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Dear Pam

Consultation on Draft Occupational Pension Schemes and Pension Protection Fund (Equality) (Amendment) Regulations 2012

We are writing with our response to your consultation document on the above and the accompanying 'possible methodology'.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

The consultation document proposes changes to legislation to implement the government's opinion that, following the result of the *Allonby* judgment, an actual comparator is not a pre-requisite before schemes are required to equalise benefits in relation to the unequal GMP formula. However, to our knowledge *Allonby* (and for that matter any other court case) does not address the question of whether there is a need to equalise. Although the consultation document says that the government's view is that such a need exists, our understanding is that there is no legal consensus about the extent to which this is the case, nor how equalisation should be achieved if it is indeed necessary.

One of the arguments against adjusting benefits is that GMPs are a State benefit substitute and State benefits can discriminate between the sexes.

Specifically GMPs are intended to substitute for the state earnings related pension (SERPS) in occupational schemes contracted-out on a salary related basis between 1978 and 1997, and its calculation formula reflects the SERPS formula at the time. To the extent there were differences initially, these reflected practical differences between what a state pension could achieve (for example, originally SERPS was calculated using only the best 20 years of salary) and what occupational pension schemes could provide.

Subsequently, the SERPS formulae and payment conditions have been revised, without similar adjustments being made to the legislation relating to GMPs, introducing differences between the two that were not justified by the different nature of provision. Legislation was also passed (for example, anti-franking) that altered the GMP's position as an underpin to scheme benefits, to the extent that the formula can now result in pensions higher than originally intended being paid even though the GMP 'underpin' does not bite. These differences in the legislative approach to the two statutorily defined formulae have exacerbated the already complex relationship between scheme and state benefits. For example, increasing payment ages for SERPS whilst not making a parallel increase for GMPs makes it more difficult for some schemes to access exemptions from equal treatment legislation that would otherwise permit justifiable inequalities to arise (for example, the exemption provided by regulation 3 of *The Equality Act 2010 (Sex Equality Rule) (Exceptions) Regulations 2010*).

The position of GMP as a substitute for state benefit and the fact that the Government chose not to equalise the formula for calculating GMPs following the *Barber* judgment has led trustees (and their legal advisers) to be reluctant to take a view as to whether they need to equalise benefits to remove the differences in scheme benefits created by the GMP formula. The complexity of the exercise, and the very small effect on the vast majority of members' benefits, has also militated against any desire to take steps to equalise.

We expect there will be very few cases where equalising benefits to address inequalities in the GMP formula will make a material difference to scheme members' benefits. We estimate that, on average, pension amounts will increase by only about 2% due to such an exercise: the effect is thus small for most individual members, but would increase employer's costs by about £13 billion in total, or about £3.25 million per scheme. Compared with this limited benefit, the cost of administering the exercise is disproportionate (we estimate total implementation costs of about £75,000 per scheme). To impose these costs on employers at a time when the Government is championing a reduction in red tape seems inconsistent; instead, the Government should look for alternative approaches.

In the first place, even if the Government considers that trustees must proceed to equalise benefits, the draft guidance it has published is not helpful:

- The approach is probably the most expensive that could be proposed;

- It will not be useful to trustees wanting to wind schemes up since insurance companies will be reluctant to administer the parallel calculations that will be required;

- The examples are simplistic and ignore the very real complexities introduced as a result of different, and changes in, scheme designs (we have listed some 'difficult' examples in our answer to the consultation document's Question 2);

- There is no acknowledgement that, in many cases, data will be missing.

Our preference would be for the draft guidance to be explicitly withdrawn.

