



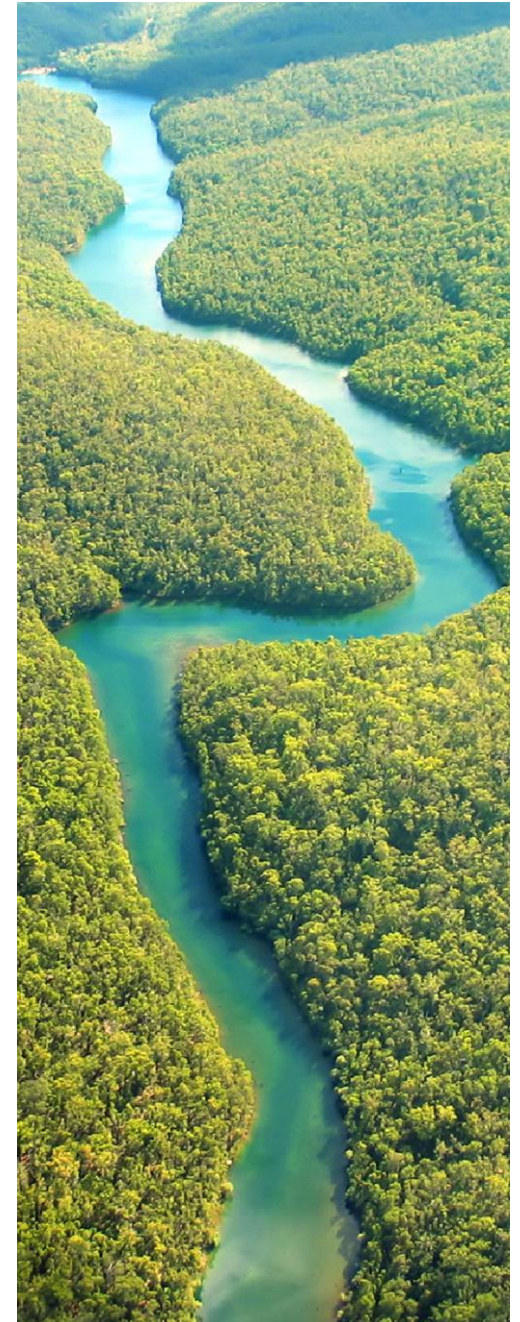
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GMP equalisation

What now?

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What we are going to cover



- Background



- Judgment



- Implications & tricky issues



- Q&A



Background

Background to claim

- A claim was originally brought by the third defendant against the Trustee and Lloyds Bank Plc in the Employment Tribunal
- The Trustee considered that the complex and far-reaching GMP equalisation questions should be considered by the High Court in Part 8 proceedings
- The Employment Tribunal claim was stayed by agreement to allow for Part 8 proceedings
- Interest based representation in the Part 8:
 - Three representative beneficiaries made arguments on behalf of those members in whose interests it was for the Trustee to equalise benefits
 - The Banks made arguments on its own behalf and on behalf of those members in whose interests it was for the Trustee not to equalise benefits
- HMT and DWP were joined to the proceedings

Recap: Impact of GMPs in a DB scheme

- Between 6 April 1978 and 5 April 1997 a company's defined benefit occupational pension scheme could "contract out" of the state earnings related pension scheme
- If a scheme contracted-out, members were entitled at statutory pensionable age (60 for men, 65 for women) to receive a weekly pension not less than the **"Guaranteed Minimum Pension"**
- Most contracted-out schemes provided benefits in excess of the statutory minimum so members accrued a GMP element and an "Excess" element

Recap: Impact of GMPs in a DB scheme

- The rules governing GMPs are found in the Pension Schemes Act 1993. They provide that:
 - the GMP must be payable at “pensionable age” - 65 for men, 60 for women
 - it is calculated applying revaluation in deferment up to pensionable age
 - GMP is increased in payment from pensionable age, and
 - a late retirement increase is applied if it is not put into payment at pensionable age
- The rates of escalation and revaluation will often differ for the GMP element and the Excess element
- The unequal payment age for GMP, combined with the differing rates of increase applicable to the GMP and to the Excess, can cause a man and a woman with equal age, service and earnings to have different pensions in payment

The claim in the *Lloyds Bank* litigation

Broadly speaking, three questions for the court:

1. Liability

Is the payment of unequal pensions to male and female members as a result of the requirements of the GMP legislation in breach of the sex equality rule deemed to be incorporated into the rules of pension schemes by s67 EA10 and contrary to the directly effective rights of scheme members to equal pay under Art.157 TFEU?

