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Equalising pensions for GMPs? High Court says 'yes'

Speed read

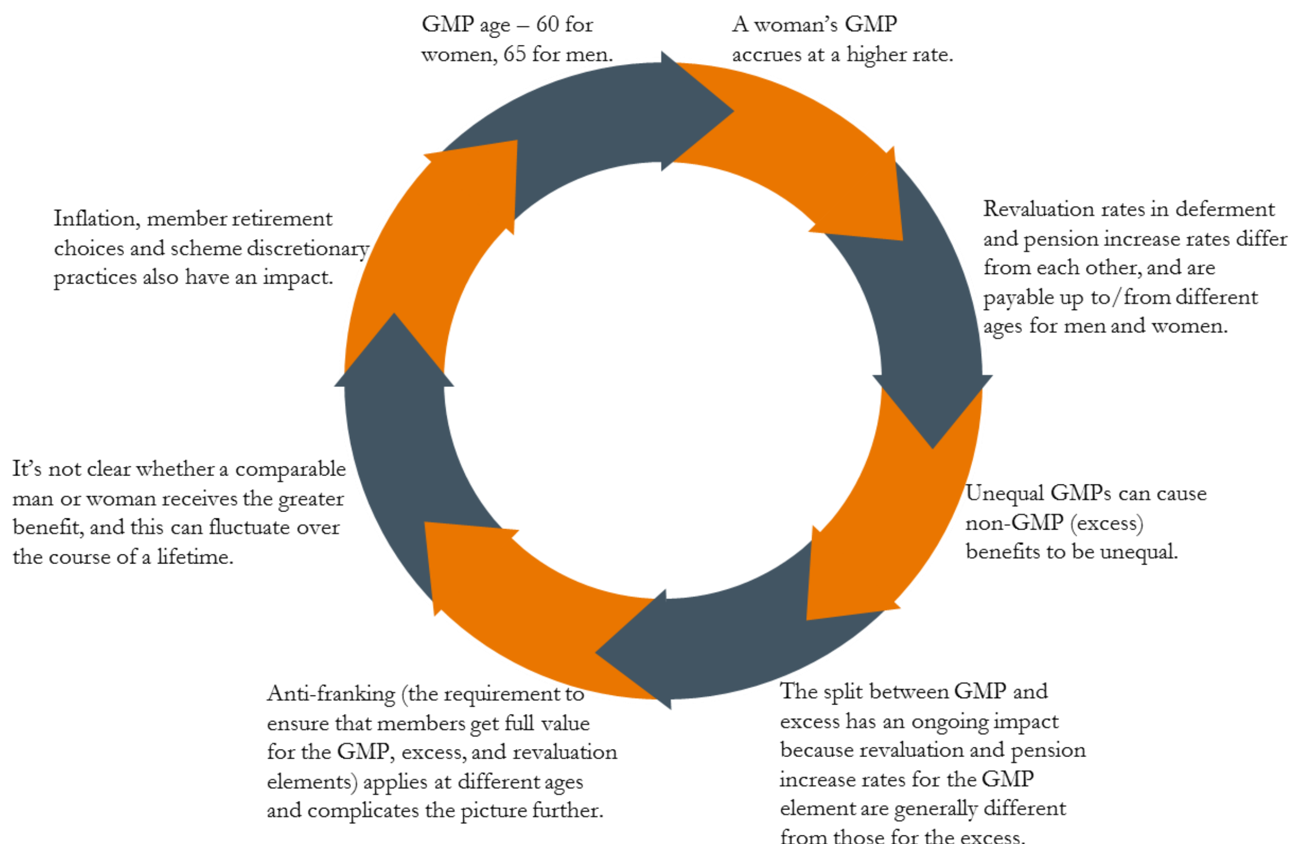
Once every few years a case comes along that changes the pensions industry. The Lloyds case is in that category. For nearly 30 years, there has been a question about whether pension schemes have to equalise for the effects of unequal guaranteed minimum pensions. Now we have the High Court's answer – yes – and some guidance on how to do it. The cost and complexity is likely to be significant, but scheme rules could help mitigate the liability.

What's it all about?

The issue starts with contracting-out of the State Earnings-Related Pension Scheme (SERPS). Contracting-out meant that employers and workers paid lower National Insurance contributions, with alternative arrangements for guaranteed minimum pensions (GMPs) to be provided by an occupational scheme, broadly as a replacement for the SERPS benefit.

