Equalisation of Guaranteed Minimum Pensions (GMPs): what about transfers out?

December 2020 Pension briefing

HIGHLIGHTS

A further judgment from the High Court has clarified what pension schemes must do in relation to previous transfers out after 17 May 1990 (the date of the *Barber* decision) where the transferring member had a right to a guaranteed minimum pension (GMP).

It has been confirmed that:

- Transferring trustees are expected to revisit previous individual transfers under the cash equivalent transfer value (CETV) legislation and to pay a top up transfer value to the receiving scheme.
- Top ups should be paid in respect of unequalised CETVs paid from 17 May 1990 (the date of the *Barber* decision).
- In contrast, bulk transfers on a mirror image basis in accordance with the preservation legislation do not need to be revisited.

The judgment is the latest in long-running litigation concerning equalisation for the effects of GMPs and heard by Mr Justice Morgan. This note considers the judge's findings and explains our recommended approach to dealing with historic transfers.

CONTENTS

This note covers:

INTRODUCTION AND BACKGROUND

The High Court confirmed in October 2018 that schemes must equalise for the unequal effects of guaranteed minimum pensions (GMPs) between men and women. The practicalities of how this may be done are highly complex and the case left almost as many unanswered questions as it addressed.

One such area of unanswered questions concerned the treatment of previous transfers out: in particular whether the transferring scheme has an obligation to revisit previous (unequalised) transfers out and, if so, what the transferring scheme trustees (or employer) should do by way of remedy.

The parties in the *Lloyds* case returned to court to air some of the possible ways of treating earlier transfers and seeking clarification of what (if anything) the transferring trustees must do.

For an explanation of the inequalities which arise in relation to GMPs please see Appendix I below.

For information about the different methods for equalising for the effect of GMPs addressed in the first *Lloyds* judgment, please see Appendix II below.

THE JUDGMENT IN A NUTSHELL

The judge held the following.

- Historic CETVs should have been calculated on a basis that equalises for GMP inequality, where the member accrued GMPs in the period 17 May 1990 to 5 April 1997.
- Schemes which did not pay equalised CETVs owe a duty to the former member to make a top up CETV payment to the receiving scheme. However, the former member is not entitled to demand a residual benefit from the transferring scheme.
- The duty to pay a CETV top up applies regardless of whether the receiving scheme:
    - provided defined benefit (DB) or defined contribution (DC) benefits;
    - was contracted-out on a salary related (COSR) or money purchase (COMP) basis or contracted-in;

  - was an occupational or personal pension scheme; or
  - has subsequently wound up.
- The CETV top up should be calculated using the assumptions and methodology used for the original transfer. Interest should be added at 1% above base rate.
- Trustees should revisit transfers out made on or after 17 May 1990 – no statutory limitation periods apply.
- The scheme forfeiture rules did not apply and individual discharges given by former members were ineffective.
- While a former member does not have a *right* to a benefit from the transferring scheme, it is possible to agree a compromise to settle the claim, for example with a payment direct to the former member.
- There is no need to revisit bulk transfers which had taken place without consent on mirror image terms, in accordance with statutory requirements.

Following the judgment, the GMP Equalisation Industry Working Group (of which Duncan Buchanan is a member) is expected to issue updated guidance on transfers.

Glossary

CETV: cash equivalent transfer value under the Pension Schemes Act 1993.

Comparator: a hypothetical person of the opposite sex to the member but with an identical date of birth, earnings history and pensionable service. When implementing GMP Equalisation, the benefits (GMP and excess over GMP) earned by the member during the period 17 May 1990 to 5 April 1997 must be compared with the benefits which would have been earned by the Comparator for the same period.

GMP Equalisation: an exercise to ensure that members with GMPs accrued in the period 17 May 1990 to 5 April 1997 receive benefits that are at least equal to the benefits which would be payable to the member's Comparator in respect of the same period.

GMP Reconciliation: the process (separate to GMP Equalisation) of comparing and, where necessary, reconciling the scheme's records with HMRC's records of members' rights to GMPs.

GMP Rectification: adjusting benefits following GMP Reconciliation to remedy any past over or underpayments and to ensure that correct benefits are paid going forward.

PRACTICALITIES: HOW SHOULD TRUSTEES RESPOND?

The practical implications of revisiting past transfers out to achieve GMP Equalisation are significant:

- in many cases, the transferring scheme will not have sufficient data to recalculate the Comparator's transfer value; and
- many receiving schemes, or annuity providers, will not accept additional very small payments, raising the question of should be done with (mostly very modest) equalisation uplifts.

