



GMP conversion

Full steam ahead for equalisation?

Briefing

April 2019

Introduction

Given a choice between tracking inequalities in GMPs forever and getting rid of them in one fell swoop, many trustee boards are leaning towards GMP conversion. We now have government guidance on how to deliver equalisation of pension benefits via converting GMPs into other benefits. So is it full steam ahead now? No – we are still waiting on changes to the conversion process and answers to the tax problems. The guidance raises more questions than it answers, but at least we can start to design the project.

Seven key points

- “GMP conversion” means removing GMP rules for a member.
- Trustees do not have to choose the same equalisation solution for every scheme member.
- If trustees apply conversion to an individual member (or survivor), all GMPs for that member must be removed, not just the GMP for the period requiring equalisation.
- Trustees cannot convert benefits without employer consent.
- Trustees do not need member consent (unless you go outside your powers).
- The weekly amount of a pension in payment cannot be reduced on conversion.
- GMPs stopped in 1997, which is when compulsory pension indexation came in, so there is flexibility around what indexation, if any, to give on the new benefits.

GMP conversion: what is it and how does it work?

All schemes which were contracted-out of the State earnings pension between May 17, 1990 and April 5, 1997 have to equalise benefits between men and women, to remove the inequality caused by unequal guaranteed minimum pensions (see our [December 2018 briefing](#)). The judge in the *Lloyds Banking Group* case last year approved up to five methods of equalisation, with the range of options available to a particular scheme dependent on whether the sponsoring employer agrees the method, or a default applies.

One of the options is “Method D2”, GMP conversion. This does need sponsoring employer consent. The method uplifts the benefit value for the disadvantaged member and immediately converts the GMP into conventional benefits. This prevents inequality creeping back in over time and avoids the need to track future variations of GMP values.

The conversion option law is overriding. It

- Allows trustees to remove GMP requirements.
- Provides protections for members.
- Fixes the change process.
- Gives the pensions regulator power to undo defective conversions.

The protections are

- The pre-conversion benefits and post-conversion benefits must be actuarially equivalent in value.
- Pensions in payment cannot be reduced.
- Benefits cannot be converted into a defined contribution structure.
- Survivors’ benefits must be paid in the same circumstances as before.
- The change process includes prior consultation with members, the consent of the employer and full notification of the changes to affected members and survivors.

The government has to issue guidance under the regime and the Department for Work and Pensions has now produced that guidance. The guidance focusses on a step plan for conversion, which you will find later in this briefing, but otherwise passes full responsibility onto the trustees/employers, frequently referencing the need to take advice. We have been working behind the scenes to get ready to help you, and to work with your providers, to solve the challenges in the guidance (and a few more).

Getting ready for conversion: making your mind up

Much will depend on your scheme, but here are a few thoughts on some of the decisions you will need to make before you start.

Which equalisation method?

Which method would increase scheme liabilities the least – the default option which does not need employer consent? Which would cost least/most to deliver? And which would make the least impact on employer accounts?

It might not be enough to analyse your data at the scheme-wide level. Try a segmented basis against the types and categories of members in the scheme – you could decide to use conversion for one type of member but find it would be simpler and cheaper to, for example, track and correct GMP inequalities annually for others (Method B in the *Lloyds Banking Group* case).

Which members/survivors?

Assuming you choose conversion, the segmentation analysis also applies to the timing of conversion in the member journey. For your scheme, are there categories or types of beneficiaries that should be included/excluded from the initial conversion exercise because another method would be more beneficial or less prejudicial/expensive/confusing to members? Conversion is legal, with employer consent, but the judge acknowledged there would be winners and losers with that approach. Active members present a particular challenge – should you leave them in another method of equalisation at least until their benefits crystallise?

What benefits should be converted?

The table below shows the periods of service to think about. If you convert a member’s benefits, you must remove the GMPs from periods 2-5 highlighted below. However equalisation for the effect of GMPs only applies to periods four and five (six should have already been fully equalised). Do you need to cover some or all pre-1978 service too?

Service period	GMPs	Normal retirement age
Pre April 6, 1978	No GMPs	Likely to differ by sex
April 6, 1978 to April 5, 1988	Pre-1988 GMPs	Likely to differ by sex
April 6, 1988 to May 16, 1990	Post-1988 GMPs	Likely to differ by sex
May 17, 1990 to equalisation	Post-1988 GMPs	Lower age applies
Equalisation to April 5, 1997	Post-1988 GMPs	Unisex age
April 6, 1997 onwards	No GMPs	Unisex age

What valuation basis?

When valuing benefits, the actuary must ignore benefits that have already been commuted or paid, or which have already become due, as well as discretionary benefits. However the legislation does not say what basis to use – it is for the trustees to decide after taking actuarial advice.

The DWP nudges schemes towards the cash equivalent transfer value basis, but points out the scheme's normal assumptions may need tweaking to reflect the population being considered. The DWP has also questioned the use of sex-based actuarial factors, which are still permissible under UK law.

For scheme funding purposes, the valuation basis is potentially a neutral issue – in actuarial terms the benefits will be worth the same before and after conversion. However sponsoring employers may have a real interest in this decision if the basis chosen results in liabilities increasing significantly in accounting terms.

What new benefits?

Do you want just to do the minimum changes needed to remove GMPs and deliver equalisation for periods four and five above or would you like a more sweeping change? GMPs all relate to the period before indexation of pensions became compulsory, so you could make the replacement benefit for the pre-1997 period a flat rate pension. However do think about the specifics of your scheme – do members have guaranteed pension increases or a generous practice of discretionary benefits which they would be upset to lose?

The conversion regime allows trustees to include any additional scheme amendments “necessary or desirable as a consequence of, or to facilitate, conversion”. That might look like a generous power to make sweeping changes, but members' benefits are affected and the court only approved conversion because it was a statutory regime. We could expect the courts to interpret this power restrictively.

GMP conversion: DWP recommended process

Before you begin: reconcile your scheme data and plan the project out.

- Employer agreement.
- Choose members, benefits to change (including all GMPs for the member concerned) and new benefit structure.
- Set a date for conversion.
- Consult members on high level plans.
- Value the benefits to be converted.
- Equalise the values for the period May 17, 1990 to April 5, 1997.
- Calculate new benefits.
- Actuary's certifies that the pre- and post-conversion benefits are actuarially equivalent and all calculations are complete.
- Change the scheme to change the benefits.
- Tell members and survivors what has happened, in detail.

Why it might be worth waiting a bit longer to start conversion

We have the DWP guidance, and the judge in the Lloyds Banking Group case said the conversion legislation was operable. That said there are a more than a few difficulties with the current version of the conversion legislation. The DWP is looking at some changes which may make the whole process a little easier.

One good example of where change is needed is over employer consent. Employer consent is needed – but as defined, that is probably the employer that employed the individual while they were building up their GMP, which may even have been in another scheme. If that entity cannot be identified, has left the group or has been wound up, does that mean no employer consent is needed, or that GMP conversion is impossible? Would the consent of the companies currently sponsoring the scheme be good enough? Could the Pensions Regulator give an appropriate clearance, or does the DWP need to step in? This issue will not affect schemes where all relevant employers are still going.

We are also waiting on answers from HMRC to all the tax problems inherent in suddenly increasing benefits decades after they were accrued. The continuing risk on tax issues may dissuade trustees and employers from initiating their conversion exercises quite yet, but planning can certainly start now.

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