

White Paper Conference – March 2016
GMP Equalisation – Duncan Buchanan Hogan Lovells¹
Speaker's Notes/Handout

¹ All views are my own as are any mistakes.

1. THE CHALLENGE

1.1 I have been set quite a challenge by the organisers of this year's conference. They have asked me during the next 35 minutes to share with you my thoughts of:

- (a) What can and should trustees of schemes in wind up do about the inequalities of GMPs; and
- (b) Can we be certain that GMP equalisation is a requirement under current law.

1.2 The 35 minutes includes time for questions too.

1.3 I have assumed some existing knowledge of GMPs in preparing this talk and prepared a handout/speaker notes just in case I run short on time and have to skim over a slide.

2. AGENDA

2.1 My talk will look at:

- Why GMPs are unequal and what schemes are doing in practice.
- Where the Government is coming from.
- Does the law currently require equalisation of the effects caused by unequal GMPs.
- Schemes in wind up under three scenarios – PPF, 100% solvent and PPF Plus
- If we have any time left we can then discuss questions.

3. AN EXAMPLE OF UNEQUAL GMPs

3.1 This slide shows how the inequalities in GMPs can impact on members' benefits. I put it together for my 2012 talk to the APL conference and a friendly actuary confirmed it was broadly right (which I took as compliment).

3.2 Two members, David and Jane joined a contracted out defined benefit pension scheme in April 1990 (i.e. shortly before Barber day) – they left on the same day seven years later in April 1997 (when GMPs ceased accruing) when both were aged 57. Their earnings were the same throughout the seven years they worked next to each other.

3.3 The pension scheme provided an n/60ths accrual rate with an equalised NRD of age 60 – pensions in payment (in excess of GMPs) carry no indexation in retirement. The Scheme revalues GMPs in deferment at the fixed rate (which is 6.25% pa for leavers in 1997)

3.4 At the Date of Leaving both Jane and David had a deferred pension of £600 pa from age 60 so they had fully equalised benefits – or so they thought. Jane's GMP is slightly higher than David's but this is contained within the £600 at this point.

3.5 What actually happens is shown on the graph on this slide. Namely:

- (a) Jane's GMP is payable from her GMP pension age of 60 (which is NRD) so she gets three years of fixed rate revaluation of her GMP on top. This cannot be franked against her other benefit due to the notoriously complex anti-franking legislation. So her pension is about £50 pa more than David at age 60.
- (b) Between age 60 and 65 David gets a flat rate of pension of about £630 pa but Jane's pension (the GMP element) increases in line with RPI/CPI (3% pa in my example – all GMPs here are post 88 to keep it simple!).
- (c) Once David gets to 65 he reaches his GMP pension age and his GMP with eight years of fixed rate revaluation. Again this fixed rate revaluation cannot be franked and the extra 5 years of revaluation compared to Jane means that his pension overtakes Jane's (even though his GMP at date of leaving was less).
- (d) After 65 both David and Jane's pensions (GMP element) increases at 3% fixed so David receives a slightly higher increase each year compared to Jane.

4. **BUT...**

- 4.1 My example slide is very much a simplified example to illustrate the difficulties in the GMP legislation.
- 4.2 Scheme benefit designs vary significantly in practice and not all people leave and join on the same day and most provide benefits which are in excess of GMPs.
- 4.3 The GMP legislation is still inherently discriminatory between males and females and this will not change.
- 4.4 It is important to note that having a higher GMP may be an advantage or disadvantage depending on the benefit structure of the scheme concerned.
- 4.5 Finally, those who are interested in State pension benefits may well have had the delight to delve into the Contracting Out Deduction and perhaps discovered what the DWP call the "aggressive COD". A talk in its own right.
- 4.6 The concluding point on this slide is that it will not be possible to say until members have died whether they will receive a higher or lower benefit than a comparator of the opposite sex or measure the quantum of the difference.

5. **WHAT ARE ONGOING SCHEMES DOING**

- 5.1 This is a short slide so it won't take up much of my time as the answer is "nothing" in practice.
- 5.2 I have yet to come across an ongoing scheme that has equalised for the effects of GMPs although there was a rumour a few years ago that one scheme had done it. The issue for ongoing schemes is how do you achieve true equality? If you go too far and overcompensate one sex at the expense of the other then you will need to improve benefits even further (a ratchet effect).
- 5.3 Most pension managers are busy people getting to grips with the constant tax changes, scheme funding issues and preparing for the ending of contracting out (if their scheme is still open to future accrual). They probably take the view that as GMPs stopped accruing in 1997 the problem is not getting any worse so why do anything until the position is clearer.

