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Supplementary guidance on transfer payments for GMP equalisation

The GMP Equalisation Working Group has published [guidance](#) for defined benefit (DB) pension schemes on past transfers in the light of the most recent judgment in the Lloyds case last year.

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Background

Historically, where a pension scheme which was contracted out on a salary-related (COSR) basis calculated transfer values, it would not have taken account of the need to equalise a member's benefits for the effect of guaranteed minimum pensions (GMPs) in respect of the period from 17 May 1990 to 5 April 1997 (the Equalisation Period). The value transferred may have been higher had the calculation reflected the need for GMP equality.

The Lloyds judgment in 2020 ruled that COSR schemes which have paid statutory cash equivalent transfer values in respect of former members who had service in the Equalisation Period could be required to pay a top-up payment in respect of a former member. (The right is to a top-up payment and not to a residual benefit in the transferring scheme.)

A top-up payment would be required where the transfer value actually paid would have been higher if the value of the member's benefits had been that of a comparator of the opposite sex. The transfer value assumptions originally used for the member should be applied when making the comparison (i.e. using the sex-based factors applicable to the former member for the comparator calculation).

Interest will need to be added to any top-up payment. In the Lloyds judgment, this was set at 1% simple over bank base rates (from time to time).

Non-statutory payments were treated separately in the Lloyds judgment and whether any liability exists in relation to them will depend amongst other things on the rules of the particular scheme. The guidance notes, however, that in many cases it will not be possible for schemes to be able to work out whether a historic transfer was a statutory or non-statutory one.

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The guidance

The Lloyds judgment left many issues unresolved and, given the high cost of court proceedings and the modest impact of failure to equalise GMPs on individual transfer payments, some issues may never be resolved by the court. The guidance is an attempt to assist schemes and their advisers in finding a pragmatic solution to equalising historical transfers. It repeats the judge's comment in Lloyds that the administration costs involved could easily exceed any correction payments needed.

The guidance is divided into three parts:

1. Transferring schemes that paid individual transfer values.
2. Receiving schemes that have received individual transfers.
3. Bulk transfers.

Transferring schemes that paid individual transfer values

The duty to equalise past transfers is unlimited in time with no statutory limitation period applying. Forfeiture rules in a scheme and member discharges are unlikely to be effective. However, if a scheme has provided specific equal treatment warranties or indemnities to receiving arrangements, they should be considered in light of the Lloyds judgment.

The guidance notes that the judgment means trustees need to be proactive in addressing historical transfer values. However, it also appears to permit trustees to think about factors such as cost of calculation, data issues and other practicalities when determining how to implement a correction process. Transferring schemes will need to take advice as to whether their approach to past transfers is appropriate, recognising there are several practical hurdles, which will mean perfection isn't achieved.

There will, of course, be significant practical difficulties, such as locating past members and receiving schemes, even where trustees identify top-up payments are needed. It may also not be possible to gather the necessary member data or work out what transfer value assumptions were used historically.

In some cases, there will not be enough information to calculate top-up payments and the scheme will retain the ongoing undischarged liability. This could cause an issue where a scheme is winding up. It's uncertain the extent to which trustees would be protected by statutory advertisements and/or if run off insurance cover would provide protection. In practice, employers may need to provide indemnities to trustees of schemes in wind up to cover such liabilities, if they can't be resolved before completion.

Where a receiving scheme is unable or unwilling to accept a top-up payment, the transferring scheme may choose to either seek to make a payment to the former member direct (which may have tax implications) or to retain the top-up payment in the transferring scheme until the former member provides details of another pension scheme prepared to accept the top-up payment.

Receiving schemes that have received individual transfers

The judgment did not clarify the position for receiving schemes. The judge did not decide whether a receiving scheme is under a duty to increase the benefits payable to a transferred-in member to make good any shortfall in the original transfer value when the member reaches retirement age.

In practice, receiving schemes are unlikely to know whether a transfer value would have been higher if the GMP had been equalised. Without that information there is little receiving scheme trustees can do. Given this, trustees will have to decide whether or not to now accept top-up payments.

They will also have to decide what adjustments, if any, are needed for benefits granted in respect of those historic transfers. One option open to receiving schemes would be to treat the total transfer credit as if it relates to benefits earned in that scheme. Indeed, for some schemes it won't be possible to separate a transfer credit from a member's other benefits (particularly where the pension is in payment). This approach has the merit of consistent treatment with benefits which accrued in respect of pensionable service in the receiving schemes during the Equalisation Period.

In practice, defined contribution schemes are likely to be more willing to accept top-up payments than DB schemes, as there is a cost to a DB scheme in working out what additional benefits are to be awarded in respect of a top-up payment.

Bulk transfers

Bulk transfers (e.g. on scheme mergers) are often done on the basis that the receiving scheme agrees to mirror the benefits the members had in the transferring scheme regardless of the value of the assets transferred. They are also often done on the basis of actuarial certification rather than member consent.

Where benefits are mirrored, the Lloyds judgment held there was no duty for a transferring scheme to make a top-up payment.

The guidance suggests, however, that receiving schemes should recognise and correct GMP inequalities.

The situation is less clear where the transferred members were not granted mirrored benefits, but service credits based on the receiving scheme's benefit structure. In some cases, members would have been granted service credits based on the receiving scheme's benefit structure, and in those cases specific advice should be taken.

Comment

The issue over equalising historic transfers is a very complicated one. This latest guidance is very welcome, but it repeatedly advises trustees to seek legal advice on the particular circumstances of the transfer in question.

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