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A quick guide to GMP equalisation

This guide will help Trustees get up to speed with GMP equalisation, why it's necessary, the challenges schemes face and what schemes can do now to get started.

March 2020



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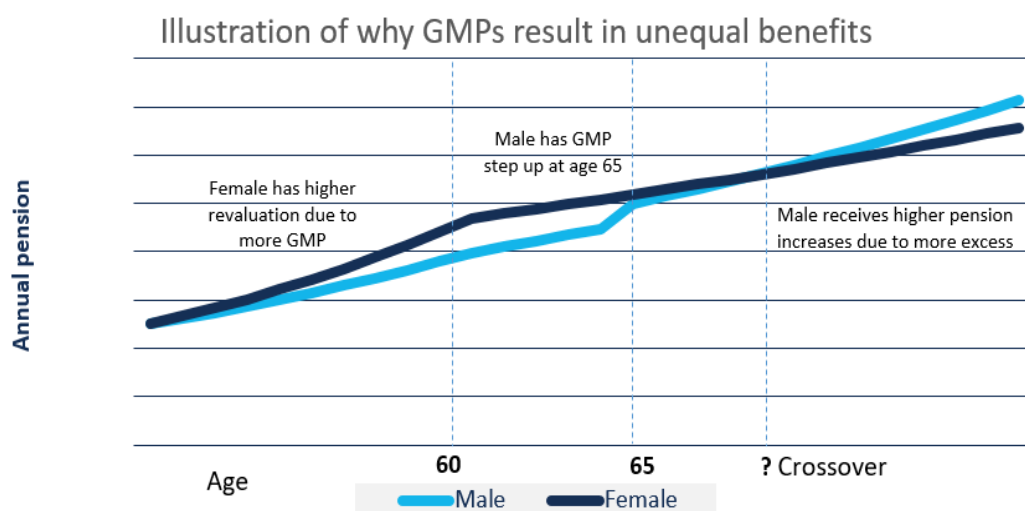
An introduction to GMP equalisation

Guaranteed Minimum Pensions (GMP) and subsequently GMP equalisation have been around for almost 20 years. But it's now that they are coming to the top of the agenda. Much of the debate following the Lloyd's judgment has focused on the difference between the methods defined by the Court, such as the relative merits of *GMP conversion* versus *dual records*.

The reality is that GMP equalisation is a set of data and system challenges. The data challenges are broadly the same *regardless* of the method used. The system challenges will depend on your administration system and your administrator's capability.

What is it?

GMP was the minimum amount an employer had to provide for any scheme contracting out of the state system between 1978 and 1997. But, as state pension ages and GMP accrual rates were different at the time for men and women, so were the GMPs.



In 1990 the Barber case threw the spotlight on unequal benefits based on sex and in 2018 the Lloyds case put the focus on GMPs. Schemes need to make sure they've equalised members' benefits accrued between 1990 and 1997 (when GMP accrual ended), and this now included equalising for the effects of GMP.

Since then there's been a raft of guidance from the DWP, HMRC and the cross-industry GMP Equalisation Working Group around how schemes should approach equalising GMPs. Much of the subsequent debate has centred on the relative merits, and costs, of the different equalisation methods.

