



Pensions Alert - Schemes can no longer avoid GMP equalisation

Key points

- In a landmark judgment on the complex question of “GMP equalisation”, in *Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank PLC and others*, the High Court confirmed that trustees of formerly contracted out defined benefit pension schemes have to amend scheme rules to equalise for the effect of unequal guaranteed minimum pensions (GMPs). The court also provided some guidance on the method to be used to equalise GMPs.
- Although pension schemes have had to provide equal scheme benefits to male and female members for benefits built up since May 1990, most schemes have not equalised for the effect of unequal GMPs. The pensions industry has grappled with the question of whether equalisation is needed, and the method that should be used, but without any consensus until now.
- This judgment is expected to cost the bank between £100m and £500m to pay higher pensions to affected members. It could have significant cost implications for many pension scheme trustees and sponsoring employers.
- Employers and trustees of defined benefit pension schemes will need to seek advice on the implications of this judgment on their scheme, for example, in relation to transfer requests, as most schemes are unlikely to have equalised for the effect of GMPs.
- Employers will need to consider the cost of equalising benefits as the current funding position of most schemes is unlikely to include reserves for the cost of equalising GMPs.
- Suggested actions for employers and trustees to deal with the impact of the judgment are set out in this alert.

Background

GMPs were introduced in April 1978 and enabled schemes to contract out of the additional state pension (known as the State Earnings Related Pension Scheme or “SERPS”) by providing a minimum amount of pension, the “guaranteed minimum pension” (GMP), broadly equal to the pension that would have been provided by SERPS. Many schemes will have members with GMP benefits up to 5 April 1997 when the GMP rules were abolished for future service.

Under legislation, GMPs are determined on an unequal basis because a female member’s GMP accrues at a greater rate than that of a male member due to the fact that they are payable by reference to a member’s state pension age, which was 60 for female members and 65 for male member’s was 65. Thus a female member’s overall GMP will be greater than the GMP of a male member with identical work history. There are also other factors (unrelated to a member’s sex) that affect the calculation of a GMP for a particular member, including how GMPs are revalued before payment and how they are increased after payment.

A key problem facing many schemes is that unequal GMPs could result in other non-GMP scheme benefits or overall benefits pensions payable to equivalent male and female members being unequal. In *Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank PLC and others*, the High Court was asked to consider whether the trustee of three schemes operated by the bank is required to equalise for the effect of unequal GMP.

Decision of the High Court

(i) Obligation to equalise GMPs

The High Court ruled that under European and UK law, the trustee of the schemes in question is required to adjust the benefits payable under the schemes to address the impact of the difference between the GMPs for male and female members so that the total pensions received by male and female members with equivalent age, service and earning histories are equal. This applies to GMPs built up in respect of service between 17 May 1990 (the date of the landmark decision on equalisation, *Barber v Guardian Royal Exchange*) and 5 April 1997.

(ii) Method of equalisation

The court was asked whether there is a single correct method, or different permissible methods to adopt, and if so, which method the schemes in question should adopt to equalise GMPs. The court concluded that only one of the four main methods identified by the parties produced minimum interference with the rights of any party and therefore, the bank (as sponsoring employer) could require the trustee to adopt that particular method to equalise for the effect of GMPs.

The method that the court said should be adopted by the schemes in question is based on comparing year-by-year calculations of the pension the member would receive under existing provisions and the pension they would have been receiving had they been of the opposite sex (all else being equal) but with some offsetting. If the comparison changes from favouring one sex to the other, the less generous calculation starts to be paid until accumulated gains prior to the change are exceeded by the divergence in payments after the change.

The other methods put forward by the parties would have resulted in higher costs to the bank. While the judgment provides some high level principles which can guide the selection of an appropriate equalisation method, it does not provide a definitive, one-size-fits-all method that all schemes should use. The appropriate method for a particular scheme will be a matter of judgement.

What steps should employers and trustees be taking to deal with GMP equalisation?

