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 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

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 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 advice 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.

Written by Theo Andrew

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