PENSIONS
TECHNICAL NEWS

SOLVING THE GMP EQUALISATION PUZZLE
ONCE PIECED TOGETHER THE PICTURE IS NOT QUITE WHAT YOU WOULD EXPECT!

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Executive summary

Much of the debate following the Lloyds judgment has focused on the different merits of the methods approved by the court e.g. Guaranteed Minimum Pension (GMP) conversion versus dual records. The reality is that GMP equalisation is a set of data and systems challenges that are broadly the same regardless of the method that is used.

Background

Over 29 years ago the European Court of Justice ruled in the Barber case requiring pension schemes to provide benefits of equal value for men and women. However it wasn't clear how the Barber ruling should apply to GMPs. GMPs are inherently unequal as the calculation of GMPs is set down in legislation. This meant that for many years the thorny issue of GMP equalisation remained unresolved. Finally last October much needed clarity was obtained via the High Court's judgment in the Lloyds Banking Group case. The judgment made it abundantly clear that schemes must equalise benefits for the impact of unequal GMP and provided insight into possible methods for doing so.

And much of the subsequent debate has centred on the relative merits, and costs, of these different methods.

What's the issue?
Why are GMPs unequal?

GMPs can result in inequality because:

- GMPs accrue at different rates. A woman's GMP comes into payment at 60 and a man's at 65. As a result a women's GMP accrues more quickly to reflect her shorter working life so a woman will have more GMP than an identical man.
- The GMP and excess element of a member's pension will generally revalue in deferment

at different rates, come into payment at different ages and then increase in payment again at different rates.

In a typical pension scheme, due to the effect of GMP, women are often better off in the early years that a pension is in payment. However, this can crossover to males being better off in the later years that a pension is in payment, as shown in the illustration below. This would typically be where pension increases payable on excess pension are higher than those payable GMP. Whether an individual is better off as a male or female overall can be difficult to predict.

What does the Lloyds judgment mean for pension schemes?

Clarification that benefits accrued over the period from 17 May 1990 (the date of the Barber judgment) to 5 April 1997 (when GMP accrual ended) must be equalised for the impact of GMP.
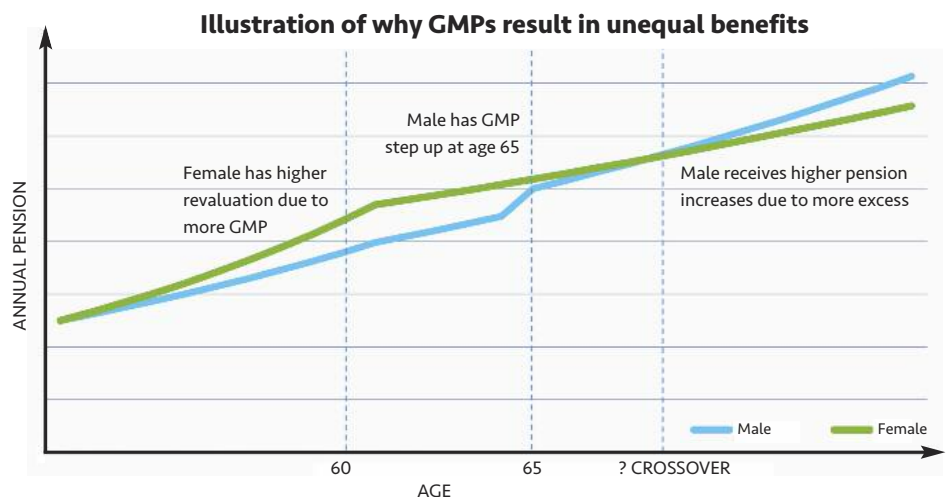
The judgment also covered which of the methods for equalising GMPs are permissible. The methods referred to in this article are labelled B, C1, C2 and D2 consistent with the terminology used in the Lloyds judgment. These methods are well documented -

more details can be found at www.itmlimited.com/gmpe

The methods enable schemes to achieve the following:

- **Correcting for 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.

- **Ensuring 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).

So, what work is involved? The work boils down to three areas that ALL schemes need to address, plus a fourth area which will depend on whether the scheme chooses conversion or ongoing checks for GMP equalisation.

Illustration of why GMPs result in unequal benefits

Area 1: Data preparation

An important first step is to get your data GMP equalisation ready. Given the length of time since benefits accrued this may well be challenging particularly as the data required is more detailed than that which is generally needed for ongoing scheme administration. Data preparation includes the following:

- GMP Reconciliation and Rectification – reconcile GMPs with HMRC and rectify any errors considering how rectification will interact with the GMP equalisation project.
- Data audit – ensure member data such as sex and service dates are validated and clean. Data to support tranching and historic rectification – such as commuted cash at retirement.
- Scheme level data – detailed data will be required including historic factors such as early retirement, late retirement and commutation going all the way back to 17 May 1990, alongside information on administrative practices such as anti-franking.
- Opposite Sex GMPs – these will need to be calculated alongside the corresponding excess benefit elements.

