PENSIONS ACT 2004, PART 2 CHAPTER 6

APPEAL TO PENSION PROTECTION FUND OMBUDSMAN

DETERMINATION BY THE DEPUTY PENSION PROTECTION FUND OMBUDSMAN

Applicant	**:**	Mr M D Parker, on behalf of Babcock Pension Trust Limited
Scheme	**:**	Babcock International Group Pension Scheme

1. The Pension Protection Fund (**PPF**) Ombudsman has received a reference of a reviewable matter, following a decision by the Reconsideration Committee of the PPF dated 13 August 2008.

Grounds for Referral

- An inaccurate statement in the MFR roll forward methodology gave rise to a discrepancy in the calculations and the result was that the Scheme's pensioner liabilities were overstated by 20%;
- The PPF Determination for the year in question stated, in a number of places, that the annuities used to switch between the calculations in sections 4(a)(vi) and 4(c)(i) of the methodology are the same and, therefore, not critical to the eventual result;
- The methodology applied by the PPF in calculating the Scheme's levy is not in accordance with the terms of its Determination;
- Had the PPF responded to the query on the calculations within 28 days, a Section 179 valuation would have been prepared and filed on behalf of the Scheme.

Background

2. The Scheme utilised the "equity easement"[1] for pensioner liabilities in its most recent MFR valuation.

[1] The provision whereby MFR pensioner liabilities may, in part, be calculated by reference to the assumed rate of return on equities, rather than by reference to gilt yields. The easement is available to schemes where the pensioner liability (calculated in the usual way) exceeds £100 million.

3. On 18 January 2007, the Scheme's Actuary contacted the PPF querying a discrepancy they had identified in the pensioner liabilities for the 2006/07 levy. They asked the PPF to review their calculations. The PPF's Stakeholder Support Team responded on 28 February 2007 outlining an anomaly they had identified, but explaining that they could not complete the review because the Actuary's calculations had not followed the published methodology. The information was resubmitted on 15 March 2007. The PPF's Stakeholder Support Team referred the query to their actuarial department and provided a comprehensive response on 22 June 2007.

4. The Scheme Actuary wrote to the PPF, in September 2007, saying:

   - For schemes subject to equity easement, the methodology adopted by the PPF to adapt MFR valuations to a Section 179 basis was misleading;
   - The interpretation adopted by the PPF for this area of the published guidance was technically inconsistent and led to significant overstatement of the liabilities where an equity easement applied;
   - The methodology was based on two calculations (one to adjust MFR liabilities to Section 179 liabilities and another to adjust the Section 179 liabilities to PPF benefits), which was technically unnecessary, but clearer to document;
   - The methodology stated that the annuities used to switch between the two stages should cancel out (reference: footnote 4 in the methodology) so that the assumptions were not critical to the final results;
   - There was no reference to cases where the equity easement applied;
   - They had been referred to a "frequently asked question" (**FAQ**) on the PPF website, which acknowledged that the comment, to the effect that the annuities cancelled out, did not apply if an equity easement was allowed for;
   - The methodology set out in the consultation document was not sufficiently clear to enable useful comment on the proposed methodology at the time of consultation;
   - A response to a FAQ was not an acceptable place to amend the guidance;

- It would be more appropriate for the annuities to cancel out in cases where an equity easement applied;

- The inconsistent application of the two stage switching process had resulted in an increase to the pensioner liabilities for the Scheme of 20%.

5. The FAQ on the PPF's website said,

> "**In section (c)(I) of the methodology, annuityfactor2 and annuityfactor4 are said to be the same as two annuityfactors in (a)(VI). However (a)(VI) contains both "standard" annuities based on MFR or S179 mortality assumptions and annuity certains based on fixed terms if the equity easement applies to the scheme. Which annuityfactors should be used?**
>
> Refer to the "standard" annuities in (a)(VI) for calculating annuityfactors 2 and 4 in (c)(I), i.e. those using mortality assumptions and not the annuity certains.
>
> The methodology also comments that because these annuities are the same they are not critical to the eventual result of the calculation. We acknowledge that although this comment applies where the equity easement is not allowed for (i.e. when M=0, see (a)(IV) for definition of M) because the numerator annuities in (a)(VI) cancel out with those in the denominators in (c)(I), the annuities do not cancel out if the equity easement is allowed for (when M>0).

