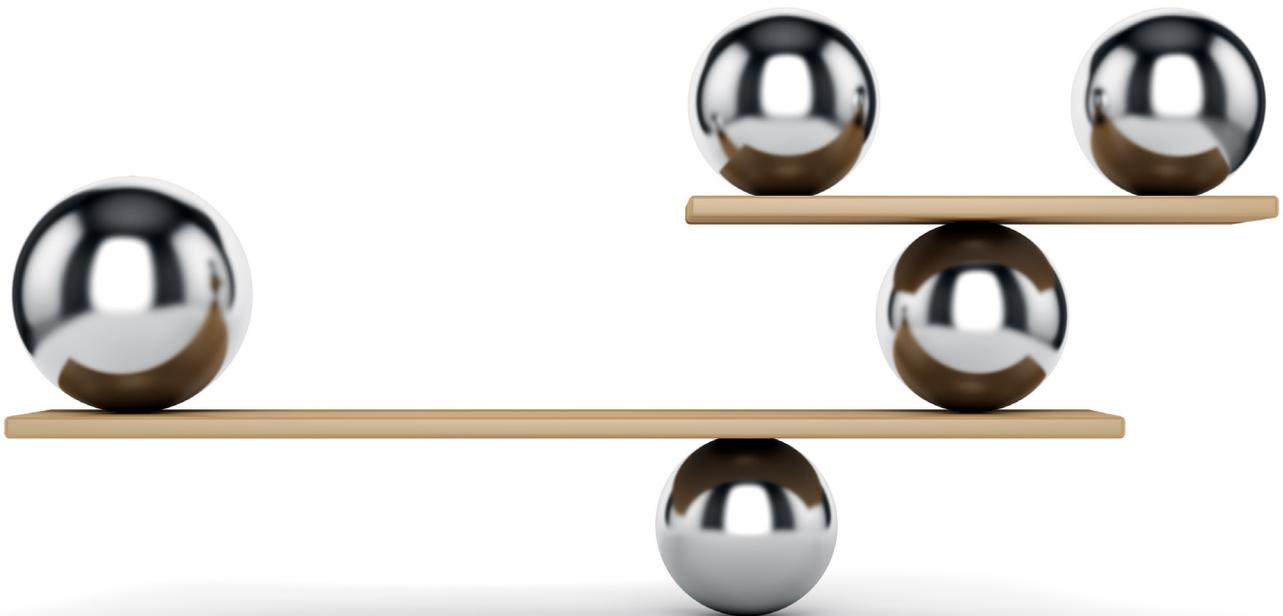


## GMP equalisation

Essential planning – the questions trustees need to ask

July 2021



# 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. More recently, 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.

Whilst the judgments to date have helped to clarify a number of issues, some essential questions remain unanswered. Industry guidance is aiming to bridge some of those gaps.

This checklist, the first in a short series, sets out key questions and actions that trustees of occupational pension schemes should be addressing to help navigate their GMP equalisation journey.

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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### Further checklists

Watch out for further checklists in the series, which will include tips on dealing with the past (eg transfers and pensions in payment), as well as GMP conversion.

### 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.

# Laying the groundwork

## Summary

Trustees will need to consider and seek advice on any number of issues during their GMP equalisation journey. It is important that trustees deal in the art of the possible, planning upfront so that they have a good grasp of the likely bumps in the road ahead. Bearing in mind the costs involved and the potential benefits payable, some judgement calls may be needed along the way.



### Do you understand the process?

Trustees need to understand, initially at a high level, how the GMP equalisation process works, as well as the potential challenges and how they could be overcome. This should include the necessary steps involved if GMP conversion is part of the project.



### Do you have the resources in place?

Appropriate resource will need to be on hand to carry out the GMP equalisation project. Steps should be taken to ensure this is in place. A working group of trustees and advisers, including scheme administrators, scheme actuary and lawyers, is one possibility.