- 5.4 The recent Pension Ombudsman involving Dr Kenworthy will give further support to those pension managers who do not want to take any action at this stage. The Ombudsman held that it was not unreasonable for the trustees of the pension scheme not to take action to equalise for the effects of GMPs until the law is clearer as to how schemes should achieve equality.
- 5.5 Whilst that may be OK for schemes that are on-going the nettle needs to be grasped when a scheme goes into winding up and benefits have to be secured outside of the scheme. I will discuss wind ups shortly.

6. GOVERNMENT STATEMENTS AND CONSULTATION

- 6.1 The Department of Work and Pensions has known for a long time that GMPs were unequal and there are statements in Hansard from the Lords debate during the Bill that became the Pensions Act 1995.
- 6.2 However I think it fair to say that GMP equalisation was not highlighted by anyone and people kidded themselves that GMPs did not require equal treatment.
- 6.3 Then in January 2010 the then Minister for Pensions, Angela Eagle announced (out of the blue) that HM Government considered that schemes should equalise for the effects of GMPs.
- 6.4 Shortly after that there was a General Election and the coalition Government was formed. Steve Webb the new minister for pensions took up the GMP equalisation issue and in April 2011 he announced that he believed GMPs should be equalised and that he was going to issue draft legislation that would resolve any legal uncertainties and guidance to help schemes equalise benefits.
- 6.5 It took DWP until January 2012 to issue the draft regulations and guidance. The guidance could be described as gold plated in that it suggested that schemes should operate two pension payrolls for each member with a post 1990 GMP (one with the GMP calculated using the other sex) and pay the higher of the two calculations.
- 6.6 I recall at the time there was a very strong response to the guidance and, thankfully the Government withdrew the guidance and the draft legislation saying it was going to consult with industry on GMP equalisation and update its guidance in due course.
- 6.7 Here we are four years later and industry is still working with the DWP to try to develop a practical and effective way for schemes to equalise GMP inequalities. Nothing in this area moves quickly as there is not much enthusiasm for a resolution!

7. DOES THE LAW REQUIRE EQUALISATION?

- 7.1 We have known since the Barber case of 17 May 1990 that pensions are pay and therefore should be equal between the sexes and most schemes then took action to equalise normal retirement ages so the overall pension is the same between the sexes.
- 7.2 There are some areas where the law recognises that there are differences between men and women when it comes to pension so the legislation permits sex based actuarial and transfer value factors (at least at this point).
- 7.3 The law also permits bridging pensions to be different between men and women to reflect unequal state pension ages and this was confirmed by the European Court in the Birds Eye case.

- 7.4 It is arguable that, like bridging pensions, unequal GMPs are a factor of the State pension (at least for those members whose State Pension Ages have not been equalised) and therefore do not need to be equalised. After all the inequalities of GMPs are forced upon schemes by legislation and could be said to be an alternative or quasi state pension (which do not need to be equalised)
- 7.5 Unfortunately, there has not been a full Court case on equalisation of GMPs (it was suggested to DWP back in 2010 but they said it would take too long!). The closest we came was the 1990s appeal against a Pension Ombudsman decision in the Williamson case. In that case the Ombudsman determined that the Mercer pension scheme should take steps to equalise for the effects of GMPs but this was overturned by the High Court on the grounds that the Pension Ombudsman did not have jurisdiction to make that determination.
- 7.6 The judge in the Williamson case heard legal argument from no less than Mr Sumption QC but declined to address the most important issue as to whether GMP inequalities needed to be addressed.
- 7.7 I mention the Allonby case as the DWP seem to place a lot of emphasis on it. That case held that there was no need to find a comparator of the opposite sex where the inequality was caused by legislation. Outside the DWP I don't believe anyone seriously considers that the comparator issue is a defence (except perhaps in those rare schemes which have only ever had members of one sex).
- 7.8 For a long time I held out against admitting that GMP inequalities need to be addressed but I think now that the better view is they do but for now no one knows how to do it.

8. **SCHEMES WINDING UP IN THE PPF**

- 8.1 The PPF was an early adopter of taking steps to equalise for the effects of GMPs. Their argument was that there is a separate statutory duty on the PPF to provide equal benefits and this is contained in section 171 Pensions Act 2004.
- 8.2 The concept of a GMP disappears on a member being provided with PPF compensation so the continuation of inequality stops effectively at the start of the PPF assessment period.
- 8.3 After much consultation the PPF decided that it would operate what it called "Modified Method (2)" to equalise for the effects of GMP. In short this method involves looking at the benefit that accrued in the scheme during the period 1990 to 1997 and basing the PPF compensation on the higher of the male or female equivalent benefit. This tends to result in a higher benefit for the member as more of his PPF compensation will be calculated by reference to an NPD of 60.
- 8.4 That is not the end of the matter as the PPF go further and seek to put right any past inequalities – potentially going back to May 1990. The quote on the slide comes from the PPF's guidance on GMP equalisation.