2. Methodology

If it is, how should benefits be equalised?

3. Back payments

Are trustees required to make back payments and if so over what period, and should interest be applied?



The judgment

Issue 1: liability

- Question

- Is there an obligation on the Trustee to adjust the Excess benefits to equalise for the effect of GMPs or is it lawful to pay unequal pensions?

- Answer

- Yes, there is an obligation to equalise for the unequal effect of GMPs
 - a) Properly characterised they are “pay” for purposes of Article 157 TFEU
 - i. No, GMPs are not part of the state social security system
 - ii. It does not matter that they are a substitute for SERPS
 - iii. Obiter comments on whether a breach of s67 EA10
 - b) No, there is no objective difference between men and women; the differences resulting from the legislation are based on gender. This cannot comprise an objective justification
 - c) No, there is no material factor defence for the same reason

Poll question 1

- Do you think that the High Court reached the right conclusion in holding that trustees are required to equalise members' benefits for the effect of GMPs?
 - Yes
 - No

Poll question 1

- Do you think that the High Court reached the right conclusion in holding that trustees are required to equalise members' benefits for the effect of GMPs?



Issue 2: methodology

- **Question**
 - If there is an obligation to equalise for the effect of GMPs, is there a choice of methods by which equalisation can be effected?

Issue 2: methodology

- **Method A - “Gold Plating”:** equalises each unequal aspect of the GMP & Excess separately
 - Puts into payment the higher total pension that would be paid to the unequalised female or unequalised male. At each subsequent annual increase, the total increase that would be paid to the (un)equalised male and female is compared, and the higher increase is paid to both sexes
- **Method B - “Annual better of”:** higher of the two annual pensions is paid to both sexes each year
 - Each year the total pensions payable to the unequalised female and to the unequalised male are compared and the higher of the two is paid to both sexes, i.e. the pension of the disadvantaged sex is uplifted to meet the level of the pension received by the advantaged sex

Issue 2: methodology

- **Method C - “Cumulative aggregate”**: each sex receives the same cumulative total pension
 - Each year an annual pension is paid to both sexes that would result in the accumulated pension instalments paid to date equalling the higher of the accumulated pension that would so far have been paid to the unequalised female or unequalised male (Can include applying interest to account for the time value of money)
- **Method D - “Values approach”**: pays benefits of equal actuarial value
 - Option 1 – An actuarial value is placed on the projected benefits of the unequalised male and female. The sex with the lower actuarial valuation is awarded an additional benefit equal in actuarial value to the difference between the two
 - Option 2 – As for Option 1, it places an actuarial value on the projected benefits of the unequalised male and female and the values are compared. The whole pension of both sexes is then converted into a re-shaped non-GMP pension, using the GMP conversion legislation, with an actuarial value equal to that of the advantaged sex

Issue 2: methodology

- **The Court's analysis**

- a) What is the “relevant term” which must be modified?
- b) What role does “minimum interference” play?

- **Argument on “relevant term”**

- Widest interpretation looks at each element which impacts the calculation of the pension separately – i.e. revaluation, anti-franking and increases
 - This interpretation supports “gold plating” method
- Narrower interpretation looks at the overall amount of pension paid as the “relevant term”
 - This interpretation supports one of the other methods

Issue 2: methodology

- **Answer**

- The “relevant term” is the overall benefit and not the individual calculation factors (i.e. gold plating is not the only method that produces equality of treatment)
- This means that there is more than one method which could produce equality of benefits
- If there is more than one method, then the method to be used is the one which produces “minimum interference” with the rights of any party

