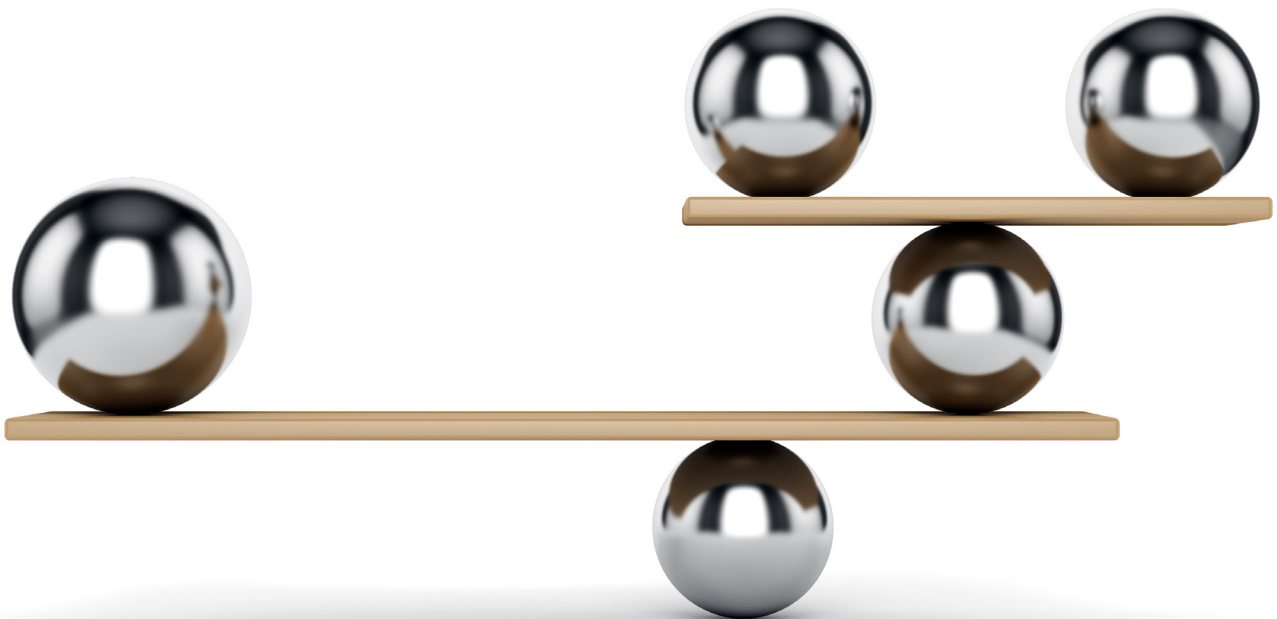


GMP equalisation

Correcting the past – the questions trustees need to ask

November 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 second in a short series, sets out key questions and actions that trustees of occupational pension schemes should be considering to help correct the past. 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

For our first checklist in the series, see [GMP equalisation – essential planning – the questions trustees need to ask](#) (“Checklist 1”). Our final checklist in the series will include tips on dealing with 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.

Essential planning – a quick recap

Summary

Checklist 1 highlighted some of the fundamental elements which trustees need to consider before embarking on their GMP equalisation journey. When correcting the past, much of the ground covered in Checklist 1 will be equally pertinent. For ease of reference, selective highlights are set out below.



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** (“the equalisation period”), 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.



Is your data accurate?

Gaps in data could cause particular challenges when correcting the past, especially as information can date back as far as 30 years ago. Records should ideally pinpoint members’ GMPs built up during the equalisation period, as well as those referable to benefits transferred into the scheme.

Depending on the type and significance of missing information, 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 advisers where to draw the line, ie where the extra costs of obtaining more accurate data outweighs the potential benefits.



Have you identified a suitable landing slot?

Devising a realistic timetable for carrying out a GMP equalisation project is essential, bearing in mind other projects which may be vying for airtime. Trustees should engage with all relevant advisers 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.



Which method?

A summary of the GMP equalisation calculation methods, and relevant variations, considered in *Lloyds No.1* can be found on page 5 of Checklist 1. Confirming which method(s) the scheme administrators’ systems can deal with will be crucial. As far as possible, decisions regarding the chosen method(s) should also be future-proofed, eg taking into account possible changes in administrators or plans to transfer risk in the short to medium term.