Many trustees and administrators have already dedicated considerable resources to dealing with GMP Reconciliation, GMP Rectification and GMP Equalisation more generally. The judgment leaves schemes and the employers who fund them with even more to do, with (as explained below) probably little or no benefit for many members.

Proactivity or pragmatism?

The court found that the transferring trustees need to be proactive in that they must consider:

- the rights and obligations identified;
- the remedies available to members;
- the absence of a time limit;
- *"and then determine what to do"*.

The judge was asked not to reflect on wider considerations of administrative costs.

We have set out an action plan below which we recommend transferring trustees follow when addressing historic transfers of GMPs. However, we recognise that schemes' circumstances vary and that there may come a point where a nuanced approach is more appropriate. We will be pleased to discuss the best way forward in your particular circumstances.

TRANSFERRING TRUSTEE ACTION PLAN

Check data and categorise transfers

We recommend that you check the availability of data for your historic transfers out and allocate each transfer to one of the following categories:

1. **Known knowns**: recent transfers out where full data is available;
2. **Known unknowns**: historic transfers out where only partial data is available;
3. **Unknown unknowns**: historic transfers out where no data exists (for example, following a change of administrator or deletion of data as part of data protection procedures).

As well as individual member data, you will need the historic actuarial assumptions used to calculate the original CETV. This is likely to require input from your scheme actuary.

Category 1: recent transfers ("known knowns")

Where full data is available, trustees should do the following.

- Calculate the CETV for the member's Comparator, on the same actuarial basis used for the original transfer.
- Where the CETV actually paid is greater than the Comparator's CETV, no further action is needed.
- Where the CETV actually paid is less than the comparator's CETV, the difference (plus interest) should be paid as a top up CETV (please see Payment of top ups below).

Category 2: partial data cases ("known unknowns")

Where only partial data is available, we recommend that you:

- identify what data is missing; and

- take reasonable steps to fill in the gaps in your data, for example by writing to the former member at their last known address to ask for any missing data.

Where you have reason to believe that the former member's CETV is more likely than not to have been underpaid, you could give the option of taking a small lump sum payment in settlement of any claim they may have, as an alternative to providing the missing information and having the CETV recalculated. For tax reasons it is preferable for a compromise lump sum to be paid by the sponsoring employer rather than the trustees.

Category 3: no information cases ("unknown unknowns")

Trustees will not know about such cases until they are contacted by former members. You should ask any former members who contact you with a potential claim to provide:

- relevant information, including their National Insurance number and dates of employment; and
- evidence of their membership of the scheme and of the transfer out they claim was made.

You should review the information and evidence for each claim, preferably with the sponsoring employer, before deciding on the approach to take.

- One option would be to offer the member a compromise payment in settlement of any claim (in a similar way to Category 2: partial data cases above).
- However, there is a risk that schemes could become a target for spurious claims, encouraged by unscrupulous advisers – especially if it is known that a large scheme is offering compromise payments as an alternative to carrying out a full investigation and recalculation.
- To help counter unfounded claims, trustees might consider asking a claimant for an up-front payment to cover administrative expenses, to be refunded if the individual is found to have had pensionable service in the period from 17 May 1990 to 5 April 1997.

Double benefit : the effect of *Coloroll*

It is ironic that for a former member who transferred his GMP from one DB scheme to another, payment of a CETV top up to his receiving scheme is likely to provide no (or negligible) personal benefit.

The reason for this is that under earlier EU case law (*Coloroll*), a receiving DB scheme is obliged to provide benefits equalised between men and women, including in respect of rights previously transferred in. The combined effect of *Coloroll* and the 2018 *Lloyds* decision is that the receiving scheme must equalise benefits for the effects of GMPs, even where the GMPs in question were accrued while the member was in pensionable service under a previous scheme.

A member is therefore likely to see no increase in benefits following the payment of a CETV top up to his receiving scheme. The only expected benefit to the member if a top up is paid is that the funding position of the scheme would be very marginally improved.

The flipside of this is that, if compensation is paid direct to the former member instead of as a top up to the receiving scheme, the former member will receive a double benefit:

- compensation from the transferring scheme in settlement of the claim to have an equalised CETV; plus
- an equalised GMP from the receiving scheme.

