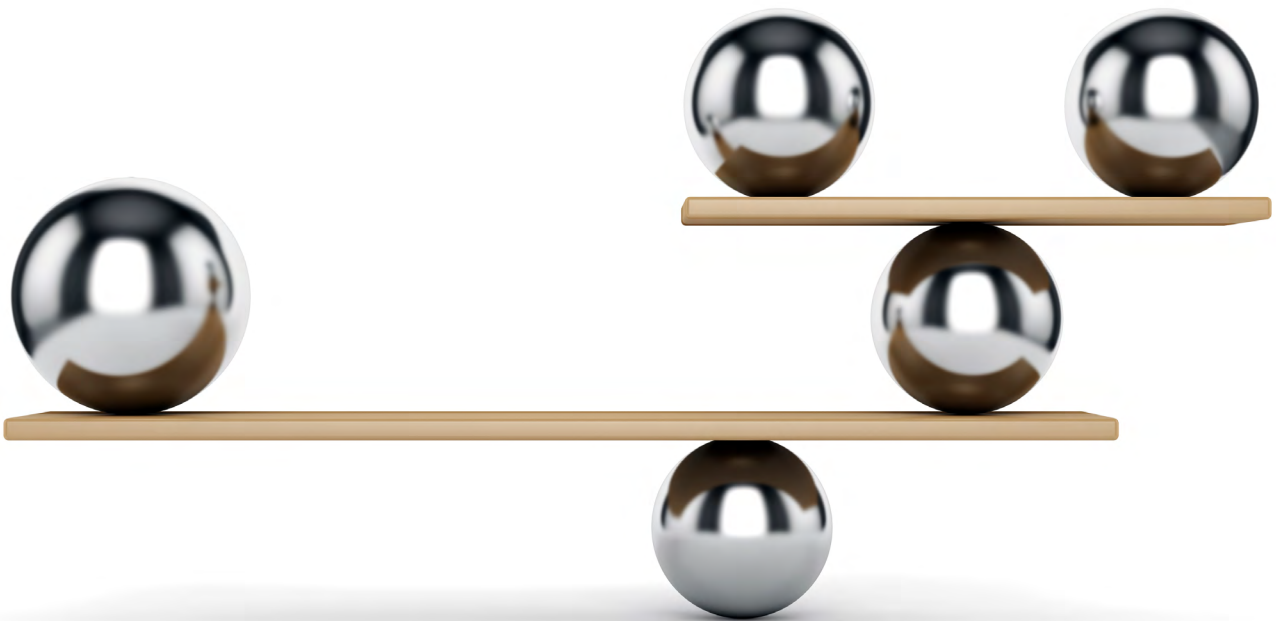


## GMP equalisation

The conversion process – the questions trustees need to ask

April 2022



# Introduction

Back in 2018, Mr Justice Morgan held in *Lloyds No.1* that schemes are under a duty to equalise for the effect of GMPs. Two years later, with Mr Justice Morgan once again at the helm, the High Court concluded in *Lloyds No.3* that, in certain cases, trustees owe a duty to make a transfer payment reflecting the member's right to equalised benefits.

One of the key takeaways from *Lloyds No.1* is that there were several ways in which equalisation can be achieved, one of which is by using the statutory facility to convert GMPs into ordinary DB benefits. This checklist, the third and final in a short series, focuses on the key questions to be addressed where the trustees and employer have chosen to adopt this route, or are considering doing so.

For a working copy of this document, please get in touch with your usual Sackers contact. For more information on what is unequal about GMPs, and the journey from *Barber* to *Lloyds*, please see our [website](#).

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### Other checklists in this series

For our first checklist in the series, see [GMP equalisation – essential planning – the questions trustees need to ask](#) (“Checklist 1”). For our second checklist, see [Correcting the past – the questions trustees need to ask](#) (“Checklist 2”).

### Notes

- References to “GMP equalisation” are to the need to equalise overall benefits for the effect of GMPs.
- Key questions and actions are denoted by “**Q**” and “**A**” respectively.

# GMP conversion – an overview

## Summary

Introduced on 6 April 2009, “conversion” is a legislative facility which allows schemes to be amended to convert GMPs into ordinary DB scheme benefits, following which the GMP rules cease to apply. As a result, schemes no longer need to separately track and monitor GMPs, which may both simplify administration and help make it easier for members to understand their benefits.

