Sackers

GMP Equalisation Working Group publishes methodology guidance

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Introduction

Following the publication of a "Call to Action" back in July, the cross industry GMP Equalisation Working Group ("the Group") has published guidance ("the Guidance") outlining methods that schemes could use to equalise for the effect of GMPs. The Guidance follows on from the High Court's decision in the *Lloyds* case back in October last year.

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 (on 6 April 1997).
- Launched by the Pensions Administration Standards Association ("PASA"), the Group's aim is to help schemes equalise for the effect of GMPs in a "cost effective, proportionate and pragmatic way".
- Accompanied by worked examples, the Guidance is divided into three main sections (see below).
- The Group intends to update its Guidance to reflect future developments, such as the outcome of the next instalment of the *Lloyds* case on transfers out (scheduled for April / May 2020) and guidance from HMRC on pensions tax.

Background

On 26 October 2018, the High Court held that schemes are under a duty to equalise for the effect of GMPs. Whilst the judgment helpfully approved certain methods for achieving equalisation, some key questions were left unanswered.

Recognising that outstanding questions may never be subject to judicial scrutiny (given the cost and complexity of going to court), the Guidance suggests possible approaches to common unanswered issues.

Section A – Correcting past underpayments

When addressing past underpayments, the focus is on members and survivors whose benefits are already in payment. The Guidance looks at a number of issues concerning correcting underpayments, including the following:

The comparator

One of the issues left unanswered by *Lloyds* was whether equal treatment legislation requires a claimant to be able to point to an actual opposite sex comparator. Acknowledging the difficulty in finding an actual opposite sex comparator (where arguably it would involve finding someone with the same date of birth, identical earnings history, and date of joining and leaving the scheme), the Guidance advocates the use of a hypothetical one.

The Guidance suggests that trustees should take legal advice in “the rare case of a scheme which has only ever had members of one sex”. However, based on European cases, the DWP’s view seems to be that there is no need for an actual comparator when it comes to equalising for the effect of GMPs.

Year by year approach

All schemes undertaking an equalisation exercise will need to review past payments and, where necessary, correct underpayments. The review of past payments requires a “year by year approach” to be adopted in respect of the crucial GMP equalisation period, ie **on and from 17 May 1990 up to and including 5 April 1997**.

In the *Lloyds* case, the High Court approved three “year by year” methods for achieving equalisation, known as **Methods B**, **C1** and **C2** (see our summary of the methods). Schemes will need to decide which year by year method to use to correct past underpayments, with the Guidance listing relevant factors such as the impact on scheme liabilities, the number of members affected, administration costs, and the ease of member communication.

De minimis

Also picked up in the Guidance (and left unanswered by *Lloyds*) is whether schemes can “choose not to make any adjustment to a member's benefit if it is considered the adjustment is below an agreed tolerance level”?

The Guidance steers schemes away from adopting de minimis tolerance levels where a benefit is currently in payment. This is because there is unlikely to be any significant cost saving for schemes and, in determining whether a member is disadvantaged (and therefore within the tolerance level), most of the administrative work will have been done. In addition, having calculated any adjustment, for most schemes putting the corrected benefit into payment could simply form part of the next annual pension increase exercise (with a one-off lump sum for the past).

Where schemes wish to consider applying de minimis levels, the Guidance makes clear that the parties should take advice.

No Further Liability cases

So-called "No Further Liability" cases are possible instances where, "in conjunction with the employer", trustees "may decide not to incur costs in trying to review and if necessary correct" past payments. Examples include where benefits have been extinguished by way of trivial commutation or where a member (or his / her survivor) has died with no further benefits payable. Possible obstacles which might arise in such cases include a lack of relevant data, the fact that "it may prove impossible or disproportionately expensive to trace the member" (or his/her next of kin) to pay what may be a relatively small sum, or there may be tax complications in paying corrections.

Deciding not to pursue No Further Liability cases will not extinguish the scheme's liability to equalise for the effect of GMPs. Therefore, where trustees decide to go down this route, the Guidance suggests sending a communication to the member's (or next of kin's) last known address. On a scheme wind-up, it might also be sensible to see if the trustees can insure this risk.

Past transfers out

Whether or not schemes need to revisit past transfers will be the subject of a further hearing in the *Lloyds* case, which is currently earmarked for spring next year. Unsurprisingly, therefore, the Guidance acknowledges that schemes may want to wait "until the legal position is clearer". However, as former members who have transferred out are "a discrete class", this should not prevent or delay an equalisation exercise being implemented for remaining members.

