GMP Conversion

Jason Eshelby, FIA

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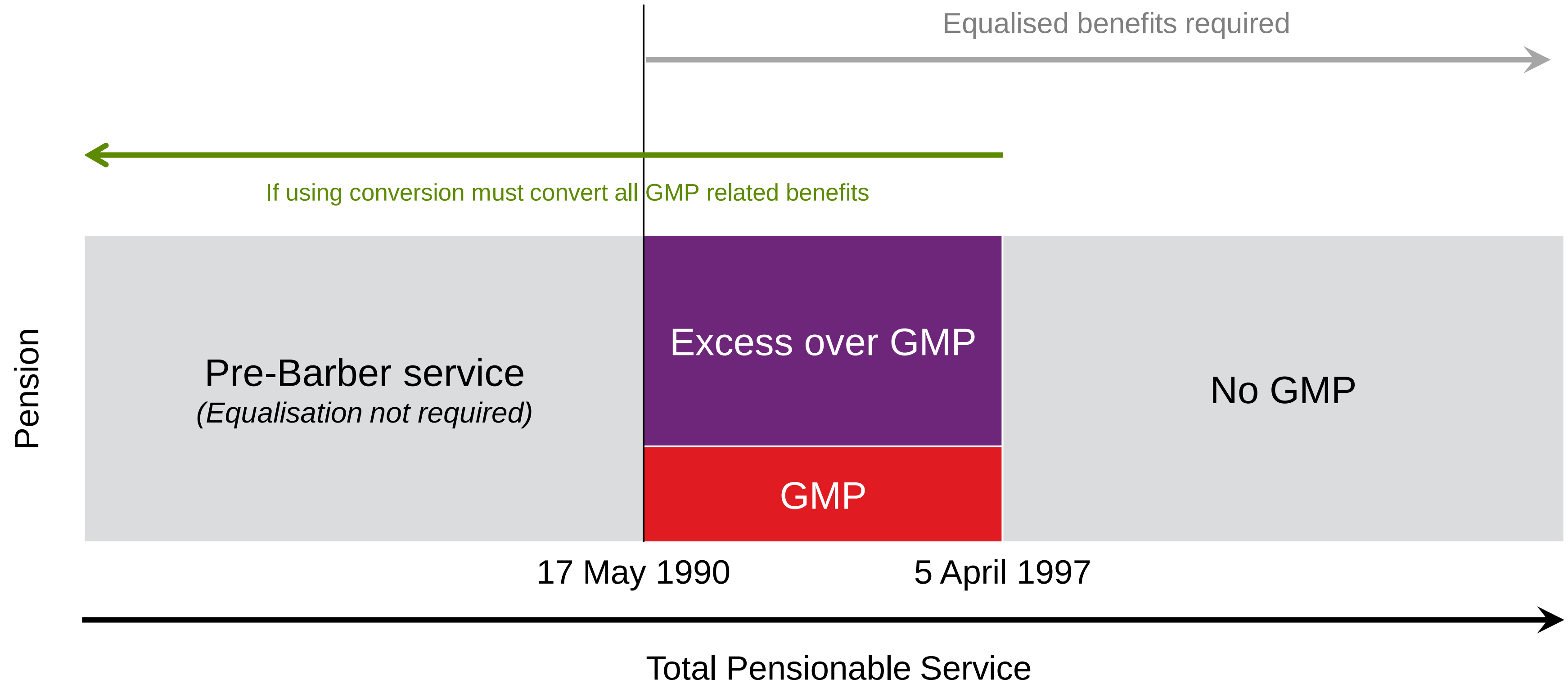
Prepared by Aon

Recap - what are we equalising?