Whilst the trustees are usually in the GMP conversion driving seat, and this checklist assumes they are, strictly speaking it is the parties “responsible under the scheme for effecting amendments” who are in charge under the legislation. Depending on the scheme’s rules, this means that the principal employer might technically be responsible for conversion, although an employer in this position may wish to involve the trustees.

### What conditions apply?

The trade-off for allowing a scheme to remove the obligation to provide GMPs for members and their survivors is that certain statutory conditions must be met, some of which can prove problematic in practice. As currently drafted, the conditions include:

- **Condition 1** – post-conversion benefits must be actuarially at least equivalent to pre-conversion benefits. A certificate of actuarial equivalence, using assumptions set by the trustees on advice, must be obtained from the scheme actuary (see pages 5 and 7)
- **Condition 2** – pensions in payment cannot be reduced
- **Condition 3** – converted benefits must be DB, which may be a concern for DC schemes with a GMP underpin
- **Condition 4** – a minimum survivor’s benefit of “at least half the value of the pension to which the earner would have been entitled” must be provided post-conversion, as opposed to 50% of GMP pre-conversion. Subject to a scheme’s rules, this restricts the possibility of diverting pension where there is a financial dependant as well as a legal spouse / civil partner, or of withholding a pension on a so-called “deathbed marriage”
- **Condition 5** (not schemes in wind-up) – certain procedural requirements must also be met including:
  - employer consent in advance – the legislation’s drafting implies the consent required is that of employers of earners in pensionable service at the time GMPs built up. Given the impact of conversion on a scheme’s funding, PASA’s methodology guidance sensibly suggests that the consent of current “statutory employers” be sought. There is also no express power, as there is elsewhere in pensions legislation, for a principal employer to consent on behalf of all participants in a multi-employer scheme
  - HMRC must be notified – whilst HMRC has stated that it no longer requires this condition be met, as it remains a legal requirement, the PASA conversion guidance recommends that schemes continue to notify
  - some members must be consulted in advance and certain beneficiaries notified about the conversion (see page 6).

A [Private Member’s Bill](#), which has Government support, is currently making its way through Parliament. It proposes removing the requirement to notify HMRC, expands consultation requirements to survivors in certain circumstances, and lays the groundwork for other changes to be set out in regulations. These include clarifying the parties whose consent is needed for conversion and the survivors’ benefits payable post-conversion.

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## Key Questions & Actions

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- Q** Have the trustees sought legal advice on the party responsible for conversion under the legislation?

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  - Q** If someone other than the trustees is responsible, has power been delegated to the trustees to lead the exercise?

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  - Q** Have the trustees been advised that GMP conversion would be appropriate for the scheme?

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  - Q** Have the trustees received legal advice as to which employer(s) must consent to the conversion and have the trustees sought their agreement before pressing ahead with such an exercise?

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  - Q** Where the principal employer is proposing to consent on behalf of all employers in a multi-employer scheme, has legal advice been sought on this approach?

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  - A** Trustees should undertake appropriate training before embarking on a GMP conversion exercise
-

# Planning the project

## Summary

Following *Lloyds No.1*, the DWP published detailed guidance in April 2019 outlining a 10-stage process for using the conversion legislation to address GMP equalisation. Taking account of that guidance, the typical steps involved in a GMP conversion exercise are set out below.



### Step 1 – reach agreement with the employer

As the legislation requires employer consent to GMP conversion in advance, trustees should engage with them at an early stage. As well as seeking agreement to the conversion exercise itself, trustees should also take soundings on the various options available and likely timings (see page 7), particularly if extra costs may be involved.



### Step 2 – which members?

Conversion can be undertaken in stages, eg by starting with pensioners first (see page 7). The duty to equalise for the effect of GMPs only applies in respect of GMPs built up 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 (“the equalisation period”). In contrast, the whole of a selected member’s GMP must be converted, not just the part affected by the requirement to equalise. As it was possible to build up GMPs in a contracted-out scheme from 6 April 1978 onwards, conversion can therefore apply to members whose GMPs built up entirely before the *Barber* judgment and which the trustees are not required to equalise.



### Step 3 – set the conversion date

This is when conversion takes effect and is the date around which everything else pivots, so trustees should liaise with their advisers, especially scheme administrators, and relevant employers to find a suitable landing slot.



### Step 4 – consult members

Trustees must take “all reasonable steps” to consult affected members before tackling a conversion (see page 6).



### Stage 5 – value the benefits

According to the DWP’s guidance, this involves carrying out two calculations in respect of each affected member’s pre-1997 benefits, with one of the calculations based on the opposite sex GMP entitlement during the equalisation period. Although the legislation does not specify any particular assumptions here, the DWP’s guidance notes that “it would often be reasonable to use the assumptions used in CETVs as a starting point”.