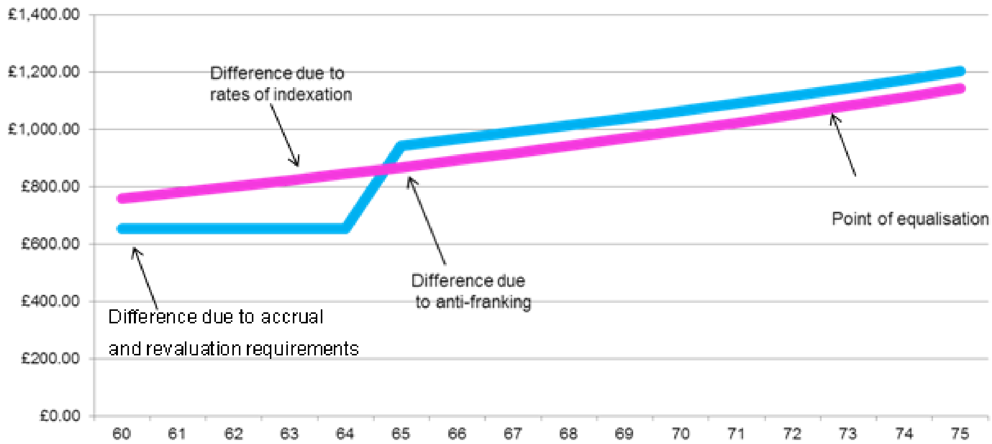
There are also other steps the Government could take to mitigate the risk to trustees and the cost, assuming the need to equalise exists. For example:

- It could make clear that, where a scheme has changed its normal pension age (for example, if, following the *Barber* judgment, it equalised NPAs at 65) then the requirement to provide benefits at 60, owing to the female GMP payment age, can be treated as an alternative to a short service benefit. We take this view since, typically, NPA for preservation purposes is a single age. This would remove the need to make additional benefit comparison once members reach age 65, as illustrated in Example 6 of the draft guidance.

- There should be no need to increase both the man's pension and the woman's, since this is 'gold plating': 'equalisation' should not result in both parties being better off; it should just ensure that one party is not worse off. The implication is that this comparison should be made on an actuarial basis and a Government statement to this effect, setting out how it could be achieved (for example, using a gender neutral basis) could be helpful.

- It could work with the industry to develop a broad brush method allowing for data and other information inadequacies that would enable trustees to use the GMP conversion regulations to address the issue. Considering this in conjunction with the proposed removal of contracting out, expected from 2016, to achieve an outcome similar to the liberal approach taken to the removal of protected rights on the abolition of contracting-out on a money purchase basis, would seem a more proportionate outcome.

The Chart below indicates how a man's (the blue line) and a woman's (the pink line) pension could change as a result of equalising using the method in the draft guidance (which suggests the higher amount should always be paid) so that both sexes can gain an advantage from the approach.



The ACA understands from a Joint Working Group meeting with DWP officials that the Government's sole intention in implementing the proposed change to the *Equality Act* is to establish that no comparator is needed for there to be a need to equalise benefits in relation to sex equality requirements. This is not what the consultation says. However, if it is the case, then since the draft regulation is drafted specifically in relation to steps taken in relation to inequalities in the formula for GMPs, it goes beyond the impact of the *Allonby* case, and, as discussed above, potentially introduces a requirement that doesn't exist.

In general, our preference is for less legislation rather than more, unless there is a particular need. We are not lawyers, but we understand that, since the *Allonby* case has established that there is no need for a comparator, courts will rely on the case law established and so the proposed amendments are unnecessary for the facts of the case to be reflected in the law.

Consequently, our preferred outcome from the consultation would be for no amendments to be made to the *Equality Act*; a second alternative would be for any amendment made to be limited to just clarifying that there is no need for a comparator. We are aware that the Association of Pension Lawyers is submitting a draft revision to the amendments to achieve this, and we commend these changes to the Government.

The amendment in relation to the *Pensions Act 2004* only affects PPF compensation and seems to implement policy that the Board of the PPF is already putting into place, so we have no additional comments on this.

Our responses to the specific questions asked in the consultation are in the Appendix to this letter.

We hope that you find our comments of assistance, and would be happy to discuss these issues further if that is helpful. You can contact me on 020 7082 6228 (Charles.young@hymans.co.uk) or my colleague Deborah Cooper (Deborah.r.cooper@mercer.com) on 020 7178 7184.

Yours sincerely

Charles Young
Chairman
ACA Pension Schemes Committee

Appendix: Specific consultation questions

Question 1: Do you think the draft Regulations achieve the intended outcome?

Our understanding is that the intended outcome is to put the effect of the *Allonby* case, regarding the need for comparators in equal treatment cases, into law. We are concerned that the effect of the proposed amendment goes beyond this, creating a legislative requirement for schemes to equalise benefits to address inequalities in the GMP formula, even though it is currently unclear that such a need exists. Therefore we think that the draft Regulations go further than required or desirable. If the amendments are not removed completely (which in our view would be the preferable outcome), we commend wording changes that are being proposed to the DWP by the Association of Pension Lawyers.

