

Apollo 11 travelled approximately 240,000 miles on its epic journey to set the first man on the moon; it took a mere 76 hours. It feels as though pensions equalisation has journeyed a similar distance over a period of more than 28 years.

The Eagle Has Landed! Or Has It?

On 26 October, the long awaited judgment in the *Lloyds*¹ case was finally published. Those involved with defined benefit schemes have been holding their breath, hoping for clarity regarding whether and how their schemes' benefits should be equalised for the effect of Guaranteed Minimum Pensions (commonly referred to as "GMP equalisation"). We now have 174 pages of guidance and a detailed analysis of relevant case law and legislation courtesy of the High Court. Although some issues remain unresolved, it looks like pension scheme trustees and employers will now have to start work on their own GMP equalisation project. It is not going to be easy – amongst other things, they will now have to identify the appropriate method of GMP equalisation for their scheme and address the thorny issue of paying arrears of pensions that have been underpaid in the past.

Back to the Launch Pad

Why Has GMP Equalisation Been So Problematic?

This case is the latest development in a long running saga.

Many defined benefit schemes are obliged to pay GMPs to their members as a result of the scheme having been used for contracting out of the State Earnings Related Pension Scheme between 6 April 1978 and 5 April 1997. The GMP forms part of the total pension payable to a member. Legislation prescribes how the GMP is calculated and paid, and treats men and women differently: crucially, women become entitled to GMP from age 60, whereas men have to wait until age 65 (to reflect historic State Pension Ages). Add to that matters such as a woman's GMP accruing at a faster rate than a man's and legislation requiring minimum increases to be applied to the GMP. The result is that it is not always clear whether a male member or female member will receive the greater benefit, and the position can change over time.

For many years, the government has maintained that European and domestic equality legislation obliges pension schemes to adjust total benefits payable to men and women to remedy the inequality caused by unequal GMPs in respect of benefits accruing from 17 May 1990 (the date of the *Barber*² judgment). It has never explained how that should be done, although the Department for Work and Pensions (DWP) issued consultations in 2012 and 2016 on possible methods. Given the complexity and uncertainty, most schemes have parked the issue, awaiting further guidance from the courts or government.

Prepare for Lift Off

What Did the Court Decide?

The case concerned a number of pension schemes providing benefits for individuals who work or have worked for the Lloyds Banking Group (for simplicity we refer to them as the "Lloyds Schemes"). In common with many defined benefit schemes, the Lloyds Schemes had not taken action to equalise scheme benefits for the effect of unequal GMPs. Prompted by a challenge brought by members, the Trustee of the Lloyds Schemes asked the court to clarify its obligations regarding GMP equalisation.

The court decided that:

- The Trustee is under a duty to equalise benefits in the Lloyds Schemes for men and women to remove the inequality caused by GMPs accrued from 17 May 1990
- The Trustee should use an equalisation method that results in "minimum interference" with the rights of any party (including the employers, unless they consent)
- The beneficiaries who have been underpaid pensions are entitled to arrears of payments due to them
- The period in respect of which the arrears should be paid is not limited by statute, but could be limited by the rules of the Lloyds Schemes
- It would be appropriate for the arrears to include simple interest at 1% above base rate

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* (C-262/88)

Houston, We Have a Problem

How Should Schemes Equalise for the Effect of GMPs?

The words uttered by the crew of Apollo 13 could also have been spoken by any number of pensions professionals – How exactly should GMP equalisation be achieved? The court considered a number of proposed approaches. These are summarised below.

Method A	Equalise each unequal aspect of the pension calculation separately. This was the most expensive option.
Method B	Carry out an annual comparison of the member's benefits against the benefits they would get if they were the opposite sex. Provide the more generous pension each year.
Method C1	Similar to Method B, but offset any benefit uplifts the member has received in previous years as a result of GMP equalisation.
Method C2	Similar to Method C1, but also offset an allowance for interest on the GMP equalisation uplifts that the member has received in previous years.
Method D1	Carry out a one-off assessment of the actuarial value of the member's benefits then compare it against the actuarial value of the benefits they would have received if the opposite sex. Provide additional benefit to make up any shortfall.
Method D2	Similar to Method D1, but instead of paying additional benefits, use GMP conversion to convert the higher actuarial value to non-GMP benefits.

In weighing up the options, the judge applied the legal principle of "minimum interference", summarised as:

"... the principle of minimum interference requires the court to compare possible options and to consider in relation to any particular option whether the obligation to provide equal benefits can be complied with in some other way involving less interference with the rights of any party."

He rejected method A (the most expensive option) and method D1 (the cheapest) on the grounds that they were inconsistent with this principle.

He went on to consider methods B, C1 and C2 and concluded:

"Method C is somewhat less costly than method B and method C2 is somewhat less costly than method C1. In those circumstances, applying the principle of minimum interference again, the Banks are entitled to say that the Trustee must adopt method C2 and may not adopt method C1 or method B."

Method D2, involving GMP conversion was ruled out in this case (as the Banks had not provided the required consent to GMP conversion) but, in principle, it was a lawful method. It could therefore presumably be permissible for other schemes to adopt this approach.