Issue 2: methodology

- Answer

- Minimum interference

- “gold plating” method offends the principle of minimum interference from the Banks’ perspective; therefore the trustee is not entitled to adopt it
- “values approach” option 1 offends the principle of minimum interference from the members’ perspective (because it interferes with their rights to receive payments due under the scheme levelled up to remove any inequality); therefore the trustee is not entitled to adopt it
- “values approach” option 2 would be permissible to the extent that it makes use of the conversion legislation (because the legislation effectively sidesteps the question of minimum interference) but it is not available at present because the Banks do not consent to it
- “annual better off” and “cumulative aggregate” methods provide equality.
- the only method the Trustee can adopt (unless otherwise agreed with the sponsor) is the cumulative aggregate method, taking account of interest (relying on the principle of minimum interference judged from the position of the Banks)

Note: the Court held that the conversion legislation is effective as currently drafted

Issue 3: back payments

- **Question**

- If there is an obligation to equalise, are trustees obliged to make back payments and if so, how far back?
- Should interest be applied to back payments and if so, at what rate?

- **Answer**

- Beneficiaries are entitled to receive arrears of payments due to them
- The period for which beneficiaries are entitled to back payments is governed by the rules of the scheme
- The Limitation Act 1980 does not afford a six year limitation period on the recovery of back payments
- Interest should be payable on arrears; the appropriate rate is 1% above base rate

Note: the Court's finding on limitation periods will have wider ramifications and could affect all claims for back payments. Scheme rules will be important



Implications and actions

What do we know?

- The judgment is clear that trustees must take steps to equalise benefits
- Trustees can adopt method C2 unilaterally
- Trustees cannot adopt unilaterally any of the other methods that were considered
- Other methods can achieve equality but trustees cannot implement them without employer / member consent (on the basis that those methods interfere with the employer's / members' rights to a greater extent than cumulative aggregate method with interest applied)
- The Court did not find that the methods considered were exhaustive; other methods may exist

What do we know?

- The current GMP conversion legislation is effective and can be used in conjunction with one of the equalisation methods to achieve equalisation by a one off change
- Back payments must be paid for the period prior to equalisation
 - there is no overriding time limit on these, this will depend on a scheme's own rules
 - interest should be paid at 1% above base rate
- It is not known if trustees must revisit past transfer payments

How to approach equalising

- Initial review
 - Understand and obtain advice on the different methods - this includes considering the methods in the context of scheme's own rules
 - Review data and consider suitability for purposes of initial actuarial advice
 - Obtain advice on the cost and practicality of different methods
 - Consider options for simplification (e.g. compromise or conversion)
- Implementation decision
 - Two stages:
 - (i) equalisation of benefits in payment; and
 - (ii) approach to equalising on an ongoing basis
 - Understand limitation period (if any) for back payments under scheme rules
 - Adopt a wait and see approach to past transfer value payments

How to approach equalising

- Practical issues influencing implementation
 - Availability of data and options for making data assumptions
 - Cost / benefit analysis (i.e. de minimis members)
 - Discretionary practices
 - Member communications
- GMP reconciliation exercises will need to be completed

Poll question 2

- Do you expect that your scheme(s) will have sufficient data to be able to equalise members' benefits?
 - Yes
 - No

Poll question 2

- Do you expect that your scheme(s) will have sufficient data to be able to equalise members' benefits?

