Sackers

GMP equalisation – DWP guidance published on using conversion legislation

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Introduction

Just in time for Easter, the Government has published its long awaited guidance on using the GMP conversion legislation to crack the GMP equalisation conundrum. The culmination of work carried out by the DWP's industry working group over the last few years, the guidance follows on from the High Court's confirmation in the Lloyds case (back in October last year) that benefits do need to be equalised for the effect of GMPs.

Key points

- The duty to equalise for the effect of GMPs **only applies in respect of GMPs accrued on and from 17 May 1990 up to and including 5 April 1997**, ie from the date of the *Barber* decision to the day before GMPs were abolished.
- Back in 2013, the DWP established an industry working group tasked with considering whether and how the GMP conversion legislation "might be used to equalise scheme benefits for the effects of unequal GMPs, and to seek a solution that would allow schemes to provide equal benefits but without imposing overly onerous burdens".
- Whilst the legislative facility for converting GMPs into ordinary scheme benefits has been in force since 6 April 2009 (under the Pensions Act 2007), it has been rarely used in practice.
- The guidance includes a 10-stage process for adjusting benefits to compensate for GMP inequalities and converting those benefits into ordinary scheme benefits, as well as a brief Q&A section.

What is unequal about GMPs?

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 therefore a component of a member's total scheme pension. GMP accrual was abolished from 6 April 1997 onwards.

The method for calculating GMPs is set out in legislation and can result in inequality because:

- GMPs are payable from different ages (65 for men, 60 for women)
- GMPs consequently accrue at different rates (with a female's benefits accruing more quickly)
- different payment ages also create differences in the periods for which GMPs are subject to pre- and post-retirement increases
- revaluation of GMPs is usually higher than revaluation applicable to non-GMP excess benefits (which is more favourable to women), and
- statutory increases on GMPs tend to be lower than those applicable under scheme rules to non-GMP excess benefits (which is more favourable to men).

Equalisation of GMPs – a brief history of time

- 1990 – in the Barber case (17 May 1990), the European Court 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 GMPs were designed to integrate with the then state pension, and the rules governing them are set out under legislation, there was some doubt as to whether *Barber* applied.
- 2010 – in her statement to Parliament on 28 January 2010, the then Pensions Minister (Angela Eagle) announced that "domestic legislation requires equalisation in respect of differences resulting from GMPs whether or not real comparators exist" (namely, a worker of the opposite sex who is being treated more favourably). Two Government consultations on possible methods for achieving this followed.
- 2012 – the first method consulted on (see our Alert) would have required schemes to compare, on a year by year basis, the position of a man and a woman to pay the better of the two benefits. But this method was criticised for being "administratively expensive" and resulting in better benefits for both sexes than either sex would otherwise have received.
- 2016 – the DWP's subsequent method (see our Alert) 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 using the legislative facility for converting GMPs.
- 2018 – on 26 October, Mr Justice Morgan found that the Trustee of various Lloyds Banking Group schemes "is under a duty to amend the Schemes in order to equalise benefits for men and women so as to alter the result which is at present produced in relation to GMPs". In reaching his decision, the judge blessed possible methods for achieving this which, crucially, included holding that GMP conversion is a lawful method for equalising for the effect of GMPs.

The DWP methodology

First consulted on as part of its 2016 methodology, the guidance sets out a 10-stage process for adjusting benefits to compensate for GMP inequalities and converting those benefits into ordinary scheme benefits. The stages include the requirements for achieving conversion set out in the legislation itself.

Once conversion has taken place, the converted benefits will no longer be required to comply with the GMP rules.

A summary of the 10 stages can be found on our website. The DWP makes clear that the guidance "will be updated from time to time to reflect any changes to legislation that take place in the future and any material developments in case law".

The DWP responses to questions

The guidance provides answers to some questions posed in relation to the DWP's proposals. Having responded to the first ("Why not...abolish GMPs instead?") in the negative, particular highlights from the Q&As include:

Does an opposite sex comparator have to exist for an equalisation exercise to take place?

This question was not directly addressed in the *Lloyds* judgment. However, relying on a line of European cases including the Allonby decision, the DWP makes clear its understanding that "as inequality resulting from the GMP rules arises from state legislation, the requirement to remove any unfavourable treatment resulting from those rules is not subject to the requirement that an opposite sex comparator exists".

Which employer needs to approve the conversion?

The DWP comments that this should be the employer "in relation to the scheme" but that, where participating employers have changed over the years, "legal advice should be taken as to how (or whether) the consent requirement applies". But the legislation is not as clear as it could be, as it implies that all employers must consent and not just the principal employer. This could cause complications in practice for multi-employer schemes.

What about DC schemes which provide GMP underpins and other similar schemes?

Recognising that not all schemes with GMPs will be DB, the DWP says that it "will be for trustees to decide how the methodology should be applied having taken their own legal advice". However, the difficulty with DC benefits with GMP underpins is that, under the legislation, it is not possible to convert a GMP into DC benefits.

What about tax?

In short, the wait continues for any answers on the tax implications of either adjusting members' benefits for the effect of unequal GMPs or reshaping them on conversion. Areas known to be under consideration by HMRC include the impact on the LTA, the AA, lump sums, transfers and tax protections.

Helpfully, the guidance acknowledges that tax issues could arise in the short-term "because members with a GMP in the relevant period may want to retire, take full cash out, transfer etc" and that trustees may want to pay out "the current benefit with the possibility of a later adjustment, the amount (if any) not being known for some time".

As noted in its March 2019 Newsletter (108), HMRC has now formed its own working group and we can expect further updates in future newsletters.

Next steps

The Government notes that it is considering changes to the GMP conversion legislation to clarify certain issues. In its 2016 consultation, possibilities on the table included replacing the requirement to consult members with a requirement to notify members both before and after the conversion takes place. But the guidance stops short of saying what changes the Government currently has in mind.

With primary legislation needed to amend the statutory steps for achieving conversion under the Pensions Act 2007, we can hopefully expect more detail in the forthcoming Pensions Bill.

If you have any questions on any of the above, **please speak to your usual Sackers contact**.

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