A project plan will help keep everything on track and on time. This should set out clear roles, expectations and objectives. Getting advisers working together from the outset will help ensure that, as far as possible, issues are identified and dealt with promptly.



### Which members are affected?

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. In contrast, GMP conversion applies to all of a member's and their survivor's GMP. Bearing this in mind, trustees will need to work alongside their advisers to identify the members in scope for GMP equalisation.



### How does it fit with GMP reconciliation and rectification?

GMP reconciliation involves cross checking a scheme's records against those held by HMRC to ensure consistency. In ongoing schemes, reconciliation used to take place at retirement. Following the abolition of DB contracting-out, HMRC closed its doors to future reconciliation. Schemes were required to sign up to continue to use its service by 5 April 2016. GMP reconciliation can be a complex exercise, often taking years to complete.

Any GMP benefit errors identified should generally be rectified within a reasonable timeframe. As further adjustments to members' overall benefits may be needed as part of the GMP equalisation process, trustees might consider dovetailing the two exercises rather than adjusting benefits twice in relatively quick succession. Factors to weigh up include the number of members affected, the impact on them, how easy it will be to communicate, the costs involved, what's administratively workable, and the expected timescales for making adjustments. Trustees should ensure that any decisions made are clearly recorded.



### Is your data accurate?

Gaps in data, sometimes dating back as far as 30 years, could pose problems for many schemes. Equalising GMPs will involve collating and analysing a broad range of data, eg the member's name, date of birth, gender and national insurance details. Trustees will need to take advice on appropriate steps to ensure they have the necessary data. A full data cleanse may even be advisable.

Records should ideally pinpoint members' GMPs accrued from 17 May 1990 up to and including 5 April 1997, as well as GMPs referable to benefits transferred into the scheme. Trustees will need to check this with their scheme administrators.

Depending on the type of information missing and its significance, options for addressing data gaps include contacting past and present sponsoring employers and scheme administrators.

Members might also recall details of employment history, such as periods of part-time work. Where gaps remain, approximations and assumptions may be appropriate. Trustees should discuss with their advisers where to draw the line, ie where the extra costs of obtaining more accurate data outweighs the potential benefits.

Finally, trustees should bear in mind data protection implications when seeking personal data from individuals who are no longer scheme members.



**Have you identified a suitable landing slot?**

This will largely be dictated by the time needed to carry out the above tasks, as well as other projects which may be vying for airtime. Trustees should engage with all relevant advisers and their scheme administrators to assess what's realistic, including suppliers' capacity constraints, and how long the process might take.

Other projects potentially in the works should also be factored in, eg plans to buy out certain benefits or to consider other options for removing risk from the scheme in the near future.

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**Key Questions & Actions**

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- Q** Have all trustees had appropriate initial training on the GMP equalisation process?<sup>1</sup>

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  - Q** Has a project plan been drawn up and the project costed?

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  - Q** Do the trustees have appropriate and sufficient resources in place?

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  - Q** Are professional advisers on board and working together to identify and address issues as they arise?

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  - Q** Which members are in scope for GMP equalisation and is the scheme's reconciliation process complete?

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  - Q** Have the trustees received legal advice on whether to combine benefit adjustments arising from rectification and equalisation?

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  - Q** Does the scheme's administrator hold sufficient and accurate data?

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  - Q** If not, has advice been sought on options for plugging the gaps?

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  - Q** Do trustees have all the information they need to make key decisions?

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  - Q** What other projects or plans are in the works which could affect timing?