In our experience, aside from conversion, the following are currently the most commonly used methods, but there may be others:

- **Method B** – which compares the member’s overall benefits annually with what he/she would receive if they were of the opposite sex. Rather than looking to equalise each unequal element of benefit, it involves a single calculation on the overall male and female basis
- **Method C2** – using the same starting point as **Method B** but, in effect, equalising cumulative pension to avoid overcompensating members. Because of the way in which GMPs built up and are increased, sometimes a woman will be better off and sometimes the man. If and when the two trade places, benefits are not adjusted until any accumulated advantage has been offset by any ensuing disadvantage. Individuals in this position are known as “cross-over members”. Simple interest of 1% over bank base rate is then applied “when comparing accumulated gains and losses in the case of a switch in calculation from one sex to the other”.



Employer consent?

As GMP equalisation will entail additional costs, trustees should open a dialogue with sponsoring employers at the earliest opportunity (see page 6 of Checklist 1). Sponsoring employers can also insist on the use of **Method C2**, so their agreement should be sought to the chosen method(s).



Communicating with members

Trustees will need to decide when and what to communicate to members. Many are choosing to keep members up to speed with ongoing developments, rather than waiting until benefits are actually altered. Regular communications, such as the scheme newsletter, can play a useful role here. Care should be taken not to over promise.

Communications should be clear, as jargon free as possible, and kept to a digestible length. PASA's communications guidance offers useful suggestions, including model questions and answers for members.



Keeping records

Discussions and decisions about GMP equalisation should be clearly recorded. Laying a paper trail can also 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, see page 10 of Checklist 1. Any advice taken and decisions made in relation to correcting past benefits (see pages 5 & 6) and dealing with historic transfers (see pages 7 & 8) must also be properly logged.



Documentation

Lloyds No.1 makes clear that trustees are "under a duty to amend" scheme rules to equalise GMPs built up during the equalisation period. Options for achieving this are discussed on page 10 of Checklist 1.

Key Questions & Actions

- Q** Have the trustees identified members, including survivors, in scope for GMP equalisation and is the scheme's reconciliation process complete?
- Q** Do the scheme's administrators hold sufficient and accurate data?
- Q** If not, has advice been sought on options for plugging the gaps?
- Q** Which equalisation method(s) will be used, and is an alternative to those approved in *Lloyds No.1* being contemplated?
- Q** What other projects or future plans are in the works which could affect timing / choice of method?
- Q** Is the current and future administrative impact of adopting a specific approach / approaches being factored in?
- Q** Has sponsoring employer agreement / input to the equalisation method(s) and project generally been sought?
- Q** Have the trustees discussed with their advisers when and what to communicate to members?
- Q** Do trustees have all the information they need and is a suitable paper trail being laid in respect of key discussions and decisions?
- Q** Has legal advice been sought on options for recording GMP equalisation in the scheme rules?
- A** Engage with your scheme administrators at an early stage to ensure the trustees' chosen method(s) can be integrated without material disruption
- A** Engage with sponsoring employers on possible equalisation method(s) and potential cost implications
- A** Seek legal advice on drafting suitable changes to the scheme's governing documents

Correcting past benefits

Summary

Correcting past benefits in respect of current members will be a key stage of a scheme's GMP equalisation exercise. Revisiting benefits in respect of former members and their survivors to whom trustees may owe a continuing duty could also prove particularly challenging (see also pages 7 & 8).

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.

Correcting underpayments

As well as ensuring GMP equalisation for future benefit payments, trustees must review past payments, correcting underpayments where necessary. For current pensioners this involves checking whether, had they been of the opposite sex, their pension would have been greater year by year during payment.

Different methods could produce differing results. For example, for cross-over members (see page 3) **Method B** will produce a higher past underpayment than **Method C2**, but it is likely to be less costly to implement. In contrast, **Method C** might involve a reduction in future pension, which is not permissible where GMP conversion is also in the mix.

