



Pensions GMP equalisation alert

Action stations to equalise pensions for GMPs – Lloyds judgment

Briefing

October 2018

Introduction

After over 25 years of uncertainty, we now know that UK pension schemes must remove the last traces of sex inequality from benefits built up since May 17, 1990. Guaranteed minimum pensions are required to be different for men and women, and they create differentials in otherwise equal pensions which fluctuate over time. As a result of the Lloyds Banking Group judgment, trustees must correct those differentials for the future, and pay arrears for the past, but employers can control the costs of doing so.

In the *Lloyds Banking Group judgment*, the judge, Morgan J, confirmed that

- Trustees and employers cannot justify the differential caused by guaranteed minimum pensions (GMPs) so they must correct it via the main scheme benefits.
- Trustees can (and must) change the scheme rules to comply, but can only do so without employer consent if they do the minimum necessary to comply.
- If there is a choice of ways to deliver equalised benefits (as there was for Lloyds Banking Group), the trustees can only select the option that interferes least with the employer's funding obligations, unless the employer agrees.
- Three methods were identified that correctly delivered equalisation for the past, with a further option of conversion of benefits available for the future (if the employer consents).
- Arrears of underpaid pension must be paid (subject to any limits on back-payments in the scheme rules) and will carry simple interest at one per cent above base rate while they remain unpaid.

The effect of this judgment is that the obligation to pay benefits equally actually started on May 17, 1990, so schemes are already in breach and in arrears. There is now going to have to be a big push to correct everything as speedily as possible. You cannot wait for individuals to come forward to claim their benefits.

The judgment affects all pension schemes which contain salary-related contracted-out benefits built up between 1990 and 1997 (i.e. GMPs). This includes defined contribution schemes with an underpin of contracted-out benefits, but doesn't directly affect pure defined contribution schemes.

Stage 1: immediate next steps

Everyone: talk to your advisers.

This is going to be an unavoidably complex process, and you will need help from legal, administrative, actuarial and accounting professionals. Start that process now – there will be a lot of employers and trustees needing help in a hurry and it will take a long time to calculate and deliver the correct benefits

Trustees and employers: talk to members and staff.

They will have seen the reports in the press and may be worried, excited, confused or angry. Get onto the front foot and put up a short note on your scheme website, or write to members, to say what's going on, confirm that you will be correcting benefits and contacting affected beneficiaries individually, and explain that this will take some time to get right as it is a complex issue. Confirming you will be adding interest on past underpayments at the Court-approved rate until the arrears are all paid out should help members cope better with the delay and avoid complaints. Give your administrators and switchboard/pensions team a statement to give to members who contact them.

Trustees and administrators: change benefit processes

For transfer quotes, transfer requests, trivial commutation and other small lump sum payments.

- We suggest adding a warning on your new transfer quotes that the calculation does not include the outcome of the equalisation process you are about to start. If the member insists on proceeding with the transfer in the meantime, they should be aware their benefits may be undervalued. We suggest not promising any follow-up top-ups at this stage – we don't yet know which members will need it.
- Contact members who request transfers, or who have already requested transfers that have not yet been processed. Think about giving them the same warning and ask them to reconfirm whether they still want to transfer. If you don't catch a transfer currently going through, make sure a record is kept to review later once you know what you have to do on transfers (see below).
- Can you suspend trivial commutation and similar small lump sum payments? You are now on notice that your calculation may not include the whole benefit so there may not be a full discharge.

Employers: talk to your auditors.

This additional liability will need to be assessed and disclosed, and it will ultimately hit both profit/loss account and balance sheet. However at this stage we understand there is still some uncertainty over the level of disclosure required, the treatment of the liability in the profit/loss account and the level of approximation that auditors will accept at this stage. If for example you are in the process of delivering year-end accounts for a March 31 year end, there is not much time left to settle this.

Stage 2: getting it sorted**Trustees and employers: talk to each other.**

There is no one-size fits all solution for this particular issue. You need a plan for paying future equal benefits, and a plan for fixing the past. Employers can insist on trustees choosing the solution that costs the least, but working out which one that is will take time and data. The answer will depend on your own scheme's history, administration and demographics. That means employers and trustees have to run the numbers and talk to each other about the options to agree what works best for each scheme.

Trustees: check your scheme rules on payment of arrears.

There is no overriding limitation on how far back you need to make up past underpayments, except the original equalisation date of May 17, 1990. However your scheme rules may require, or permit, you, to limit back payments to the last six years-worth. It's all in the drafting so let us know if you would like us to review your forfeiture clauses.

Trustees: assess your data.

To deliver accurate equalisation you will need to understand the breakdown of members' benefits between the various elements of GMP and the excess over the GMP over time. Now would be a good time to commission data-cleansing if you haven't done so already. The second stage will be working out the appropriate assumptions and methodology to fill in the gaps where data is missing and still deliver legal equalisation.

Trustees and insurers: check your buy-outs and buy-ins.

For future transactions, make sure the benefit specifications cover fully equalised benefits – this may mean that any current transactions have to be delayed until the scheme's own equalisation method is selected. For existing buy-outs and buy-ins, it's a question of looking at the contracts to see who has liability and whether there is any alternative cover for the liability. Again, let us know if you would like us to help with this.

Employers and trustees: factor this liability into funding discussions and valuations.

Should you hold an out-of-cycle valuation if there is already significant funding strain? Talk to your actuary. The impact on individual schemes will depend on each scheme's circumstances, and given the length of time it may take to recalculate and reset benefits, you may find your existing valuation timetable is actually still fit for purpose.

What are we still missing?

A second hearing in the *Lloyds* case, possibly early next year, will need to address some outstanding issues

- What to do where the actual change in benefits after equalisation might be insignificant – the judge confirmed that administrative costs are not a consideration in choosing an equalisation method, but there may still be a case for some rounding off.
- Treatment of transfers in and out. The judge suggested schemes should be responsible for transfers in, but parked what residual liability there might be for transfers out. Who picks up the tab for past transfers to personal pensions and other defined contribution structures?

The tax treatment of arrears is a separate issue. We expect HMRC to have to change its approach to ensure all benefit corrections are authorised. If you plan to start correcting past payments quickly, we would suggest contacting HMRC to confirm their tax treatment.

Whilst it is possible that the *Lloyds* case might be appealed, we currently think this is unlikely.

Contacts

If you would like further information please contact:

London



Lesley Browning
Partner

Tel +44 20 7444 2448

lesley.browning@nortonrosefulbright.com



Peter Ford
Partner

Tel +44 20 7444 2711

peter.ford@nortonrosefulbright.com

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