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  - A** Consider establishing a working party with suitable delegated authority and engage on a realistic project plan

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  - A** Take appropriate advice before making any decision to defer GMP rectification and on bridging data gaps
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<sup>1</sup> Where relevant, this should include training on the pros and cons of GMP conversion

# Choosing the method

## Summary

The key GMP equalisation calculation methods, together with relevant variations, considered in *Lloyds No.1* were as follows:

- **Method A** – equalising each element of the member’s benefits separately on an annual basis
- **Method B** – this compares the member’s overall benefits annually with what he/she would receive if they were of the opposite sex
- **Method C1** – using the same starting point as **Method B** but, in effect, equalising cumulative pension to avoid overcompensating members. This takes account of the fact that, because of the way in which GMPs built up and are increased, sometimes a woman will be better off and sometimes the man. **Method C2** involves the same calculation except applying simple interest of 1% over bank base rate “when comparing accumulated gains and losses in the case of a switch in calculation from one sex to the other”
- **Method D1** – 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
- **Method D2** – a variation of **Method D1** but using the statutory facility to convert GMPs into ordinary DB benefits.

### What did the Court decide?

When considering options for equalising pension benefits, the “principle of minimum interference” requires the Court to consider whether there are alternatives involving less interference with parties’ rights. Disregarding **Method A** (too expensive from the Banks’ perspective) and **Method D1** (unfavourable to the beneficiaries), the judge concluded that **Methods B, C1 and C2** are all acceptable. But sponsoring employers could require the trustees to adopt **Method C2**. Subject to agreement from sponsoring employers, **Method D2** is also a “lawful method”.

### Do trustees need to use the same method for all members?

Trustees might consider using different methods for different classes of member or for particular purposes. For example, using one method for trivial commutation and transfers out pending a decision being made on equalising GMPs for the remaining membership. Trustees should seek legal advice on their duties to members and ensure that their approach does not run the risk of unlawfully discriminating against a particular group, eg on the grounds of age or sex.

### What other factors should trustees consider?

It will be important to check which methods the scheme administrators’ systems are geared up to deal with. In our experience, an increasing number of schemes are opting for **Method B** because it is easier to use, although generally slightly more expensive.

As far as possible, trustees need to future-proof their decisions. For example, if plans are afoot to buy out certain benefits or to consider other options for removing risk, insurers or providers may prefer a particular GMP equalisation method be used. Also bear in mind that scheme administrators may change in the future.

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## Key Questions & Actions

- 
- Q** Which equalisation method(s) are the trustees considering using, and is an alternative to those approved in *Lloyds No.1* being contemplated?

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  - Q** Is the intention to use the same method across all groups / for all purposes?

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  - Q** Is the current and future administrative impact of adopting a specific approach / approaches being factored in?

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  - Q** Is the potential impact of future plans being taken into account?

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  - A** Seek advice on costings and the different methods

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  - A** Engage with your scheme administrators at an early stage to ensure the trustees’ chosen method(s) can be integrated without material disruption
-

# The sponsoring employer's role

## Summary

Whilst the GMP equalisation burden falls squarely on the trustees, given the costs involved, early engagement with sponsoring employers will be vital. Areas where sponsoring employer input will be needed or could be helpful include:

- **choosing the method** – sponsoring employers can insist on **Method C2**, so employer agreement should be sought to the use of any other GMP equalisation method
- **administrative practices** – a GMP equalisation exercise may unearth longstanding practices not forming part of either the legal or scheme rule requirements. Employer input on any cost implications may be needed
- **plugging data gaps** – as discussed on pages 3 and 4, discrepancies in data held by the scheme will need to be considered and addressed. Sponsoring employers could be approached to help fill any gaps
- **DC benefits with a GMP underpin** – where members have these benefits, the first port of call for dealing with GMP equalisation is likely to be the member's pot, although some scheme rules may not permit this. Where the member's pot is insufficient to support an equalisation adjustment, in the form of an extra DB underpin, additional employer contributions may be necessary
- **GMP conversion** – the laws on conversion require employer consent.

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## Key Questions & Actions

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**Q** Has sponsoring employer agreement / input to the equalisation method(s) been sought?

**Q** Might sponsoring employers hold information which could assist with GMP equalisation, such as employment records and former member contact details?