DC benefits with GMP underpins

For current members, arguably the first port of call for funding equalisation is the member's pot, with any adjustment needed being DB in nature. Obligations may hinge on the basis on which benefits have been promised / secured, and the checks carried out at the relevant time. Ways forward for remedying both the present and the past should be carefully discussed with advisers.

Death benefits

As part of their GMP equalisation exercise, trustees will also need to consider:

- survivors in receipt of benefits following a member's death who may have been disadvantaged in the past in respect of both their own pension and the deceased member's
- lump sum death benefits calculated by reference to the amount of a member's pension, such as a "five-year guarantee" payable on the death of a pensioner.

"No further liability" cases

These are circumstances in which a scheme has, on the face of it, already paid out entitlements such as:

- trivial commutation or "small pots" lump sums
- serious ill-health lump sums
- the death of a member or survivor where no further benefits are payable.

Not all of the above will require action, as the recipient may not have been disadvantaged. There may also be significant practical issues in some cases, eg lack of data and difficulty tracing would-be recipients. Trustees should seek legal input on the extent to which such benefits might have been discharged, whether a forfeiture rule might apply, and the pros and cons of taking a "commercial" decision not to review bearing in mind the likelihood of a beneficiary making a successful future claim.

Anti-franking

Anti-franking is designed to ensure that, except in limited circumstances, the revaluation provided in respect of GMPs in deferment cannot be offset against a member's other benefits. It is a technical area of GMP legislation that can have a significant impact on equalisation. PASA's anti-franking guidance highlights particular areas to consider so as to assist schemes and their advisers in factoring it into their GMP equalisation projects.

Key Questions & Actions

- Q** Is the intention to use the same equalisation method for all current members?

- Q** Will the same method be used to address the past as is being used to equalise future payments?

- Q** Where the scheme is DC with GMP underpins, has advice been requested on remedying any current or past inequality?

- Q** Have trustees considered the position of so-called “no further liability” cases and taken advice on a suitable way forward?

- Q** Are the trustees’ advisers factoring anti-franking into the GMP equalisation exercise?

- A** Take advice on the extent of benefit adjustment obligations and the practicalities of tracing beneficiaries

Historic transfers pre-dating *Lloyds No.1*

Summary

Lloyds No.3 concluded that, in certain circumstances, trustees owe a duty to pay a transfer on a GMP equalised basis. Where that duty has been breached, trustees are on the hook to pay a top-up to the receiving scheme and should pursue potential cases “proactively”, rather than waiting for former members to come forward. But the extent of this duty, and its practical application in certain circumstances, is not always abundantly clear.

Individual transfers

In line with *Lloyds No.3*, trustees have a duty to equalise in respect of past individual statutory transfers out, ie CETVs. Given the judge’s comments, it seems unlikely that a scheme’s forfeiture rule or the wording of any member discharge would change this position.

In contrast, an individual transfer made under a specific scheme rule may have extinguished the transferring member’s claim for equalised GMPs. Whether this is the case may depend on the background to the transfer, what was said to the former member at the time, and possibly the wording of any member discharge.

PASA’s transfer guidance suggests that transferring schemes might “choose to correct any non-statutory transfers in the same way as statutory transfers (unless there are exceptional circumstances)”. Additionally, in practice, scheme administrators “may not be able to differentiate between statutory and non-statutory transfers paid in the past”.

Bulk transfers

Bulk transfers are commonly used to transfer members and assets on a business sale, on a scheme merger, or on a transfer to a master trust.

There is no obligation under *Lloyds No.3* for a transferring scheme to pay a GMP equalisation top-up in respect of a bulk transfer made on mirror-image terms, where that transfer was accompanied by an actuarial certificate of broad comparability in line with relevant legislation. PASA’s transfer guidance suggests that a mirror-image transfer with individual member consent, ie as opposed to an actuarial certificate, might be treated in a similar way.

But not all bulk transfers would have taken place on a mirror-image basis. For example, transferred members may have been granted service credits based on the receiving scheme’s benefit structure. In such instances, the extent of any GMP equalisation obligation is likely to hinge on legal agreements entered into at the time, including possible indemnities.

