Lovells

JOINT SESSION APL and ACA

GMPS AND EQUAL TREATMENT

Duncan Buchanan
April 2010

1. INTRODUCTION

1.1 I have only 15 minutes for this presentation and much to say on the subject of Guaranteed Minimum Pensions (GMPs) and equal treatment. As will become clear this is a subject on which I have strong views not only on whether there is a need to equalise but also on how the subject is being dealt with by the various Government bodies.

1.2 This talk focuses on the recent announcements by the Government and Government bodies (for this purpose including the Board of the PPF) which have again raised the complex issue of whether benefits from occupational pension schemes need to be equalised to make good the inherent inequalities that are imposed on schemes by the GMP legislation as contained in the Pension Schemes Act 1993.

1.3 As a lawyer in private practice I have had to advise a number of schemes on the need to equalise benefits between the sexes. In practice, the inherent inequalities of GMPs only fell to be considered when schemes were winding up. Most of the schemes I have advised which are in winding up were significantly underfunded and therefore making adjustments to GMP benefits always seemed to me to be akin to rearranging the chairs on the Titanic. I had no issues with advising trustees of schemes in winding up that it was acceptable for them not to adjust benefits for GMP inequalities – doing so would incur significant additional expense and would end up robbing Mary to pay Paul (in most cases a small but expensive adjustment). Better I believe to use the meagre resources available to provide benefits on an unequalised GMP basis recognising every £ spent on expenses is a £ less pension for a member whose benefits were already being scaled back.

1.4 These wind ups were prior to the introduction of the Pension Protection Fund (PPF) and the expansion of the Financial Assistance Scheme (FAS). These bodies have now made strong statements about the need for them to provide benefits which are equalised to reflect GMP inequalities.

1.5 In this talk I want to demonstrate that the approach being proposed by the PPF and FAS is wrong and results in higher benefits and additional cost which is to be met by either the PPF levy or by the taxpayer.

1.6 In particular I question the need to equalise GMPs at all and then the basis in which it is been proposed that these benefits should be equalised.

1.7 There is a health and safety warning on these slides. The views expressed are mine alone and do not necessarily reflect the views of Lovells LLP. Of course this talk is not a substitute for legal advice.

2. BACKGROUND TO GMP INEQUALITIES

2.1 I do not want to spend too long on this slide. I think it is sufficient to say that GMPs are by their very nature discriminatory between male and females. They are payable at different ages and accrue at different rates between the sexes so that the female gets the more valuable GMP.

2.2 The complex and mystical anti-franking requirements of the 1993 Act – which require GMP revaluation increases to be protected further compound the issue. Finally most schemes only provide increases to pensions in payment in excess of GMP so male members would have a higher non GMP benefit which could enjoy larger increases that the GMP element.

2.3 Fortunately, GMPs ceased to accrue in 1997 and were replaced by a reference scheme test benefit (which is equal between the sexes) but this still leaves GMPs which accrued between 17 May 1990 (Barber date) and April 1997 payable on an unequal basis.

2.4 I think it is important to note that GMPs are a replacement to the State Earnings Related Pension and all members still receive a SERPS benefit but it is reduced by their scheme GMP.

2.5 The GMP obligations are overriding so where a scheme operates what looks to be equal benefits – say n/60th payable from age 65 – the actual benefit payable will be slightly different because of the GMP obligations imposed by legislation.

2.6 Finally, if an insolvency event arises and the scheme enters a PPF assessment period the GMP is effectively converted into PPF compensation and the GMP inequalities are removed going forward (but will apply for the period to the start of the assessment period).

3. WHAT GOVERNMENT BODIES HAVE SAID

3.1 As mentioned the recent focus of the inequalities of GMPs was prompted by the PPF issuing a consultation document in April 2008 suggesting that the Board has a statutory duty to ensure equal treatment and that it was going to take steps to ensure equality of GMPs when calculating benefits.

3.2 The PPF have chosen not to disclose the legal opinions they received and this is in contrast to their position on dealing with unequal normal retirement ages. As a lawyer I would caution against putting too much reliance on legal opinions – sometimes clients treat the contents of an opinion as being set in stone. However as someone once said to me – with every court case there are at least two (in pension cases often more) counsels' opinions and normally one of them is found to be wrong by the judge.

3.3 Once the PPF had set the ball rolling the operators of FAS needed to consider their position on GMP inequality. This resulted in further consultation being issued in January this year with an accompanying statement from the Pensions Minister.

