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EXPOSÉ

Out of the frying pan, into the fire

While GMPs can now be converted into ordinary pension entitlement, there are many added costs for doing so

Now that our pension system has been 'simplified', the government has decided to review pension legislation in an attempt to find areas ripe for deregulation.

One of the areas to come under the microscope as part of this deregulatory review is the issue of guaranteed minimum pensions (GMPs). The logic behind this was that, if a contracted-out scheme does not have to provide GMPs for post April 5, 1997 service, then why should it have to do so for service on or before this date?

The government clearly thought this was a good question and as a result, the Pensions Act 2007 contains legislation that will allow schemes to convert GMPs into ordinary pension entitlement.

At first sight, this looks like a good idea, since GMPs revalue at different rates in deferment, increase at different rates once in payment and have truly complicated survivors' benefits. Rationalising all this so that members could instead have a single, simple benefit structure certainly sounds a good idea in theory.

However, if we go through the process that trustees will have to follow to convert GMPs, then it becomes apparent that this is not as straightforward as it first appears.

So let's look at the proposed

conversion process. Conversion can be done at any time for either an individual member, a group of members or the whole scheme. There is no limit on the number of conversion exercises, so a scheme can convert members in tranches over many years. These options are flexible and provide scope to convert GMPs in a way best suited to the scheme. So far so good.


There are a number of procedural requirements that must be met, but none of these are onerous. The difficulties start to appear when you consider what benefits will replace the GMPs.

Replacement benefits must be at least 'actuarially equivalent' to the pre conversion GMP benefits. However, this (sensible) requirement means schemes cannot simply remove GMPs from their calculations, because £1 of GMP will not be equal in value to £1 of non-GMP pension (due to the differences in revaluation and increases in payment).

The example that accompanied the draft regulations looked at a male who, at the date of conversion was aged 52 and had a total benefit (revalued to date) of £1,320, made up of £371 GMP and £949 excess. After conversion this member had a total (non-GMP) benefit of £1,385.

The sting in the tail is that, had there been a comparable female

member with the same pre conversion benefit, her post conversion benefit would be (based on my calculations) around £1,338. Given this benefit relates to post May 1990 service, there is a problem, because we have unequal benefits for male and female members with the same service.

To get over this, the female member's benefit will have to be increased, and there will be a cost attached to this. At a superficial level, GMP conversion may look attractive to schemes, but a conversion exercise will incur costs and if you are not careful, all you will have to show for it is an equalisation issue that will cost you even more to resolve. 

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