HIGH COURT CONFIRMS SCHEMES MUST EQUALISE GMPS

In this special edition of the UK: Pensions Update we consider the High Court's decision in the case of *Lloyds Banking Group Pensions Trustees Limited.*[1]

In the judgment, which was handed down on 26 October 2018, the High Court has provided an answer to one of the oldest legal questions in pensions – whether schemes must equalise for the unequal effects of guaranteed minimum pensions (GMPs) – and its answer is a firm "yes". The case also provides a clear steer as to how to equalise GMPs (using the lowest cost method). However, (a) it is not yet certain whether the case may be appealed and (b) whilst giving a clear headline answer, the judgment does not resolve all the outstanding issues in this area. Trustees and scheme employers will therefore need to seek legal advice about the precise implications for their own scheme.

BACKGROUND

There has been ongoing uncertainty around if, when and how GMPs should be equalised for a quarter of a century:

- In 2010, the Government issued a statement confirming its view that following the 1990 case of ***Barber***[2] (which held that the principle of equal pay for work of equal value applies equally to pensions as a form of deferred pay) schemes should equalise for the effects of GMPs.
- In 2012, the Government consulted on draft regulations and published guidance detailing a possible equalisation method, but this was not progressed.
- In July 2015, a Pensions Ombudsman determination gave some comfort to schemes which had not yet equalised; with the Ombudsman taking the view that failure to equalise was reasonable and schemes could continue to defer taking action whilst the issue remained generally unresolved.
- In December 2016, the Government consulted on another proposed equalisation method. The Government published its response to this consultation in March 2017, but this did not take the position much further forward.

What are GMPs?

Minimum benefits a scheme had to provide if it contracted-out of part of the state pension during the period between 6 April 1978 and 5 April 1997.

Why does the inequality arise?

Legislation requires GMPs to be determined and paid on an unequal basis (reflecting the state benefit the member would otherwise have received if he/she had not been contracted-out). This then flows through to result in an inequality in the total scheme benefit (an inequality which is often compounded by different rates of revaluation and increases applying to the GMP and the rest of the scheme benefit (the "excess")).

1 *Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank PLC and others [2018] EWHC 2839 (Ch).*

2 *Barber v Guardian Royal Exchange Assurance Group [1991] 1 QB 344.*

THE LLOYDS JUDGMENT

This case concerned a claim brought by the Trustee of three pension schemes within the Lloyds Banking Group, seeking clarification as to whether the Trustee was required to equalise benefits for the effects of GMPs and if so, how.

The judge decided the Trustee was under a duty to equalise scheme benefits for the effect of unequal GMPs.[3] This was on the basis that the totality of the pension benefits (including the GMP element) paid to members under the schemes was "pay" and therefore the clearly established principle in ***Barber*** of equal pay for work of equal value should apply to the total benefit.

In terms of how to achieve equalisation, a number of potential methods were considered (please see table at the end of this briefing for more details) ranging from adjusting every element of the pension calculation (the highest cost approach) to more of an overall test (the lowest cost approach), and other approaches in-between. Although considered in the context of the Lloyds schemes, the judge was clear that the issues are not scheme-specific and would therefore appear to apply to many other occupational pension schemes. (He did, however, acknowledge that other schemes may be in different circumstances e.g. schemes which have entered the PPF and those schemes which have been equalised in the context of buy-out (which may be considered "special" cases).)

Applying the "minimum interference" principle, the judge concluded that the higher cost methods (methods A1 to A3, B and C1 in the table) could not be adopted without Lloyds' consent. This therefore left method C2 (providing the better of male or female comparator pensions each year, subject to accumulated offsetting and factoring in interest to reflect the late payment). It may also be possible, with employer consent, to carry out GMP conversion and a one-off actuarial equivalence calculation to compare the actuarial value of the male/female benefits and provide an uplift as necessary (method D2).

The judge also decided the Trustee must make back-payments to affected members going back six years and pay interest on the arrears at the rate of 1% above base rate (simple). (NB. The six-year limitation came from the relevant schemes' rules and may not apply in all cases.)

WHAT DOES THIS MEAN FOR PENSION SCHEMES AND EMPLOYERS?

To date, most ongoing occupational pension schemes have been taking a "wait and see" approach to GMP equalisation. It is not yet certain whether there will be an appeal and the judgment has left open some areas parked by the judge which may be dealt with at a supplementary hearing. Subject to that, this judgment is likely to act as the catalyst which brings an end to this "wait and see" approach.

However, whilst giving a clear headline answer, the judgment does not resolve all the outstanding issues in this area. In particular, the judge did not rule on the issue of whether the Trustee's equalisation obligation would also apply to benefits which had been transferred-out of the schemes or wholly commuted, or what should be done in relation to beneficiaries who have now died. In addition, the judge acknowledged there may be "data availability" issues which impact implementation of equalisation. Trustees and scheme employers will therefore need to seek legal advice about the precise implications of the judgment and the various issues it raises for their own scheme. Employers will, in particular, need to consider the issues the judgment raises from an accounting perspective, which will likely require input from both auditors and legal advisers.

[3] The judgment is clear this only relates to remedying inequalities arising out of GMP legislation in respect of the period between 17 May 1990 (the date of the ***Barber*** judgment) and 5 April 1997 (when GMPs ceased to accrue).

Table: Methods	
Method A: equalise each unequal aspect of the pension calculation separately and adjust it to remove any inequality. This would require two notional records (one assuming treatment as a male, one as a female) to be maintained for each affected member so that every year they can be compared and the more generous applied to the member (requiring, a third, actual record also to be maintained). There were three variations of this method (A1 - A3) considered.	*Infringes the principle of minimum interference from the employers' perspective and therefore may not be adopted without Lloyds' consent.*
Method B: provide better of male or female comparator pensions each year. Unlike method A (which takes each differing element of the calculation), this method is done on a single calculation basis. As a result, there is some offsetting of the 'better of' elements within method A. It also requires two member records to be kept in addition to the actual record.	*Infringes the principle of minimum interference from the employers' perspective and therefore may not be adopted without Lloyds' consent.*
Method C: provide better of male or female comparator pensions each year, subject to accumulated offsetting. It again requires the maintenance of two additional member records. **Method C1** is a variation of method B, but differs in that, 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. **Method C2** is as for C1, except that interest from the date of payment to date of calculation is allowed for in the comparison of the values of accumulated gain prior to the switch and loss since the switch.	***Method C1*** *infringes the principle of minimum interference from the employers' perspective and therefore may not be adopted without Lloyds' consent.* ***Method C2*** *permissible method for Trustee to adopt without Lloyds' consent.*
Method D: this involves carrying out a one-off actuarial valuation using various assumptions of the future right to benefits of the male and female comparators. **Method D1** identifies if the actuarial value of the member's unequalised benefits is less than the actuarial value of the unequalised benefits that would apply to a member of the opposite sex. If this is the case, an additional benefit equal in actuarial value to the difference is provided to the member. Although the actuarial value of the male/female benefits would be equal after doing this, the annual payments may differ. **Method D2** is as for D1, except that instead of providing an additional pension, a pension which converts GMP structures into an alternative format using the GMP conversion legislation and which is of equal actuarial value to the larger of the compared values is then put into payment.	***Method D1*** *infringes the principle of minimum interference from scheme beneficiaries' perspective and therefore not a permissible method.* ***Method D2*** *permissible method to adopt if employer consents (as employer consent needed to GMP conversion).*

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