# First Briefing, November 2018
# GMP Equalisation

## Introduction

The matter of how to deal with Guaranteed Minimum Pension (GMP) equalisation has been put on the back burner for years. The judgment in the Lloyds Banking Group case has at long last provided clarity, although it may not have given the answer many had hoped for.

This briefing covers the recent judgment and considers where we go from here.

## Why is GMP equalisation an issue?

The key principle of equalisation is that any two people with identical pensionable service and salary will be entitled to the same benefits, whether they are a man or a woman. The equalisation requirement, driven from what is known as the "Barber judgment", has applied since 17 May 1990. Following this, schemes "equalised" their retirement ages and at the point pensions were put into payment, were deemed equal.

However, many pension schemes were historically contracted out of the State Earnings Related Pension Scheme (SERPS), resulting in a GMP benefit being payable. GMP mirrors SERPS and is unequal. Over time this creates inequality in scheme benefits for the following reasons:

- Calculation of GMP is different for males and females. This also results in differences in the amount of pension in excess of GMP.
- Differences between the increases to pension in payment for GMP and the pension in excess of GMP, which will result in differences in total pension year on year.
- GMP is payable from age 60 for females and 65 for males (so between age 60 and 65 males receive revaluation on their GMP while females receive statutory payment increases).

The effort and costs involved in equalising benefits for GMP often exceed the value of any additional benefit granted. It is for this reason that the pensions industry has been reluctant to equalise GMPs until they know they have no option but to do so.

## The Lloyds Banking Group case

The case was brought by three female members of the Lloyds Banking Group pension schemes. They claimed sex discrimination as their GMPs increase at a lower rate than male members.

In 2017 the Lloyds Banking Group Trustee (the Trustee) applied for the High Court's directions on a number of questions, with the case heard during July 2018.

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## Judgment

On 26 October 2018, Justice Morgan ruled that the Trustee is under a duty to make sure that equal benefits are paid, including where these benefits are in the form of GMP.

**All schemes with GMP rights will have to act to allow for equalisation of GMPs.**

Justice Morgan then went on to consider the different approaches presented to achieve equalisation. There were four different methods (known as A to D), some with variants, resulting in eight different approaches being considered.

A legal principle of 'minimum interference with the rights of any party' was applied when deciding which approaches would be possible. This led the judge to disregard some of the proposed methods in the table below, such as Method A (from the Banks' perspective) and Method D1 (from the beneficiaries' viewpoint).

| | Description | Judgment |
|---|---|---|
| A | Equalise each unequal aspect of the benefit separately. | This approach could result in more generous benefits than necessary, at the highest cost. Permitted only with the consent of the employer. |
| B | Carry out an annual comparison of the male/ female pension and pay the higher amount. | This approach is possible but will be more costly than options available under C. |
| C | Pay the annual pension that would result in the accumulated pension paid to date being equal to the higher of the accumulated pension payable to either an unequalised male or female. Where the higher amount switches from one sex to another over time, this approach allows for offsetting.<br><br>C1: no allowance for interest.<br><br>C2: allows for interest on accumulated gains, reducing the overall cost. | Both C1 and C2 are possible (and will be less costly than B).<br><br>For C2, an interest rate of 1% above bank base rate should be used.<br><br>And in the Lloyds case, the employer is entitled to insist the Trustee adopts C2 as this is the least costly method available to them. |

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| | Description | Judgment |
|---|---|---|
| D | D1: A one off calculation determining the actuarial equivalence of cashflows generated by one of the above methods and then provide a higher benefit to provide benefits of equal value.<br><br>D2: As D1 but as part of the process, convert all GMP to non GMP. | D1 is not permitted on the grounds it infringed the principle of minimum interference for beneficiaries' rights.<br><br>D2: would be permitted but, in the Lloyds case, was not currently allowed under the scheme rules. |

## Back-payments

Individuals with pensionable service between 17 May 1990 and 5 April 1997 who have retired (or died, with survivor's benefits coming into payment) will need to be re-calculated and if necessary corrected, with back-payments paid.

Justice Morgan said there was no time limit on claims for arrears of pension, but this would be subject to scheme rules. In the Lloyds case, their scheme rules required that claims for unpaid benefits be made within 6 years of when the benefit is due to be paid.

Legal advice will be required to establish the extent of the trustees' duty to make back-payments. Where back-payments are made, then interest of 1% above bank base rate will need to be applied.

## Transfers

The court was asked to consider how the transfer of rights both into and out of the scheme should be considered. Justice Morgan has deferred his judgment on this part.

Consideration will need to be given as to how to deal with GMP equalisation when it comes to the calculation of cash equivalent transfer values.

# Next steps

## How to equalise?

The judgment clarifies that there is more than one possible approach. Trustees and Employers will need to consider which approach to use. Legal advice will be required to consider which options may be available.

Having decided the approach to adopt, a further decision can be made:

Whether to carry out the assessments each year and adjust benefits as required, or to carry out GMP conversion which would allow the calculations to be carried out once and the benefits simplified at the same time (as per D2).

The advantages and disadvantages of each approach should be considered.

## What if GMPs have already been equalised using D1?

Where schemes have already addressed GMP equalisation, such as a buy-in or buy-out of benefits with an insurer, method D1 has typically been used. The judgment only considered the methods appropriate for a continuing scheme and did not consider the approach taken by the PPF, which is akin to D1.

The judgment did state that buy-out transactions *"could be considered to be a special case, as in a buy-out the liability to pay benefits is transferred from the scheme to an insurer acting as a third party. In those circumstances the commercial imperative to achieve risk transfer in the buy-out will outweigh the risks of the equalisation approach subsequently being deemed inadequate"*.

It is therefore not yet clear how the judgment will apply to buy-outs and it may take some time for a new consensus to emerge.

## Additional liabilities

It is expected to take some time before trustees and employers will have taken the necessary advice and agreed the approach to use, and hence additional liabilities can be known.

In the meantime, action will need to be taken to consider how to make an approximate allowance for GMP equalisation in:

- Funding valuations
- Pension Cost Accounting Disclosures – If material, auditors will expect a reserve to be held and current thinking is that the additional cost may need to be recognised in Profit and Loss.

## Further guidance

We are expecting the DWP to issue further guidance to trustees on how to take GMP equalisation forward.

## Further information

For further information, please contact your usual First Actuarial consultant.