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Legal issues affecting s.75 certificates

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Importance of legal assumptions in certifying s.75 debts:

- Actuarial assumptions are a matter of judgment and difficult to challenge.
- Errors in legal assumptions provide a clear basis for challenge. *Cornwell v Newhaven* [2005] 55 PBLR does not offer full protection from legal challenges.
- Although the Actuary is not responsible for determining legal issues, or giving legal advice, he/she needs to be able recognise where there may be an issue on which he/she needs legal advice.

Penalties for getting legal assumptions wrong are severe:

- Even if the certificate is not challenged, the scheme may lose out on large sums if actuary certifies too low an amount based on incorrect legal advice.
- Potential PPF exclusion if the s.75 debt is certified at too low a figure and the trustees then agree a full and final settlement in that sum?   Reg.2(2) ED Regs 2005.
- If the certificate is challenged it will be set aside, not declared valid *pro tanto*
- If certificate set aside, re-certification may not be possible within the applicable limitation period.

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Re-certification ?

- Recertification possible in theory, but subject to 6 year limitation period: s.9 Limitation Act 1980
- Key issue is from when does time run? Two schools of thought:
  - When the Actuary actually <u>certifies</u> the debt because no debt arises until this time : See Morritt VC in in *Phoenix Venture Holdings [2005] 38 PBLR* and Legal *Services Commission v Henthorn* [2012] 1 W.L.R. 1173
  - From the <u>trigger</u> date, the certificate being a formality within the sole power of the claimant to comply with: *CEGB v Halifax Corp* [1963] AC 785 and *Swansea CC v Glass* [1992] QB 844.

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Dealing with legal uncertainty - What to do:

- Press for instructions to certify asap after trigger event, particularly in relation to large multi-employer schemes.
- Identify legal issues which might affect Actuary's ability to certify at early stage. Resolve legal issues (if necessary by legal proceedings) while data cleansing proceeds.
- Serve certificate well before the 6 year limitation period expires, to allow recertification if challenged.
- Minimise information given to s.75 employer to make any challenge more difficult: *Cornwell v Newhaven* [2005] 55 PBLR.

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Dealing with legal uncertainty - What not to do:

- Certify at a higher amount to protect scheme (or lower amount to reduce the risk of challenge) unless legally sound basis for doing so.
- Serve alternative certificates (unless one clearly identified as “real” or “primary” certificate):
  - otherwise employer will have good argument that obligation has not been unequivocally certified
  - even if “primary” and “without prejudice” certificate served, tactic will guarantee litigation if alternative certificate is lower.
  - disclosure requests in litigation likely to lead to an unravelling of all the assumptions.

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Key legal issues which arise:

- Which employers are included in the K/L (“Liability Share”) formula?
- What are the legal requirements for valuing the **assets** as at the trigger date?
- What are the legal requirements for valuing the **liabilities** as at the trigger date?
- What fees and expenses can be included in the section 75 debt?
- What is the scope for apportioning orphan liabilities to particular employers?

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Ascertaining the employer's liability share ("K/L")

- To ascertain the correct liability share, Actuary needs to know the identity of <u>all</u> statutory employers making up "L" in K/L.
- Main difficulty is identifying "former employers" and deciding whether they have ceased to be statutory employers.
- Important to identify that there may be an issue asap.
- But not always easy to spot there is an issue.

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Ascertaining the employer’s liability share – spotting potential problems

- Have ECEs occurred in past and not been noticed?
  - Are scheme’s employment records up to date?
  - Was the scheme open for s.75 purposes (i.e. could an ECE still occur)?
  - What are the “danger signs”?
- If an ECE or insolvency event has occurred :
  - Has a s.75 debt been paid?
  - If not, has the employer ceased to be a statutory employer by virtue of :
    - Condition H: Reg. 9 (13) ED Regs 2005 ?
    - Condition I: Reg. 9(14) ED Regs 2005 ?

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Have ECEs occurred in past and not been noticed?

- "Danger signs" where client is trustee of multi-employer scheme which is (i) large (ii) mature (iii) apparently closed.
- An apparently "closed" scheme may have remained open for s.75 purposes (allowing ECEs to continue to be triggered) if:
  - Past service benefits were linked in some ways to continued employment (e.g. a "final salary link")
  - Pre 2008, the eligibility requirements for scheme membership:
    - were not amended so as to exclude the possibility of future membership; or
    - were amended in a way that left open the possibility of future membership see *PNPF v Taylor* [2009] 050 PBLR

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If s.75 debts have been triggered but not paid, do those employers remain in the K/L formula ?

- Condition H : Former Employer will be excluded as a statutory employer if the reason for non-payment of his debt, was ***“solely”*** because the debt was not notified in time to allow it to be paid before the second debt was triggered.
- Difficult issues arise where Former Employer was not notified but was also:
  - insolvent; and /or
  - unwilling to pay when notified.
- Condition I : Former Employer will be excluded if its s.75 debt has been **“***excluded from the value of the assets of the scheme because it is unlikely to be recovered without disproportionate cost or within a reasonable time”*
- However, simply because the debt has not been recorded in the accounts (and the employer is insolvent) does not mean it has been “excluded”

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What are the legal requirements for valuing the assets as at the trigger date?