### Stage 6 – equalise the benefits

Equalisation is achieved “as part and parcel of conversion by using a conversion value for each selected member which is the higher of” the two amounts calculated under stage 5. Although one of the Court approved methods (see page 5 of Checklist 1), GMP conversion can only be used to equalise for the future. As such, another method is needed to make good past arrears, subject to any limitation provisions in a scheme’s rules (see page 10 of Checklist 2).



### Stage 7 – convert the benefits

This involves turning the conversion value into a revised DB benefit (see page 7 for some of the options here).



### Stage 8 – certify the calculations

The scheme actuary will need to certify actuarial equivalence. The certificate, which should cover all members whose benefits are being converted, must be sent to the trustees no later than three months after the calculations have been completed.



### Stage 9 – amend the scheme

Helpfully, the legislation provides a mechanism for trustees to make changes to their scheme rules by resolution to allow GMP conversion. This resolution can include other amendments the trustees think “necessary or desirable as a consequence of, or to facilitate” GMP conversion. In addition, section 67 of the Pensions Act 1995, which protects benefits already built up, will not apply where schemes are amended to enable GMP conversion.



### Stage 10 – notify beneficiaries / HMRC

Trustees must take “all reasonable steps” to inform affected members and survivors about the impact of conversion on their benefits either in advance or as soon as reasonably practicable after the conversion date (see page 6).

Whilst it no longer wishes to be contacted, schemes should carry on notifying HMRC until such time as the legislation is amended (see page 3).

## Key Questions & Actions

- Q** Are there other projects in progress or in the pipeline which could impact timing and/or which must be completed before conversion can begin? For example, a membership data cleanse or a risk transfer exercise?
- Q** Is there a project plan in place and has the exercise been thoroughly costed?
- Q** Do the trustees have appropriate and sufficient resources at the ready?
- Q** Are professional advisers on board and working together to implement the project plan, and to identify and address issues as they arise?
- Q** Do the scheme administrators hold sufficient and accurate data? If not, has advice been sought on options for plugging the gaps?
- Q** Do trustees have all the information they need to make key decisions?
- Q** Have the trustees recorded the factors they considered when deciding to implement GMP conversion (which will help when designing consultation communications)?
- A** Obtain advice on the most suitable options for equalisation
- A** Consider setting up a working party with an appropriate governance framework, including establishing terms of reference, the extent of its decision making power, and the degree of oversight by and reporting back to the trustees
- A** Agree a realistic project plan

# Consulting and notifying beneficiaries

## Summary

As well as obtaining prior employer consent to GMP conversion, trustees must take all reasonable steps to:

- consult “the earner” in advance
- notify all members, and survivors with an immediate entitlement to benefits, whose benefits have or will be converted either before, or as soon as is reasonably practicable after, the conversion date.

The DWP’s guidance makes clear that trustees should take the usual steps to contact a member they would take when providing information under the Disclosure Regulations.<sup>1</sup> In other words, it is reasonable to send communications to a member’s last known address.

### Who to consult?

“Earner(s)” are scheme members who built up GMPs through their employment. This means those in receipt of survivor benefits are currently excluded from the consultation requirement. However, as highlighted on page 3, a Private Member’s Bill is set to expand consultation requirements to survivors in certain circumstances. Schemes looking to convert GMPs at a future date should therefore take advice on how to structure consultation and on the possible implications of the current Bill.

### How to consult?

This is a standalone consultation obligation which is not governed by the usual 60-day consultation requirements which apply when a **listed change** is made. Trustees should therefore seek legal input on the minimum requirements, including appropriate timeframes. The DWP guidance also offers some suggestions for “high level” content here.

Pensions case law makes clear that consultation “involves more than the mere giving of notice”.<sup>2</sup> In this context, therefore, simply notifying members that their GMPs will be converted would not constitute consultation. They must genuinely be invited to express their views and trustees must consider their feedback before deciding whether, and if so how, to proceed.

### Post conversion notifications

Again, although the legislation does not go into detail, the DWP guidance sets out various points this notification should cover. For example, it should make clear the date on which benefits have been (or will be) converted, the date on which any benefits in payment will change or have changed, as well as informing members and survivors what this means in terms of the amount and shape of their benefits going forward.