Payment of top ups

Where a top up CETV is payable and you know its amount (please see above), we recommend that you contact the former member and either:

- ask for details of their receiving scheme and pay the top up to the receiving trustees; or
- agree to pay a lump sum direct to the former member in settlement of their claim.

A payment of the amount of the top up required to achieve GMP Equalisation may be made to the member as a "relevant accretion" for tax purposes (please see the box below) and will be subject to income tax.

Where you do not know the amount of the CETV shortfall (because of either inadequate data or a decision to compromise the claim without a full calculation), a payment direct to the member will not be a relevant accretion. Payment by the trustees of a lump sum which does not exactly equal the value of the member's rights would be an unauthorised payment, meaning that it is preferable for the payment to be made by the sponsoring employer.

What is a relevant accretion ?

The tax rules recognise that after a member's right to benefits under a scheme have (apparently) been extinguished by either a transfer out or buying out with an annuity, it may come to light that the member is entitled to further rights under the scheme which were not known about at the time of the transfer or annuity purchase.

These additional rights are known as a "relevant accretion". The Pensions Tax Manual explicitly refers to the application of sex equalisation legislation as an example of where administrators may not have previously been aware that a member was entitled to additional benefit.

The value of these additional rights may be paid as a trivial commutation lump sum (and so be an authorised payment for tax purposes) if certain conditions are met:

- The lump sum must extinguish the member's rights to benefits under the scheme.
- It must not exceed £10,000.
- It must not be greater than the value of the relevant accretion; and
- It must be paid within six months of the relevant accretion becoming known.

Where the member has died, the additional rights may be paid as a trivial commutation lump sum death benefit provided the same conditions are met.

A compromise amount which exceeds the value of the member's right to a top up CETV cannot be a relevant accretion.

OTHER ISSUES FOR TRANSFERRING TRUSTEES

Rules based transfers

Some individual transfers out may have been carried out under transfer provisions in your scheme rules rather than under legislation. Two examples of where this can happen are a partial transfer of the member's rights or if the transferring member is within one year of normal pension age (and so has no statutory right to a transfer value) but is nevertheless able to transfer out under the scheme rules.

Our understanding of the judgment is that transferring trustees do not need actively to revisit rules based transfers. Legally, it would be for an individual former member to apply for a court order to set aside the exercise of your transfer power.

It seems highly unlikely that individual former members would apply to court in this way. However, practically, it may involve more work for schemes to determine whether historic individual transfers out were rules based or statute based. A more pragmatic approach may be to treat all past individual transfers in the three category way described above.

Transfers to DC schemes

The judge did not distinguish between payment of unequalised CETVs to DB or DC schemes and the obligation to pay a top up CETV is the same. Our three category approach can be used for historic transfers to both DB and DC arrangements.

The position of the former member is, however, somewhat different following a transfer to a DC scheme or personal pension. In this situation, the receiving trustee (or the personal pension provider) is not obliged to equalise for the effects of GMPs under the receiving scheme, nor can the sponsoring employer of the receiving scheme (or the personal pension provider) be required to fund any increase in benefits necessary to equalise GMPs.

It follows that a former member whose CETV was underpaid will suffer loss unless the underpayment is remedied by payment of a top up CETV or a compromise lump sum.

Deceased members

The duty to pay a top up CETV to a receiving scheme will continue even after the former member has died. Such cases may also be divided into Categories 1, 2 or 3 and treated accordingly. An amount equal to the top up CETV (plus interest) may be paid to the member's personal representatives (PRs) as a relevant accretion (please see the box above).

The position will be more complicated where the deceased member has no PRs. A pragmatic approach would be to take no action unless a survivor comes forward to make a claim.

WHAT ABOUT WINDING UP?

Schemes currently in winding up

Trustees of schemes which are going through winding up face additional challenges.

As part of the wind up process (or in preparation for an earlier buy-in), you are likely to have already cleansed your member data as far as practicable. Past individual transfers out which you are aware of can therefore be treated as either Category 1 or Category 2 above.

The difficulty arises with Category 3 transfers, as you won't know of potential claims until they materialise – and, following completion of winding up, you will no longer have assets available to meet any claims.