Further details can be found at www.itmlimited.com/gmpe

Area 2: Historic rectification

The next step is to calculate equalised pension payments and determine which members and dependants have been underpaid using the method agreed by the trustees (B, C1, C2). These underpayments will then need to be rectified. The process broadly falls into the following steps:

1. Roll back pension to date of retirement
2. Unwind cash and early/late retirement
3. Roll back to date of exit
4. Calculate Barber tranches
5. Calculate opposite sex pension
6. Roll back up to current date and rectify

Area 3: Admin System BAU Calculations

Administration systems will need a set of changes implemented irrespective of the equalisation method that is chosen:

- **Member data updates** – additional data required to administer equalised benefits.
- **Scheme calculation changes** – to calculate the equalised benefits when members retire, transfer out or take trivial commutation.

Area 4: The Option! Dual Records vs GMP Conversion

Having made it through the first three pieces of the jigsaw, you have tackled most of the challenges – but have one remaining: how to ensure benefits remain equalised after the rectification. The High Court approved two broad approaches for this:

- A DUAL RECORD approach involving a year on year comparison of the member's current benefits with those that would apply for the alternate sex, to establish if a crossover point arrives where the alternate sex record is beneficial and should now apply.
- CONVERSION – using existing GMP conversion legislation to convert GMPs and other pre-1997 benefits into alternative benefits.

GMP Conversion

- GMP conversion will be an option for some schemes, particularly where there is a fiduciary objective for undertaking an exercise (for example changing the structure of the benefits to reduce costs for buy-in/buy-out).
- Without a fiduciary objective, conversion remains a significant exercise to undertake with the scheme membership at the same point as historic rectification – and conversion does nothing to reduce the burden of the data and rectification parts of the GMP equalisation jigsaw.

In addition it is likely that converted benefits will still require re-programming on administration systems.

- Many of the initial arguments for conversion seem to have been that the alternative is too horrible to contemplate. However, the industry is becoming more comfortable with the reality of what is required as the detail is emerging.

Dual Records – Not as bad as it seems!

The dual record approach involves a year on year comparison of the member's current pension elements in payment with those that would apply for the alternate sex, to establish if a crossover point arrives where the alternate sex record is beneficial and should now apply (Method B).

Method C1 is a variation that involves basing the crossover point on the cumulative pension paid. Method C2 is a further variant where an interest adjustment is added to gains made as the current sex in previous years - this is the least costly method of compliance with the judgment and hence open to trustees to follow without employer consent.

What do these extra records mean for administration systems?

Not a huge amount. The main requirement is to simply add additional sets of pension elements, in the same way that administration platforms currently already support dual records such as for administration of pension increase underpins, or pension debits for deferred members.

In this case we would:

- Hold a new set of deferred pension elements for the opposite sex.
- Hold both true and opposite sex pension elements, and flag which ones are in payment.
- Hold an opening balance of accumulated interest on gains at the point of rectification (Method C2 only).

How likely is a member to ever require crossover?

- In many schemes, a member crossing over will be the exception rather than the norm.
- The likelihood of crossover will be dependent on scheme rules, and indices that drive pension increase formulae such as CPI.
- In some schemes it can be proven it will never happen – in other schemes only certain clearly identifiable members will ever be at risk of crossover.
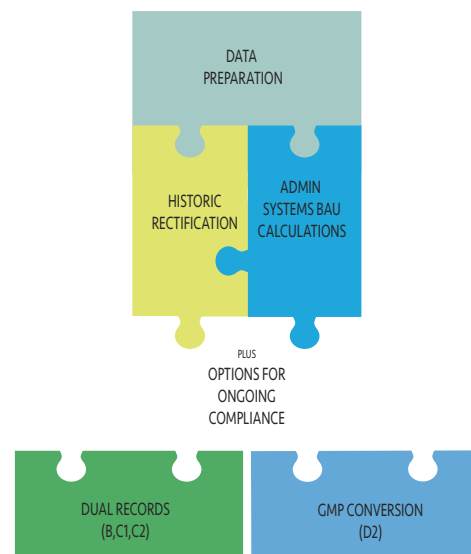
How will admin systems cope with processing members who crossover?

- As a minimum a basic scheme process can be implemented to enable crossover members to be flagged and dealt with in much the same way as a GMP would be 'put into payment' in a pension history.
- To support this there will also need to be a facility to put an opposite sex GMP 'into payment' – for example at age 60 for a male member.
- Small volumes will most likely mean that these events are treated in a similar way to other ad-hoc pension in payment adjustments.

Conclusion

The full picture of the GMP equalisation puzzle reveals that it is a data and systems challenge, and like any data and systems challenge there is no magic bullet that can make it go away. But there are tried and tested methods and approaches that can ensure a successful rectification for GMP equalisation is implemented in tandem with the necessary changes to your BAU admin system calculations.

Whether you then choose to stick with ongoing checks to identify future crossover members, or instead have a reason to undertake immediate GMP conversion, you will have completed the GMP equalisation puzzle and can start on a new one – how about Dashboard?

DATA PREPARATION

HISTORIC RECTIFICATION

ADMIN SYSTEMS BAU CALCULATIONS

PLUS OPTIONS FOR ONGOING COMPLIANCE

DUAL RECORDS (B,C1,C2)

GMP CONVERSION (D2)

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