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## Key Questions & Actions

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- Q** Do the trustees have the necessary contact information to consult and/or notify the relevant individuals?
  - Q** If not, have they discussed with their advisers what steps should be taken to trace them?
  - Q** Have the trustees sought legal advice on the minimum information to include in the consultation and the most appropriate timeframes to allow?
  - Q** Have they also discussed with their advisers the information to include to fulfil the notification requirements?
  - A** Trustees should take advice on fulfilling their consultation and notification obligations
- 

<sup>1</sup> The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734)

<sup>2</sup> *Pitmans Trustees v The Telecommunications Group* [2004] 32 PBLR

# Conversion options and key decisions

## Summary

Conversion can either be implemented as a once and for all exercise for all affected members (including survivors), for tranches of members, or at the point any affected member chooses to draw their benefits. Which members are in scope will largely depend on the goal of the exercise, ie is it solely to equalise for the effect of GMPs or, for example, would the trustees also like to simplify the scheme's overall benefit structure?

### Post-conversion benefits

As explained on page 4, the whole of a selected member's GMP must be converted, as it is not possible to dissect the GMP and convert only the part referable to the equalisation period.

Subject to complying with the statutory conditions (see page 3), post-conversion options can range:

- from replicating the GMP, but without its complications, eg by removing the restrictions relating to early retirement, lump sums, and anti-franking
- to replacing the GMP with its guaranteed increases in payment by an initially larger flat-rate pension.

Where a scheme is amended to effect GMP conversion, trustees may "include other amendments which they think are necessary or desirable as a consequence of, or to facilitate, the GMP conversion". This means trustees may be able to reshape benefits other than the GMP, but they should take advice to ensure any remodelling is within the scope of the legislation and to determine whether member consent should be obtained and/or options provided.

### Timing

The trustees and the employer must agree a date for the conversion to take effect. This can be a future date, eg for non-pensioners it could take place at retirement. It will also be important that the scheme actuary and administrators agree at an early stage how the process will work in practice.

As mentioned on page 5, the scheme actuary needs to provide the trustees with a certificate of actuarial equivalence no later than three months after relevant calculations have been completed. This process works well for a one-off bulk conversion exercise, eg conversion of all pensions in payment. However, it can pose practical challenges where an individual conversion process is envisaged, eg where active or deferred members' GMPs are only converted at retirement, requiring rolling actuarial certification at least every three months covering relevant retirees.

Although changes can be made to the actuarial equivalence process by regulations, we are unaware of any proposals currently on the cards which might help make at-retirement conversions easier.

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## Key Questions & Actions

- 
- Q** Have the trustees taken actuarial and legal advice about whose benefits to convert, as well as the shape and cost implications of post-conversion benefits?
- 
- Q** Is the degree of post-conversion remodelling of benefits being contemplated within scope of the power to make changes under the legislation?
- 
- Q** If not, has legal advice been sought on how the change may legally be made?
- 
- Q** Has the proposed "conversion date" been discussed with relevant advisers and employers?
- 
- Q** If offering at-retirement conversion, is the scheme actuary primed to carry out necessary calculations and certification, and has the process been agreed between all relevant parties and properly documented?
- 
- Q** Have the trustees discussed with their advisers when and what to communicate to members?
- 
- A** Trustees should liaise with relevant advisers and employers on all of the above
-

# Pensions tax

## Summary

GMP conversion raises a number of issues in relation to both the AA and LTA. In general, these are of greater concern to members who left service on or after 6 April 2006 (A-Day). The main pensions tax considerations are addressed below, although thinking in this area continues to develop.

Published recently, HMRC tax guidance No.3 deals with some of the tax issues arising on GMP conversion. For the purposes of the guidance, HMRC assumes that “post conversion benefits have the same or virtually the same actuarial value as the pre conversion benefits”, so changes going further than this will need to be considered carefully.

Quite separately, PASA’s conversion guidance offers commentary on the potential pitfalls of GMP conversion. While generally recommending that trustees obtain specialist advice, PASA also suggests seeking non-statutory clearance from HMRC where the tax implications of any particular aspects of the exercise are unclear.