Conversion applies to more than the net GMP difference between men and women

DWP 2016 consultation on using GMP conversion for equalisation

- **Interesting and flexible solution**
- **Focus on simplification – simplification requires reshaping member benefits**
- **Actuarial certification ensures members are safe-guarded under any benefit reshaping**
- **Presented as joint lowest cost for:**
  - **administration fees and**
  - **increase in benefits**

GMP Conversion

Spectrum of approaches

Simplify

Single calculation

Focus on admin simplification

But create member winners and losers

Member Choice

Reshape but provide member with choices

Eg ACA “pension £”

Minimal Interference

Reshape only to the extent needed.

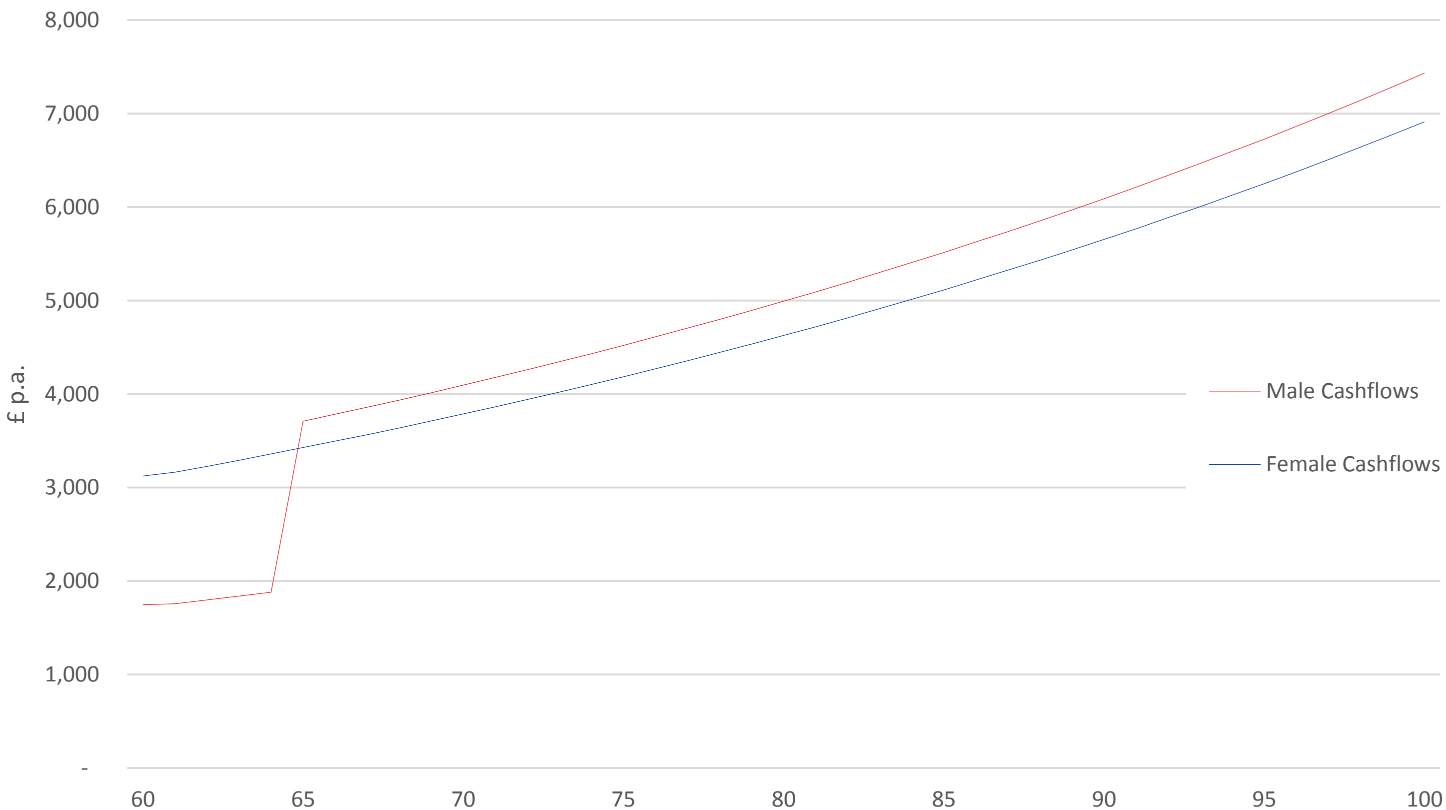
But practical considerations likely to drive how close get to true minimal

Mirror Image

It behaves like GMP just called something else.

