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## GMP CONVERSION – THE FACTS

### 1 INTRODUCTION

Amendments made to the Pension Schemes Act 1993 (the Act) by the Pensions Act 2007, included a facility to allow contracted-out occupational pension schemes to convert members' Guaranteed Minimum Pensions (GMPs) into ordinary scheme benefits.

On 2 September 2008, following a commitment made in Parliament to consult before bringing the facility into force, draft Amendment Regulations<sup>1</sup> were published for consultation by the Department for Work and Pensions (DWP).

The consultation period closes on 28 October 2008.

### 2 KEY POINTS

- Schemes will have an option to convert GMPs into ordinary scheme benefits, provided five stringent conditions are met (sections 5 and 6).
- The key condition of actuarial equivalence involves comparing benefits pre- and post-conversion (section 5).
- Affected members (i.e. anyone who may have their GMP rights converted) will need to be consulted (section 6).
- But converting GMPs does not, of itself, deal with the possible need to equalise GMPs (section 8).

<sup>1</sup> The draft Occupational Pension Schemes (Contracting-out)(Amendment) Regulations 2009

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### **3 BACKGROUND**

Between 6 April 1978 and 5 April 1997, defined benefit occupational pension schemes could be contracted out of the state second pension if they promised that the pension to be provided to the member would not be less than a specified minimum (the GMP).

Reflecting their status as replacement state benefits, there are complex rules governing GMPs. As well as being separately tracked and monitored by the scheme, they must be used to provide specified benefits for survivors.

### **4 GMP CONVERSION**

Schemes are to be given the option of converting GMPs into ordinary scheme benefits – with the aim of allowing schemes to simplify benefit structures and to enable members to understand their benefits more easily. Recognising that some schemes have not been able to take advantage of legislative easements<sup>2</sup> in the past because of restrictive scheme amendment powers, the Act helpfully includes provision for trustees to modify a scheme by resolution to effect GMP conversion, as well as providing an exemption from the requirements of section 67.

Before conversion can take place five stringent conditions must be met (sections 5 and 6 below). But the good news is that if all the conditions are met, trustees will receive a statutory discharge from their responsibilities to provide GMPs.

The Pensions Regulator has been given responsibility for overseeing the conversion process and will be able to consider complaints from members<sup>3</sup>, in particular on the conduct of consultation and the actual conversion on the basis of actuarial equivalence. The Regulator will be able to prevent the conversion process going ahead whilst concerns are being investigated or even “unpick” the conversion in extreme cases.

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<sup>2</sup> Such as the reduction in April 2005 of the cap on pension increases in payment from 5% to 2.5%

<sup>3</sup> Members will, of course, retain their right to make a complaint to the Pensions Ombudsman for maladministration

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### **5 ACTUARIAL EQUIVALENCE CONDITION**

Condition 1 provides that the post-conversion benefits “must be actuarially at least equivalent to the pre-conversion benefits” as certified by the scheme actuary.

Although the actuary provides the certificate, the responsibility for determining actuarial equivalence lies with the trustees. Under the draft Amendment Regulations, the trustees are also required to choose the assumptions to be used by the actuary (after taking advice from the actuary).

The actuary must then calculate the actuarial value of the member's pre-conversion and post-conversion benefits, using those assumptions but ignoring certain benefits – such as benefits which have been surrendered, commuted or forfeited, and also discretionary benefits. The consultation paper suggests the actuary may use the same method for GMP conversion as for calculating transfer values.<sup>4</sup>

### **6 OTHER CONDITIONS FOR GMP CONVERSION**

#### *Post-conversion benefits*

- Condition 2 ensures that, where a person is entitled to a pension immediately before the conversion date, the application of the actuarial equivalence test must not reduce the pension in payment (in effect this operates as an underpin).
- Condition 3 prevents the GMP being converted into defined contribution benefits.
- Condition 4 requires the same survivors' benefits to be attached to the post-conversion benefits as the pre-conversion benefits. Broadly, this means that half of all GMP rights must be used to provide a survivor's pension for a widow or widower (or civil partner).

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<sup>4</sup> If the individual is an active member, the trustees will need to set an assumption for when that member will leave pensionable service



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### *Procedural Requirements*

Condition 5 focuses on procedural requirements. The trustees will have to take “all reasonable steps” to consult<sup>5</sup> affected members before going ahead with the conversion (unless the scheme is in wind-up). The consultation paper makes it clear that the term “reasonable steps” is intended to assist schemes who cannot contact a member. But it stops short of suggesting what steps might satisfy this requirement - only saying that “they will differ depending on the circumstances”.

The other procedural requirements which apply are that the employer's consent must be obtained before conversion and, after conversion, HM Revenue and Customs (HMRC) must be notified.

## **7 MISCELLANEOUS**

- The consultation contains as an Appendix a “simple guide” setting out how the DWP envisages GMP conversion will work.
- This guide suggests that as part of the conversion exercise, schemes will need to contact the National Insurance Contributions Office of HMRC to request a reconciliation of scheme records against central records in order to establish the affected member's GMP entitlement.
- Even after conversion members will still have a notional GMP which will be used to calculate certain social security benefits to prevent “double counting”.
- The legislation allows statutory restrictions to be placed on onward transfers of converted benefits but, subject to consultation, the Government say that they are “not planning, at this stage, to use this power”. This is because an individual can decide not to transfer if he does not think the terms offered are acceptable (and bulk transfers will require actuarial certification in any event).

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<sup>5</sup> The consultation paper suggests including an estimate of the converted benefits

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### 8 THE OLD CHESTNUT

Trustees are left with the old chestnut of whether GMPs need to be equalised<sup>6</sup>. The method of calculating GMPs is different for men and women as GMPs are based on unequal state pension ages. But very few ongoing schemes have equalised GMPs, principally because of a lack of consensus about how it should be achieved.

The consultation paper states that:

“The law requires the overall pension based on rights that accrued from 17 May 1990 paid to a man to be the same as that which would be payable to a woman in the same circumstances (and vice versa). The conversion of GMPs will not relieve trustees of this requirement.”

This has echoes of the recent Pension Protection Fund (PPF) consultation<sup>7</sup>, which suggests equalisation of GMPs is required for schemes entering PPF assessment periods, and begs the question of whether equalisation needs to be addressed before this conversion facility is used.

<sup>6</sup> For accrual since 17 May 1990, as a potential result of the decision in *Barber v Guardian Royal Exchange* [1990] 2 All ER 660

<sup>7</sup> “Consultation on the requirement under section 171 of the Pensions Act 2004 to equalise compensation to allow for differences in the GMP formula”