



Unwinding ineffective scheme amendments and managing significant hidden liabilities

The scheme

Our client's scheme started life as a defined benefit (DB) arrangement in the 1970s. However, on 1 April 1994 changes were made to turn it into a hybrid scheme. From that date:

- members who had already left the scheme (deferred members) retained their DB entitlement
- new joiners would enter a defined contribution (DC) section
- past service rights for existing active members were converted to a DC basis, subject to a Guaranteed Minimum Pension (GMP) underpin.

These changes subsequently created a funding surplus, which was used to meet past benefit equalisation commitments and subsidise employer contributions over the next few years.

In May 2011, shortly before the sponsoring employer became insolvent, PSIT was appointed as independent trustee to assist with taking the scheme through the Pension Protection Fund (PPF) assessment process. At the time of our appointment we were told to expect a straightforward case. The scheme was likely to be more than fully funded on the PPF S179 basis, meaning both DC and DB entitlements were likely to be secured outside the PPF.

The issue

Upon our appointment, our review of the scheme documents highlighted some interesting issues. For example:

Although changes were made to the scheme with effect from 1 April 1994, the scheme documents had not been amended until December 1997.

There did not appear to be adequate segregation of DB and DC assets. If this was correct, and the scheme did not enter the PPF, the DC members may need to subsidise the cost of securing DB members on a full buyout basis.

It was unclear whether the power of amendment in the rules permitted the conversion and transfer process.

We were unsure that proper informed consent to the change had been received from members.

As these were fundamental points, which could significantly affect both members' benefits and the scheme's liabilities, we felt it appropriate to take legal advice. Our **counsel advised that the conversion of benefits from DB to DC was not valid prior to December 1997 and that we should consider taking legal action against the scheme's advisers** at the time of the change.



The outcome

The effect of the legal opinion would be to significantly increase the scheme's liabilities, taking the deficit to around £8 million – a level that would cause the scheme to enter the PPF. Following negotiations with the PPF, they agreed to accept our counsel's advice – a good outcome for the members.

Potential action against former advisers

We carefully considered the case for suing the scheme's advisers at the time of the ineffective changes. Our ability to take action was limited, as claims must be brought within 15 years of the negligent act occurring. This meant we could only raise a claim in respect of one year's benefit accrual and we felt **the cost of litigation outweighed the potential benefit that could be gained**.

The effect on members

Hundreds of scheme members are affected. Working together with the scheme administrator, we are now reconstructing and recalculating benefits for two key sections of the membership:

- individuals who were active members as at 1 April 1994
- new joiners in the period April 1994 to December 1997.

Benefits accrued up to December 1997 are being converted or reconverted from a defined contribution to a defined benefit basis, which includes a link to final salary for many members. Once this work is complete, an announcement will be issued to all affected members explaining what has happened and how the shape of their benefits has changed.

The scheme is currently still in the formal PPF assessment period, and is expected to enter the PPF in due course. For DC members, this means they can now expect to receive their full benefit rather than face the prospect of losing some or all of the value due to the need to cross-subsidise the DB members.