Hard to deliver even for pre-90 benefits

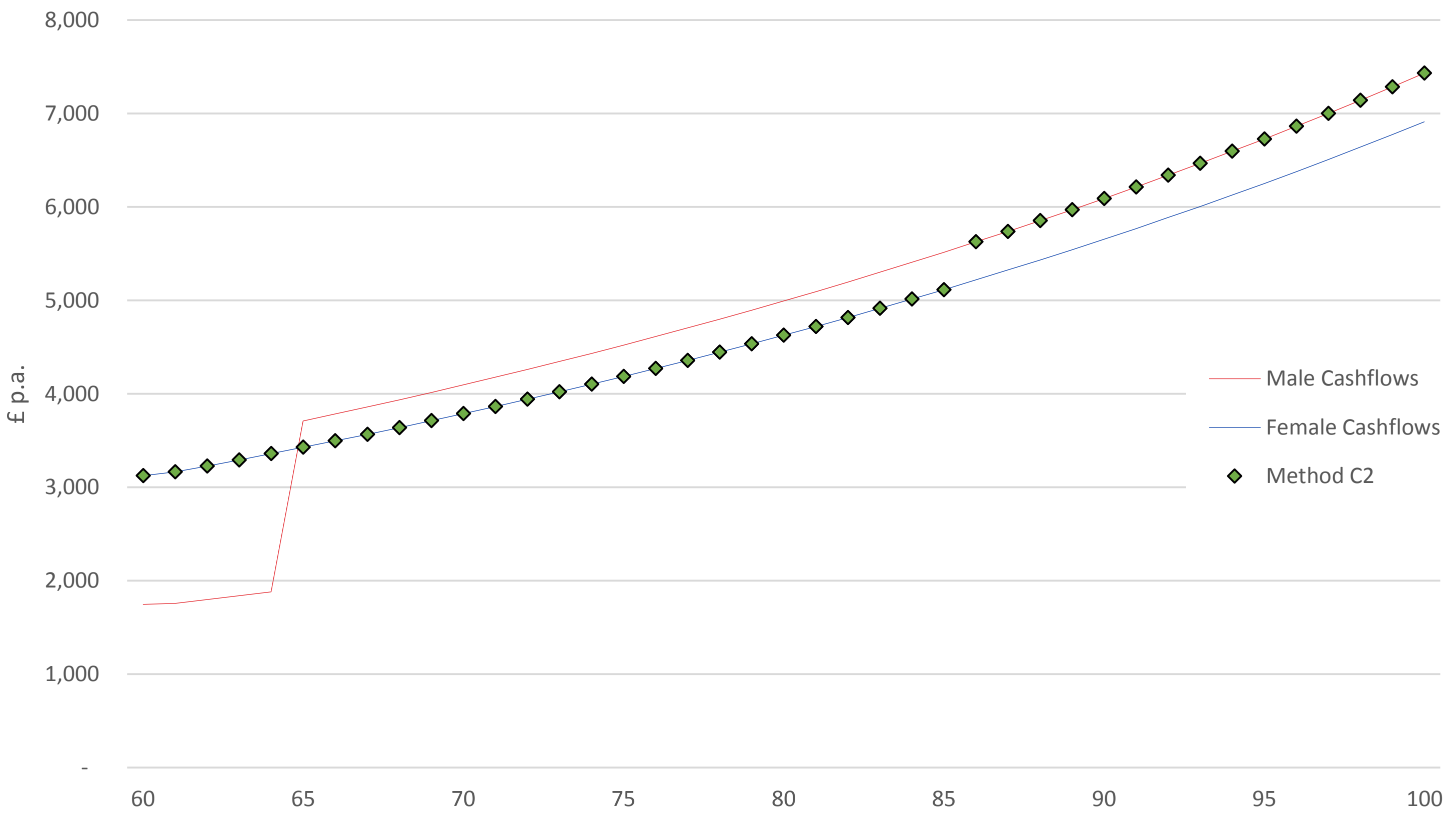
Example – Cross-over member



- Deferred pensioner
- NRA 60
- Retiring at 60
- Statutory increases in deferment
- In payment:
  - GMP: statutory increases
  - Non-GMP: CPI capped

Clear inequality but advantaged sex changes over time

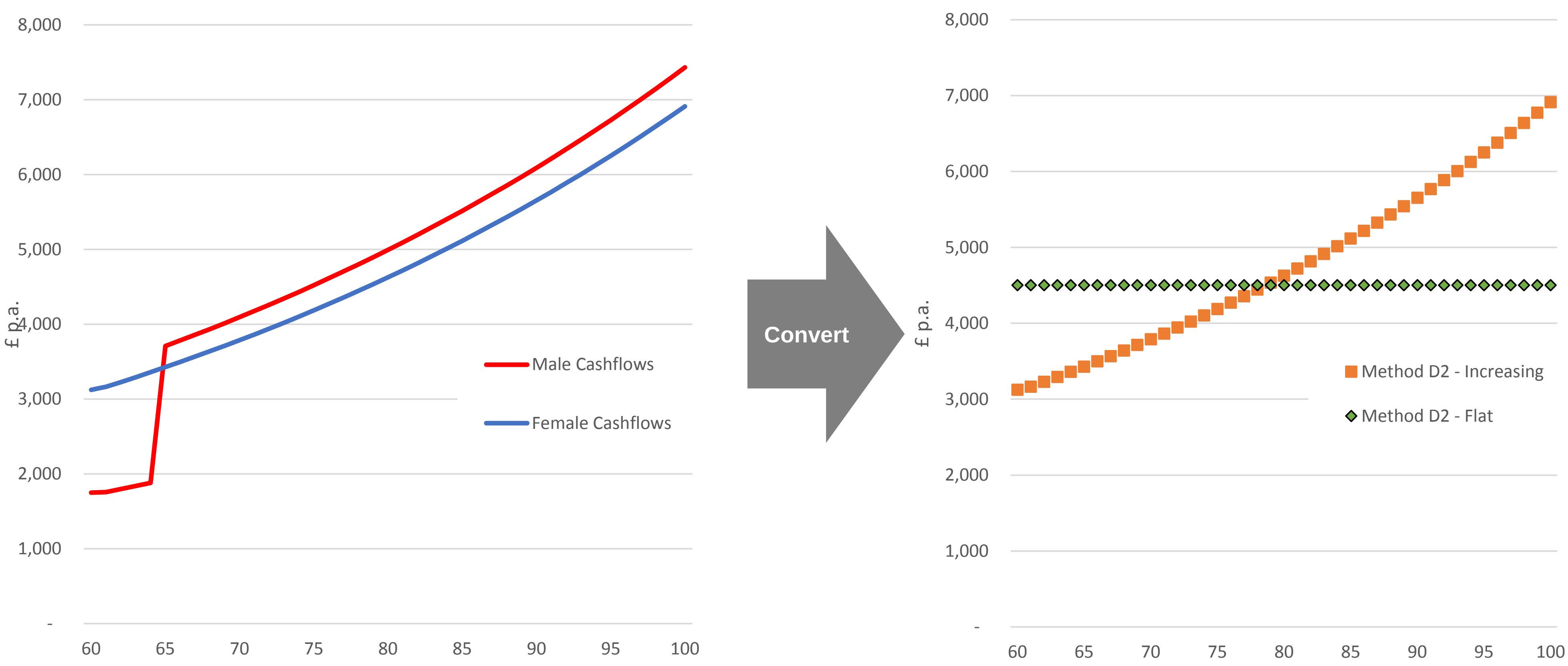
What does Method C2 pay



- Dual records "gets it right" over the course of a member's life time
- Pays the same total to men and women
- Very little additional expected cost due to aggregation
- Administratively burdensome
- May expect no increase for many members but may still need to maintain the dual records
- Actual impact will depend on experience