## AA

The AA limits the amount of pension savings that can be built up in each tax year across all registered pension schemes without triggering a tax charge. GMP equalisation will not generally constitute new benefits requiring a test against the AA (see page 9 of Checklist 2). But GMP conversion could trigger a test against the AA:

- **pre-A-Day deferred members** – who have not built up benefits since that date under a particular arrangement are not subject to the AA regime. HMRC has confirmed that this will remain the case provided an individual’s post-conversion benefits are actuarially equivalent to their pre-conversion benefits
- post A-Day members covered by the “**deferred member carve-out**” – ie where a member has been deferred throughout the AA testing period, or is deferred and then becomes a pensioner, provided benefits do not increase above an inflationary amount, they are treated as having nothing to test against the AA. HMRC tax guidance No.3 notes that the removal of the GMP rules may cause the loss of the deferred member carve-out, resulting in an amount to test against the AA for the tax year, as well as subsequent tax years. As a consequence, HMRC is undertaking “further work in this area to determine the appropriate outcome and treatment, and the potential for any legislative change”.

## LTA and tax protections

The LTA limits the amount of tax relieved pension savings that an individual can build up across all registered pension schemes over their lifetime without incurring a tax charge. When it was first introduced, as well as each time it has been subsequently reduced, protections have enabled individuals to continue benefiting from a higher LTA subject to certain conditions being met. Benefit adjustments made solely for GMP equalisation should not prejudice LTA protections (see page 9 of Checklist 2). But where such adjustments go beyond equalisation there could be a new entitlement for tax purposes, possibly triggering the loss of eg **fixed protection**.

Conversion could also result in new benefits being built up, not least because the whole of a member’s GMP needs to be converted not just the part subject to equalisation (see page 4). PASA’s conversion guidance illustrates ways in which schemes have sought to address this. For example, by using a “constrained” form of GMP conversion and/or providing member options, or even excluding from the conversion exercise members known to have certain protections.

Helpfully, HMRC has confirmed that conversion of a pensioner’s benefits any time after retirement would not trigger the loss of fixed protection, provided all benefits in the arrangement have been crystallised. However, conversion of a pensioner’s benefits resulting in an immediate jump in pension beyond a permitted margin could trigger a test against the LTA (and for **enhanced protection** purposes), known as a **benefit crystallisation event**.



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**Key Questions & Actions**

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- Q** Have the trustees identified members whose current AA position may be impacted by conversion?

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  - Q** Have the trustees identified whether any scheme members hold LTA protections which could be affected?

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  - Q** If members have relevant LTA protections, has detailed tax advice been taken in relation to the proposed conversion exercise?

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  - Q** Has an approach to HMRC for non-statutory clearance been considered?

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  - Q** Have the trustees considered offering special terms to those with LTA protections?

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  - A** Seek input from advisers on the tax implications of conversion and possible solutions
-

# Documenting the process

## Summary

Trustees should ensure that all discussions and decisions made during their GMP equalisation / conversion journeys are clearly recorded.

### Keeping records

Laying a paper trail can help when dealing with queries in the future, eg from members or when contemplating a risk transfer exercise. For details of some of the key decisions which trustees will need to make in relation to GMP equalisation, see page 10 of Checklist 1. Key GMP conversion decisions which should be appropriately recorded include:

- why conversion is being adopted by the scheme
- choosing which members to convert
- choosing the conversion terms, including the shape of post-conversion benefits
- selecting the date
- obtaining consent from the employer, including advice as to who the employers are in this context
- setting the assumptions to be used for checking actuarial equivalence
- determining what steps to take to trace and notify members whose contact details are not up-to-date
- deciding how to consult earners, including the timeframe for consultation and its contents
- considering how best to address pensions tax implications in respect of affected members.

### Scheme amendments

Changes made to accommodate GMP equalisation must be reflected clearly in scheme rules and may be made using the scheme's amendment power. Trustees also have power under legislation to make alterations by resolution where, for example, the trustees do not have power to make changes or could only do so "by a procedure that is likely to be unduly complex or protracted". This resolution power only allows changes to be made in respect of the equalisation period (see page 4), so it will not help if GMPs are being equalised from an earlier date (eg 6 April 1988).

GMP conversion also requires scheme rule amendments. The legislation:

- provides a free-standing power for trustees to modify the scheme rules by resolution to effect GMP conversion
- disapplies section 67 of the Pensions Act 1995 (protection of subsisting rights), which would otherwise prevent the scheme's usual amendment power being used to effect GMP conversion
- provides a power for trustees to "include other amendments which they think are necessary or desirable as a consequence of, or to facilitate, the GMP conversion" (see page 5).

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## Key Questions & Actions

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**Q** Have the trustees obtained legal advice where the possibility of operating conversion in a different way for different members is being considered?

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**Q** Are detailed records being kept of all key conversion discussions and decisions?

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**Q** Has legal advice been sought on options for recording GMP equalisation / conversion in the scheme rules?