Limitation periods and Forfeiture rules

When considering arrears of pension, the judge in *Lloyds* concluded that the position is governed by the scheme rules. Under the majority of the schemes in question, this generally meant that a beneficiary could only claim arrears of payments in respect of the previous six years. However, by virtue of section 21(1)(b) of the Limitation Act 1980, no limitation period applies to beneficiaries seeking to recover such arrears.

As the specific drafting of scheme rules will dictate the extent to which arrears of pensions have to be paid, the Guidance refers to the need for legal advice here.

Section B – Approaches for equalising future benefit

The two main methods approved by the High Court for equalising future benefits are the year by year approach, and the legislative facility for converting GMPs into ordinary scheme benefits on an actuarially equivalent basis. The latter is known as "**Method D2**" and was the subject of DWP guidance published earlier this year (see our Alert).

Whilst avoiding repeating the DWP's guidance, amongst other things, the Guidance:

- looks at using different approaches for different categories of member, for example, by equalising deferred members' benefits through a conversion exercise whilst operating a year by year approach for existing pensioners. If this is being considered by trustees, the Guidance recommends that legal advice be sought on any potential discrimination issues
- discusses the logistics of carrying out conversion on an individual "at retirement basis" for actives and deferreds
- suggests that trustees might want to approach GMP conversion "from the starting point of minimal interference" to the shape of future benefits, with the possibility of further reshaping where this in the interests of the membership as a whole

- emphasises the need to consult and communicate with members on proposals to reshape benefits
- recognises the difficulties in obtaining the consent of “employers” to conversion (as required by legislation), given that GMPs ceased accruing over 20 years ago. As the DWP’s rationale for employer's consent was most likely driven by the impact of conversion on scheme liabilities, the Guidance pragmatically suggests seeking consent from the “employers responsible for funding the scheme under legislation”. However, it also notes that schemes may wish to take legal advice on this point.

Section C – Common unanswered issues

Individual transfers

Both the parties and the judge in *Lloyds* accepted that, on an individual transfer, the obligation for eliminating any discrimination in the transfer value falls on the receiving scheme. Next year’s *Lloyds* hearing will focus on transfers out, and whether the transferring scheme adequately discharged its obligations. However, when issued, it is possible that the judgment may touch upon transfers in and so the analysis currently set out in the Guidance may change.

One of the main difficulties when considering transfers in is having relevant information to hand. As the obligation on a receiving scheme to adjust benefits only arises where it can be shown the original transfer value was inadequate, and a receiving scheme will not generally be in a position to determine this, the Guidance places the onus on the member to try to establish this with his/her former scheme. As this may prove fruitless (eg because the former scheme no longer exists), this could give rise to a “stalemate” in which the receiving scheme cannot be sure whether it needs to adjust benefits.

In anticipation of next year’s hearing, the Guidance recommends some preparatory steps, including identifying affected members, checking the status of former schemes from which historic transfers have been received, and locating documents relating to the transfer to ascertain whether a discharge and/or indemnity was granted to the former scheme by either the member and/or the receiving scheme.

Bulk transfers

On a bulk transfer, the receiving scheme would normally grant benefits to members by reference to their accrued rights (or the value of them) in the former scheme. The Guidance therefore suggests that “a receiving scheme is likely to have an obligation to correct past GMP inequalities”. However, as the background underlying the bulk transfer could be a commercial transaction or a scheme merger, schemes might consider reviewing any legal agreements entered into at the time for possible indemnities.

Depending on the quality of the data shared at the time of the bulk transfer, the receiving scheme may well be able to calculate any GMP equalisation adjustment. Where this is not possible, the Guidance suggests taking actuarial advice on adjusting benefits using an estimate.

DC benefits with GMP underpins

DC schemes with a GMP underpin also need to consider the requirement to equalise and so the Guidance looks at a whole range of issues, including how to secure benefits, which part of the DC fund to consider when applying the underpin, and the position on transfers.

One important point to bear in mind is that the conversion legislation prevents GMPs being converted into DC benefits. For DC schemes wishing to use this route, this means that the GMP would have to be replaced by a DB underpin.

What is next in 2019?

Further guidance covering data, impacted transactions and tax is expected to be published by the Group "in the coming months", as well as guidance on reconciliation and rectification. Quite separately, HMRC's guidance on pensions tax issues is expected any time soon. So, whilst the pieces of the GMP equalisation jigsaw are beginning to fall into place, we do not yet have the full picture.

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

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