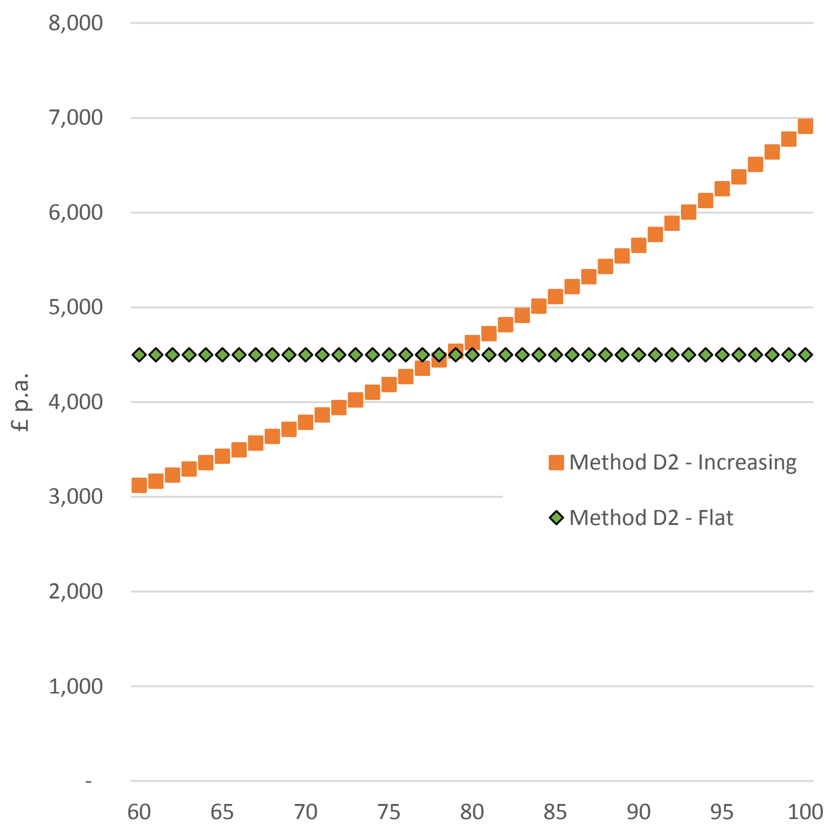
Minimal impact to overall required to deliver equal benefits