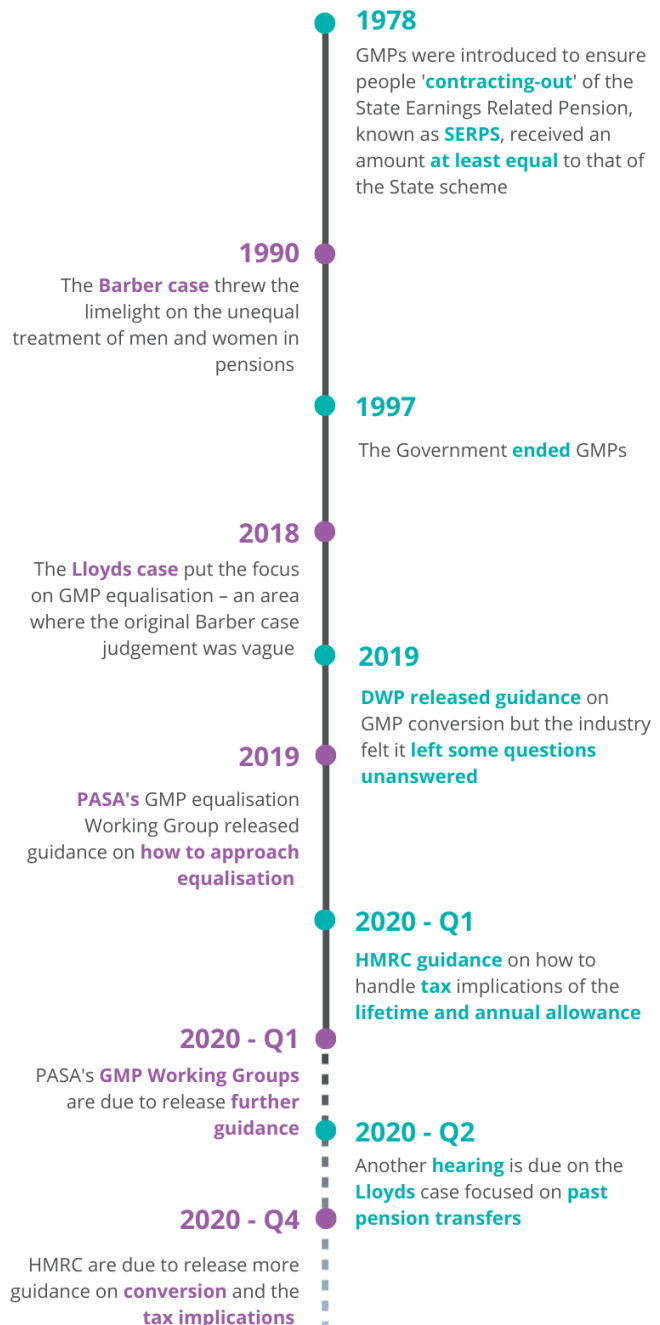
The story so far...

Over the past few years there's been a raft of guidance, from the Lloyd's case itself, from HMRC, the DWP and the cross-industry working group for GMP Equalisation.

The industry has been calling for further guidance on some of the complexities around GMPs, transfers and tax – much of which is due this year.

A BRIEF HISTORY OF GMP EQUALISATION

The words GMP equalisation have been bouncing about for so long it's hard to remember how it started, and why it's still an issue almost 30 years on.



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What needs to be done?

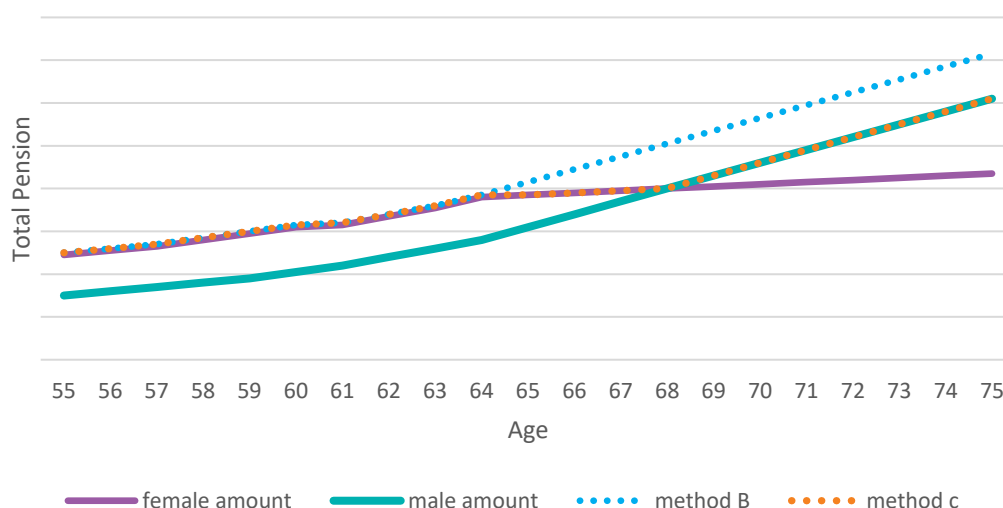
The guidance provided so far sets out 3 methods that can be used to correct the past:

Method B – You compare both the member's and the opposite sex equivalent, year by year. When the opposite sex GMP is higher you pay the GMP element on the higher amount.

Basing this year on year doesn't take into account the cumulative amount, so members could end up better off.

Method C1 – It's similar to method B but is designed to equalise the cumulative benefit each year to avoid over-compensating members.

Method C2 – This is the same as method C1 but also includes interest (1% over base rate) on accumulated gains.



Once you've sorted the past and paid any arrears due, you then need to continue to keep track of both male and female amounts to check for crossover points like those on the graph above, or you have the option to remove GMPs through 'conversion'.