Paying a top-up

Calculating any top-up will involve comparing the transfer value actually made with that of a comparator of the opposite sex with the same mix between GMP and excess benefits during the equalisation period (see page 3). PASA’s transfer guidance suggests applying the original transfer value assumptions when making this comparison. Where available records prevent this, options include using reasonable estimates of the transfer basis at the relevant time.

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

Interest must be applied reflecting the period from the date of the original transfer payment to the date when the shortfall is made good. This must be at least 1% above base rate simple interest, although PASA’s transfer guidance suggests that some scheme administrators may prefer to use compound.

Top-up alternatives

A receiving scheme may be unwilling to accept a top-up or, depending on the passage of time, the scheme may no longer exist.

No firm conclusions were reached in *Lloyds No.3* regarding possible alternative routes, with the outcome likely to boil down to what the parties agree or what a Court might order, including the possibility of “compensation in lieu”. The judge was clear though that trustees are unable to require a member to accept a residual benefit or vice versa. PASA’s transfer guidance echoes this, noting that a former member’s entitlement is akin to that of a creditor rather than a beneficiary.

Where a top-up is unfeasible, trustees should seek legal advice on alternatives. For example, it may be possible to pay a **small lump sum** not exceeding £10,000 directly to the former member (see pages 7 & 8 of Checklist 1).

Accepting top-ups

The exact nature of a receiving scheme's obligations in respect of a top-up are unclear, with relevant case law taking slightly different approaches.¹ Receiving scheme trustees will need to decide whether they are willing to accept a top-up where one is payable and, if so, what to do with it.

Where a scheme has already completed its GMP equalisation exercise, the trustees may be reluctant to re-open things. As PASA's transfer guidance notes, theoretically a DB scheme could, in some circumstances, simply "pocket" the extra cash, although members "may well consider it odd" that their benefits have not been increased to reflect the top-up. But providing extra benefits could incur more costs than the top-up actually received. It is vital that receiving schemes take legal advice here.

Divorce cases

Leaving aside the position under Scottish law, a pension sharing order awards an ex-spouse a percentage of a member's entitlement at a point in time, as opposed to a pounds and pence amount (as is the position in Scotland). Given *Lloyds No.3*, an ex-spouse could argue that a transfer made under a pension sharing order should now be topped up. This chimes with PASA's methodology guidance which suggests that, where the member had pensionable service during the equalisation period (see page 3), earmarking or pension sharing orders may also need to be revisited.

In practice, much may depend on the specific wording of the relevant Court order and any adjustments are likely to be modest.

Key Questions & Actions

- Q** Have steps been taken to identify past transfers that might be caught by the requirement to equalise GMPs?
 - Q** Can the scheme's administrators distinguish between CETVs and individual transfers made under a specific scheme rule?
 - Q** Are available records sufficient to show the basis on which past transfers were calculated?
 - Q** If not, have the trustees taken advice on how to proceed, including the possibility of using estimates?
 - Q** Have past bulk transfers, and the basis on which they took place, been identified?
 - Q** Have the trustees taken legal advice on whether scheme rules and/or the transfer agreement terms remove the need to take further equalisation action?
 - Q** Where paying a top-up is unfeasible, have trustees received appropriate advice on possible alternatives?
 - Q** In the case of a receiving scheme, are the trustees able and willing to accept a top-up and, if so, have they received legal advice on its use?
 - Q** Has advice been taken on the possible need to pay transfer top-ups in respect of past pension shares?
 - A** Trustees should take advice on the extent of the scheme's obligation to equalise past transfers and the tax consequences of doing so
 - A** Receiving schemes being offered top-ups should seek help from relevant advisers on applying funds received
-

¹ In *Coloroll* (1994) the European Court of Justice referred to increasing benefits to make good any shortfall in the unequal transfer value whilst *Lloyds No.3* focuses on equalising the pension amount for the effect of unequal GMPs

Pensions tax

Summary

The main pensions tax considerations emerging from correcting the past for current members are addressed below. As there have been any number of pensions tax changes in recent years, the actual position in any particular circumstance may differ.

HMRC tax guidance No.1 takes a largely pragmatic approach to the impact of GMP equalisation on the AA and LTA. PASA's tax guidance builds on that guidance, expanding on some of the practical issues it inevitably raises.