- Reg. 5(6) ED Regs 2005: *"The value to be given to the assets of a scheme by the trustees or managers is…(a)the* ***value given to those assets in the relevant accounts*** *or in the* ***updated asset assessment*** *less, in either case, the amount of the external liabilities*"
- Reg. 2 ED Regs 2005: *"****Updated asset assessment****" means an update (whether or not audited) of the value of the assets of the scheme identified in the most recent relevant accounts received by the trustees or managers which-*

    (a)is prepared by the trustees or managers, and

    (b)estimates ***where they consider appropriate*** *any alteration in the value of t he assets of the scheme* ***between the date by reference to which those accounts are prepared and the applicable time****;*

Key points on calculation of assets:

- Very prescriptive – use the value in the last audited accounts
- No discretion (other than via updated asset assessment) to depart from values in accounts subject (perhaps) to fraud: cf *BESTrustees v Kaupthing Singer & Friedlander* [2013] 081 PBLR.
- Updated asset assessment only allows alteration in the value of the assets of the scheme <u>between the date by reference to which those accounts are prepared and the applicable time i.e:</u>
    - can add in <u>new</u> assets acquired post-accounting date;
    - changes in value of existing assets occurring post-accounting date;
- No general power to revise values of assets in accounts - only to the extent that new asset, or change in value, arose as a result of events between date of account and trigger date.

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Updating asset values –example - Section 75 debt not recognised in accounts at accounting date

- Section 75 debts should be included in accounts unless “*unlikely to be recovered without disproportionate cost or within a reasonable time*”: see reg. 5(4) (b).
- But general rule is that if not included in accounts should not be taken into account when second s.75 debt triggered (subject to fraud).
- Updated asset statement not designed to correct errors in the accounts.
- However <u>if</u> existence of s.75 debt came to light between date of accounts and date on which second s.75 debt triggered, <u>argument</u> that could be included in updated asset assessment, on basis that discovery has increased the likelihood that the debt will be recovered and therefore increases its value (depending on circumstances).

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Legal requirements for valuing the liabilities as at the trigger date

- Reg. 5(2) ED Regs 2005: *The liabilities which are to be taken into account for the purposes of section 75(2) and (4) of the 1995 Act shall be determined by the trustees or managers and the amount of those liabilities shall be calculated and verified by the actuary.*
- Reg. 5(11) ED Regs 2005: *The amount of the liabilities in respect of pensions and other benefits is to be calculated and verified by the actuary on the assumption that they will be discharged by the purchase of annuities … and for this purpose the actuary must estimate the cost of purchasing annuities.*
- Reg. 5(12) ED Regs 2005: *For the purposes of paragraph (11), The actuary must estimate the cost of purchasing the annuities-(a)on terms the actuary considers consistent with those in the available market …or (b)where the actuary considers that it is not practicable to make an estimate in accordance with sub-paragraph (a), in such manner as the actuary considers appropriate in the circumstances of the case.*
- Reg. 5(14) ED Regs 2005: *An updated liabilities assessment may be prepared by the actuary for the purposes of paragraph (8) if-*
- *(a)the trustees or managers, after consulting the actuary and the cessation employer, so decide; and*
- *(b)section 75(4) of the 1995 Act applies by virtue of an employment-cessation event.*

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Ascertainment and valuation of liabilities – key points

- Completely different approach than in relation to assets:
  - Fresh valuation as at trigger date
  - Can (and should) use best information and data as to what liabilities were, and what value was, as at trigger date (even if information and data not available, or not known, as at trigger date).
- Reg. 5(14) seems implicitly to preclude the use of "roll forward" techniques from last valuation to value liabilities, save where there has been an ECE: see *BESTrustees v Kaupthing [2012] 034 PBLR* - (para 31).
- Annuity market must be taken "as is" on the Trigger Date

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Including expenses in the calculation of liabilities and the s.75 debt

- 2 types of expense potentially included in the overall s.75 debt:
  - Estimate of winding up expenses should be included in the cost of liabilities: Reg. 6(13).
  - Where ECE, estimate of "cessation expenses" must be included in the sum certified as due: reg. 6(1)(e). Cessation expenses defined by reg. 2 as : "*all expenses which, in the opinion of the trustees or managers of a scheme, are likely to be incurred by the scheme in connection with an employment-cessation event occurring to an employer in relation to the scheme*"
- What should be included in such expenses ?
  - Costs of calculating debt ?
  - Costs of negotiation (trustee time?)
  - Costs of prospective legal proceedings ?

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Scope of power to "attribute" Orphans

- Sometimes argued that Reg. 6(4)(c)(i) (bb) ED Regs 2005 gives a general power to reallocate orphans to whichever employer they please:

  "(bb)the liabilities in respect of any member which cannot be attributed to any employer shall be attributable in a reasonable manner to one or more employer (which may or may not include Employer A)"

- However, Reg. 6(4)(c) as a whole concerns <u>only</u> persons whose status as orphans is unclear (in the way described Reg. 6(5)) ("Reg. 6(5) Orphans").
- Better view therefore is that Reg. 6(4)(c)(i) simply giving choice, where it possible to demonstrate <u>in relation to a Reg. 6(5) Orphan</u> that their last employer <u>was</u> a statutory employer, as to how to allocate the liabilities attributable <u>to such Reg 6(5) Orphans</u>.
- No general power to reallocate "true" orphans to whichever employer the trustees please.

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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