These two options are:

Dual records

Methods B, C1 & C2

Dual records involves tracking both the member's pension (including GMP) and the opposite sex equivalent in respect of accrual between 1990 and 1997.

Conversion

Method D2

The alternative is known as GMP conversion - converting GMP benefits to non-GMP of equal value.

Dual records methods require schemes to keep true and opposite sex records, as well as ongoing balances of accumulated pension and interest gains. This enables schemes to see when a GMP becomes unequal and an adjustment could be made. It does mean schemes would need to adapt their administration system and processes.

The conversion method doesn't require the maintenance of proper dual records as long as all GMP records in payment are converted. Some methods require that GMP conversion is applied when members retire which can be a complex ongoing calculation to apply. Conversion still means a significant change to a scheme's data, and changes to scheme processing rules.

These methods enable schemes to achieve the following:

- ✓ **Correct past inequalities** – The judgment defined a number of acceptable methods for rectifying the past and calculating underpayments due to members. The only method that can be adopted without the consent of the employer is Method C2 this being the 'least costly' way of dealing with the inequality.
- ✓ **Ensure equal treatment in the future** – By default, whichever method was used to rectify past inequalities is also implemented in the future. As an *alternative*, the judgment stated that future benefits could be converted under existing GMP conversion legislation to provide an equalised actuarial equivalent benefit (method D2).

Things to consider

Planning your equalisation project is the final piece of the GMP jigsaw. There's still lots to do before that point, so it's worth thinking about...

1

Overlap with other projects, like GMP reconciliation

Many schemes have completed GMP reconciliation with HMRC and are due to move on to correcting members benefits. Once you've identified members with benefits that need correcting it's important not to delay. Paying the right benefit at the right time is your duty as Trustee.

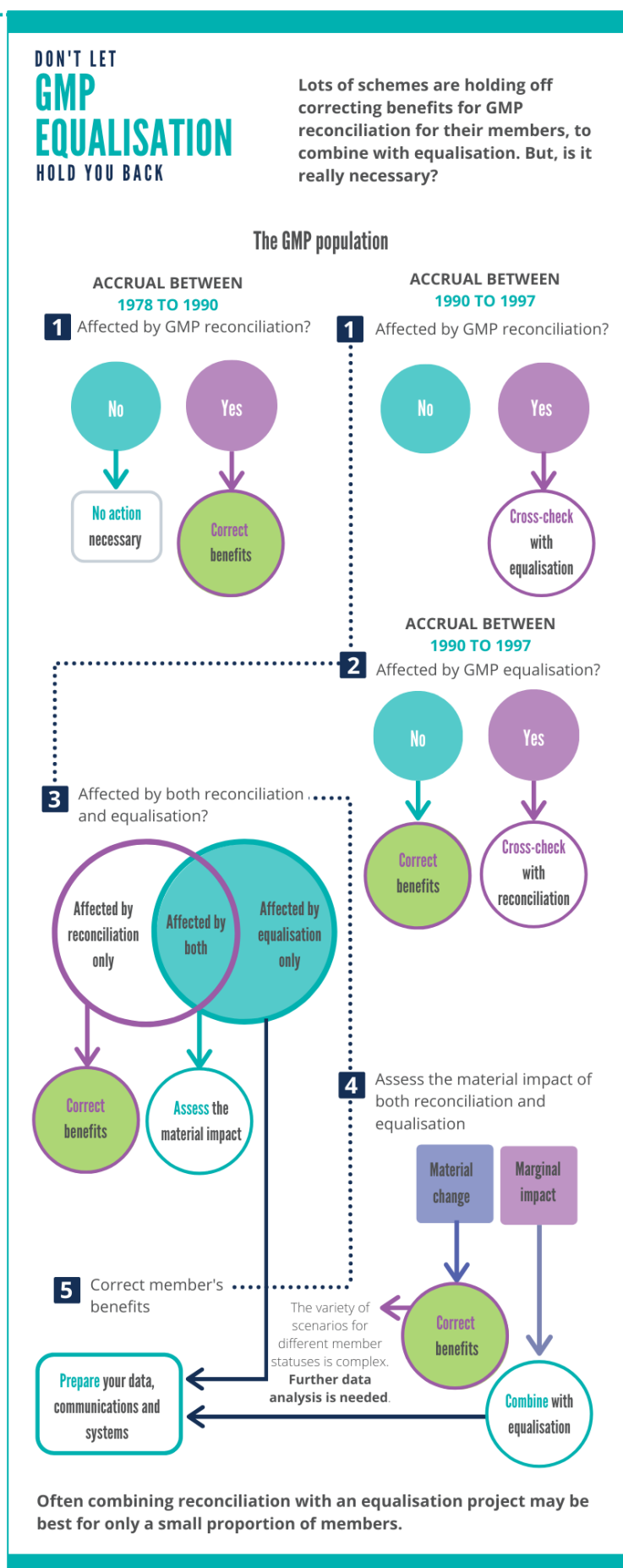
You may consider holding off correcting benefits after reconciliation because you're waiting for equalisation – and you don't want to correct member's benefits twice.

