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▶ **100 days later – GMP equalisation** – 3 February marked 100 days since the ruling in the Lloyds Bank GMP equalisation case, affecting thousands of UK DB pension schemes and millions of members. Tom Yorath, an expert witness in the Lloyds case, shares his views on how the industry has moved forward since the judgment date following almost 30 years of legal uncertainty **p40**

▶ **Tip of the iceberg** – As schemes start to fully understand the implications of the High Court ruling on guaranteed minimum pensions (GMP), what, apart from the harrowing complexity, are the issues we should be focusing on? Theo Andrew investigates **p42**

# GMP equalisation focus:

## Stepping up



▶ **Thomas Yorath, principal consultant, Aon**

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# 100 days later – GMP equalisation

**3 February marked 100 days since the ruling in the Lloyds Bank GMP equalisation case, affecting thousands of UK DB pension schemes and millions of members. Tom Yorath, an expert witness in the Lloyds case, shares his views on how the industry has moved forward since the judgment date following almost 30 years of legal uncertainty**

## Scheme sponsors

With the financial impact of GMP equalisation directly impacting the profits reported in company accounts, it should come as no surprise that the largest immediate reaction to the judgment was from scheme sponsors.

While many sponsors were aware in advance of the potential for a hit to company profits, the timing of the judgment so close to calendar year ends meant that some were blindsided and were left with both a nasty financial surprise and a mad rush to calculate numbers.

The analysis conducted by Aon on more than 250 schemes suggests that the expected cost for two-thirds of schemes is less than 1 per cent of their overall liabilities and while 1 per cent of liabilities is easily lost in noise on most

company balance sheets, a reduction in profits of 1 per cent of scheme liabilities can be hugely significant and concerning for sponsors.

What's more, the submission of equalisation costs in company accounts is by no means the end of the involvement of sponsors in equalisation.

The judgment from the High Court put much of the power over which method to use in the hands of sponsors. With the overall costs and merits of the various court-approved methods so different, it should not come as a huge surprise that many sponsors are keen to take an active part in this project rather than leaving the work solely to the trustees.

## Scheme trustees

Following the judgment, trustees found

a number of burning platforms that needed to be addressed.

However, for the most part, we saw most trustees adopting a 'keep calm and carry on' attitude as far as possible. The majority felt that it was disproportionate to put projects and business as usual on hold indefinitely, preferring pragmatic workarounds, particularly given that equalising GMPs is unlikely to be a quick fix. There are workarounds suitable for member option exercises, risk settlement projects and ill health retirement. Practical solutions regarding the communication around transfer values have been developed. The exceptions have been small pots and trivial commutation, where most have either needed to quickly update their process or put the projects on hold until there is guidance from HMRC that they would

not be unauthorised payments.

Over the past month, trustee attention is now beginning to turn to two main areas:

- Preparation – in particular sourcing and cleaning scheme data, and reviewing and understanding benefit practices.
- Method – in particular whether there is a preference towards converting benefits or running a dual record approach.

While some schemes have excellent historic data, many are finding that significantly more data is needed for the purposes of equalising than to administer the pension scheme. The good news is that this preparation work is not a wasted endeavour and will stand schemes in good stead regardless of which method they choose, as well as making them well-prepared for any future settlement activity.

Although schemes have started the job of preparing and considering their options on solutions, the vast majority are rightly waiting for further guidance – whether that be from industry bodies or subsequent court hearings. Many trustees are concerned that implementing too quickly risks falling on the wrong side of industry norms before they are even formed, with very limited upside.

### Members

Despite the case making the front page of a national newspaper, for the most part the response from members has been quite muted. In practice this may be a combination of factors:

- It is hard for members to work out whether they are affected
- The issue is horribly complicated
- The financial impact for many is small

The most member noise has been made in response to those cases where members have had their retirement plans directly impacted by the case; for example, those members who had been expecting or relying on a trivial commutation lump sum and who now face a delay to their payment while the trustees decide how best to adjust their processes for

equalisation. Remember that, despite the name, these trivial commutation lump sums may not be trivial to the recipient.

