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GMP and the Equalisation Issue

The High Court in October 2018 has ruled that occupational pension schemes must equalise GMPs.

Trustees and sponsoring employers of relevant occupational pension schemes now face the difficult and costly task of implementing equalisation.

The Lloyds judgment leaves a number of questions unresolved including crucially the method to be used to equalise.

A supplementary High Court judgment in December 2018 may mean that the statutory conversion of GMPs into ordinary scheme benefits may become much more popular.

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Background

The State Pension was traditionally comprised of two elements for employees: the basic State Pension and the additional State Pension. Between 6 April 1978 and 5 April 2002 the additional State Pension was known as the State Earnings Related Pension Scheme (SERPS). The legislation relating to SERPS created inequalities in the treatment of men and women, these equalities were not unlawful under EU law, and neither did they infringe anyone's human rights.

SERPS, being a social security benefit is not caught by the requirement to equalise benefits and the government is not under a duty to equalise SERPS.

Until 5 April 1997, it was possible to contract out of the benefit provided by SERPS by making alternative arrangements which provided for guaranteed minimum pensions (GMPs). GMPs were calculated in broadly the same manner as SERPS but were not identical to those benefits. The legislative provisions relating to GMPs were complicated, and unsurprisingly created a number of inherent inequalities, as GMPs were intended to replicate an unequal State benefit and legislation actually required GMPs to be determined on an unequal basis.

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For example:

- A woman's GMP accrues at a greater rate than that of a man in recognition that a woman's working life for State Pension was, at that time, five years shorter than that of a man (State Pension age then being 60 for women and 65 for men). Thus, where a man and a woman have identical work histories, the woman's overall GMP will be greater than the man's.
- Women were entitled to receive their GMP at 60 and men at 65 (GMP pension age). Revaluation provisions applicable up to GMP pension age and indexation of GMP after it comes into payment are different. So the different GMP pension ages again introduce inequality. Anti-franking adds another layer of complexity.

As a result of this, it is not clear which sex receives the greater total benefit and it can change over the course of a lifetime with, for example, an individual who is advantaged initially becoming disadvantaged later.

GMPs can also cause other pension accrual to be unequal as they are generally (but not always) only part of a member's total pension payable. So where a man and woman with identical pensions have different GMPs then their other pension benefits (the excess over GMP) is different. Where GMP and the excess over GMP increase at different rates, in deferment or payment, inequality occurs.

Barber and the Duty to Equalise

The European Court of Justice judgment in the case of Barber v Guardian Royal Exchange decided that trustees were required to treat men and women equally in relation to benefits under an occupational pension scheme from 17 May 1990. Since then, there has been a question mark over whether GMPs need to be equalised between 17 May 1990 and 5 April 1997.

Is there a duty to equalise GMPs?

The government's argument (that GMPs are intended to replicate SERPS to try to ensure no one was worse off by contracting out of SERPS and that SERPS benefits don't have to be equalised, so it is illogical to require GMPs to be equalised) was rejected by the High Court in the recent judgment of Lloyds Banking Group Pension Trustees Limited v Lloyds Bank. If this judgment is not appealed, trustees will have to "equalise GMPs". GMPs are, however, a product of legislation and trustees can't change the law, so GMPs will not actually be equalised. Changes will instead have to be made to the excess over GMP to equalise overall benefits.

What method should be used to equalise?

The High Court considered four options with a number of subsets to those options:

1. Method A: equalise each unequal aspect separately;
2. Method B: provide the better of the male or female comparator pensions each year;
3. Method C: provide the better of the male or female comparator each year, subject to accumulated offsetting;
4. Method D: complete a one-off actuarial equivalence.

These options are broadly ranked in order of magnitude of their financial impact, with Method A being the most expensive and Method D the least expensive.

The High Court did not decide which route should be adopted generally by occupational pension schemes. For the Lloyds pension scheme (based on its scheme rules) Methods A and D were rejected in its October judgment. The High Court also ruled that arrears must be paid with no limitation period and interest applied at 1% over the Bank of England base rate. Whilst no statutory time limit applies for claims, scheme rules may limit the period over which arrears may be paid.

In deciding on their equalisation method the High Court took account of the principle of minimum interference with the scheme rules. Before adopting a method the trustees need to decide if there is some other way to equalise with less interference with the rights of members.

Statutory Conversion of GMPs

Method D (which was considered by the High Court in its October judgement) had two different options. Method D2 involved the conversion of GMPs into ordinary scheme benefits. It was rejected in the first judgment of the High Court as employer consent was needed to go down this route, and initially the employer was not willing to give consent. The High Court made it clear that Method D2, statutory conversion, would be available to other schemes with employer consent.

Since 6 April 2009, schemes have had the option to convert GMPs into ordinary scheme defined benefits, to simplify the benefit structure and at the same time hopefully make it easier for members to understand the basis of their pension rights.

Very few pension schemes have undertaken GMP conversion to date.

Following a short hearing on 3 December 2018, the High Court (in a supplementary judgment) has ruled that, where trustees are using the statutory conversion route, they can ask their scheme actuary to calculate the actuarial equivalent of the unequalised male and female pensions and “equalise” by taking the higher of the two figures. Following the October judgment it had not been clear that trustees could equalise (in respect of future payments) in a single step.

The Court stated that it was for the scheme actuary to determine the higher of the actuarial equivalents of the unequalised male and female pension rather than the Court. The assumptions to be used for this purpose are for the actuary to determine.

The second supplementary judgment is to be welcomed as the High Court has provided a relatively straightforward solution which is far less complicated than many in the pension industry had feared. Being a statutory conversion route, the principle of minimum interference with the scheme rules does not apply.

Is the law now settled?

This is a problem which the government created through legislation and arguably should have been sorted out through legislation but to date there is no sign of it doing so. It remains to be seen whether Brexit encourages the government to change the legislation.

There is also a possibility this case might now be appealed to a higher court.

The Department for Work and Pensions (DWP) response to its November 2016 consultation on equalisation is still awaited and will hopefully now be expedited.

Action for Trustees

Assuming the Lloyds judgment is not appealed trustees will need to consider:

- Whether they now need to increase benefits and pay arrears in respect of unequal GMPs? This will, in part, involve checking to see if their scheme rules impose a time limit on the period for which underpayments may be corrected.
- Which method of equalisation is appropriate for their scheme taking into consideration their specific rules?
- What communication, if any, should be sent to members?
- What should be done, if anything, about those who have transferred out of the scheme, or are currently in the process of doing so?
- Whether there are implications for buy-ins, buy-outs, wind-ups in progress, de-risking exercises etc?
- Any funding implications?

Transfers out

Where trustees are continuing to quote cash equivalent transfer values and pay transfers out, we are including a statement in transfer quotations to the effect that GMP equalisation is now required, but has not yet been implemented, and that once completed may result in a higher transfer value, but if the transfer proceeds it may not be revisited.

Retirement illustrations

For current retirement illustrations we are including a statement to the effect that GMP equalisation is now required, but has not yet been implemented, and that once completed this may result in an adjustment to benefits.

Comment

Some 28 years after the Barber judgment, the judgment in the Lloyds case is not the end of the matter. Most lawyers had already taken the view that GMP equalisation was necessary and the Lloyds judgment confirms this. The real issue is around the method of equalisation and the possibility that trustees who did equalise might subsequently be found not to have properly done so. Whilst recognising there is more than one way of doing this, the Lloyds judgment does not provide an answer for occupational pension schemes generally.

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