

Newsflash

GMP Equalisation: the High Court rules

What insurers should be thinking about

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. The ruling offers clarity for the pensions industry to move forward; it is important that insurers understand how it impacts them and ready themselves.

A rough rule of thumb for **the impact of GMP equalisation is a 1-2% increase in annuity liabilities**, but it is acknowledged that there is a huge amount of variability around this and it could be higher. However the potential impact on expenses and administration complexity could be very high – some thoughtful solutions will be needed to manage this. To recap on what GMP equalisation is and how this impacts pensions, a brief description can be found in our Sixty Second Summary².

What was the ruling?

The judge was asked whether the law requires equalisation of GMP differences and if so, is there a single correct method of doing so. The parties put forward four possible approaches to equalisation.

The judge's response was:

- The law requires equalisation to eliminate disparities as a result of GMP.
- The methods advanced were all, in one form or another, legally acceptable means of achieving equalisation. However, schemes are directed to adopt a method where running totals of current benefits and gender-opposite benefits are calculated on a year-by-year basis, and members are paid the amount that puts them in the better of the two overall positions each year. One of the alternative, more costly methods could be chosen, although employer consent would be required.
- Equalisation payments should be backdated. He said that the backdated payments should be made with simple interest at 1 per cent over the Bank of England base rate.

Of the possible methodologies put to the court, the one that was chosen was not the most costly. General consensus is that an appeal won't happen. It is however possible that further clarity will come if follow-up questions are asked of the court. For example, the treatment of transferred out benefits and 'de minimis' limits.

What does this mean for insured annuities?

Most pension schemes with GMP will have waited for more legal clarity before embarking on equalisation; this ruling is a trigger for schemes to start the process. As more and more schemes partially or wholly transfer

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

² [https://www.hymans.co.uk/media/uploads/1810_lloyds_judgment_\(gmp_equalization\)_60SNS.pdf](https://www.hymans.co.uk/media/uploads/1810_lloyds_judgment_(gmp_equalization)_60SNS.pdf)

liabilities to the insurance market using bulk annuities, the issue becomes more and more important to insurers – both for existing and new business.

Buy-ins

Many older buy-in contracts will have excluded any adjustment for GMP equalisation, more recent contracts may have provisions for the inclusion of it, although the method, timing and cost will be varied. Schemes will be looking to ‘top-up’ the insured benefits to align with the equalized benefits.

Buy-outs

The picture will be more complex for those schemes that have fully bought annuities and subsequently wound-up: some schemes would have attempted to equalize prior to insuring, others won't. At the minimum, dealing with these schemes will be an operational strain and we anticipate that there will be an increase in the liabilities for the insurer, with no recourse to a now non-existent scheme sponsor.

Future pipeline

The ruling will have an impact on new bulk annuity business; schemes coming to market will expect that with the clarity provided by the judgement, insurers will now better accommodate GMP equalisation in their proposition. An insurer's readiness for this will impact their success in the market.

What's the impact on an insurer?

The ruling has wide ranging impacts on an insurer with DB pension liability. Although no timescales have been given, the scope and impact of this means that firms will need to understand and plan for it. We explore a number of the potential implications on insurance functions below:

Function	Consideration
Reporting	<ul style="list-style-type: none"> Insurers' liabilities will increase both in respect of the additional benefit payments and the increase in projected expenses incurred in administering the changes. An additional liability needs to be included in the next reporting date. At this stage it will need to be an estimate. Some firms may have already setup a reserve in their accounts for the issue, although the judgement should prompt a review on its suitability. This may lead to a release of some of, or an addition to the reserve. Depending on the materiality of the impact of the ruling, it may be necessary to include a note to the disclosures in the 2018 year-end financial statements. Where reinsurance treaties don't allow (or don't accurately allow for GMP equalisation) there will be a mismatch between the benefits paid by insurers to policyholders and the reinsurance recoverables. A change in an insurer's liability in respect of GMP equalisation may not translate into an equivalent change in the reinsurance recoverable. In these cases, net liabilities may increase by more than expected.
Capital	<ul style="list-style-type: none"> There may be a small impact on the longevity risk SCR and therefore on the calculated risk margin. We don't expect this impact to be material.
Data management	<ul style="list-style-type: none"> In order to more accurately calculate equalisation for a policyholder the insurer may need further information on the member – this data might not exist, and if it does, it could be incomplete or inaccurate.
Bulk annuity origination & pricing	<ul style="list-style-type: none"> As schemes complete their own equalisation exercises, those with bulk annuities may want to approach providers to align the insurance with the equalized benefits by making a small uplift to the buy-in. Firms will need to work out whether and if so, how to accommodate these requests and process efficiently alongside existing commitments.

	<ul style="list-style-type: none"> • Schemes with a buy-in that have previously equalized may conclude that they want to adjust the methodology – again another distraction from winning new business. • The same is true of longevity swaps – insurers intermediating swaps will likely need to handle requests to align benefits.
Operations & payroll	<ul style="list-style-type: none"> • Firms will need to carefully evaluate what equalisation method to apply. If the default method is adopted then administration systems would require significant development. • It's unclear as to the treatment of transferred out benefits – many pension schemes are considering pausing transfer values until such time as clearer guidance is published. • After the equalisation, it's likely that a number of one-off payments will need to be made – payments will need to be tracked and reviewed to manage future offsetting.
Customer support	<ul style="list-style-type: none"> • Beneficiaries will want to understand what the impact is on them – effective and proactive communication of what is a very technical matter will be vital. • The issue is complex and the resolution will not be immediate – there will likely be an increase in policyholder queries. This may require additional call handling staff for a short period of time following communications with beneficiaries. • There is a high risk of third parties intervening to 'support' policyholders – regular and clear communication will help manage this.
Legal	<ul style="list-style-type: none"> • Understanding what a firm is permitted to do will be key to defining what needs to be done – additional clarification on the ruling and subsequent guidance will be helpful. • Bulk annuity contracts will have changed dramatically since the inception of the market; the contractual liabilities and remedies will vary greatly. There will be work in understanding and communicating internally what is required.
Risk & oversight	<ul style="list-style-type: none"> • Where information is incomplete or inaccurate, judgements will need to be made – review will be necessary to ensure they are reasonable and in line with acceptable industry practice.

So what next?

The High Court ruling doesn't open the floodgates, yet it does prompt schemes and insurers to start the process. Further guidance on the ruling will be needed before firms pull the trigger on equalisation. However, understanding the ruling in detail and the implications for your business is essential.

Hymans Robertson has a wealth of experience supporting schemes with GMP equalisation and combined with the specialist knowledge of the insurance industry we are extremely well placed to support firms.

If you'd like to know more about GMP equalisation, discuss how it might impact your firm and what you could do to manage it, please get in touch.