Practical points: Schemes will now have to weigh up their own methods for equalisation, but we expect many will follow the lead of the court and opt for method C2.

We also predict a resurgence of interest in GMP conversion. Many schemes will look favourably on the prospect of converting GMP benefits into ordinary scheme benefits, thereby simplifying benefit structures and reducing administrative costs in the long run. The DWP also appears to favour this approach – the equalisation method it proposed in 2016 incorporated GMP conversion. We hope that the DWP picks up where it left off and consults on further guidance and legislative changes to ensure that GMP conversion operates smoothly in practice.

Looking Back Down to Earth

What About Pension Payments Made in the Past?

The parties accepted that the Trustee should pay arrears of payments to those members that would have received higher pension payments if the Lloyds Schemes had equalised benefits for the effect of GMPs. The judge decided that arrears of payments should bear simple interest at 1% over base rate.

The judge went on to consider how far back the Trustee should look when calculating the arrears that were due (often referred to as a "look-back period"). He concluded that no statutory limit applied. However, scheme rules could restrict the look-back period. In this case, four of the five example rules he considered from the Lloyds Schemes limited the look-back period to six years. In the fifth example, the Trustee was given a discretion to do the same.

Practical point: Seek legal advice on your scheme rules to establish whether there are rules that limit the look-back period for calculating arrears of pension.

Clearing the Lunar Dust

What Remains Unclear?

Whilst this case is a big step forward and provides schemes and sponsoring employers with answers to some of the key questions, there is still some way to go before we have the full picture.

First, it is not clear whether the judgment will be appealed.

Second, the judge did not answer questions about whether the obligation to equalise for the effect of GMPs extends to benefits transferred out of a pension scheme. This is a critical and complex issue. It is likely that a further court judgment will be required to provide a definitive answer.

There are also areas of uncertainty that were not directly addressed in the judgment, as well as practical issues that will require further consideration by trustees. These include:

- Whether administrative cost and complexity can be taken into account when weighing up the different equalisation methods.
- The extent to which the ease with which members will understand a method can be factored into the choice of equalisation method.

- How to equalise where schemes have gaps in their membership data. Many schemes will already be grappling with incomplete member records as they try to complete GMP reconciliation exercises.
- From what point a look-back period in the scheme rules will run. This will predominantly depend on the wording of the rules in question, but such wording will be open to interpretation. Legal advice is likely to be required.

Of course, pension schemes that have already taken action to equalise benefits (for example, as part of an exercise to buy out members' benefits with an insurer) will now be questioning whether they need to take any further action.

A Bumpy Landing and a Period of Reflection

What Should Pension Scheme Trustees Be Doing Now?

Generally, trustees should avoid knee jerk reactions and should take a careful and considered approach. It is possible that elements of the judgment could be appealed, in which case it would make sense to wait and see, so far as possible, how that might change the position. Likewise, further clarity and guidance may be provided by the courts (particularly regarding the tricky issue of transfers out) or by the DWP. Industry consensus is also likely to emerge as the dust settles.

Trustees should, however, consider taking the following actions now:

- Seek legal and actuarial advice on the GMP equalisation method that will be suitable for their scheme and discuss the options with the employer(s) that sponsor the scheme. It is likely that employers will also want to gain an understanding of likely GMP equalisation costs and any increased funding obligations for their own accounting purposes.
- Review scheme rules to establish whether there are any limits on the extent to which the trustees can look back when calculating arrears.
- Prepare and agree standard responses to queries from members about the impact of the *Lloyds* case on their benefits (although in most cases we would discourage issuing a general announcement to members at this stage, as it may generate more queries than it deflects).
- Review standard communications and warnings sent to members who are seeking or being sent information about their benefit entitlements, particularly those members who are approaching retirement.

Dealing with requests for transfer values is one area that will require urgent attention. We discuss this further below.

Practical point: Do not panic! GMP equalisation is a long-term project and it is important that the trustees get it right – taking into account further decisions of the courts and guidance from the DWP. In the meantime, there are preparatory steps that trustees can take. Urgent attention should be given to dealing with member queries and the calculation and payment of transfer values.

How Will GMP Equalisation Affect the Calculation of Transfer Values?

Where a member requests (or has requested) a cash equivalent transfer value as they are considering transferring their benefits out of the scheme, urgent consideration should be given to whether/how GMP equalisation should be factored into the calculation of that transfer value.

Where the member is exercising a statutory right to a transfer, the legislation prescribes strict deadlines for the provision of the required cash equivalent transfer value and for processing the transfer. The deadlines can only be extended in very limited circumstances. It is therefore important that trustees consult their advisers to assess whether transfer values can be adjusted to allow for GMP equalisation within these deadlines and whether there is any flexibility in the timeline.

Member communication is also key. For example, if the transfer value has not been adjusted to reflect GMP equalisation, the implications and risks of proceeding with the transfer should be flagged to the member. Delays in providing transfer values or processing transfers should also be explained.

Practical point: There is some leeway to delay the provision of transfer values and payment of transfers within the statutory deadlines. However, bear in mind that there are only limited circumstances where those statutory deadlines can be extended.

For further information, please contact any of the partners listed or your usual member of our Pensions team.

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