Range of options under Method D2 - Conversion



Design choices over how to implement – But not as simple as it looks

Range of options under Method D2 - Conversion



Increasing pension

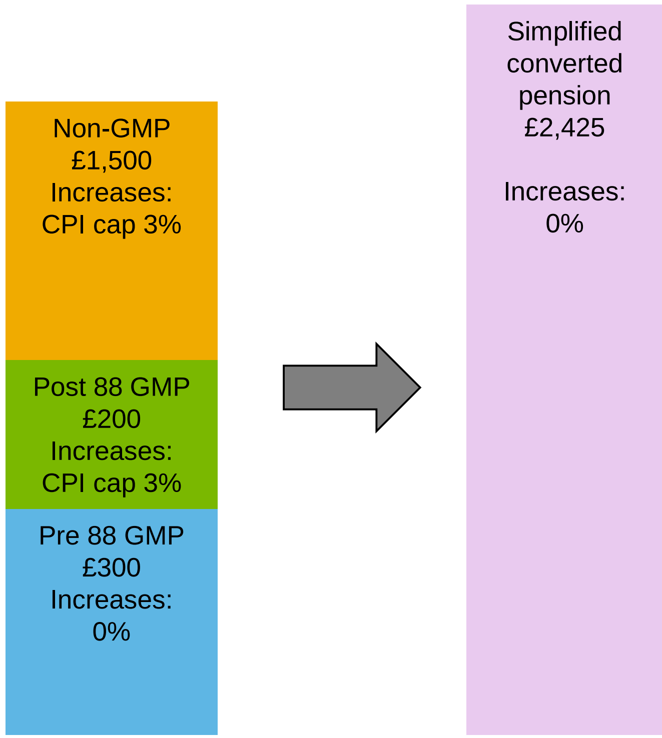
- Similar benefits out-come to C2 and indeed D1
- Simpler administration than C2
- Increases on the pre-conversion benefits are driven by the level of GMP and non-GMP and vary by member
- Match the current shape will require retaining most of the features of GMP - not wider simplification

Flat pension

- Delivers wider administration simplification
- Members can be a material winner or loser
- Potential material cost to company

Design options but no one size fits all

Why isn't conversion necessarily cost neutral?



Total: £2,000 **Total: £2,425**

Funding and conversion basis

Cost of £1 pa pension with CPI cap 3% pa increases	£25
Cost of £1 pa pension with 0% increases	£20
Value of pre conversion pension is	
£1500 x 25 +200 x 25 + £300 x 20	£48,500
Post conversion benefits equal	
£48,500 / 20	£2,425

IAS19

Values inflation as 3% less inflation risk premium of 0.25% pa

Cost of £1 pa pension with CPI cap 3%	£24.6
Cost of £1 pa pension with 0% increases	£20
Value of pre-conversion	
£1500 x 24.6 +200 x 25 + £300 x 20	£47,900
Value of post conversion is	
£2,425 x 20	£48,500
Cost of "cost neutral" conversion	£600
Increase in cost of total liabilities	1.25%

Guidance

April 2019	Awaiting further guidance		
1	2	3	4
DWP Guidance	**PASA Guidance**	**HMRC**	**Further legal hearing**
Provides high-level practical guidance for GMP conversion	To help promote good practice across all approaches to GMP equalisation	Lots of tax issues need to be addressed. HMRC working group looking at these.	Unanswered legal questions from 1st case, including transfers

