

Sixty second summary

Judge says GMP equalization is obligatory

A High Court judge has ruled that the trustees of UK defined benefit pension schemes must compensate members for differences attributable to guaranteed minimum pensions (GMPs).¹

Recap

For details of the background to this case, please read our earlier Sixty Second Summary, *GMP equalization: brace yourselves*.² To recap, GMPs accrued in contracted-out salary-related schemes from 6 April 1978 to 5 April 1997. In broad terms, the GMP replaced and replicated the State Earnings Related Pension Scheme (SERPS); however, there are some differences, notably in the details of pre-retirement revaluation and post-retirement increases. Crucially, pensionable age for GMP purposes remains 65 in the case of a man, and 60 in the case of a woman, despite the equalization of occupational and State pension ages. The combined effects of GMP inequality can mean that a particular member's pension is lower at any point than it would be if he or she were of the opposite sex; they can also mean that the position is reversed at a later date, placing the same member in the 'advantaged' category.

What was the Court asked?

The main questions put to the judge were—

- Does the law require equalization for GMP differences?; and
- If so, is there a single correct method of doing it; or do the trustees have a choice of acceptable methods?

The parties to the litigation put forward (broadly) four equalization methods. Roughly summarized, they involve:

- A. separately considering, and where necessary equalizing, each feature of the pension (GMP and non-GMP), annually;
- B. annually, calculating the member's pension and what it would be if that member were of the opposite sex, and paying the higher of the two;
- C. performing the same annual comparison as in Method B, but keeping a running total of pension paid, so that a member who has benefitted from equalization increases is not overcompensated if the advantaged and disadvantaged sexes later swap places; and
- D. valuing the benefits of the member and the opposite-sex comparator actuarially, at a single point in time, then paying the difference to disadvantaged members in the form of an actuarially calculated pension increase.

In anticipation of a decision that equalization was necessary, the judge was asked some supplementary questions, most notably:

- whether there is a limit on how far back the trustees might have to go in equalizing past instalments of pensions in payment;
- whether they should pay interest on those under-payments; and
- the implications for past transfers (both inward and outward).

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

² <www.hymans.co.uk/news-and-insights/research-and-publications/publication/gmp-equalization-brace-yourselves>.

The ruling

Although the ruling was about the specific pension schemes involved, the judge recognized that his ruling would be widely applicable. He said that the trustees in the case are legally obliged to equalize overall benefits to eliminate the disparities produced by GMPs. The methods advanced were all, in one form or another, legally acceptable means of achieving equalization. However, the ‘principle of minimum interference’ meant that, unless the employers consented to a more-costly, alternative calculation, the trustees would be required to adopt a variant of Method C above: year-on-year calculations, but offsetting any accumulated ‘gains’ made through equalization against later payments, to avoid overcompensation.

The judge went on to rule that equalization payments for pensioners should be backdated. Their claims to arrears are not subject to a statutory limitation period; but they could be restricted under a specific scheme’s rules. He said that the backdated payments should be made with simple interest at 1 per cent over the bank base rate.

Consideration of some issues has been deferred. One such question is whether the trustees could adopt a different process for members for whom the estimated costs of equalization are disproportionate to the value of the additional benefits that they stand to gain. Another is whether the trustees have any obligations in relation to benefits that have been transferred out of their schemes (the judge held that *transferred-in* benefits must be equalized).

It is possible that additional questions will be asked of the Court, or that one of the parties involved will seek permission to appeal. Even allowing for that, it will take a while to resolve the implications of the judgment, especially with so many schemes in the process of reconciling their GMP records. Areas for consideration include:

- **funding valuations and cash contributions**—extra liabilities will need to be quantified, and will worsen the funding position, perhaps requiring extra cash contributions;
- **administration and member payments**—as well as uplifts in respect of historical payments, schemes will need to consider the implications for payments including transfer values, trivial commutation and upcoming retirements;
- **communicating with members**—schemes may want to update members, as they are likely to have many questions as a result of press coverage of the case;
- **buy-ins and buy-outs**—schemes that have undertaken or are undertaking a buy-in or buy-out will need to consider how to deal with the potentially higher pensions;
- **investment decisions**—if GMP equalization causes a step change in the funding position, de-risking triggers and investment strategies may need to be reviewed (trustees may also want to look at the impact on liability-driven investment (LDI) benchmarks, particularly those with high levels of hedging); and
- **corporate accounting**—the assessment and treatment of extra reserves will need to be considered, and it is possible that this change could go through Profit and Loss (P&L).