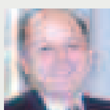
Ask the experts:
Potential to surprise

What are treasurers are doing about their D&B rating? David Whelan faults the D&B approach, Ian Peake assesses the pension protection fund implications, and Tony Chitty defends D&B's stance.



David Whelan, Director of Group Treasury, Capita Group

There are several key elements of the D&B rating that make the method it uses very unsophisticated, in my opinion, compared to the methods used by Fitch, Moody's and Standard & Poor's.

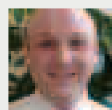
For example, the D&B rating has an override mechanism whereby any company with negative net assets automatically has a failure score, which rates the company as having a higher than average chance of risk failure, although the override is not applied for Pension Protection Fund (PPF) purposes. The D&B failure score is created using statistical modelling techniques based on the historic performance of a large number of businesses.

Another issue is county court judgements (CCJs). While a creditor with a relatively low amount outstanding can petition for liquidation, once these are settled by a company they are still taken into consideration by D&B until officially discharged.

Historic data regarding payment records and so on do not directly drive the quality of assets and the future income-generating capability of a company. By definition, publicly available information does not reveal information of a confidential nature, so any attempt to provide an opinion based on only this information, backed by surveys carried out in relation to payment histories, will also be of very limited value.

Many companies are credit-rated by the Big Three agencies. These organisations are 'invited' into company offices and records and given access to private and confidential information which is often price-sensitive. The credit rating agencies have access to, and will often interview, the senior management team of the company as well. Usually these ratings look at the ability of the company to pay its creditors over the short term (12 months) and the long term (five years). In addition, the individual rating (from Fitch) reviews and provides an opinion on the quality of the company's financials on a standalone basis.

All lending institutions normally carry out their own credit assessment of the potential borrowing company's financials on a basis which is very similar to the credit rating agencies'. Capita Group is not credit-rated but is able to borrow funds at reasonable margins because of the credit analysis work undertaken by the lending institutions, which include banks as well as assurance companies.

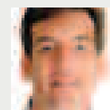


Ian Peake, Deputy Treasurer, Hanson

Hanson has worked with the rating agencies for many years and has a very good dialogue with Fitch, Moody's and Standard & Poor's. Transparency is important on both sides and as an issuer it's essential that we have a good understanding of key financial ratios and threshold levels if we are to plan effectively and avoid surprises, pleasant or otherwise. With this in mind, following the PPF's decision in August 2005 to use the D&B failure score to assess its risk-based levy from April 2006, we discussed with D&B how we might improve transparency on how the failure score is calculated.

Our first task was to model the PPF levy that we would expect from our pre-existing D&B score for each of our principal employers and potential guarantors. From there we've worked on improving the key inputs to the D&B model and monitored the effect on the score. The initial focus for short-term improvements has been on variables such as registered charges and CCJs, which in many cases were out of date and hadn't been a priority to have released, as they were immaterial. As we've gone through this process we've monitored the effect on the D&B score and the potential risk-based levy.

We will continue to monitor the inputs and the score. The downsides are that as a relative measure the failure score can still surprise and is an administratively-intensive process likely to be with us for some time to come.



Tony Chitty, Group Treasurer and Company Secretary, Mace

Treasurers have been subjected to some harsh blows in recent years, forcing them to consider pensions in a very different way. We all knew we had a demographic issue to deal with soon, but people were not focusing on it in quite the same way as they are now. I have no doubt that the combination of changes in accounting standards and the significant effect of the withdrawal of the dividend tax credit has focused people's minds on the pensions issue.

I do not believe that the pensions levy is as significant as some treasurers think it is. Whatever payments companies are required to make, I find it hard to be confident that the regulator will have sufficient resources to deal with the inevitable failures. It is only a matter of time before every defined benefit scheme is closed (and even wound up) to new entrants and the pensions that people (including treasurers) are currently planning to rely on in their retirement will be severely devalued.

There is a lot of hot air about the D&B failure score and I think it is unnecessary. Playing about with the levy and how you tweak your D&B rating is akin to shifting the deck chairs on the *Titanic.* I appreciate some companies will find themselves with significant obligations in relation to levy payments and that the numbers may well be large, but I dispute their significance in comparison with the overall problem.

Some treasurers are concerned that there is not enough transparency about the methodology, but I think D&B is being as transparent as it can. You have to apply a degree of common sense. D&B is using its hard-earned market knowledge, and by revealing its methodology and the sources of inputs completely, it would compromise its own commercial position.

■ **For more on D&B's failure scoring, see the March issue of *The Treasurer*, page 30.** **Comments/letters to the editor at the usual address.**