**Q** Would a joint working party with sponsoring employers be helpful?

**A** Engage with sponsoring employers on the equalisation method(s)

**A** Seek legal advice as to when / if it would be appropriate to regard the principal sponsoring employer as speaking on behalf of all employers

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# Transfers and lump sums post *Lloyds No.1*

## Summary

Whilst a single, big-bang, event for all affected members might sound attractive, in reality it is likely that trustees will have to consider GMP equalisation in respect of certain members in advance of the main body of membership (see page 5). For example:

- when a member exercises their legal right to transfer their benefits to another scheme
- on trivial commutation
- when considering paying serious ill-health lump sums.

## Transfers

GMP equalisation should be a factor in the mix in respect of any transfers paid out of schemes on or after 26 October 2018, the date of the *Lloyds No.1* decision.

Where unequalised transfers have been paid on or after that date, a top-up payment may be due to the receiving scheme. But a receiving scheme may be unwilling to accept such a payment, unless it agreed to do so at the time of the original transfer. As an alternative, it may be possible to pay a small lump sum not exceeding £10,000 directly to the former member (see page 8).

It is now clear from *Lloyds No.3* that trustees will need to revisit certain historic transfers with a view to paying a GMP equalisation top-up. This will be covered in a later checklist.

## Trivial commutation and small lump sums

For a trivial commutation or a small lump sum to be paid, the member must have reached normal minimum pension age (currently age 55<sup>2</sup>), or an earlier age where they are retiring on the grounds of ill-health or they have a **protected pension age**. The following monetary limits apply:

- **trivial commutation** – the value of a member's pension rights across all registered pension schemes must not exceed £30,000. A member effectively has one bite at the cherry, with all such benefits needing to be cashed out within 12 months
- **small lumps sums** – the payment from the scheme must not exceed £10,000.

## Serious ill-health lump sums

For a serious ill-health lump sum to be paid, trustees must have received advice from a registered medical practitioner that the member is expected to live for less than a year. All of the member's benefits must be converted into a cash lump sum. An exception applies here in respect of former contracted-out survivor benefits, which will need to be retained within the scheme under a separate arrangement.

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## Key Questions & Actions

- 
- Q** Have all transfers and lumps sums post *Lloyds No.1* been paid on a GMP equalised basis?

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  - Q** If not, has a decision been made as to which equalisation method to use?

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  - Q** Where unequalised transfers / lump sum payments have been made post *Lloyds No.1*, have trustees received advice on options for correcting those payments?

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  - A** Where a pragmatic approach to equalisation is contemplated so as to allow payments to be made as quickly as possible, trustees should seek both actuarial and legal advice
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<sup>2</sup> Normal minimum pension age is set to rise to age 57 with effect from 6 April 2028

# Pensions tax

## Summary

The main pensions tax considerations resulting from the payments described on page 7 are considered below. However, all such payments are subject to certain conditions being met which are not covered in detail in this checklist. In addition, as there have been any number of changes to pensions taxation in recent years, the tax position and applicable limits described below may have been very different at the time of the original payment.

### Correcting transfers

A top-up to a receiving scheme should be capable of being a **recognised transfer** and therefore an “authorised payment” for tax purposes.

As an alternative, the trustees might want to explore whether a **small lump sum** not exceeding £10,000 may be paid directly to the former member, known as a “relevant accretion”. This is a possibility where trustees become aware of an entitlement to further benefit “in circumstances where they could not reasonably have been expected to be aware of it at the time of the transfer out”. The payment must be made within six months. Whilst the exact date from which the clock starts ticking is unclear, in our view, this is unlikely to be before a clear entitlement has been identified and the amount due calculated.

### Lump sums

**Trivial commutation** and **small lump sums** must extinguish a member’s entitlement to benefits under the scheme (and, where relevant, contingent beneficiaries’ rights). Where unequalised lump sums have been paid post *Lloyds No.1*, an adjustment now could push the initial trivial commutation or small lump sum over the relevant monetary limit (currently, £30,000 and £10,000 respectively).

