PPF would wish to be as transparent as possible I am both surprised and dismayed that this is not the case in the part of the process all the more so as it has such an influence on the value of the levy. In this respect I feel your process is flawed.”
27. Mr Foulds also told me, during the course of my investigation, that, in September 2007, he had written to D & B to query the ‘SIC codes’ which had been given to

the Company (the SIC codes denoting the line of business which a company was in). D & B had indicated that the SIC code for the Company would be changed and that a change in the code might have an impact on the failure score. The PPF, commenting on this, told me that, while they accepted that the SIC code had been changed, this did not affect the failure score and therefore had no bearing on the calculation of the levy invoice.

## CONCLUSIONS

28. This is a reviewable matter by virtue of paragraph 19 of Schedule 9 to the Pensions Act 2004. The reviewable matter in question is the calculation of the risk-based levy required of the Scheme in the financial year 2006/07.
29. The PPF levies must be calculated in accordance with the Determination. There is no evidence that the Board has not done that, nor indeed has Mr Foulds sought to argue that. The PPF has correctly submitted that it is beyond my remit (or theirs) to determine whether it is “fair or sensible” for schemes to pay the levies, or whether it is sensible to have different methods of calculating scheme liabilities.
30. I have noted that D & B have reviewed their calculation of the Company’s failure score, but refuse to amend that score, or to give Mr Foulds details of their workings. I have no jurisdiction over D & B, so am unable to direct them to take any further steps in relation to the score.
31. However, I may review the calculation of the levies, and I have therefore considered whether correct figures - in particular the Company’s failure score - have been used in working through the formula for the risk based levies. Mr Foulds has complained that the failure score used in the Board’s calculation does not match the score in D & B’s report. But the higher score of 67 was provided in a report compiled in December 2006, while the score used to calculate the levy was as at March 2006, the date of the Determination. I can see that it is frustrating for Mr Foulds, and the Scheme, to have the lower score used, but the Board is required, in accordance with paragraph 26 of Part 3 of the Schedule to the Determination, to use data as at 31 March 2006. That is what they did in arriving at the levies. Amendments to data after 31 March 2006 (such as the change to the SIC code) could not be taken into account. It seems to me in any case that it is fair to fix a date at which information should crystallise. For some schemes, this

will result in a more favourable failure score; for this Scheme, the reverse is true. But that does not mean that the PPF has proceeded improperly or unfairly.

32. Mr Foulds brought to my attention his concern that he was unable to verify D & B's calculation and thus that he might be in breach of his duties as a Trustee in approving a payment that he could not independently approve. He is, of course, right to keep in mind his fiduciary duties. However (and putting to one side the Scheme's obligation to comply with the legislation) I consider that he has taken all necessary steps to ensure that he has acted in accordance with his duties.
33. I conclude that 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.

**CHARLIE GORDON**  
Deputy Pension Protection Fund Ombudsman

20 February 2008