### IFAs

IFAs want to make sure they are giving best advice to members and their biggest concern is that they are making a fair comparison between options. So, typically, they are comfortable advising on a transfer value that has not been adjusted for GMP equalisation, against a benefit that also has not been altered for GMP equalisation, accepting that there may be a top-up payment at some point. This complexity again emphasises the need to have an IFA who really understands DB pensions, and the challenge that members face if they are trying to seek an IFA of their own without trustee or company support.

### Insurers

Q4 2018 did not see any slackening in the pace of risk settlement project completion, despite the GMP equalisation issue. Although many schemes are at the early stage of decision making on their GMP equalisation method when considering a transaction, it is worth understanding the insurer view. Insurers have an obvious preference for the standardisation and simplification provided by GMP conversion.

But this does not mean that schemes should hold off from pursuing a buy-in or buyout while addressing GMP equalisation. For schemes looking to reduce risk using buy-ins and buyouts – and at a time when pricing is attractive – being flexible has become important to capture the best pricing. GMP equalisation is another area where flexibility from schemes is likely to increase insurer engagement. It is therefore even more important to ensure you have an experienced adviser who has a clear understanding of the solutions available and who can help you navigate through the current busy market.

### Government and industry bodies

There is still a need for further guidance

from the courts, government, TPR and industry bodies. They need to tackle areas questions such as

- Will there be a de-minimus threshold?
- What is the impact on annual and lifetime allowances?
- What about transfers out?
- How will GMP conversion work in practice – for example, is it aiming for minimum interference or maximum administration simplification?
- Will there be best practice codes (similar to the Code of Good Practice in Incentive Exercises)?

To continue to facilitate a competitive administration, market standardisation of the details of implementation will be beneficial and the Pensions Administration Standards Association (PASA) are taking a look at that to bring clarity to the market. Building industry norms will help manage the costs of this complex exercise for the entire industry.

### Next steps

There is plenty of work to be done, even before all this guidance is available. You need to analyse gaps in your data, understand your administration practices, and consider interaction with GMP reconciliation projects. In practice, we expect that schemes are still some way off a decision on what GMP equalisation method to use and while schemes may want to quickly address member event processes such as trivial commutations and transfer calculations, for most, full implementation of pensions is likely to be mid-2020 at the earliest.

If you'd like more detail on this please email [talktous@aon.com](mailto:talktous@aon.com) for a copy of our technical summary on the topic.



Written by Thomas Yorath, principal consultant, Aon

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### Summary

- In October, the High Court ruled that Lloyds must start the process of equalising GMP, which has had huge consequences for thousands of pension schemes.
- Schemes are now getting to grips with the ruling, which could cost them anywhere between 1 to 3.3 per cent of liabilities, but are still awaiting guidance from the Department for Work and Pensions on the best method to apply.
- The complexity of the equalisation process has highlighted issues around insufficient data and general lack of human resource to deal with demand.

## Tip of the iceberg

As schemes start to fully understand the implications of the High Court ruling on guaranteed minimum pensions (GMP), what, apart from the harrowing complexity, are the issues we should be focusing on?

Theo Andrew investigates

For many pension schemes, it is the iceberg they saw coming. A clear danger away in the distance, but one they were anticipating. Others, despite the warnings, have not readied themselves for what lies beneath.

In October, the High Court ruled that Lloyds must equalise pensions benefits related to guaranteed minimum pensions (GMP) for men and women. Since then, the industry has been in somewhat of a frenzy to find an adequate, cost effective, solution.

In the month after the ruling, a Herbert Smith Freehills survey found that despite 78 per cent of schemes agreeing with the verdict, 61 per cent said that they had insufficient data to equalise.

First introduced in 1978, GMP were a means of allowing schemes to contract out of State Earnings Related Pension Schemes (SERPS), as good as the statutory amount, which were allowed to be calculated differently for men and women.

For now, schemes have been doing their best to estimate what effect it will have on their liabilities. Compass Group estimated a cost of 1-2 per cent of liabilities, while Haynes Group say it could range from anywhere between

2-3.3 per cent.

Recent research from XPS Pension Group painted a brighter picture for schemes, when it said it could cost less than 1 per cent of total liabilities.

What though, for schemes who have yet to be provided with guidance, can trustees be doing now?

### The data crunch

It's the question that pension schemes will have been asking themselves from the off. Do we have sufficient data to carry out the process of GMP equalisation, and what do we do if we don't?