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**A** Ensure ample time is allowed for making suitable changes to the scheme's governing documents in the project plan and seek legal advice on the drafting

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# Appendix – defined terms and links to relevant guidance

## DWP guidance

- [Guidance on the use of the GMP conversion legislation](#) dated April 2019 (see our [Alert](#))

## HMRC guidance

HMRC has issued the following GMP equalisation related tax guidance:

- [HMRC GMP equalisation tax newsletter – AA and LTA issues](#) dated February 2020 (“HMRC tax guidance No.1”, see our [Alert](#)) – focusing solely on “plain vanilla” GMP equalisation
- [HMRC GMP equalisation newsletter – past and future lump sums](#) dated July 2020 (“HMRC tax guidance No.2”) – again, focusing solely on GMP equalisation
- [HMRC GMP equalisation newsletter](#) dated April 2022 (“HMRC tax guidance No.3”, see our [Alert](#)), focusing on historical transfers and conversion.

## PASA guidance

A GMP equalisation working group chaired by PASA is producing guidance on various aspects of GMP equalisation. So far it has published the following:

- [Call to Action](#) dated July 2019
- [Methodology guidance](#) dated September 2019 (see our [Alert](#))
- [Reconciliation and rectification guidance: When to rectify?](#) dated March 2020
- [Data guidance](#) dated July 2020
- [Communications guidance](#) dated August 2020
- [Tax issues guidance](#) dated February 2021 – building on HMRC tax guidance No.1 and No.2 (see our [Alert](#))
- [GMP conversion guidance](#) dated July 2021 (see our [Alert](#))
- [Transfer payments guidance](#) dated August 2021 (see our [Alert](#))
- [Anti-franking guidance](#) dated September 2021 (see our [Alert](#)).

## Abbreviations

<b>AA:</b> annual allowance
<b>A-Day:</b> 6 April 2006
<b>CETV:</b> cash equivalent transfer value
<b>DB:</b> defined benefit
<b>DC:</b> defined contribution
<b>DWP:</b> Department for Work & Pensions
<b>GMP:</b> guaranteed minimum pension
<b>HMRC:</b> HM Revenue & Customs
<b>LTA:</b> lifetime allowance
<b>PASA:</b> the Pensions Administration Standards Association

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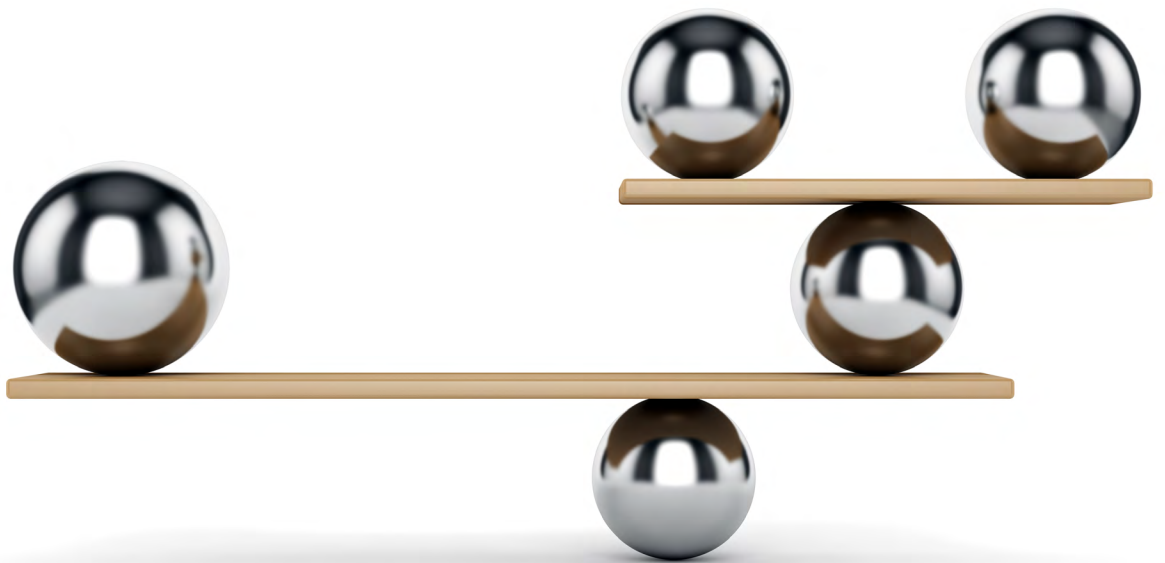
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