Sackers

The High Court decides – how to solve a problem like GMP equalisation

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Introduction

The High Court handed down its highly anticipated decision in Lloyds Banking Group Pensions Trustees Ltd v Lloyds Bank plc and others on 26 October 2018, concluding that benefits do need to be equalised for the effect of GMPs.

Key points

- The case involved subsidiaries of the Lloyds Banking Group plc ("the Banks"), the trustee ("the Trustee") of the "Lloyds No.1 Scheme", the "Lloyds No.2 Scheme" and the "HBOS Scheme" ("the Schemes"), representative members and trade unions.
- Mr Justice Morgan found that the Trustee "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 conclusion, the judge took account of the "principle of minimum interference" set out in previous pensions equalisation cases.
- Given its past consultations on equalising for the effect of GMPs, the DWP was also joined as an interested party, as was HM Treasury.

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 male against a female and 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. As a result, the DWP set up a working group in 2013 to consider other possibilities.
- **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 under the legislative facility for converting GMPs. However, the DWP made clear that trustees would not be obliged to use this method, as it did not consider providing a "safe harbour" method for achieving equalisation would be appropriate.
- **2018** – whilst further work to make the 2016 method a reality has been undertaken, unsurprisingly the Government reserved its position pending the outcome of the Lloyds case.

The proposed methods for equalising

Four main methods for equalising for the effect of GMPs were considered in the case, together with a few variations on each theme. In summary, the key methods were as follows:

- **Method A** – "takes each aspect of the pension calculation separately and adjusts to remove any inequality on an aspect-by-aspect approach", on an annual basis. As a variation on this, **Method A3** would recognise any equalising increase as a non-GMP excess benefit, attracting increases under the scheme rules on this basis (as opposed to on a GMP basis) in subsequent years.
- **Method B** – rather like the Government's 2012 method, this would involve a year on year calculation of and comparison between the member's actual benefits and what he/she would have received if they were of the opposite sex. The greater of the two calculations would then form the basis of the payment to the member. Unlike **Method A**, this is not an element by element approach but involves a single calculation on the male and female basis.

- **Method C1** – uses the same initial calculation as **Method B** but is designed, in effect, to equalise cumulative pension paid (not pension paid each year) so as to avoid overcompensating members. So, if the annual benefit comparison reveals that the previously advantaged sex has now become the disadvantaged one (ie the two sexes have traded places), instead of applying an automatic increase to the now disadvantaged sex, the lower of the two calculations is paid "until such time as the accumulated excess prior to the switch equals the accumulated loss after the switch".

  As a variation on the above, **Method C2** (which was ultimately favoured by the judge) uses the same calculation except that interest is allowed for "when comparing accumulated gains and losses in the case of a switch in calculation from one sex to the other".

- **Method D1** – this would involve a one-off actuarial calculation of the future rights to benefits of male and female comparators, with any difference paid to the disadvantaged members as additional pension. As a variation on this, **Method D2** would involve using the GMP conversion legislation and providing "a pension which converts GMP structures into an alternative format (for example in line with non-GMP benefits) and is of equal actuarial value to the larger of the compared values". This method is akin to the Government's 2016 proposals, although the judgment notes that there may be differences in detail.

  (It was also noted that versions of **Method D** have been used when schemes have been buying out benefits with an insurer although, in those circumstances, "the commercial imperative to achieve risk transfer in the buy-out will outweigh the risks of the equalisation approach subsequently being deemed inadequate".)

The judge's main conclusions

- Mr Justice Morgan found that the Trustee "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". This duty only applies to GMPs accrued post-*Barber*.

- In reaching this conclusion, the judge took account of the "principle of minimum interference" set out in previous pensions equalisation cases, most notably the Court of Appeal's 2009 decision in Foster Wheeler v Hanley. Where possible, this principle requires the Court to give effect to *Barber* rights by considering "in relation to any particular option whether the obligation to provide equal benefits can be complied with in some other way involving less interference with the rights of any party". This led the judge to disregard some of the proposed methods for equalising, such as **Method A** (from the Banks' perspective) and **Method D1** (from the beneficiaries').

- However, **Methods B, C1** and **C2** all provide for equivalence in relation to benefits, but the Banks can require the Trustee to adopt **Method C2** "by relying on the principle of minimum interference". The rate of interest to be used for **Method C2** should be 1% over base rate simple interest.

- Perhaps to the great relief of many, the judge also noted that, although not currently available as the Banks have not given their consent as required by legislation, in principle **Method D2** (involving GMP conversion) "is a lawful method to which [they] could consent". The judge also concluded that the use of the GMP conversion legislation would enable the conversion of survivors' benefits in payment, an issue over which some doubt had been expressed in the case.

Limitations on claiming backdated benefits?

When considering arrears of pension, the judge concluded that the position is governed by the scheme rules. Under the Schemes, this generally means that a beneficiary will only be entitled to claim arrears of payments for the period of six years before his/her claim. Such arrears "should bear simple interest at 1% over base rate".

However, by virtue of section 21(1)(b) of the Limitation Act 1980, no limitation period applies to beneficiaries seeking to recover such arrears.

Some issues left unanswered

Having concluded that the obligations in relation to GMP equalisation apply to benefits accrued in other schemes post-*Barber* which have been transferred in to the Schemes, the judge stopped short of reaching any conclusions about the position on transfers out. In doing so, he stated that "it might be undesirable to deal with the arguments at a high level of generality and without regard to specific facts".

Another issue left unanswered was whether a different equalisation method should be adopted for members for whom "the estimated cost of calculating and implementing Methods A to D is the same as or greater than the projected additional benefits" to which they would then be entitled.

The position of DC benefits with GMP underpin benefits also remains uncertain as, under legislation, it is not possible to convert a GMP into DC benefits.

Next steps

With no announcement yet from the Government in response to the case, it remains to be seen whether it will press ahead with planned changes to the GMP conversion legislation and possible variations to its proposed methods more generally.

Clearly, the issue of GMP equalisation has been hanging over schemes for some decades, so the first key message is not to panic. Over the coming months, schemes should start discussions with their advisers about possible next steps, including any allowances to make in upcoming valuations and what to do about transfers out in the immediate future.

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

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