A **serious ill-health lump sum** must extinguish all of a member’s “uncrystallised” rights under an arrangement, ie benefits in respect of which a test against the LTA has not yet been triggered.

### Taxation

A serious ill-health lump sum paid to a member who has reached age 75 will be taxed as pension income. No tax is payable where the member is below that age, unless the LTA is in play.

The starting point for all of the other lump sums above is that they are taxed as pension income. But the first 25% of any payment in respect of uncrystallised benefits will be tax-free, reflecting a member’s general right to tax-free cash on retirement.

### HMRC’s tax guidance

HMRC’s tax guidance No.2 makes clear that lump sums paid in the past will not stop being authorised “purely because, due to GMP equalisation, further entitlement is later identified” that could not reasonably have been known about at the time of the original payment. This reflects “the exceptional circumstances associated with” GMP equalisation and applies once the scheme’s chosen equalisation method is adopted.

However, when it comes to the monetary limits and GMP equalisation, HMRC distinguishes between:

- small lump sums – where the limit applies to the actual sum being paid. Provided the original lump sum did not exceed the relevant monetary limit, it will not stop being authorised simply because further benefit is identified
- trivial commutation – where the monetary limit applies to the value of a member’s benefits across all registered pension schemes on a particular date (known as “the nominated date”). If GMP equalisation takes the value above the monetary limit as at the nominated date, then any adjustment cannot count as trivial commutation.<sup>3</sup> A small lump sum might be an alternative here.

The AA and LTA implications of adjusting benefits for GMP equalisation were discussed in HMRC’s tax guidance No.1 and will be covered in a later checklist.

<sup>3</sup> The PASA tax guidance suggests that there may be circumstances where it is reasonable and appropriate (on advice) for trustees to assume that the member was within the relevant monetary limit, but careful thought should be given to this

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**Key Questions & Actions**

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- Q** Where unequalised transfer payments have been made post *Lloyds No.1*, has legal advice been sought on options for paying a top-up as an authorised payment?

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- Q** In light of HMRC guidance, have steps been taken to pay lump sum adjustments to former members?

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- Q** Where a trivial commutation lump sum was paid, would the original payment and any adjustment combined exceed the monetary limit?

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- Q** If so, has legal advice been sought on possible alternatives?

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- Q** Are adjustments needed in respect of former members who took trivial commutation before A-Day?<sup>4</sup>

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- A** Where they have not already done so, trustees should seek appropriate actuarial and legal advice on equalising transfers and lump sums

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<sup>4</sup> The PASA tax guidance suggests that such a GMP equalisation adjustment would be regarded as a new lump sum payment for tax purposes

# Communication and documentation

## Summary

### Communicating with members

Trustees will need to consider when and what to communicate to members. Whilst there is no absolute obligation to communicate with members until benefits are being altered, many trustees have chosen to keep members informed of developments. Regular communications, such as the scheme newsletter, can play a useful role here.

All member communications should be clear, as jargon free as possible, and kept to a digestible length. The PASA communications guidance offers useful suggestions, including model questions and answers for members. Care should be taken not to over promise in communications, as it is possible that GMP equalisation may result in a small number of members having their annual pension reduced.

### Keeping records

Trustees should ensure that any discussions and decisions made during their GMP equalisation journey are clearly recorded. Laying a paper trail can help when dealing with queries in the future, eg from members or when contemplating a risk transfer exercise.

Some of the key decisions highlighted in this checklist include:

- whether to dovetail benefit adjustments for GMP rectification with equalisation
- solutions arrived at to deal with possible challenges, such as data gaps and administrative practices
- choosing the equalisation method(s), including reasons and the possibility of different methods for different members or purposes
- obtaining input and/or consent from the sponsoring employers on certain decisions, such as the method(s)
- addressing transfer top-ups or further lump sums in respect of unequalised payments made post *Lloyds No.1*
- when, what and how often to communicate with members.