But it's worth considering a few key things:

- *GMP equalisation must be calculated based on the post-reconciled benefits – so you'll need to correct this first anyway.*
- *Different members are impacted by reconciliation and equalisation, so it's likely that very few members will be materially affected by both.*

This infographic shows the steps you might go through when deciding whether correcting benefits for members requiring reconciliation should be combined with your equalisation project.

In our experience, very few members are materially affected by both. Even when they are, further data analysis often means you can continue correcting benefits for reconciliation before equalisation.



2

The scheme's strategic goals for the next few years

If you're considering de-risking exercises in the future, particularly those involving an insurer such as longevity swaps, buy-ins and buy-outs you should think about how this might impact your choices. Marrying up your de-risking timeline with your GMP equalisation implementation will help make both projects run smoothly.

Insurers will have different views on conversion and dual records, so it's worth thinking ahead and understanding the wider impact of all the options.

If your de-risking approach is likely to include consolidation, it's still important to make sure your GMP equalisation implementation is aligned with your aims. And with a greater focus on the standards and governance of superfunds, they're likely to have their own requirements.

3

The impact on ongoing administration

Regardless of the GMP method you choose, you'll need to make changes to your administration systems and processes.

It's good to involve your administrator or in-house teams early on in your project. Starting conversations early about the feasibility of changes needed will enable you to create a realistic project plan and, ultimately make ongoing administration easier.

If you decide to take the conversion route, there's a few additional things you should consider...

- Is it justifiable for members?
- How feasible is implementation?
- Will the outcome achieve simplicity for ongoing administration?

The challenges you face

Making sure members, both men and women, are getting the right pensions should be high on trustee agendas, but there are challenges...

- 1 The industry is still waiting on further guidance:
 - a further hearing on the Lloyds case which focuses on how to handle transfers
 - more guidance from HMRC about conversion.
- 2 You're going to need far more data than you'd use for day-to-day administration. So, thinking early about what data you have and where you might get the additional data you need is important.
- 3 Dealing with data that is almost 30 years old may mean you need to spend some time on preparing your data and carrying out tracing and mortality checks.
- 4 Taking a proportionate approach and focussing on the members most affected. It's important to identify which members are impacted by GMP equalisation, and gain an idea of how material the changes will be.
- 5 After GMP equalisation you'll need to ensure ongoing administration is practical and efficient, regardless of the method you choose. If careful planning about ongoing administration is not considered early, your approach could become unfeasible to manage.
- 6 GMP equalisation will put a strain on the industry, with lots of schemes trying to equalise at the same time. The demand may outstrip the supply so doing what you can now will set you up for the future.
- 7 Member communication – in particular explaining the complex nature of the method you've selected, and whether you'll be combining GMP rectification and equalisation.



Next steps for trustees

The Pensions Minister, Guy Opperman has called on schemes to ‘act now’ when it comes to equalisation. So, what should be done now?



Assess which members are impacted and by how much

Carrying out in-depth analysis and identifying how many members, who they are, and the materiality of the changes.



Identify gaps in data

For the members impacted, identify what data you already have, where it's stored and how you'll handle cases where the data cannot be found. This could include deciding what sort of assumptions you'll use and considering whether de-minimis levels should apply.



Overlay with rectification members

Once you've identified members impacted by GMP equalisation it's a good idea to overlay this with members affected by rectification. This could help you make decisions about whether to rectify now or hold off.



Assess admin-system capabilities

Can administration systems cope with the changes needed? Thinking about what system and process changes might be needed will enable you to begin those conversations with your administrator or software provider and get an idea of costs.



Consider readiness and appetite for dual records vs conversion

Think about which method is going to be most feasible and align with your strategic goals.

If you'd like to talk about GMP equalisation, reconciliation or anything else in this guide please give us a call on **020 7648 9990**. You can also visit our website at www.itm.co.uk to learn more about what we do.