AA implications of correcting underpayments

GMP equalisation will not generally constitute new benefits requiring a test against the AA in respect of the following:

- **pre-A-Day deferred members** – who have remained outside of the AA regime in relation to a particular arrangement, with any GMP equalisation adjustment simply reflecting benefits built up before A-Day
- post A-Day members covered by the “**deferred member carve-out**” – eg 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, an individual in these circumstances is treated as having nothing to test against the AA.

The above position will change if GMP equalisation goes beyond what is legally required, eg if a scheme chooses to equalise benefits attributable to service prior to the equalisation period (see page 3).

For active members, and deferreds falling outside of the above (eg because **benefits remain linked to salary**), there is no need to revisit the past. However, AA calculations in the tax year of implementing GMP equalisation, as well as subsequent years, will need to take account of any revised benefit amount.

LTA implications of correcting underpayments

Subject to some exceptions, GMP equalisation adjustments will not generally trigger a test against the LTA in respect of pensions which came into payment before A-Day. For other pensions in payment, where GMP equalisation results in an increase to what should have been the individual's starting benefits, the original amount should be corrected. The test for any LTA charge should then be assessed by reference to the individual's remaining LTA at the time. Trustees must inform members of changes so that any knock-on effect on benefits in other arrangements can be considered. Appendix 2 of PASA's tax guidance provides template wording.

An increase representing a mixture of GMP equalisation and other adjustments could give rise to a new entitlement for tax purposes.

LTA protections

Comfortingly, adjustments made solely for GMP equalisation should not prejudice applicable LTA protections, eg such as **fixed protection**. But if GMP equalisation results in the value of rights protected by **primary** or **individual protection** being higher than originally notified, HMRC must be informed of the corrected figure “without undue delay”. Similarly, when carrying out relevant accrual calculations for individuals with **enhanced protection**, the value of a member's rights as at 5 April 2006 may need to include any GMP equalisation adjustment.

Conceivably, GMP equalisation could push an individual's benefits into the realms of an LTA protection. If this happens, HMRC could be approached with evidence to support late notification.

Key Questions & Actions

- Q** Have the trustees taken actuarial and legal advice on the AA and LTA implications of making GMP adjustments?
 - Q** Where pensioner benefits are adjusted, have trustees made them aware of the impact on their available LTA?
 - Q** Has legal advice been sought on tax authorised options for addressing unequalised transfers paid pre-*Lloyds No.1*?
 - A** Take advice on the potential tax implications before taking any steps to correct the past
-

Arrears and limitations on claims

Summary

On 18 June 2021, the High Court handed down its judgment in the *Axminster Carpets case*. With Mr Justice Morgan once again in charge, the case helps clarify the arrears and limitations aspects of *Lloyds No.1*. Based on *Lloyds No.3*, there are no limits on bringing claims for past transfers.

What type of rule is it?

In *Lloyds No.1*, Mr Justice Morgan decided that the scheme rules in that case meant that a beneficiary was only entitled to arrears of pension payments for the period of six years prior to any claim. (This is consistent with pensions legislation, which permits the forfeiture of unclaimed benefits after six years.) In addition, such arrears “should bear simple interest at 1% over base rate”. A claim for arrears must be specific, reflecting the need to equalise for the effect of GMPs. Merely asking for a pension to be put into payment is not enough.

Demonstrating the need to check rules carefully, in *Axminster* the judge looked at two different provisions, concluding that only one allowed forfeiture of unclaimed benefits.

Can a forfeiture rule be introduced?

Whether trustees can introduce a forfeiture rule, as they did in *Axminster*, will depend on a number of considerations, including any restrictions in scheme rules and the impact of section 67 of the Pensions Act 1995 (protection of benefits built up).

What if trustees have discretion to pay beyond six years?

Where trustees have discretion to pay arrears beyond the six-year period, it is “obviously relevant to the exercise” of that discretion “to consider how the situation has arisen and the consequences of the discretion being exercised or not”. As the *Axminster* rules included such a discretion, the judge made clear that “the absence of fault on the part of beneficiaries and/or the presence of fault on the part of the trustees are capable of being relevant factors”. In addition, “the first reaction” of trustees “should be to make good the earlier underpayments without further delay”.

