GMP equalisation: actions for pension schemes

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The High Court has ruled in the Lloyds Banking Group ("LBG") case that UK pension schemes that have contracted out of the State Earnings Related Pension Scheme will need to equalise benefits for the effect of unequal Guaranteed Minimum Pensions between men and women.

The judgment may be subject to appeal and this will be confirmed over the next two months.

**Actions for employers and trustees**
Barring an unexpected appeal outcome the following actions will be required:

### Immediate Actions
- Recognise in company accounts: decide accounting treatment and cost estimation method
- Review impact on projects including actuarial valuations, member options and insurance
- Determine interim approach to benefit crystallisation events (including transfer values) and communicate to members

### Longer Term
- Determine equalisation method
- Agree how additional liabilities will be funded
- Implement benefit administration remediation plan for past and future benefits

**Details of the Judgment:**
The judgment confirms a range of equalisation methods as “permissible” (i.e. resistant to future challenge). It also states that the sponsor has control of the method and may direct the trustee to use the lowest cost method. This method (termed ‘C2’) involves paying the better of the male or female pension on a year-by-year basis and allowing the offsetting of accumulated gains with interest in cases where the better-off sex changes over time.

Interestingly, while using an actuarial value to equalise benefits is expressly not permitted (method ‘D1’), the ruling allows the conversion of GMPs using an alternative method (‘D2’) provided sponsor consent is given. It is therefore for the sponsor to largely determine the method of equalisation, albeit cost considerations would typically mean the decision is between method C2 and conversion.

The judgment means the cost of GMP equalisation is at the lowest end of the ranges previously indicated. While the amount depends on a number of scheme-specific factors, LBG expects the cost of GMP equalisation to be £100m - £150m or roughly 0.3% of total pension obligations.

The actual cost for other schemes will vary and scheme specific advice will be required. For example, some trust deeds include time limitations for backdating of claims for past underpayments which reduces the cost (as with many of the LBG schemes). Some questions remain unresolved such as whether past transfer outs need to be revisited.
Immediate actions

**Accounting for pensions**

01 **Planning & stakeholder engagement**
Following the judgment, disclosure is required and hence there will be a need to educate internal stakeholders including board members and audit committees. All clients will need to consider how to recognise and explain this issue to readers of the accounts in a way that is clear, and importantly will need to take advice on how to best estimate their additional obligation.

02 **Accounting treatment**
The judgment is that there is an obligation to equalise for the effect of GMPs which dates back to 1990. We anticipate in most cases the accounting treatment will be as a plan amendment (past service cost to Profit or Loss, due to a change in the benefits payable). In limited circumstances the correct treatment may be as a change in estimate in Other Comprehensive Income (i.e. where the effects of GMP equalisation were actually previously accounted for on the balance sheet). Disclosures will be key to explain this issue to readers of the accounts.

03 **What needs to be disclosed?**
Disclosures should include a description of the issue, the accounting treatment adopted and the impact. Companies should also comment on the level of judgment involved in making estimates on the impact, for example if an estimate is being made ahead of full analysis being carried out by the scheme trustees, which is likely to be the case given that most corporates will have to make an estimate in their year end or interim accounts by Spring 2019.

**Review impact on projects**

01 **Actuarial valuations**
Most pension schemes will not have funded for equalisation of GMPs and the judgment will generate an additional liability. Where an allowance has already been made for this, the judgment may require it to be reviewed. For those schemes currently undergoing an actuarial valuation, the company and trustees will need to agree whether to allow for the cost of equalisation and, if so, how. This will likely need to be done on an approximate basis as timescales may not permit an accurate calculation.

02 **Member options**
Sponsors and trustees need to consider how GMP equalisation will affect any current or planned exercises. For example, should trustees continue to pay unequal transfers and, if not, how should they be adjusted.

03 **Pensions insurance**
The methodology for GMP equalisation which has been used most often when buying out historically differs from the court judgment. For forthcoming transactions trustees and sponsors should review the methodology they are planning to use as insurers are likely to require one of the methods blessed by the court judgment to be implemented. This could be done alongside GMP conversion which may be attractive, time permitting, as it is likely to reduce insurance costs. Sponsors and trustees may also need to review past transactions to determine whether any remediation is required and, if so, who is responsible for meeting the cost of this (scheme or insurer).

**Interim approach to benefit crystallisation events**

01 **Process considerations**
Decide on an interim approach to benefit crystallisation events (e.g. retirements, transfers out etc.) to minimise need for future redress whilst permitting members to continue to access benefits. Particular consideration should be given to benefits which are paid in full and final settlement, e.g. transfers, trivial commutations and certain death benefits.

02 **Member communication**
Decide how the agreed approach is communicated to members. This should include support to administrators and contact centre staff on how to manage member queries on this issue.
Longer term actions

**Determine equalisation method**

The sponsor has a significant role in agreeing the appropriate equalisation approach with the Trustees, including whether GMP conversion should be pursued. The approach will depend upon the scheme rules and specific legal advice will be required.

GMP conversion could be attractive as it offers a once and for all solution to the equalisation problem. There is also the possibility of more generally reshaping benefits as part of any conversion further simplifying benefits and reducing future insurance costs.

**Agree how will additional benefits be funded**

For most schemes we expect that it will be acceptable to agree an approach as part of the scheduled actuarial valuation cycle rather than as an accelerated one-off. This is particularly the case where the expected cost of additional benefits is similar to or less than other inter-valuation experience items. For some clients a more accelerated approach might be appropriate e.g. where the cost is more material and the sponsor covenant is weak.

**Administration remediation plan for past and future benefits**

**Remediation:**

An exercise to back-date historic underpayments of pension arising from retrospective application of GMP equalisation will be required. Most schemes are likely to find two main challenges in undertaking remediation:

1. Availability of key data items to undertake accurate calculations. Data required may not typically have been subject to previous data analysis and cleansing (e.g. contracted out earnings).
2. Making backdated payments where it is unclear to whom the payment should be made, e.g. where a pensioner has died and there is no surviving spouse or remaining estate.

**Pension increase & retirement procedures:**

Revised procedures will be needed to allow for the complexity of GMP equalisation in future annual increases to pensions in payment and in the calculation of retirement benefits.

**Transfers out:**

Revised procedures will be needed for new transfer out calculations to include allowance for GMP equalisation. The judgment has not clarified whether pension schemes should review past transfers out to decide whether they should be retroactively increased or how to do this. These remain open questions.

**Past bulk transfers and pension insurance transactions:**

It is possible that retrospective amendment will be needed for past transactions and new ones will need to take account of GMP equalisation.

**Practical considerations:**

It is worth noting that the remediation activity required may be substantial and there is a risk that this may crowd out other desired discretionary projects.
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