Question 2: Do you have any comments on the proposed methodology?

Although the method for equalising pensions for the effect of GMPs used in the draft guidance document should generally achieve equal payment outcomes, we do not agree that it is the only or even an appropriate method. By uplifting on a year by year basis it ignores the fact that that there can be cross-overs and so it over-compensates over an individual's expected lifetime. The guidance also ignores the practical difficulties trustees will face in achieving equalisation, regardless of the method they choose. These include:

- More challenging member scenarios, for example, when members have different tranches of benefit over the equalisation period;
- Missing data;
- Treatment of people who have died, or left the scheme and, for example, transferred benefits away
- The impact of past and future discretionary pension increases
- Early retirements, where the pension was insufficient to cover the GMP, or would have been had the member been of the opposite sex.

Overall, our view is that guidance is not helpful and could result inadvertently in adverse outcomes by raising expectations that trustees and employers have no intention of meeting, or are not able to meet. Even if considerable effort is put into addressing the issues we have raised, the guidance remains non-legally binding and this must be made clear if publication goes ahead.

Question 3: The Government would be interested in whether respondents think publication would be of assistance to schemes?

For the reasons stated above, we do not think the draft guidance will be useful. Unless draft guidance is replaced by a very much more cost-appropriate approach, we believe that it would be preferable to have no guidance.

Question 4: The Government would be interested in any other suggestions as to what it could do to assist schemes in dealing with their equalisation duties?

As stated above, we consider that it is not clear that schemes have an 'equalisation duty'. If the Government has legal advice that makes this responsibility clear, then, given that there is no legal consensus on this matter, it should publish it or be willing to sponsor a test case.

If the Government does pursue its objective of imposing an equalisation duty then:
It needs to address how trustees can meet their responsibilities when data is not available;

- It should determine a de-minimis level where no change is necessary, particularly where adjustments would be approximate in any case;

- As mentioned above, there are areas of legislation affecting the need to equalise that could have been kept consistent, but have been permitted to get out of line. If these were brought back into line, with retrospective effect, there would be no need for action in certain cases. (Examples include payment ages, where the difference in GMP and S2P payment ages reduces the benefit of an exemption in relation to different rates of pension increases; and revaluation, since fixed rates do not match the revaluation applied to SERPS accrual, nor the revaluation applied to occupational pensions.);

- Anti-franking adds to the cost of equalisation, but the way it operates is imperfect. The Government previously considered revising the legislation but did not proceed: it could now do so in a way that reduces the liability on schemes that have to equalise. (For example, anti-franking should apply only once, at the scheme's normal pension age.);

- The Government is about to revise state pensions and end contracting out on a salary-related basis. It could use this as an opportunity to review the existing regime and change requirements in relation to GMPs to reduce the need for equalisation adjustments. This would be consistent with the liberal approach it took towards abolishing Protected Rights on ending contracting out on a money purchase basis. (For example, noting the protection afforded by Section 67 of the *Pensions Act 1995*, the Government could repeal legislation relating to GMPs).

- The application of HMRC rules could result in tax charges applying, for example because additional payments required to remove inequalities caused by unequal GMPs are considered to be 'unauthorised' or affect a member's Lifetime Allowance protection, for example. Legislation needs to clarify that payments in relation to GMP equalisation will not have adverse tax consequences

Question 5: The Government would be interested in whether anyone thinks there could be an adverse impact on the position of disabled people from these changes?

We can see no reason why these changes should have an adverse impact on the position of disabled people.

Question 6: The Government would be interested in whether anyone thinks there could be an adverse impact on the position of men or women from these changes?

The proposed changes can only increase benefits or leave them as they are. No member will have benefits reduced as a consequence of the changes – except in very limited circumstances in employer insolvency, to the extent that there is less money to go to a scheme that is forced to wind up outside the PPF.

The impact of the changes is different depending on scheme design, employment history, earnings history (basic pay and overall earnings) and a number of other factors. It is not possible to be definitive about whether men or women will be the greater beneficiaries of GMP equalisation, but we suspect that more men than women will receive an uplift as a result of GMP equalisation.

Response by:

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