We set out below some actions that employers and trustees should consider taking as a result of this judgment.

Actions for trustees	Actions for employers
<ul style="list-style-type: none"> Seek legal and actuarial advice to assess the impact of the judgment on the scheme, including projected costs and appropriate method(s) for equalising GMPs 	<ul style="list-style-type: none"> Consider appropriateness of equalisation method put forward by the trustees and seek advice on cost implications of proposed method(s).
<ul style="list-style-type: none"> Consider impact on scheme liabilities as the current funding position of the scheme is unlikely to include reserves for equalising GMPs. Trustees should start considering how to address the issue in the next scheme valuation 	<ul style="list-style-type: none"> Consider how to fund any additional GMP liability and over what period.
<ul style="list-style-type: none"> Check the scheme rules for any limitation that applies to beneficiaries claiming arrears of payments as the court held that beneficiaries are entitled to back payments subject to any limitation period set out in the scheme rules. 	<ul style="list-style-type: none"> Seek advice on whether any additional GMP liability needs to be reflected in group/company accounts.
<ul style="list-style-type: none"> Prepare a communication to members about the potential impact of the judgment on the scheme, including how current benefit payments will be made. 	<ul style="list-style-type: none"> Liaise with trustees on any limitation period under the scheme rules as it will affect the cost of any additional GMP liability.
	<ul style="list-style-type: none"> Inform the trustees of any steps the employer is taking in relation to the judgment which can be included in a member communication

Actions for trustees

- Consider the impact of the judgment on bulk transfers, flexible retirement exercises, buy-ins and buy-outs and ongoing winding up exercises

The Court held that the obligation to equalise GMPs applies to benefits transferred **into** the scheme from another arrangement. However, with the parties' agreement, the Court did not determine the issue of whether trustees have an obligation to equalise GMPs in relation to benefits transferred **out of** the scheme. This issue will be determined once the parties consider the impact of the judgment.

- Consider whether to suspend suspending transfer value quotations until the full impact of the judgment has been considered. Trustees should also consider the impact of that policy on statutory timescales for responding to transfer value requests and consequence of any potential breach of the legislation governing such requests.

Actions for employers

- Employers should understand how trustees are dealing with transfer requests.

- Consider whether GMPs can be removed from the scheme using legislation available to convert GMPs into ordinary scheme benefits.

Next steps

This is a long awaited and significant decision for employers and trustees of defined benefit pension schemes that have not yet equalised GMPs and could be subject to an appeal. The precise effect of unequal GMPs on male members and female members will depend on the particular rules of a scheme and employers and trustees should seek advice on the legal implications of this judgment on their scheme.

To discuss the impact of this judgment on your pension scheme, please contact your usual pensions team contact or one of our team below.



Charles Magoffin

Partner

T +44 20 7785 5468

E charles.magoffin@freshfields.com



Dawn Heath

Partner

T +44 20 7427 3220

E dawn.heath@freshfields.com



Andrew Murphy

Partner

T +44 20 7785 2708

E andrew.murphy@freshfields.com



Tharusha Rajapakse

Knowledge Lawyer

T +44 20 7785 2445

E tharusha.rajapakse@freshfields.com

freshfields.com

This material is provided by the international law firm Freshfields Bruckhaus Deringer LLP (a limited liability partnership organised under the law of England and Wales) (the UK LLP) and the offices and associated entities of the UK LLP practising under the Freshfields Bruckhaus Deringer name in a number of jurisdictions, and Freshfields Bruckhaus Deringer US LLP, together referred to in the material as 'Freshfields'. For regulatory information please refer to www.freshfields.com/en-gb/footer/legal-notice/.

The UK LLP has offices or associated entities in Austria, Bahrain, Belgium, China, England, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Russia, Singapore, Spain, the United Arab Emirates and Vietnam. Freshfields Bruckhaus Deringer US LLP has offices in New York City and Washington DC.

This material is for general information only and is not intended to provide legal advice.