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GMPS: TRYING FOR A CONVERSION?

1 INTRODUCTION

As this year's Six Nations Championship gathers pace, the northern hemisphere rugby union fraternity is steadily getting to grips with "experimental law variations". From 6 April 2009, a new pensions law variation takes to the field – the option to convert members' Guaranteed Minimum Pensions (GMPs) into ordinary scheme benefits.

Together with new regulations¹ (the Regulations), amendments made to the Pension Schemes Act 1993 (the Act) by the Pensions Act 2007 are the "props" which will permit conversion. In this Alert, we outline the main requirements for trustees of defined benefit (DB) pension schemes considering GMP conversion (and the conditions which might affect their ultimate "game plan").

2 KEY POINTS

- Occupational DB pension schemes will be able to convert GMPs into ordinary scheme benefits from 6 April 2009, provided five conditions are met (sections 4 - 6).
- Conversion will be based on a test of actuarial equivalence which is determined by the trustees on actuarial advice (section 5).
- Trustees will need to consult affected members before converting their benefits (section 6).
- The Pensions Regulator will have the power to "unpick" any conversion which fails to meet the five conditions (section 7).

¹ The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009

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3 GMPs: A POTTED HISTORY

GMPs were introduced from 6 April 1978 to allow occupational DB pension schemes to contract out of the second tier of state pension provision (now the State Second Pension). The basic premise is that schemes which were contracted-out on a GMP basis must provide members with benefits which are no less than a specified minimum, so that a contracted-out scheme member does not lose out because they no longer receive all the elements of the state pension. Although there has been no further accrual of GMPs since 5 April 1997, schemes still need to administer the GMP rights accumulated up to that date.

As GMP provision is complex – requiring separate tracking and monitoring, and the provision of specified benefits for survivors – the Government is bringing into force new legislation to permit GMPs to be converted into ordinary scheme benefits. These new provisions are designed to help schemes to streamline their processes and, as the Government says in its response to the original consultation², to enable members “*to understand their pension rights more easily.*”

4 THE CONVERSION PROCESS

GMP conversion will be optional, but the Government’s intention is that it should be accessible for all schemes. Therefore, even schemes with restrictive amendment powers should be able to convert GMPs, as the Act permits scheme rules to be amended by resolution in order to facilitate this. (A specific exemption in the Act also means that trustees and employers opting for conversion will not risk being “sin binned” for breach of section 67 of the Pensions Act 1995.)

The Act sets out five conditions which need to be met before conversion takes place. If all five are met, trustees will benefit from a statutory discharge from their responsibility to provide GMPs. The Regulations supplement these conditions by setting out how the GMP element is to be converted, on an actuarially equivalent basis, into new scheme benefits. The Regulations also outline the circumstances in which a

² <http://www.dwp.gov.uk/consultations/2008/occ-pen-contracting-out-consultation-gov-res.pdf>

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survivor's benefit must be payable from the converted benefits.

Post-conversion, GMPs will no longer exist (having become scheme benefits), and therefore the current legislation governing the revaluation and protection of increases on GMPs will no longer apply. Instead, the current rules governing DB schemes will be relevant.

5 ACTUARIAL EQUIVALENCE CONDITION

Condition 1 under the Act requires that post-conversion benefits “*must be actuarially at least equivalent to the pre-conversion benefits*”. Trustees will be responsible for determining actuarial equivalence and will have to:

- obtain and consider advice from the scheme actuary as to what assumptions are appropriate;
- decide what assumptions are appropriate; and
- arrange for the actuary to calculate the actuarial value of the pre- and post-conversion benefits in accordance with the Regulations (and those assumptions), but ignoring certain benefits such as those which have been commuted or discretionary benefits.

The actuary must provide the trustees with a certificate of actuarial equivalence within three months of completing the calculations.

6 THE OTHER CONVERSION CONDITIONS

Condition 2: Ensures that any member who was entitled to payment of a pension immediately before the conversion date will not receive a lower pension post-conversion.

Condition 3: Prohibits the conversion of GMPs into money purchase benefits, because allowing the GMP to be converted on this basis would, according to the Government, “*remove an element*

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of protection which would be unacceptable to scheme members.” This clearly gives rise to difficulties for defined contribution schemes with GMP underpins.

Condition 4: Requires the same survivors’ benefits to be attached to the post-conversion benefits as were attached to the GMP. (Broadly, half of all GMP rights must be used to provide a survivor’s pension for a widow, widower or surviving civil partner.)

Condition 5: This comprises a number of procedural requirements. For example, trustees will have to take “*all reasonable steps*” to consult affected members before tackling a conversion (unless the scheme is winding-up). While “reasonable steps” are not defined, the Government’s consultation response on the Regulations gives one illustration, suggesting that “*a reasonable step could ... in the case of deferred members, be to write to the last known address in order to satisfy this requirement.*”

In addition, the employer’s consent to conversion must be obtained beforehand and, post-conversion, trustees are required to notify HM Revenue & Customs (the National Insurance Contributions Office).

7 THE CONVERSION REFEREE

The Pensions Regulator (TPR) is responsible for ensuring fair play, with powers to require trustees to take steps to comply with the five conditions, or even to unpick a conversion which does not meet them. There is no cut-off point by which TPR must exercise this power, which may lead to some uncertainty. However, in its response to the consultation, the Government states that “*in cases of serious conversion disputes or fraudulent activity ultimately only the courts can decide the outcome*”.

That said, TPR has “*no plans to monitor conversions or oversee the process or outcomes*”. Being a risk-based regulator, it will only consider using its powers in “very extreme” circumstances.

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8 EQUALISATION OBSTRUCTION?

Schemes are required to ensure that men and women are provided with equal benefits in respect of service from 17 May 1990³. The method of calculating GMPs is different for men and women as GMPs are based on unequal state pension ages.

In the consultation response, the Government states that schemes *“should already have equalised their benefits, taking account of the GMP rules, where necessary”*. Furthermore, *“it will be for trustees and the employer (with advice from the scheme actuary) to decide what benefits should be offered to replace the GMP benefits”*.

To date, few schemes have attempted to equalise GMPs, principally because of a lack of consensus about if (and how) this should be achieved. It is to be hoped that the lack of current guidance on how to deal with the equalisation of GMPs as part of any conversion process does not have the knock-on effect of kicking GMP conversion permanently into touch.

³ The date of the judgment of the European Court of Justice in the case of *Barber v Guardian Royal Exchange* which required schemes to equalise benefits