



Pensions briefing

Guaranteed Minimum Pensions

Briefing

July 2016

Despite the end of contracting-out on April 6, 2016, schemes that were formerly contracted-out on a salary related basis still retain responsibility for Guaranteed Minimum Pensions they may hold, and special conditions attach to Guaranteed Minimum Pensions, in terms of benefits and transfers. This briefing sets out some basic information about Guaranteed Minimum Pensions and their treatment after April 6, 2016.

Introduction

Between 6 April 1978 and 5 April 2016, occupational defined benefit (final salary) pension schemes were able to contract out of the state second pension (S2P) formerly the State Earnings Related Pension Scheme. A member of a contracted-out salary-related scheme prior to 6 April 2016 (ex COSR scheme) was able to forego S2P and instead could be provided with minimum benefits under their employer's pension scheme. These benefits were guaranteed at a minimum level based on the amount the member would otherwise have received under S2P. Both a member and his employer then paid lower National Insurance contributions if they participated in an ex COSR scheme.

Guaranteed Minimum Pensions

For part of that period, from April 6, 1978 to April 5, 1997, an ex COSR scheme promised to provide pensions, known as guaranteed minimum pensions (GMPs), that were no lower than the level of benefits then specified in legislation. GMPs ceased to accrue from April 6, 1997. A different test applicable to the whole ex COSR scheme, known as the Reference Scheme Test, was introduced on April 6, 1997. Accrued GMPs were not changed, so many schemes have historic GMP liabilities.

As GMPs mirrored state scheme benefits, they were payable from state pension age, and while state pension age is now, for women, approximately 63, GMP age has stayed at 65 for men, and 60 for women (GMP age), which leads to sex equality issues. GMPs require complex administration and have to be calculated and recorded separately from the ex COSR scheme's other benefits, to ensure that the GMP promise is met.

GMPs are also payable to a member's spouse, or civil partner, and the amount is one half of the member's GMP, although for widowers, civil partners, and same sex spouses, this only applies to GMP earned after April 6, 1988. If at the date of the member's death a spouse is below age 45 (or the spouse subsequently remarries), then there is no requirement to pay a GMP. The scheme can of course, pay or continue to pay a full GMP to such a person as if they were an eligible spouse, but this is not a requirement of the legislation.

GMP restrictions

As GMPs were intended to be a substitute for state scheme benefits there have always been restrictions on their transfer and commutation. This has meant that for example, if a member retires early, his pension may be restricted to ensure that he receives his full GMP at GMP age.

Can a GMP be transferred to another scheme?

Restrictions on transferring GMPs remain. The Contracting-out Regulations now require the member's consent to transfer a GMP in most cases. A GMP can be transferred without the member's consent if it is part of a group transfer, and made between related employers, and other conditions are met, including, most importantly, that the receiving scheme is an ex COSR. A member may transfer his GMP to any occupational pension scheme or personal pension scheme where he consents as long as the transfer value at least equals the value of his GMP.

Unless the Contracting-out Regulations are amended, as time goes on, the requirement that a transfer without member consent may only be made to an ex COSR scheme, will become more difficult to fulfil, as, following group reorganisations and corporate transactions, it may be desirable to transfer a group of members to a new scheme established after April 6, 2016, which of course, could never be contracted-out.

In response to concerns raised by the pensions industry, the DWP may bring in legislation allowing a scheme which has never been contracted-out to receive a bulk transfer of contracted-out rights including GMPs, without member consent, provided that safeguards are in place. The earliest date this could happen is expected to be 2017.

When can GMPs be paid as cash?

A lump sum can be paid instead of a GMP if it is a trivial lump sum, or a small lump sum. A lump sum can also be paid if the member is seriously ill.

Calculating GMPs

When a member retires, or leaves an ex COSR scheme, GMP is calculated. GMP calculation is complex, and is based on earnings between upper and lower earnings limits (currently £43,000 pa and £5,824 per annum) for each year of contracted-out service. Before April 6, 1987, contracted-out contributions rather than earnings are used. This amount is then revalued to GMP age to protect it against inflation.

If a member starts to receive his other scheme benefits before GMP age, they may be reduced to ensure there are sufficient funds to pay his GMP from GMP age. If a member postpones receiving his GMP after GMP age, a statutory increase to GMP is applied.

When a member ceased to be in contracted-out service (before April 6, 2016), his GMP was increased or revalued, for each complete tax year to GMP age. There are now two alternative ways to revalue GMPs.

Most GMP rules allow Trustees to select which rate of revaluation the Trustees use from time to time.

Section 148 Orders

This is an index based on National Average Earnings. Section 148 Orders are published each year specifying the minimum increase based on National Average Earnings. Public sector schemes also often use Section 148 Orders for revaluation.