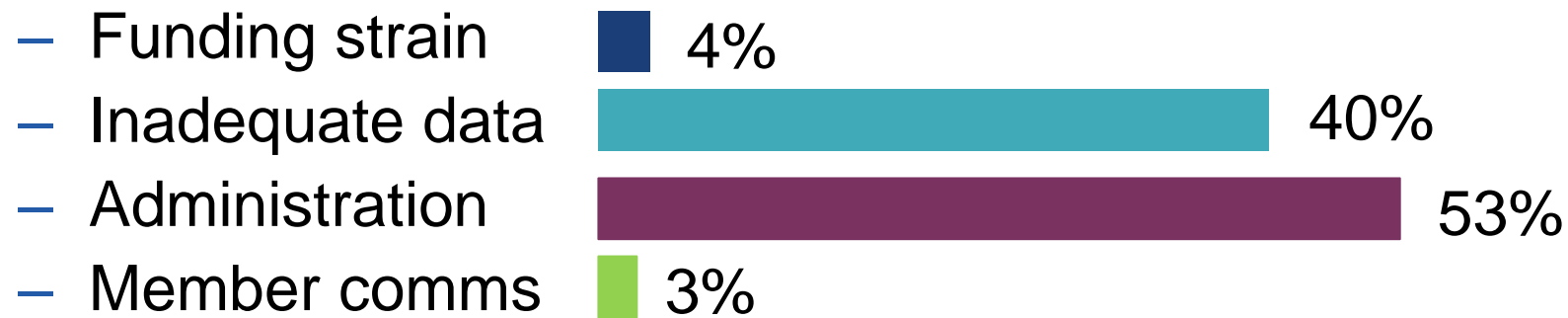


Poll question 3

- What do you think will be the biggest challenge with implementing equalisation?
 - Funding strain
 - Inadequate data
 - Administration
 - Member communication

Poll question 3

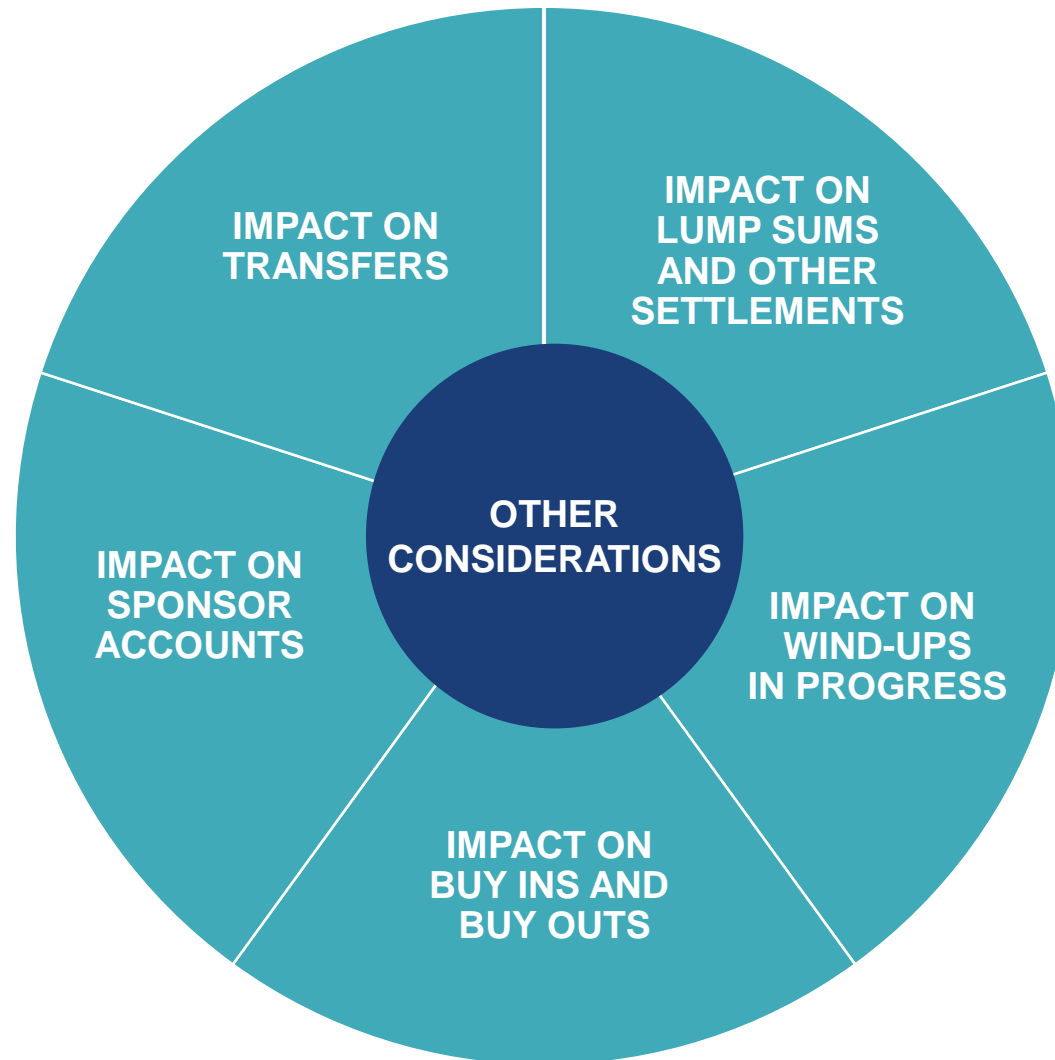
- What do you think will be the biggest challenge with implementing equalisation?



