

## GMP equalisation: light at the end of the tunnel?

### ► In brief

- The High Court has ruled on the Lloyds case concerning GMP equalisation
- Trustees do have to equalise GMPs
- Judge preferred one particular method for the Lloyds schemes; however, other methods (particularly involving the conversion of GMPs) remain possible
- At present, there is no word on whether there will be an appeal

### ► Next steps

- Trustees should discuss the possible impact of the ruling with their advisers, both legal and actuarial, and decide what to communicate to members
- Companies might wish to discuss the potential impact on company accounts with their actuaries and/or auditors
- All parties might also wish to look out for:
  - > DWP guidance on GMP conversion
  - > whether there are any supplementary rulings or DWP guidance on key unresolved issues such as members who have left

On 26 October 2018, the High Court gave its judgment on the Lloyds case which concerned whether (and, potentially, how) Guaranteed Minimum Pensions (GMPs) should be equalised.

### Background

Under the contracting-out legislation, schemes became responsible for paying broadly equivalent benefits to the State Earnings-Related Pension Scheme (SERPS) in exchange for paying lower National Insurance contributions. Many private sector defined benefit (DB) schemes have historic GMP liabilities as a result of 'contracting out' of SERPS prior to April 1997. Because GMPs broadly mimic SERPS, they differ between men and women in a number of ways, including the age from which they become payable.

GMPs are set out in legislation (so can themselves only be equalised by the Government, which there is no indication it intends to do). The key question is whether trustees have to alter members' overall benefits to remove inequalities introduced by GMPs (known slightly inaccurately as 'equalising GMPs'). Most schemes have not to date equalised GMPs due to uncertainty over whether this is legally required and also the lack of a legally mandated or widely accepted method of equalisation.

### Lloyds case

Following a class action lawsuit by the BTU (an independent trade union for staff at Lloyds Bank), it was announced in 2016 that various questions around the equalisation of GMPs would be put to the High Court, with parties to the case including the trustees of the three Lloyds schemes (the Trustees) and the sponsoring employers of those schemes, Lloyds and HBOS (the Banks). In addition to the central question of whether GMPs have to be equalised, the High Court was asked what method should be used (with a number of possible methods being put before it), how far back a member could claim for previously unpaid benefits and what should be done about transfers in and out.

On 26 October 2018 the judgment was handed down.

### Do GMPs have to be equalised?

Mr Justice Morgan held that the Trustees were under a duty to equalise GMPs accrued between 17 May 1990 and 5 April 1997 (ruling that benefits in question were 'pay' for the purposes of article 157 of the Treaty on the Functioning of the EU).

### What method should be used?

The High Court was asked to consider four main possible methods of equalising GMPs used (some of which had at least one variant):

#### Methods A & B

Methods A and B track the member's pension and the pension they would have had if they were the opposite sex (both unequalised). In broad terms, method A achieves equalisation by levelling up the pension and the different rates of annual increases separately, whereas method B levels up the amount by paying, in any given year, the higher of the two tracked pensions mentioned above and is therefore likely to be less costly than method A.

## Method C

Methods C1 and C2 modify method B so that the accumulated pension paid is restricted by clawing back overpayments to ensure that both sexes do not end up with more valuable benefits overall than they would have had if they were of the opposite sex. These methods are therefore potentially less costly than method B. Method C2 is in turn potentially less costly than C1 because it allows for interest on the accumulated pension.

## Method D

Method D1 is a comparison of actuarial value of unequalised benefits with the value of unequalised benefits of an opposite sex comparator. If the value is lower, then an additional benefit (probably pension) equal in value to any shortfall would be provided. Method D2 is a variant of D1 which includes converting the equalised GMP to an alternative format (e.g. non-GMP benefits) using the existing GMP conversion legislation.

### Which method can be used?

Methods A, B and C would all be administratively complicated, with multiple separate records being maintained per member. Method D would be much simpler, with a one-off calculation.

The judge ruled that the Trustees were not able to use method A without the Banks' consent. Methods B and C are valid approaches for equalising GMPs; however method D1 could not be used. In principle, method D2 could be used, subject to the agreement of the Banks, and the judge made clear that he thought that the existing GMP conversion legislation could be used, despite concerns that this might not be possible because of apparent defects in the drafting. Finally, the judge ruled that the Banks could compel the Trustees to use method C2 (as it is a valid method and is likely to be the least costly).

## Points to consider

### Which method should be used?

Trustees and employers should discuss, and potentially take legal advice on, how to equalise GMPs in their scheme as well as what action should be taken now. Method D2 involving a one-off conversion exercise may be the most attractive for many schemes, although it is not yet clear when we will have final guidance on this approach from the DWP.

Equalising GMPs might lead to tax implications, depending on the method used. It remains to be seen whether HMRC will do anything to address any charges arising from equalisation uplifts.

### What about back payments?

The judge held that there was no relevant statutory limitation period and that in this case the period over which back payments could be claimed was governed by the rules of the scheme. For other schemes, legal advice as to the limitation period is likely to be needed.

### Accounting treatment?

Now that it is clear that GMPs do have to be equalised, it is likely that the possible impact will have to be accounted for in company accounts. It remains to be seen whether accounting bodies will issue guidance. Trustees may also wish to reserve for GMP equalisation in their triennial scheme funding valuation.

### Settlement of benefits?

The question of what to do when settling benefits now (e.g. through individual or bulk transfers, trivial commutation exercises, buy-outs or buy-ins) also needs to be considered (as well as the extent to which previous settlements may need to be considered). The judge ruled that transferred-in benefits had to be equalised but gave no answer on the question of transfers out, although this may be the subject of a future ruling.

### Data concerns?

In practice, equalising GMPs for pensioners might be difficult due to a lack of data (the data kept by administrators might not include everything required for the calculations). Furthermore, GMP reconciliation queries may not be submitted to HMRC for review after 31 October 2018.

### Possible appeal?

It is not at present clear whether any of the (many) parties to the case will appeal (parts of) the judgment as well as to what extent there will be further judgments or DWP guidance on supplementary questions (such as how to treat previous transfers out or cases where the costs of equalisation will exceed the benefits to the members).

## Conclusion

This is a highly significant ruling, which raises the prospect of trustees of all contracted-out DB schemes having to equalise GMPs. However it may be a while yet before the dust finally settles and all questions around GMP equalisation are answered.

## For further information

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