GMPs are inherently unequal due to differing male and female retirement ages – but EU and UK law, as well as cases from *Barber* onwards, require that men and women are treated equally in relation to benefits under an occupational pension scheme. The calculation, revaluation and increase of GMPs is prescribed by law – so if inequality is created in scheme benefits, non-GMP benefits would need to be changed to equalise for that effect from the date of the *Barber* judgement (17 May 1990) up to the end of GMP accrual (5 April 1997).

How do inequalities arise?



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How should you equalise?

Four basic methods were considered, with varying price tags (A being the highest and C2 the lowest, with D variable):

Method A

Equalise each unequal aspect of benefit (revaluation in deferment, anti-franking uplift, indexation in payment) separately

Method B

Provide the better of male/female comparator pension on a year-by-year basis

Method C1

As for Method B, but if favoured sex changes from one gender to the other, allow offsetting of accumulated gains in years prior to change until exceeded by divergence in payments after change

Method C2

As for Method C1, but also make an allowance for interest on the accumulated gains prior to the change (so reducing overall cost)

Method D

One-off calculation of actuarial value based on one of methods A to C plus either (method D1) the provision of additional benefit of equal actuarial value to the shortfall, or (method D2) the conversion of the higher value into non-GMP benefits

What has the Court ruled?

First, that pension benefits – including the GMP element – are pay; it is not lawful to pay unequal benefits as between men and women.

Scheme benefits in excess of GMP must be adjusted so that the total benefits received by male and female members with equivalent age, service and earnings histories are equal.

Secondly, not all methods are appropriate or available:

Not permitted	Method D1: one-off calculation is not permissible from a beneficiary standpoint as it infringes the principle of minimum interference (see below)	
Permitted only with sponsor consent	Method A: could result in increases beyond 'levelling up' and significantly greater costs; only possible with sponsor consent	Method D2: GMP conversion would be permissible subject to prior sponsor consent
Possible	Method B is possible but more costly than methods C1 or C2	Method C1 is permissible but more costly than C2
Method to be used	Method C2 (offsetting gains/ losses over time and allowing for interest on accumulated gains at base rate + 1%)	

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Where more than one method produces equality of benefits, trustees should choose the method which results in 'minimum interference' with the rights of any party. In this case, the sponsor was entitled to insist on the use of the least costly method (C2) as it is the funder of scheme benefits.

Correcting benefits: how far back do you go?

No limitation period applies in these circumstances

But scheme rules may limit member claims for arrears

Many beneficiaries can claim only 6 years of arrears

Simple interest is payable on arrears at 1% above base rate

Like many other schemes, the Lloyds schemes provide that claims for unpaid benefits must be made within 6 years of the instalment falling due for payment. Mr Justice Morgan ruled that there was no limitation period applicable to claims for payment arrears due from a trust in these circumstances, but that this was subject to the scheme rules. As a result, many beneficiaries' claims will be limited to six years of arrears, though it is unclear what a 'claim' in this context means. Does a member have to make a claim or start formal proceedings to trigger the limitation under the rules? Or does the period roll forward until schemes are in a position to correct?

A further complication for some schemes may be that scheme rules leave forfeiture to trustee discretion – where this applies, trustees must have regard to all relevant and no irrelevant considerations and make a decision which is rational and not perverse.

Comments

This is the judgment the industry has been waiting for – and many schemes and sponsors will have been hoping not to get. Some questions are still unanswered – for example, how to deal with historic transfers-out and what this means in terms of trustee discharges in relation to those transfers. It was accepted that for many members the actual uplift payable may be relatively low compared to the overall pension – but it's not clear that there is scope to apply a minimum threshold to corrections on the grounds of administrative cost or burden.

GMP equalisation is a significant exercise; it will take time to develop a scheme-specific approach and project plan. Industry practice around the administrative practicalities of implementation may also take time to evolve and settle.

The six-year restriction on back-payments will depend on the wording of specific scheme rules – another common variant, for example, is that benefits must be claimed within six years after the later of (a) becoming payable and (b) the date on which notice of entitlement is given to the beneficiary concerned. Not all schemes will be able to rely on their rules in the same way.

The judgment provides real clarity in a complex area, just as schemes come to the end of their GMP reconciliation exercises with HMRC. Corrections to past payments can be tricky because – as many schemes have discovered in the course of those exercises – there may not be enough data to rework pension calculations from the outset.

Action points

Review scheme data (including non-GMP data) and design a process for corrections.

Consider the impact for scheme liabilities and the accounting implications for the scheme and sponsor.

Members are likely to ask questions about whether they are affected, so you may want to have a standard holding response ready.

Consider how to deal with transfers and benefit payments pending your equalisation process, and any special features of your scheme or historic practices that could affect how you deal with equalisation.

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