3.4 These statements from Government deal with two requirements. The first I have called the Equalisation Requirement and is best summed up by the Pensions Minister's statement. The second I have called the Tranching Requirement (as being the way in which equality needs to be achieved). This is best summed up by a statement from the PPF's consultation document.

3.5 It is fair to say that the Minister's statement has raised a good deal of interest and concern – hence why I have been asked to talk tonight.

4. ARE THE GOVERNMENT BODIES RIGHT?

4.1 Here is where I need to get controversial and declare that I think there is a strong possibility that there is no need for the Equalisation Requirement. In addition the case law demonstrates that the Tranching Requirement is wrong and goes further than the law would require. I set out my reasoning for these statements below.

5. THE EQUALISATION REQUIREMENT

5.1 It is easy to spend someone else's money! In making the statements about the Equalisation Requirement the Government placed an additional burden on all occupational pension schemes which were contracted out on a GMP basis after 17 May 1990. This cost will need to be met by the sponsoring employers or if they cannot afford it by the PPF (at an additional cost to the employers of other schemes).

5.2 The administration cost of the Equalisation Requirement should not be underestimated. Taken to its logical conclusion schemes would be required to go back to 1990 and readjust benefits paid since that date levelling up any benefit that would have been higher had the member been of the opposite sex. Many benefits will have come into payment since 1990 and members will have died or transferred out. Whilst the uplift in benefits might be relatively minor the administration costs are likely to be very significant.

5.3 I need to declare a conflict of interest here because if the Equalisation Requirement is correct then there will be significant work for lawyers (as well as actuaries and scheme administrators) in deciding how to meet the Equalisation Requirement.

5.4 The PPF consultation document contains an estimate of the administration costs of equalising compensation. Whilst it is not my area when I looked at them the estimates seemed very low. It is interesting that the PPF do not seem to be suggesting that it should go back to 1990 for their schemes to level up past unequal payments for example where a member has died.

6. ARGUMENTS FOR THE EQUALISATION REQUIREMENT

6.1 The legal arguments which support the Equalisation Requirement are clear. Under Article 141 EC Treaty (previously Article 119) employers must pay equal pay for equal work. This Article is directly enforceable in member states (so must be followed by national courts). In addition there is the equal treatment requirements of Section 62 Pensions Act 1995 which imports the requirements of Article 141 into national law.

6.2 We know that a man and a woman with exactly the same work pattern will receive slightly different benefits in retirement because of the inherent inequalities of GMPs.

6.3 We also know from the Barber judgment in 1990 that pensions are pay and that the unequal pension benefits must therefore be equalised.

7. ARGUMENTS AGAINST THE EQUALISATION REQUIREMENT

7.1 Whilst on the surface the arguments for the Equalisation Requirement are clear and attractive, there are a number of arguments that can be put as to why it does not apply to the inequalities resulting from GMPs. The Government seems to have decided not to test any of these arguments and I strongly believe that they should be tested in the Courts.

7.2 The first argument is that a GMP is not pay and therefore the unequal effects are outside the scope of Article 141. The pay the employer promised is a pension of (say) n/60ths from age 65 and this is equal between men and women. The fact that national legislation may then require an uplift is not "pay" as such - rather it is an alternative to an unequal State benefit.

7.3 Secondly, European law permits state pensions to be unequal as between men and women (as is the case in the UK). The GMP element under an occupational pension scheme is a replacement for the SERPS benefit (although not an exact replacement) – so the provision of the GMP relieves the state of its obligations – put another way the scheme becomes the paying agent for the state for part of the member’s SERPS benefit.

7.4 Thirdly it is possible to justify unequal pay on objective grounds. In the past the European Court has allowed unequal benefits and contributions between males and females to continue without offending Article 141. See for example the Birds Eye and Newstead cases referred to below.

7.5 Assuming these arguments on GMPs remaining unequal under Article 141 succeed there is still the obstacle of Section 62 Pensions Act and its equal treatment rule. The argument there would be that Parliament when passing Section 62 would have been able to (and perhaps required to) change the GMP requirements of the 1993 Act if they conflicted with the equal treatment rule.

8. CASES TO DATE

8.1 Time does not permit me fully to explain why I think the case law to date could support the arguments against the Equalisation Requirement. I have listed the cases in this area that could support my arguments.

8.2 From a European Court point of view the important cases are Birds Eye – where unequal bridging pensions were objectively justified and Newstead (a pre Barber decision) where higher contributions required to the UK civil service scheme from men (who benefitted from a widow's pension) were permitted. I mention Beune because it could be said to go against Birds Eye (not permitting a Dutch scheme to integrate with an unequal state system). Allonby is a more recent case which I understand the Government now suggests means that there is no need to identify a comparator in order to show unequal treatment of GMPs.