For starters, Premier head of administration, Girish Menezes, believes pension schemes shouldn't be getting ahead of themselves: "My view would be it is key that we do not run before we can walk. We don't quite know exactly the route forward, there are people saying we need to do C2 and then D2 but is that what people are going to do?"

Aon principal consultant, Tom Yorath, agrees that before they concentrate on the data issues, schemes need to be addressing their burning platforms. A process he believes many have already achieved.



"For those schemes where they have a large bulk exercise underway, transfer value exercises or annuity purchases, then trustee sponsors are having to make a decision on how to proceed," he says.

"It's not putting a handbrake on those exercises, it's just an extra consideration. Most schemes are through the burning platform stage, or have at least made a decision on how they will tackle it"

Currently, pension schemes are awaiting guidance from the Department for Work and Pensions on the best method to take, which according to Yorath, is leaving trustees in a catch-22 scenario.

"The big problem is people don't have the data, and where they do have the data, they don't have clarity on implementation."

In December, the judge on the case





fully equalised state, before we take on what effort is going to be required and what skills are needed going forward,” Menezes adds.

### The capacity crunch

The amount of work that is likely to be placed on administrators, legal firms and actuaries, could see the industry faced with a capacity crunch when working through equalisation, let alone getting on with the day-to-day running of the schemes.

A number of initiatives are already underway to mitigate this risk and stop schemes moving at a glacial pace.

In January, the Pensions Administration Standards Association (Pasa) formed a working group to advise trustees on ‘best practice’ throughout the process. It will be overseen by The Pensions Regulator, to ensure standards align with ‘regulatory expectations’.

Pasa board member and chair of the GMP working group, Geraldine Brassett, says: “It’s just the sheer amount of work this is going to be put on the industry.

“Until we actually understand what equalisation means, we are going to have an awful lot of pension schemes going through it at the same time. So being as prepared as you can is a really good thing.”

Furthermore, a number of consultancies are rumoured to have ‘beefed up’ their GMP practices.

Sackers partner, Faith Dickson, believes that while there could be a capacity crunch, not all schemes will go through the process together, meaning it could almost be three years before some have completed the process.

“Most schemes are struggling with finalising GMP reconciliation as well, and until they have done that, they can’t do the equalisation process. If all schemes are going to take a year to do it, they can’t all do it at once, so you could see it dragging on.”

Aon partner, Mike Edwards, agrees that not all schemes will be ready to equalise at the same time.

“We wouldn’t expect all schemes

to be going through equalisation at the same time, in the same way we don’t see every scheme implement buy-ins at the same time. Practically speaking, there will almost have to be some staggering of the process because of the bandwidth of administrators.”

“There will be a challenge keeping up with the day-to-day activities as well as this project,” Dickson adds.

### Bergy bits

The way schemes are likely to approach the ruling will be dependent on the size and complexity of their scheme, so it will come as no surprise that trustees themselves are split on how to equalise.

And what for the DWP guidance that we are expecting?

According to Yorath, this is likely to be focused on conversion – following on from the basis used in the DWP’s previous consultation. At the time of writing, the DWP said guidance will be delivered “shortly”.

“The big upside in conversion is it can actually result in savings for schemes, while the simplification will bring down the cost of materially of passing the scheme off to an insurer. Some are seeing conversion as a gateway to full settlement,” he says.

Schemes will no doubt be a lot more attractive to an insurer having been through the process, but trustees will have to weigh up the decision to go for the most costly conversion process, which will lead them closer to buyout, or the more cost effective dual record method which may not have as a desirable outcome.

One thing is for certain, schemes are also being urged to think about the post-equalisation landscape, and the dangers ahead, but first they must navigate themselves through the tricky bergy bits.

ruled that schemes can go directly to D2, without going through C2, and confirmed that for schemes going back to rectify GMPs, they will need the salary information for those years.

A move Menezes believes could be troublesome: “You need the salary information from those years, which a lot of schemes don’t have. GDPR also means a lot of scheme sponsors may have actually deleted the information. So what does one do?”

Depending on the circumstance of the schemes, trustees may be able to make certain assumptions about the data they are missing, which they can then use to calculate members’ equalised benefits.

“We need to do far more analysis in what we are going to have to do to move schemes from where they are now to a

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