There are several possible ways in which trustees can protect themselves from the risk of unknown future claims following a wind up, but none are ideal when facing GMP Equalisation transfer out claims. In particular:

- Residual risk insurance (covering risks such as claims from unknown beneficiaries) usually does not cover transfers out.
- Run off insurance is unlikely to cover GMP Equalisation of previous transfers out.
- Placing statutory adverts in local and national newspapers can give protection against Category 3 claims but would be ineffective in relation to transfers you already know about.
- You may ask the sponsoring employer to provide an indemnity against future claims. However, an employer indemnity is only valuable to the extent that the employer remains solvent and is not wound up.
- Discharge provisions in the scheme rules should not be relied on in this context as they only absolve the trustees from liability under the scheme, not from duties under statute (such as to pay a correctly calculated CETV).

In practice, trustees may decide (with their sponsoring employer) to delay the timetable for winding up or to buy out most benefits but keep the scheme running as a shell while GMP Equalisation for Category 1 and 2 past transfers out is dealt with.

Limitation periods after winding up

Trustees of schemes which are in winding up (or which have already wound up) may take some comfort from the potential for a different limitation period to apply to claims regarding payment of unequalised CETVs.

When the trust is wound up and no longer has assets, arguably a claim by a former member would no longer be for "recovery of trust property in the possession of the trustee", which has no limitation period - but would fall under a different provision of the limitation legislation, meaning that claims more than six years after the original transfer date were out of time.

Schemes which have previously wound up

Where a scheme has already wound up, the scheme assets will have been dispersed and any trustee company may have been dissolved, meaning that there may not be financial or human resource to investigate historic transfers out.

SHOULD A CLAIMANT COME FORWARD, YOU SHOULD CHECK THE TERMS OF ANY ONGOING INSURANCE POLICIES IN CASE THE CLAIM (OR YOUR COSTS IN INVESTIGATING OR DEFENDING IT) ARE COVERED. HOWEVER, CONCERNS ABOUT GMP EQUALISATION HAVE EXISTED FOR MANY YEARS, AND IT IS COMMON FOR POLICIES TO EXCLUDE GMP-RELATED ISSUES.

SOME WIDER CONSIDERATIONS

Position of receiving schemes

In *Lloyds*, the court did not consider rights and obligations as between the transferring and receiving trustees. According to the judgment, the duty of the transferring trustees is to pay a CETV top up to the receiving scheme. While this duty is owed to the member, the primary duty is to pay the top up to the receiving scheme.

For a typical receiving scheme, which may have accepted individual transfers in from numerous different transferring schemes, pursuing claims against different sets of transferring trustees is very unlikely to be cost effective (even assuming a valid claim could be made).

If you have previously accepted individual transfers in from members with historic GMPs, you may be contacted by transferring trustees asking you to accept a small top up CETV. This could prove a useful opportunity to fill in any data gaps in relation to your member's transferred in GMP.

Other underpaid transfers out

The court's decision that where a CETV had been paid which did not adequately reflect the member's full rights to benefits, the transferring trustee has a duty to make good the shortfall has implications beyond GMP Equalisation.

There are other reasons why a CETV may subsequently turn out to have been underpaid, for example where:

- a male member transferred out after 17 May 1990 but before his scheme equalised normal retirement ages; or
- a purported amendment of scheme rules later turns out to have been ineffective.

Potentially, transferring trustees could have a duty to pay top up CETVs (or a compromise lump sum) in these other circumstances.

Pension Protection Fund

The latest *Lloyds* decision also raises questions for the Pension Protection Fund (PPF):

- How will the PPF approach underpaid CETVs paid from schemes which have subsequently transferred to the PPF?
- Will potential liability for CETV top ups have to be taken into account in section 179 valuations?
- Presumably, a scheme currently in a PPF assessment period will need to factor in the correction of unequalised CETVs alongside GMP Equalisation more widely.

CONTACT US

We would be delighted to speak to you about how to deal with historic transfers or any other aspect of GMP Equalisation.

For more information, please speak to your usual Hogan Lovells contact or to one of the pension partners listed at the end of this note.

APPENDIX I: WHAT IS A GMP AND WHY ARE THEY UNEQUAL?

Defined benefit (DB) pension schemes that were contracted-out of the State Additional Pension (SERPS) in the period from April 1978 to April 1997 are required to provide members with a minimum level of pension (known as the Guaranteed Minimum Pension – GMP). The GMP replaces part or all of a member's SERPS entitlement.

GMPs, like SERPS at the time, were calculated differently between men and women in that:

- the age at which GMP becomes payable (GMP Age) is 60 for women but 65 for men; and
- women earned GMP at a faster rate than men.