Options for simplification

- GMP conversion
 - Advantages: one off benefit reconciliation exercise
 - Disadvantages: can have an unexpected impact on scheme liabilities
 - Risks: impact of the *Safeways* reference to the CJEU
- Compromise
 - Advantages: one off benefit reconciliation exercise
 - Disadvantages: requires member agreement or court approval

Other immediate considerations



Transfer values

- Options:
 1. Continue as previously with a top-up payment in due course
 2. Undertake calculations using method C2 (data permitting)
 3. Provide a “rough and ready” enhancement and seek member discharge
 4. Provide a “gold plated” top up (likely to require sponsor consent)
- Steps to take before deciding how to proceed:
 - Check current pipeline
 - Obtain actuarial advice on the feasibility of the above options
- Updating member comms

Option 1 - Transfer followed by top-up

- Is it a partial transfer?
 - Check rules and amend if necessary (including discharge)
 - Statutory discharge may not apply
- Member communications
 - Make clear onus is on the member to check whether top-up will be accepted by receiving scheme
 - Member declaration
 - Give member option of delaying but highlight risks of doing so
- Top-up payment options
 - Transfer to receiving scheme or another scheme
 - May be possible to pay small amounts as:
 - “relevant accretion”
 - small pot lump sum
 - trivial commutation lump sum

Lump sums

- **Serious ill health lump sum**
 - i. Pay equalised lump sum (e.g. member under age 60)
 - ii. “Broad brush” enhancement and discharge
 - iii. Top-up at a later date
 - what about need to “extinguish member’s benefits under the scheme”?
- **Trivial commutation lump sum**
 - i. Delay
 - ii. Top-up at a later
 - needs to be paid within 12 months
 - what if top-up tips individual over £30,000 limit?
- **Small pots**
 - i. Delay
 - ii. Top-up at a later date
 - what about need to “extinguish member’s benefits under the scheme”?
 - what if top-up tips individual over £10,000 limit?

Lump sums

- **Winding-up lump sum**
 - i. Delay

- **Pension commencement lump sum**
 - i. Pay 2nd PCLS if pension equalised within 12 months
 - ii. Treat enhancement as separate pension coming in to payment
 - iii. Accept that member will not get full tax free entitlement and communicate clearly

Buy-outs and buy-ins

- Schemes due to buy-out in short term (next 3 to 6 months)
 - judgment leaves open option of using methods other than year-on-year
 - insurers unlikely to be in a position to operate year-on-year true-ups
 - values method / projected year on year methods still being used
 - who bears the GMP methodology risk?
- Schemes due to buy-out in longer term
 - option of GMP conversion also available
- Buy-ins

Sponsor accounts

- Companies may need to make provision in accounts
- Points to consider:
 - effective date of accounts
 - where should it be shown (P&L or OCI)?
 - how to quantify the obligation?



Any questions?

About your speaker



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Experience

Tim manages the pension team's value-added client services and internal education. This includes helping clients to stay up to date with the latest developments in pensions law and practice by producing client briefings and bulletins and designing and delivering tailored training for clients. Tim also works with policymakers, regulators and industry bodies to help shape pensions policy and regulation as it develops. He also supports the firm's pensions litigation practice.

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