Reconsideration Committee's decision

6. The Reconsideration Committee's decision is summarised as follows:

- This calculation of the Scheme's levy was a reviewable matter by virtue of paragraph 19 of Schedule 9 to the Pensions Act 2004;

- The Scheme is a multi-employer scheme;

- The Scheme did not file a Section 179 valuation prior to 30 March 2007 and its levy invoice was, therefore, calculated on the basis of the latest MFR valuation rolled forward in accordance with the methodology set out in Appendix 2 to the Schedule to the PPF's Determination for the year in question (the **PPF Determination**);

- The Board had consulted on the risk-based levy over the period from September 2006 to March 2007;

- Under Section 175(5) (of the Pensions Act 2004), the Board was required to determine the factors by reference to which the levies would be calculated, the time at which the factors were to be assessed, the rate of the levies and the time at which they became payable;
- The Board published its Determination of these matters for the year in question on 1 March 2007;
- Reconsideration of the amount of the Scheme's levies was a reconsideration of the amount of the levies in a particular case and not a reconsideration of the PPF Determination;
- Neither the Committee nor the Board had any discretion to depart from the PPF Determination;
- The risk-based levy was calculated by reference to the formula U x P x R x c and subject to a cap (K) equal to 0.0125 multiplied by the Scheme's protected liabilities;

Specific Issues

- Delay
  - Although delay had occurred in handling the query raised by the Scheme, it could not be said to have resulted in a loss to the Scheme;
  - The Board provided assistance to stakeholders beyond what was required of it under its statutory framework, but a scheme could not rely on a query raised with the Board to exempt it from a deadline set out in the PPF Determination, which must apply equally to all schemes;
  - The problem was not that incorrect information had been used to calculate the Scheme's levy, but that the Scheme would like the calculations to be re-performed on the basis of a Section 179 valuation which had not been prepared and submitted to the Board prior to the deadline;
  - Schemes had been given the opportunity to submit a Section 179 valuation, even where they were not legally required to produce one, in order to meet the concern that rolling forward the MFR data might not produce the best information about the current position of the scheme;

- It was not considered appropriate to make the submission of a Section 179 valuation mandatory, but it was considered essential that a date was set by which any Section 179 valuation should be submitted;
- The deadline had been well publicised;
- The Applicant had suggested that there had been maladministration resulting in a financial loss to the Scheme. Even if that were the case, it would not require or permit the levy to be recalculated. The question of compensation for maladministration was a separate matter. However, in the Committee's view, there was nothing to suggest that there had been any maladministration;
- The Committee was not satisfied, on the evidence before it, that any delay in responding to the Scheme's query had caused financial loss, as opposed to annoyance and disappointment;
- The deadlines had been applied consistently to all schemes to avoid unfairness to those schemes which had expended the time and effort to comply with the deadline, as well as those which, for whatever reason, had been unable to meet the deadline;

• Roll forward methodology

- The roll forward methodology was published to enable a scheme's advisers to assess, by performing a "rough and ready" calculation, whether the likely comparative outcomes for a Section 179 and a MFR roll forward based levy calculation would mean that the costs of preparing a Section 179 valuation outside the scheme's usual valuation cycle would be justified;
- The footnote referred to by the Applicant appeared in detailed formulae drafted for and by actuarial professionals;

• Discretions

Paragraph 5

Where the Schedule to the PPF Determination had failed to make the provision necessary for a calculation to be performed, the Board could take the necessary steps to enable a calculation to be performed. In this case, the Schedule to the PPF

Determination had made the necessary provision to enable the calculation to be performed.

Paragraph 6

The Applicant had asked for the Scheme's levies to be recalculated on the basis of a Section 179 valuation which had been submitted after the relevant deadline. The information upon which the calculation had been based was not incorrect and, therefore, paragraph 6 did not apply.

Paragraph 12

There was the discretion for the Board to take such steps as it thought fit to obtain further or amended information for the purposes of calculating the levies. However, it was under no obligation to do so where information has not been provided on or before the applicable deadline. Paragraph 12 was not relevant.

Paragraph 13

Where information necessary for the calculation of the levies had not been provided in the manner or format or by the time anticipated by the PPF Determination, the Board could use equivalent information provided in another manner or format or at a different time. However, it was not under any obligation to do so. In this case, the Board had the necessary information in order to be able to calculate the levies and, therefore, paragraph 13 was not relevant.

