XPS Pensions

Briefing
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Making sense of GMP conversion

In brief

- **The Lloyds judgment has put GMP conversion under a spotlight**
- **A supplementary judgment in December clarified that conversion does not require the separate calculation of an equalised benefit**
- **The GMP conversion legislation raises a number of questions, which may be addressed by DWP guidance and/or amendments to legislation**
- **In particular, it is not clear whether non-GMPs can be converted or what shape of benefits GMPs should be converted into**
- **There are also questions about the actuarial basis to be used and the consultation process to be followed**

Next steps

- **Trustees who are considering the conversion route should discuss this early with the sponsoring employer**
- **They may also wish to take legal advice on the interpretation of the current legislation, or may prefer to wait until the DWP has published its guidance and confirmed whether it will be amending the legislation**
- **In the meantime, trustees should ensure that work is continuing on reconciling GMPs with HMRC**

The option to convert Guaranteed Minimum Pensions (GMPs) into ordinary pension scheme benefits was first introduced in 2009, but has to date only been used for a handful of schemes. However, since last year's Lloyds judgment, conversion has suddenly become a much more attractive prospect. In this briefing note, we look at what conversion involves, and at the questions that still remain to be answered.

What did the Lloyds judgment say about GMP conversion?

The Lloyds judgment of 26 October 2018 considered the validity of a number of methods for adjusting members' benefits in order to remove the effect of inequalities in GMPs between men and women and confirmed that GMP conversion (method 'D2') was an acceptable method of equalisation, where the employer gave its consent.

In particular, the judge considered an argument that conversion was not possible for survivors' pensions in payment (because of the use of the term 'earner' in the legislation), but found that the legislation did in fact enable GMP conversion in relation to survivors at the time of conversion. This disposes of one of the difficulties with the GMP conversion legislation, but by no means all.

In a short supplementary judgment given on 6 December 2018, the judge also clarified his thinking on how GMP conversion should operate in practice. He said that it was not necessary for the actuary to calculate the actuarial value of a member's equalised pension before carrying out the conversion. Instead, it was acceptable for the purposes of conversion for the actuary to determine the higher of the actuarial equivalents of the unequalised female and the unequalised male pensions and use this as the basis for conversion.

Now that it is confirmed that trustees do need to equalise for the effect of unequal GMPs, we expect to see many trustees considering whether a one-off conversion exercise is the appropriate route for their scheme.

Please see our Briefing Note 13/18, '**GMP equalisation: light at the end of the tunnel?**', for an overview of the Lloyds judgment, including the requirement to equalise GMPs, the various methods proposed for doing so and the likely implications for trustees and sponsors.

What are the legislative requirements for GMP conversion?

In order for GMPs to be converted into ordinary scheme benefits, the following conditions must be met:

1. **The post-conversion benefits must be actuarially at least equivalent to the pre-conversion benefits.**
2. **Pensions in payment cannot be reduced.**
3. **The post-conversion benefits must not include any new money purchase benefits.**
4. **Survivors' benefits must be at least 50% of the members' benefits.**
5. **Certain procedural requirements must be complied with:**
    - The employer must consent in advance.
    - The member must be consulted before the conversion and also all members and survivors affected by it must be notified either before or as soon as possible after the conversion.
    - HM Revenue and Customs (HMRC) must be notified before the conversion.

These requirements raise a number of questions, which we hope will be addressed in forthcoming guidance from the Department for Work and Pensions (DWP) and possibly also in amending legislation. In its recent consultation on defined benefit consolidation, the DWP indicated that it was confident that it would finalise its work with an industry working party on assisting GMP conversion, expected to include guidance (and possibly legislative amendments) 'in the near future'. We look below at some of the key questions.

What benefits can be converted?

The legislation refers to pre- and post-conversion 'benefits' (not just 'GMPs') and it also states that 'the trustees may include other amendments which they think are necessary or desirable as a consequence of, or to facilitate, the GMP conversion.' This raises the question of whether the legislation permits non-GMP benefits to be converted as part of the GMP conversion process, and if it does whether that would be restricted to excess pension accrued between 1978 and 1997 alongside GMP or whether it could be extended to pre-1978 and post-1997 pensions as well. Such interpretations could be attractive in that they would allow for a much wider restructuring and simplification of scheme benefits, but it is far from clear that this is the intention of the legislation.

Any trustees or employers interested in pursuing such a route would therefore need to take legal advice.

It appears that a member's whole GMP must be converted (not just that relating to 1990-1997 service) and that it is possible for GMP conversion to be carried out for some members and not for others.

What form should new benefits take?

There are few restrictions on the form of new benefits post-conversion (except for the restrictions on survivors' benefits and on pensions in payment not reducing). It would therefore seem possible for converted GMP to be replaced with a simple flat-rate pension. However, there may be practical reasons for deciding to mirror the shape of existing excess pensions in terms of revaluation and increases. As with any reshaping exercise, conversion will also lead to potential winners and losers (depending on how the pension increases and how long people live, as well as any tax consequences).

The restriction on survivors' pensions appears to require them to be at least 50% of the member's benefits, not specifically of the GMP, which is unhelpful for schemes providing a lower level of survivors' pensions. The requirement that pensions in payment cannot be reduced may also cause problems for schemes where the GMP does not increase, but where the trustees would like to replace the GMP with excess pension increasing in line with LPI.

What does actuarial equivalence mean?

The legislation specifies that it is for the trustees to set the assumptions for calculating actuarial equivalence, on the advice of the scheme actuary, and for the actuary then to certify actuarial equivalence. No basis is prescribed, although many trustees may decide to use the cash-equivalent transfer value (CETV) basis (which is prescribed for the actuarial equivalence test under section 67 of the Pensions Act 1995). Whichever basis is used, particular consideration may need to be given to whether unisex factors should be used given that the exercise is intended to achieve sex equalisation.

What information should be given to members?

As noted above the legislation also requires members to be both consulted on the conversion and then notified of it. It is not clear what form the consultation will have to take (and in particular whether it will need to follow the process for listed changes under the employer consultation regulations). In any case, it is likely to be a challenge to provide clear communications to members on such a complex topic.

For further information

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