But other factors may be relevant, such as administrative difficulties in looking back further and, conceivably, the scheme’s funding level and the sponsoring employer’s finances. Trustees might also decide that only a proportion of arrears should be forfeited. As with the exercise of all discretions, trustees must only consider relevant factors whilst ignoring irrelevant ones.

What is the timeframe for bringing a claim?

Both *Lloyds No.1* and *Axminster* confirm that no limitation period applies to beneficiaries seeking to recover arrears against current trustees. This means that a beneficiary could come forward at any point in time, even though the amount of arrears they can claim may be limited. However, Mr Justice Morgan made “tentative comments” regarding the position of former trustees. As they are no longer in possession of the trust property, former trustees should be able to rely on the usual six-year limitation period. This could, for example, limit the timeframe for bringing claims on a scheme wind-up.

What level of interest?

Whilst *Lloyds No.1* concluded that simple interest at 1% over bank base rate was adequate when it comes to paying arrears and addressing claims, this should be regarded as a floor rather than a ceiling. Some schemes may find it easier to administer more generous alternatives, such as compound interest.

Key Questions & Actions

Q Have the trustees sought legal advice on the provision(s) under the scheme rules dealing with arrears?

Q Have the trustees taken advice on what interest rate to apply when correcting the past?

A As appropriate, take legal advice on the extent of any forfeiture rule (including the ability to introduce one) and/or factors to consider when exercising any discretion to pay arrears beyond the period set by the rules

A If the scheme is winding up, discuss the possible impact of future claims and potential protections with your legal advisers

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
CETV: cash equivalent transfer value
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](#))
- [Transfer payments guidance](#) dated August 2021 (see our [Alert](#))
- [Anti-franking guidance](#) dated September 2021 (see our [Alert](#))

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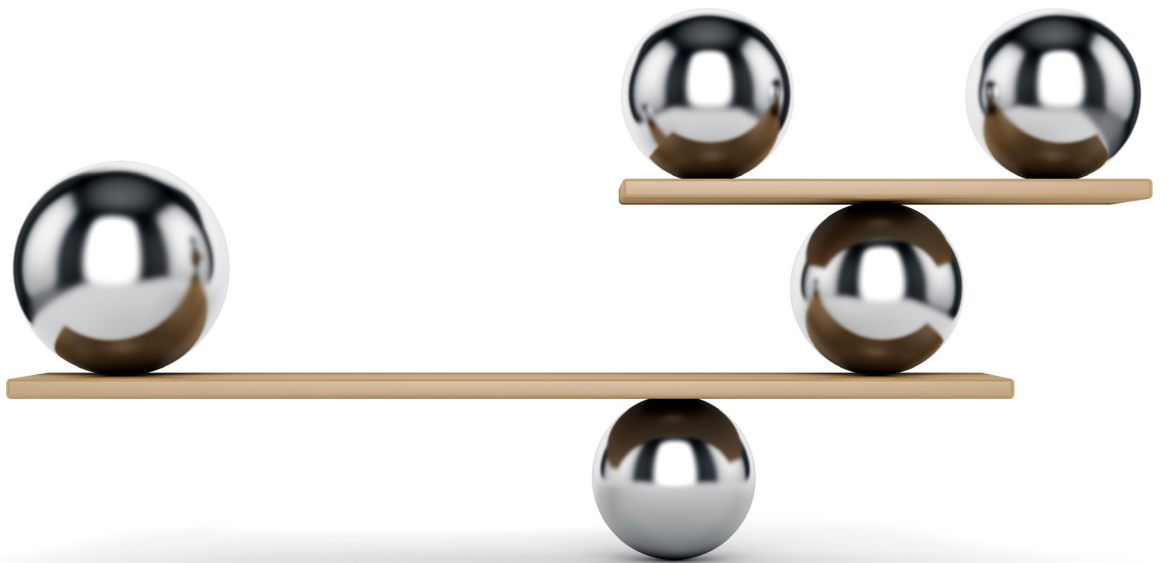
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