9. **MODIFIED METHOD (2)**

- 9.1 If we go back to my simplified pension scheme with David and Jane and apply PPF method to equalise their benefits then at the assessment date (when they are both over 75 and therefore well over normal pension age) the PPF compensation for David and Jane would be set at £1,200 (being Jane's benefit). There would be no further increases

to this benefit as it all relates to pre 1997 pensionable service which does not qualify for increases in payment.

- 9.2 That's not the end of it as we need to compensate for the past inequalities (without interest). David has been underpaid £737 (whilst he was between age 60 and 65) and Jane underpaid by £624 (for the period age 65 onwards). The PPF would make those compensation payments to the individuals.

10. SOLVENT WIND UPS

- 10.1 In recent years we have seen a number of sponsoring employers looking to wind up their defined benefit pension schemes by securing members' benefits (whether pensions in payment or deferred pensions) by assigning to them individual policies issued by an appropriate insurance company. The premium required to buy out benefits in this way is often considerably higher than the assets of the scheme and the shortfall is met by the employer making a final contribution.
- 10.2 A significant part of all wind up exercises is to ensure that all members have been identified and their benefits properly calculated. As part of this "data cleanse" exercise the Trustee will want to reconcile its GMP records with those held by NISPI (the HMRC department which is soon to be disbanded).
- 10.3 Having reconciled the GMPs the trustees will then need to decide what to do regarding GMP equalisation. In the past this issue caused paralysis and meant that many schemes remained in a winding up process for many years.
- 10.4 The Regulator was concerned about the delays incurred in winding up schemes and in 2008 it issued guidance to assist trustees. Inevitably this guidance had to address the issue of GMP equalisation and the Regulator discouraged trustees from delaying a wind up because of GMP equality. It suggested a pragmatic approach and made some suggestions but I note that this section of the guidance has now been removed from the current version of the guidance.
- 10.5 So how have trustees and employers of schemes in solvent wind ups dealt with GMP inequalities. In practice there has been a range of approaches which are listed on the slide. The ones I am seeing most often now are arranging for the annuity provider to take on the risk in return for a premium or looking to equalise benefits on a "value" basis so that whilst the quantum of benefits may be different the actuarial value of the member's benefit compared to a notional comparator of the opposite sex is the same.
- 10.6 When winding up it is sometimes necessary for trustees to take pragmatic approaches and GMP equalisation is a good example of this. For example is it sensible to spend £200 in fees to check a member's benefit that might increase by £1 pa as a result? Recognising that it is the employers who foot the bill in solvent wind ups.
- 10.7 In practice where would a member who thought that GMP inequalities had not been addressed take his claim? I would have thought the Ombudsman would not want to get involved (indeed he may not have jurisdiction) and the High court is not a practical option.
- 10.8 Finally on this slide it might be worth considering providing extra protection against future claims by putting the trustee company through a solvent liquidation process after the winding up has completed so that claims cannot subsequently be brought against the trustee company.

11. PPF PLUS WIND UPS

- 11.1 The final category of wind ups are termed PPF plus wind ups. These can happen where an employer has become insolvent and the assets of the scheme after recoveries are more than sufficient to secure PPF benefits so the scheme exits the PPF assessment and needs to be wound up outside the PPF. There have also been a few cases that I am aware of where the employer and trustees have (with regulator clearance) compromised the section 75 debt by paying an amount that allows the trustees to secure members' benefits at above PPF level but not at the full amount.
- 11.2 As the scheme has insufficient assets to secure benefits in full, attention turns to the scheme's priority order and the statutory priority order under section 73 Pensions Act 1995. This usually involves sharing assets above 100% PPF level between members (some of whom may have no GMP benefits at all).
- 11.3 As there is a finite pool of assets taking any action to equalise GMPs that results in a members' benefit being improved will result in a reduction in the value of other members' benefits – potentially members who have no GMPs. In such situations trustees will need to be absolutely certain that they are doing the right thing in "robbing Peter to pay Pauline".
- 11.4 There is also the fact that the costs of advisers in calculating GMPs equalisation (and any associated HMRC tax complexities) would further reduce the pool of assets available to members on the wind up.
- 11.5 As the first priority under the Statutory Priority order (which overrides scheme rules) is to provide for members' PPF benefits (or something akin to it) it might be said that quasi equalisation is achieved by calculating each member's PPF liability adopting the Adjusted Method (2) approach.
- 11.6 Unlike the PPF though the obligation to provide a GMP still continues post wind up and in one PPF case I was involved with we went through a process of converting the GMPs into non GMP benefits (on exactly the same terms) before the insurer would take on the liabilities.

12. PAST INEQUALITIES

- 12.1 As mentioned the PPF go back to compensate members for past inequalities as part of their on boarding process.
- 12.2 None of the schemes that I have been involved with in wind up (solvent or PPF plus) have looked to go back and correct past underpayments.
- 12.3 Going back in this way would raise questions about time limits for bringing claims and also limitation periods. A subject for a talk in its own right.

13. QUESTIONS