Fixed Rate

Most private sector schemes used a rate of revaluation which was "fixed" at the date a member left contracted-out service, so it could be ascertained at that time. Currently, the annual percentage revaluation increase is 4.75 per cent.

At April 6, 2016, all ex COSR schemes ceased to contract out, and in order that an ex COSR scheme could continue to use fixed rate revaluation, but using the rate in force at end of a member's pensionable service (rather than at April 6, 2016 when contracted out employment ended), there is now a statutory modification power, exercisable by scheme trustees before April 6, 2017 (which can be backdated to April 6, 2016).

Anti-franking of GMPs

An ex COSR scheme may not “frank” GMP revaluation increases against the benefit in excess of the GMP (or other statutory revaluation additions) when the member leaves pensionable service. This rule applied before April 6, 2016 where there was an interval between the end of contracted-out employment (whether or not pensionable service ended) and GMP age. In line with the other changes at April 6, 2016, when contracting-out ceased, the anti-franking rule now applies where there is an interval between pensionable service ending and when GMP starts to be paid.

Increases to GMPs in payment

GMPs earned after April 6, 1988 are increased in payment in line with the Consumer Price Index measured each September, up to a maximum of 3 per cent. Increases start at GMP age. Increases in excess of 3 per cent on post-1988 GMPs, and all increases on pre-1988 GMPs were provided by the State through the state pension. From April 6, 2016, when the new state pension started to be paid to individuals retiring after that date, there will be no State increases to GMPs. As a result, individuals with GMPs who reach State Pension Age after April 6, 2016 will miss out on increases to their GMPs which would have been provided by the State from state pension age if they had retired before April 6, 2016.

GMP sex equality

The method of calculating GMPs is set out in legislation and is different for men and women because GMP age is unequal.

There have been conflicting opinions following the Barber decision in 1990 as to whether or not post-May 17, 1990 GMPs need to be equalised. Arguments against equalisation include

- They are a replacement for state benefits (which do not need to be equalised)
- They are merely calculation factors in the overall pension

If an ex COSR scheme attempts equalisation, there are immediate difficulties. In fact, it is only possible to know if it is more advantageous to have a male or female GMP once the member has died. The difficulty lies in the interaction of GMP revaluation and GMP increases with state pension age for men and women. GMP equalisation now seems no

closer, and the Government may have tacitly recognised this, expecting that GMPs will continue in their present form for the foreseeable future.

The Pension Protection Fund (PPF), has a duty to pay compensation to schemes which enter it, on an equalised basis, in respect of pensionable service after May 17, 1990. The PPF must therefore take into account any differences in ex COSR scheme benefits between men and women arising from GMPs, so ex COSR schemes that transfer to the PPF after May 31, 2013 must now equalise GMPs, using the PPF’s required equalisation method.

GMP conversion

From as long ago as the Pensions Act 2007, there has been power to convert GMPs to other scheme benefits, provided that “actuarial equivalence” is achieved. The main deterrents affecting GMP conversion were the requirement to provide survivor benefits post-conversion and the fact that many schemes had not yet equalised GMPs between men and women. At first glance, converting GMPs seemed a good idea but in reality the costs could not be justified. Conversion can, however be useful if GMPs have already been equalised or when a scheme is winding-up. Alternatively, individual GMP conversions to facilitate transfers out can be made.

What happened to GMPs when contracting-out ceased completely for ex COSR schemes at April 5, 2016?

From the ex COSR scheme’s point of view, generally everything relating to GMPs continues after April 6, 2016 in the same way as before. Trustees and employers should, however, check the information which members have received about increases to GMPs in payment. As explained above, from April 6, 2016, no State increases will be paid to GMPs.

Trustees should ensure that their ex COSR scheme membership and GMP data have been reconciled against the records held by HMRC. This is achieved by comparing the ex COSR scheme’s records of GMPs with HMRC’s GMP records, and resolving any discrepancies, which could lead to additional GMP liabilities if the ex COSR scheme cannot prove that HMRC’s records are incorrect. Trustees should have started this process before April 6, 2016, and will have until December 1, 2018 to query and reconcile their GMP data with HMRC’s records.

HMRC has issued technical bulletins to assist with this, and administrators should already have registered the ex COSR scheme for the Scheme Reconciliation Service as a first step.

GMP reconciliation is important because of the need not only to ensure that the total amount of pension is correct but also to ensure that the correct GMP is paid and the correct revaluation and increases are applied. In addition, if the ex COSR scheme wishes to de-risk by buying out liabilities with an insurance company, GMPs must be reconciled with HMRC.

The reconciliation service will ultimately be scaled down and HMRC's GMP figures applied to a scheme from December 1, 2018. Schemes have therefore been encouraged to ensure that the GMP reconciliation process is undertaken as soon as possible.

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