Women's state pension age started to be equalised upwards from 1997. However, no changes were made to GMP Age, meaning that the inequalities between men and women entitled to GMPs remain hard-coded in legislation.

The *Barber* judgment

Following the European Court's May 1990 decision in the *Barber* case, most schemes took steps to equalise normal retirement ages (NRAs) between male and female members. Commonly, this meant increasing women's NRA to 65, to match the male NRA. This usually meant that overall benefits at the date of retirement, or leaving pensionable service, were equal for men and women (typically, a pension of $1/60^{th}$ of final salary for each year of pensionable service, payable from age 65).

Unequal benefits and the "cross-over" point

The statutory GMP requirements, combined with the effect of the particular scheme's rules on any benefit in excess of the GMP, mean that a male is unlikely to receive exactly the same pension in payment as a female comparator.

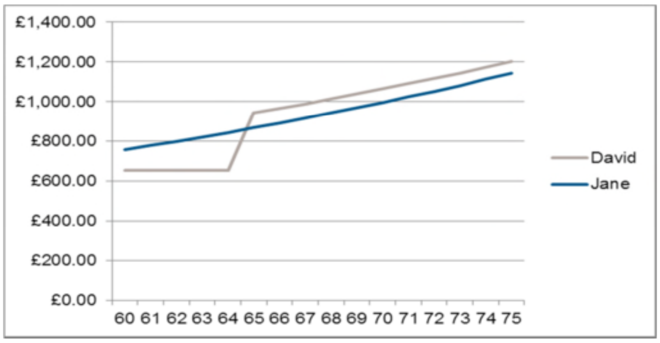
The chart below illustrates how benefits can differ between comparable male and female members – with the female receiving higher benefits between 60 and 65 and then being overtaken by the male at some point after he reaches GMP Age.

Differences can arise because:

- a man who leaves pensionable service before GMP Age will have his GMP revalued for a longer period of deferment than an equivalent woman who leaves pensionable service at the same age;
- a woman's GMP will be subject to statutory increases from age 60, while the GMP of her male comparator will only be increased from age 65;
- the notoriously complex "anti-franking" requirements of legislation (please see the box below), can result in differing treatment of male and female benefits.

The level and severity of the difference in treatment between men and women varies from scheme to scheme, depending on a number of factors – the most important being:

- how a scheme's rules increase pensions in payment;
- whether there is a period of deferment before the pension comes into payment (and, if so, what revaluation is applied in deferment); and
- the scheme's administration policy on anti-franking (please see the box below).



Anti-franking and GMPs

A member whose accrued right to pension is greater than the level of his/her GMP, will have rights to both the GMP and to the "excess over GMP". If the member leaves pensionable service before reaching GMP Age, the GMP must be revalued (protected against inflation) in line with statutory requirements.

"Anti-franking" legislation protects the member's deferred benefits – by ensuring that the growth in the GMP cannot simply be offset by making a corresponding reduction to the member's excess over GMP.

The anti-franking provisions are highly complex.

WHAT HAVE SCHEMES PREVIOUSLY DONE TO EQUALISE GMPS?

In practice, schemes have usually only sought to equalise for the effect of GMPs if the scheme was in winding up or was entering the Pension Protection Fund (PPF).

Otherwise, very few "ongoing" schemes have attempted to deal with inequalities caused by GMPs – most are aware of the issues but have been waiting for answers as to how to achieve equality (recognising that GMPs themselves cannot be equalised unless the legislation changes).

Schemes winding up needed to consider how to adjust benefits (both past and future) to reflect unequal GMPs and those that made any adjustment tended to adopt a rough and ready approach adjusting only future benefits. This was seen as a pragmatic approach to an insolvable problem.

Where schemes of insolvent employers enter the PPF, adjustments are made to compensation according to the PPF's methodology and adjustments are made to correct past underpayments resulting from GMP inequality.

APPENDIX II: EQUALISATION METHODS AND THE LLOYDS BANK CASE

In July 2018, the High Court heard an application brought by the trustee of some of Lloyds Bank's pension schemes seeking directions as to whether and, if so, how the schemes should adjust benefits to compensate for the inequalities of GMPs.

The judge was presented with the unenviable task of deciding whether there is a correct way to adjust benefits, or whether several different methods would be acceptable. He was also asked to consider what needed to be done regarding back-payments where members had been underpaid (including for those who had transferred out of the scheme).

Judgment was handed down on 26 October 2018.