- The Committee upheld the original calculation of the levies.

Written representation from the PPF

7. The PPF has confirmed that the decision by the Reconsideration Committee reflects its position.

Further representations by the Applicant

8. The Applicant further submits:

    - The difference in the levy could be around £150,000;

- The revised levy information had been presented to the PPF on 18 January 2007, but the PPF had not responded until 26 February 2007 to say that they preferred the information in a different format;
- The information was re-submitted on 15 March 2007 and the PPF did not respond until 22 June 2007;
- Had the PPF responded at any time prior to 28 March 2007, they were prepared and able to submit a Section 179 valuation on or before 31 March 2007.

CONCLUSIONS

9. This is a reviewable matter by virtue of paragraph 19 of Schedule 9 to the Pensions Act 2004.

10. The reviewable matter in question is the amount of the risk-based levy required of the Scheme for the financial year 2007/08.

11. Under Section 175(5) of the Pensions Act 2004, the Board was required to determine the factors by reference to which the 2007/08 levies were assessed; those factors were set out in the PPF Determination. The PPF has correctly submitted that the Determination, itself, is not a reviewable matter, nor is the Board able to amend the Determination on an individual application for review or reconsideration.

12. It is accepted by both parties that there is an anomaly in the methodology used by the PPF to convert MFR data into Section 179 equivalent data for the purpose of calculating the PPF liabilities upon which the levy calculation was based. This anomaly only affected those schemes which did not calculate their pensioner liabilities in the usual way for MFR purposes, i.e. those schemes which adopted the equity easement. The anomaly results in an overstatement of the pensioner liabilities, when compared with the equivalent Section 179 results. This has a knock-on effect on the risk-based levy for the scheme concerned. In the Scheme’s case, the Actuary calculated that the pensioner liabilities had been overstated by 20%.

13. The Scheme Actuary appears to have been aware that the methodology was not producing the expected results for the Scheme prior to March 2007 because a query was raised with the PPF. The PPF was also aware that the methodology it had adopted was producing anomalous results for certain schemes because it published a FAQ on its website. It has been suggested that a FAQ was not an appropriate means by which the PPF should have alerted schemes to the anomaly. I am not persuaded that this is the case. The guidance was aimed at scheme advisers who could be expected to have easy access to the website and to be aware that there was additional guidance provided in this way.

14. Clearly there was an issue with the PPF's adopted methodology for some schemes. However, the anomaly had been identified and reasonable steps had been taken to draw it to the attention of those potentially affected; and it could be avoided by the submission of a Section 179 valuation. I find that the Board has nonetheless calculated the risk-based levy in accordance with the provisions of the PPF Determination and is not required to take any action.

15. There has been reference to a delay in the PPF responding to queries from the Scheme's Actuary concerning the operation of the roll forward methodology. The PPF has acknowledged that a delay did occur, but is of the opinion that this did not result in a loss to the Scheme.

16. Any question of delay is not in itself a reviewable matter. However, in view of the fact that the Reconsideration Committee referred to the matter, and the calculation of the levy is directly affected, I make this comment. Any delay in responding to a query did not prevent the Scheme from submitting a Section 179 valuation within the relevant deadline. It was for the Scheme Trustees to decide whether it might be in the Scheme's best interests for a Section 179 valuation to be submitted. The Trustees may have preferred to wait for a response from the PPF, but they were not prevented from submitting a Section 179 by the delay in responding. That they chose not to, was their decision. The Applicant has confirmed that they were prepared and able to submit a Section 179 valuation before 31 March 2007. They chose, instead, to wait for the PPF to respond to the query they had raised.

17. If delay on the part of the PPF resulted in a higher levy, I would expect the PPF to consider very carefully the extent to which it had a discretion to mitigate the impact of that delay. In this case, it cannot be said that delay on the part of the PPF prevented the Scheme Trustees from mitigating the effects of the anomaly identified by the Actuary by submitting a Section 179 valuation. The higher levy cannot, therefore, be said to be solely or even largely the result of delay on the part of the PPF.

CHARLIE GORDON
Deputy Pension Protection Fund Ombudsman

23 July 2009