

GMP equalisation

Alert | 01 December 2016



Introduction

The DWP is [consulting on a new methodology](#) for equalising pensions for the effect of inequalities caused by GMPs in private pension schemes. Meanwhile, HMT is separately consulting on how best to treat [GMPs for affected members of public service pension schemes](#).

Key points

- The DWP's proposed new methodology seeks to achieve equal benefits in private sector pension schemes using a one-off calculation followed by GMP conversion.
- Alongside the consultation, the DWP also published a "[ten-stage possible process for resolving the GMP inequalities issue](#)".
- HMT is considering various options as it seeks to achieve equal benefits and honour the commitment by successive governments to fully index public service pensions, including the GMP.
- The DWP's consultation also looks at various elements of the contracting-out legislation which need to be revisited in the wake of the abolition of both DB and DC contracting-out.
- Consultation on the private pension proposals closes on 15 January 2017 (unusually, a Sunday), whilst the consultation for public service schemes closes on 20 February 2017.

GMPs – a brief history

From 6 April 1978, individuals could accrue an entitlement to an earnings-related addition to their basic state pension, called the State Earnings Related Pension Scheme (SERPS). An employer could contract its scheme out of SERPS if it was designed to provide a pension at least as good as a statutory minimum, known as the GMP. The GMP is a component of a member's total scheme pension.

The method for calculating GMPs is set out in legislation. It is possible for the GMP component of a scheme's benefits to be unequal between the sexes because:

- GMPs accrue at different rates for men and women

- GMPs are payable from different ages (65 for men, 60 for women), and
- a member's GMP increases at a different rate from their scheme pension.

GMP accrual was abolished from 6 April 1997 onwards.

Equalisation of benefits

In the [Barber](#) case (17 May 1990), the ECJ ruled that occupational pensions were deferred pay and, as such, schemes were required to treat men and women equally. As a result schemes “equalised” their retirement ages, often at age 65, and adjusted their benefits accordingly. However, as the rules governing GMPs are set out under legislation, there was some doubt as to whether Barber applied to GMPs.

Where any inequality is the result of legislation, there has also been uncertainty as to whether there is a need for a “comparator” – namely, a worker of the opposite sex who is being treated more favourably. The Government's view is that European case law does not require a comparator where state legislation (in this case the UK's unequal state retirement ages and its effect on GMPs) is at issue.

Whatever happened to the 2012 method?

In January 2012, the DWP [consulted on a proposed methodology for equalising GMPs](#) which would have required schemes to compare, on a year by year basis, the position of a male against a female and pay the better of the two benefits. Many at the time pointed out that this approach would “not only be administratively expensive, but would also result in both men and women receiving equalised pensions that would be higher than either a man or woman would otherwise have received”.

The DWP therefore set up a working group in 2013 to look at, among other things, using GMP conversion as a means of equalising scheme benefits for the effect of unequal GMPs.

The 2016 method

In summary, the [new method](#) put forward by the working group involves a one-off calculation and actuarial comparison of the benefits a man and woman would have, with the greater of the two converted into an ordinary scheme benefit under the legislative facility for converting GMPs.

This calculation involves comparing the future expected cash flows for the member in the period that needs to be adjusted for GMP inequalities (ie 17 May 1990 to 5 April 1997) with that for the opposite sex comparator, allowing for contingent benefits. If the opposite sex comparator has the greater discounted value of expected cash flow, then that greater value is delivered. Schemes will need to consider whether it is appropriate to use the CETV calculation method, or whether another method would be more appropriate for this purpose.

GMP conversion

Once benefits have been equalised using the method outlined above, the consultation envisages [converting GMPs](#) into ordinary scheme benefits.

Legislation imposes a number of conditions on GMP conversion, including a requirement that post-conversion benefits “must be actuarially at least equivalent to the pre-conversion benefits”.

A number of changes to the conversion legislation are being proposed which are intended to make

conversion easier to use. These include provisions to replace the requirement to consult members with a requirement to notify members both before and after the conversion takes place, and clarification of some of the terms used.

A number of issues also remain under consideration by the working group, including the requirements under conversion to provide a survivor benefit, the treatment of pensions in payment, the need to notify HMRC that conversion has taken place, and certain pensions tax issues.

Public service pension schemes

Separately, HMT is [consulting](#) on solutions to indexation and equalisation of the GMP for public service pension schemes.

Under the arrangements which applied previously, the public service pension and the additional state pension (“S2P”) worked in tandem, providing a mechanism that fully indexed and equalised pension payments. However, with the removal of S2P from 6 April 2016, the mechanism no longer works and, if no action is taken, may result in an inequality in the payment of pensions between men and women.

Back in March 2016, [HMT announced](#) that public service pensioners reaching SPA after 5 April 2016 and before 6 December 2018 would have the GMPs earned in public service fully indexed by their public service pension scheme. This ensured that men and women reaching SPA in that period continued to receive equal pension payments.

The Government is now considering how public service pension payments should be increased in future, in particular, for those who have accrued a GMP and reach SPA after 5 December 2018. The consultation considers three broad policy options for addressing the joint challenge of indexation and equalisation of scheme pension to take account of the GMP:

- case-by-case calculations
- extension of the interim solution
- conversion of the GMP to scheme benefit.

HMT will also consider alternative solutions that are put forward by respondents to the consultation.

Tidying up contracting-out legislation

The DWP’s consultation also covers [draft regulations](#) which are designed to help improve administration and provide clarity for schemes that were contracted-out on a DB basis before 6 April 2016.

Among other things, the draft regulations seek to:

- extend the time period for paying a contributions equivalent premium (CEP) where the need to pay a CEP follows use of HMRC’s [scheme reconciliation service](#)
- strengthen the protections for future accrual and survivor benefits
- on [advice from GAD](#), set the percentage for schemes which revalue GMPs using the “fixed rate method” at 4% for those members who leave service on or after 6 April 2017.

The regulations are due to come into force on 6 April 2017.

Still to come?

The DWP notes that it has been unable to tackle all the points raised in previous consultations on the abolition of contracting-out.

In particular, it flags the regulatory restrictions which mean that a formerly contracted-out scheme cannot make a bulk transfer without member consent to a receiving scheme which has never been contracted-out. Since the abolition of DB contracting-out, it has no longer been possible to deploy a workaround whereby the receiving scheme contracts out for a short period so as to enable the bulk transfer to take place. The consultation makes clear that the Government is “working with stakeholders on this issue but any changes to legislation will not be introduced before autumn 2017.”

In addition, further work is set to be carried out by the DWP in relation to the actuarial certification of changes to formerly contracted-out schemes. Again, no changes to legislation are expected to be introduced before autumn 2017.

Next steps

In devising the new methodology for equalising scheme benefits for the effect of GMPs, the DWP is trying to be helpful to schemes. But it is not placing any obligation on schemes to use this method, nor is it suggesting that the method be treated as a definitive statement (or legal advice) on how equalisation should be achieved.

In addition, the DWP makes clear that trustees who are “content that they are providing equal pension benefits [...] need take no further action”. Schemes which have already converted GMPs will likewise not be required retrace their steps. The DWP is, however, particularly keen to hear views on its new proposals from trustees who have been through the process.

Once the legislation is in place, the DWP plans to issue guidance that will clarify some details of the conversion process.