EQUALISATION METHODS

In the *Lloyds Bank* case, four main methods of equalising GMPs (most with their own sub-variants) were presented to the Court. Methods A, B and C are based on the amount (quantum) of benefit paid. Method D, which is the method favoured by the DWP, looks at the actuarial value of male and female benefits.

Method A

Method A broadly speaking involved equalising different parts of the benefits. Method A3 involved equalising each "part" of the pension (GMP plus the pension which was the "excess over GMP") and levelling up each part. This would result in both male and female members receiving more in each year of payment than either would have had without equalisation. Method A is therefore a particularly expensive means of equalisation.

Method A was favoured by the representative beneficiaries.

Method B

Under Method B, each payment of pension (GMP combined with excess over GMP) is equalised, with the member receiving the higher of the benefit each year paid to a male or a female member in otherwise identical circumstances.

Under this method, in the early years of pension payment the female's pension would be higher – so the male pension would be topped up. After the "cross-over" point (please see Appendix I), the male pension would exceed the female, so a female pensioner would receive a top up.

Under Method B, both male and female pensioners would receive greater amounts over the course of their expected retirement than if the benefits had not been equalised.

In *Lloyds Bank*, no one argued that Method B was the right one to adopt.

Method C

Under Method C1, the male pension would be increased to the level of the female pension in the early years of payment but the increase would be treated (for the male) as a credit for early payment. After the "cross-over" point, the male pension would remain at the level of the female pension (by then lower than the male pension) until the accumulated credit had been used up – the second cross over point.

After the second cross-over point, both male and female pensioners would receive the amount of pension payable to a male.

For many schemes, there will be no cross-over members – in which case Method B and Method C will produce the same results.

Under a variation of Method C (Method "C2"), interest would be added to the credit for early payment, resulting in lower overall payments being made than under method C1.

Method C was favoured by the sponsoring employer.

Method D

Method D looks at the actuarial value of the projected income stream (of GMP and excess over GMP) for male and female members and would seek to equalise for the difference in treatment on a "once and for all" basis.

The DWP favoured a variation: Method "D2". Under this method, the actuarial value of benefits of an equivalent male and female member would be calculated, and the higher amount used for conversion into scheme benefits. The converted benefit would all be treated as non-GMP, with the result (in many cases) that the starting amounts of pension would be lower than before conversion. After a "cross-over "point, pension payments would be higher than pre-equalisation for both men and women.

Equalisation methods: what did the judge say?

When assessing the various suggested methods, the judge relied on the principle of "minimum interference" with parties' rights. He concluded as follows.

- Methods A, B, C1 and C2 were all permissible means of achieving equal treatment.
- The sponsoring employer could require the trustees to adopt method C2 as the method which would involve least cost (and therefore the minimum interference with the employer's rights). Similarly, method C2 is the method trustees could use without the employer's agreement to any other method.
- Method D1 was not permissible as it would infringe the rights of the beneficiaries (while other methods would not). Conversion under method D2 would also interfere with beneficiaries' rights, but this is permitted under the conversion legislation. In a second judgment given on 6 December 2018, the judge clarified that method D2 could be used for future benefit payments, while benefits already paid should be equalised using one of methods A, B or C.
- Trustees must make back-payments to make good arrears of underpaid pension, including interest at 1% simple over base rate.
- Scheme rules may limit back-payments to those falling due within the previous six years. Where the rules do not contain such a provision, there is no limitation on how far back arrears must be paid.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

KEY HOGAN LOVELLS PARTNERS

Katie Banks	**+44 20 7296 2545**	**katie.banks@hoganlovells.com**
Duncan Buchanan	**+44 20 7296 2323**	**duncan.buchanan@hoganlovells.com**
Claire Southern	**+44 20 7296 5316**	**claire.southern@hoganlovells.com**
Edward Brown	**+44 20 7296 5995**	**edward.brown@hoganlovells.com**
Faye Jarvis	**+44 20 7296 5211**	**faye.jarvis@hoganlovells.com**

About Pensions360

Hogan Lovells' broad cross-practice capability covers the full spectrum of legal advice from lawyers who understand pension clients; advising on issues from scheme investments, corporate restructurings and transactions, to funding solutions and interaction with the Regulator or the courts. The ability to draw on specialists from other practices who are not only experts in their field but have an in-depth understanding of pension issues sets us apart from our competitors.

www.hoganlovells.com