### Documentation

*Lloyds No.1* makes clear that trustees are “under a duty to amend” 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*.

Whatever method(s) are adopted, changes made to accommodate GMP equalisation will need to be reflected clearly in the scheme’s rules. Depending on who is in the driving seat, trustees may be able to use the scheme amendment power for this purpose.

However, trustees also have power under legislation to make alterations by resolution in certain circumstances. For example, where the trustees do not have the power to make changes or could only do so “by a procedure that is likely to be unduly complex or protracted”. Whilst helpful, this resolution power only allows changes to be made in respect of pensionable service from 17 May 1990, so there is a potential problem if GMPs are being equalised from an earlier date (eg 6 April 1988).

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## Key Questions & Actions

- 
- Q** Have the trustees discussed with their advisers when and what to communicate to members?

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  - Q** Is a suitable paper trail being laid in respect of key discussions and decisions?

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

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  - A** Seek legal advice on drafting suitable changes to the scheme’s governing documents

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# Appendix – defined terms and links to relevant guidance

## 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, so not GMP conversion or more extensive changes around equalisation
- [HMRC GMP equalisation newsletter – past and future lump sums](#) dated July 2020 (“HMRC tax guidance No.2”) – again, focusing solely on GMP equalisation.

## Abbreviations

**AA:** annual allowance  
**A-Day:** 6 April 2006  
**DB:** defined benefit  
**DC:** defined contribution  
**GMP:** guaranteed minimum pension  
**HMRC:** HM Revenue & Customs  
**LTA:** lifetime allowance  
**PASA:** the Pensions Administration Standards Association

## 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](#)).

Further PASA guidance on historic transfers and anti-franking is expected.

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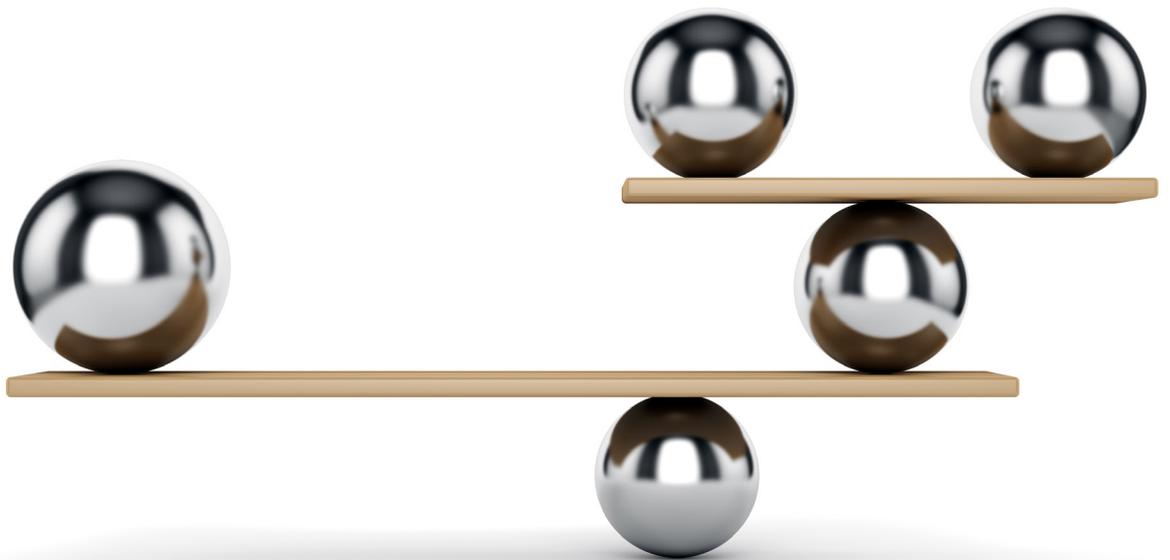
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