8.3 In England there are very few cases addressing GMPs and inequality. The main one (which I will discuss in a bit more detail) was the 2001 appeal against the Pensions Ombudsman's determination concerning the March Mercer Pension Scheme.

8.4 Otherwise there is the 2004 decision in Leadenhall where trustees of a scheme in wind up sought approval to complete the winding up without equalising GMPs – the Judge held that it was "very doubtful that Community law would require or permit changes to [equalisation of GMPs]".

8.5 Finally, earlier this year the Court of Appeal gave its decision in the Bridge case. In the High Court the Judge had suggested that (for section 73 purposes) a GMP was a separate benefit. The Court of Appeal however held that a GMP is not a separate benefit but is a minimum below which the pension cannot fall.

9. WHAT THE MERCER CASE SAID

9.1 This case is the closest we have to a full discussion of the inequalities of GMPs. It was an appeal against a determination by the then Pensions Ombudsman who had ordered the trustees to take steps to equalise GMPs under the scheme.

9.2 The Judge was able to allow the appeal on the grounds that the Ombudsman lacked the jurisdiction to make the determination (as it affected other members). However the judgment goes on to make some observations about GMPs and the inequality point. These observations are what lawyers call "obiter" which means they do not set a precedent. They are however very useful and persuasive.

9.3 The following important points were mentioned by the Judge:

(a) GMPs themselves cannot be equalised. This is because a GMP is a feature of the statute and it is what the statute says it is.

(b) GMPs are not separate elements of pay – they are merely calculation factors. European law does not extend to requiring calculation factors to be equalised. Rather the requirement of equalisation extends just to the various elements of pay. This concept recently received approval from the Court of Appeal in the Bridge case.

(c) This leads to the far more important question which is whether the law requires that the non GMP benefits are increased to make good the inequalities in the GMP. This point was (deliberately) not argued before the Judge and is referred to in the decision as the "broad unanswered question".

(d) Section 62 probably does not override the unequal GMP requirements of the 1993 Act. I say probably because the Judge said "to interpret section 62's equal treatment rule as requiring schemes…to re-write the 1993 Act's provisions relating to GMPs so as to eliminate the very discrimination which the 1995 Act appears tacitly to reaffirm involves attributing to the legislature a perverse intention"

10. WHY THE TRANCHING REQUIREMENT IS WRONG

10.1 As mentioned the PPF (and FAS) are proposing to adopt an approach so that the GMP is treated for compensation purposes as a separate benefit which needs to be treated separately for compensation purposes.

10.2 This creates a ratchet effect which means that the members receive potentially significantly higher benefit. In effect the man (assuming a normal pension age of 65) receives a tranche of PPF compensation (being his post 1990 equalised GMP) at 60 and the remainder at 65.

10.3 This approach is legally flawed and is wrong. I say this based on the Court of Appeal's decision in the Bridge Case but I also believed it before then. I should also say that I understand that the Department of Work and Pensions is seeking leave to appeal the Bridge case to the Supreme Court (previously called the House of Lords). The response of the DWP to the FAS Consultation which was issued earlier this week states that the Government is considering the effect of the Bridge decision but continues to explain how FAS schemes should equalise the inequalities of GMP by applying "tranching factors" to the benefits.

10.4 As mentioned the English case law (Mercer and Bridge) states that a GMP is a calculation factor and not an element of pay. There is only one pension and therefore only one tranche of compensation (payable at 65 in the case of a normal pension age of 65).

10.5 The impact of this is that the PPF and FAS proposals significantly over compensate members at a cost to both levy payers and tax payers.

11. CONCLUSIONS

11.1 In my view this is too big an issue to deal with in the way the Government bodies are dealing with it.

11.2 Their proposals will impose a significant administration and cost burden on schemes and employers. They will also result in higher PPF levies and a higher FAS tax burden.

11.3 As I hope I have demonstrated this is not an open and shut question and requires careful interpretation of the law. What is needed here is a fully argued test case where the courts can consider both sides of the argument. It is likely that such a case would end up in the European Court and therefore would take some time to reach a conclusion.

11.4 That in my view is the only way to reach a conclusion. If it turns out that equalisation is required and the tranching requirement also applies, then I wonder whether schemes and their sponsoring employers will consider possible claims against the Government for misleading statements made by the DWP in the past.

Duncan Buchanan

April 2010