DWP Conversion Guidance

- Really helpful guide

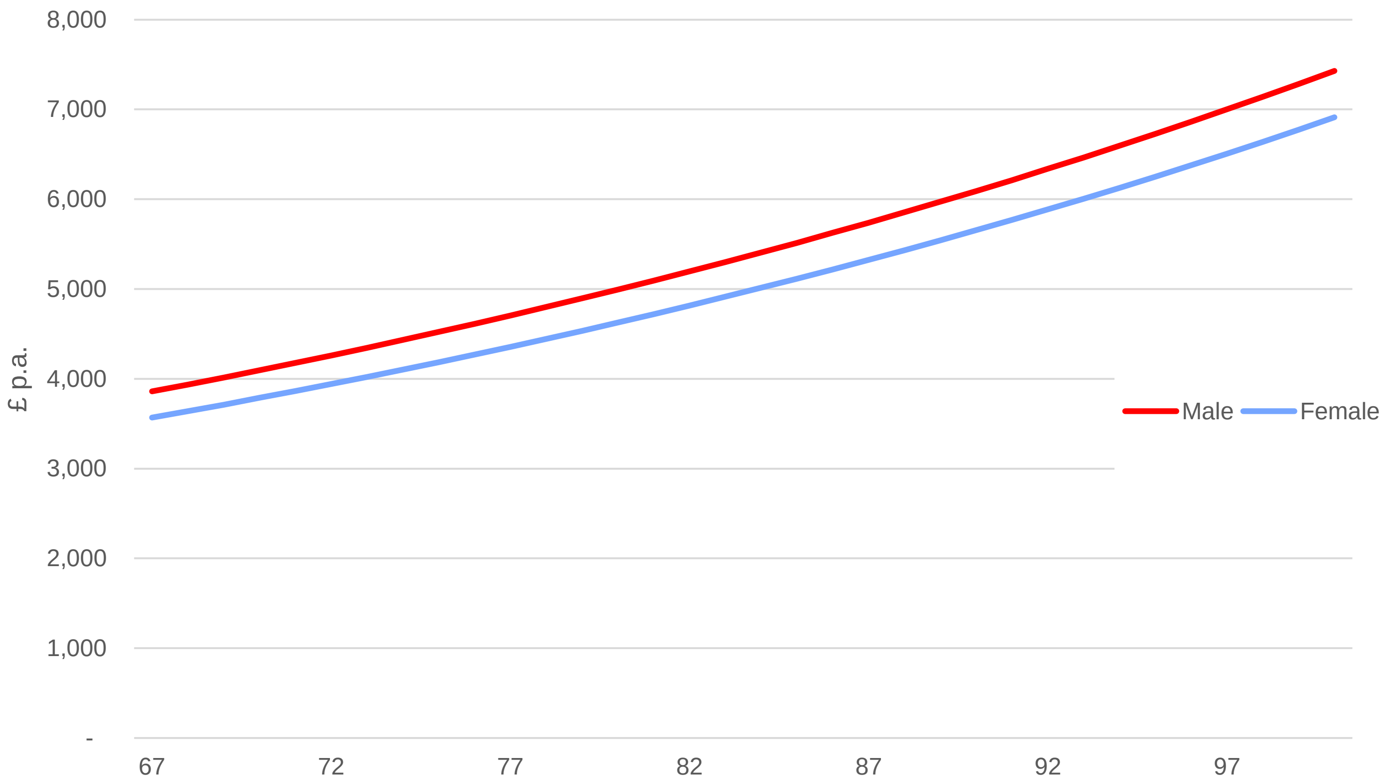
- What stood-out for me:
  - “Simplification” is not a focus
  - Points to trustee wider fiduciary duties

- A starting point for many trustees could be “minimal interference” conversion

- Practical requirements may mean that trustees move away from true “minimal interference”.

- How realistic target is “minimal interference” conversion?

Minimal interference conversion – pensioner (over SPA)



Restructure via conversion but essentially:

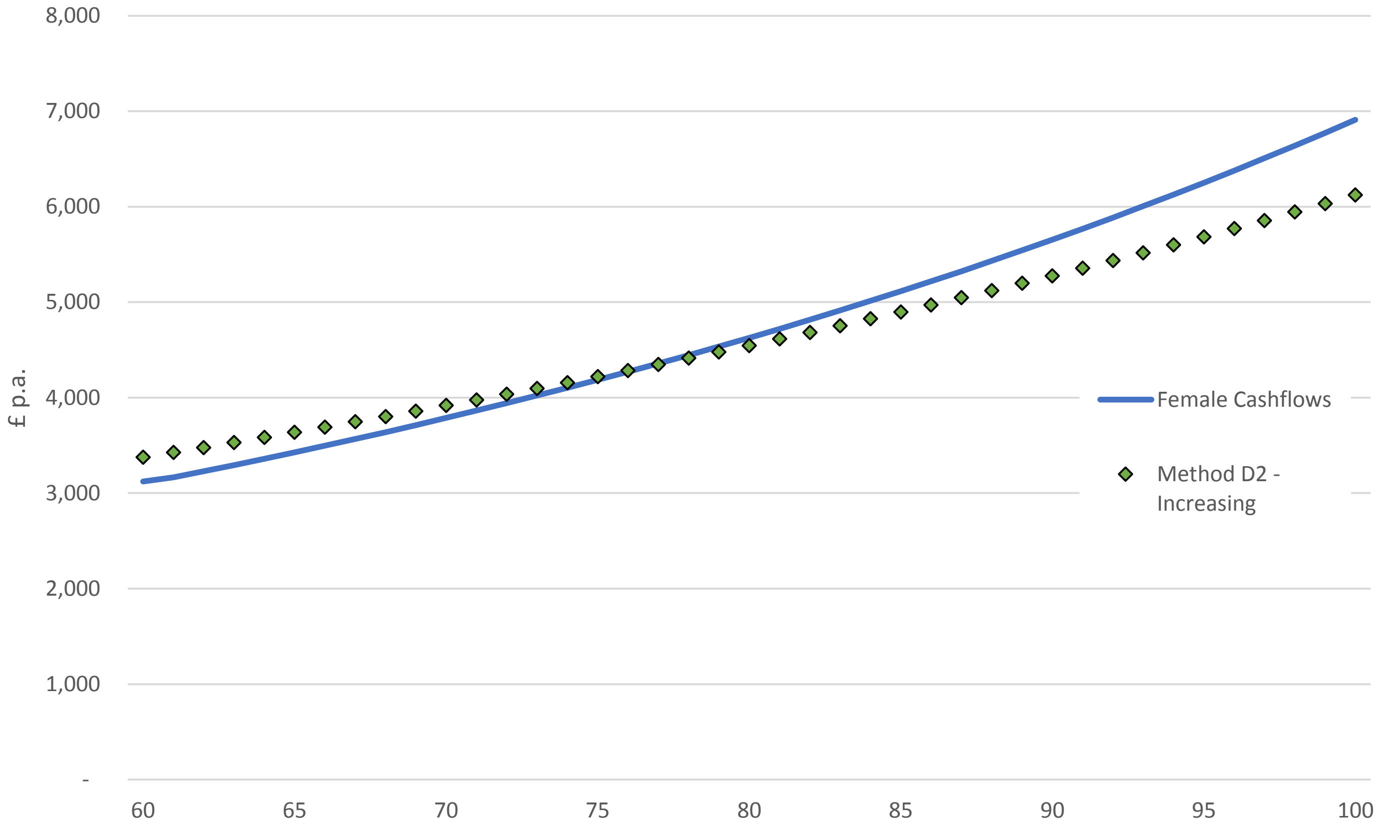
- Maintain same tranches as before but rename GMP as something (eg AMP – Alternative Minimum Pension)
- Move the female to male benefits split for 90-97 service

Minimum change to deliver equalisation

Minimal interference relatively straight-forward

Limited simplification

Conversion of mixture of RPI, CPI and flat benefits



- CPI disproportionately expensive to insure
- Changing the indexation could be attractive
- Preservation means cannot reduce the starting pension and so generally converting to lower expected overall increases :
- To apply a single fixed rate across all members would require a low rate and a higher starting pension
- Likely to be better to retain several tranches, eg
  - RPI tranche
  - Nil tranche :
- Some reshaping will result but may be considered acceptable

Limited simplification may have advantages and be acceptable within trustee fiduciary duties

Minimal interference – Deferred Pensioner

- Member decisions on when retire can materially impact the shape of benefits
- Not a problem for the conversion calculations because the early retirement pension should have the same expected value
- To match the potential for member choices to materially change the shape benefit shapes would require retaining all the features of GMP, including AF
- But
  - Unless can accommodate dual calculation post conversion, then conversion requires you pick male or female benefits
  - Could apply conversion only at the point of retirement but then converting for the next 20 years
  - If equalisation leads to increase in benefits - how is reflected in the post conversion whole service AF test?
- Practical minimal interference may look different to true minimal interference for deferred pensioners and be closer to limited simplification
- If can get comfortable with reshaping Deferred Pensions - now try Actives…..

Summary

- Conversion is an excellent solution for many schemes
- Conversion requires some benefit reshaping
- Conversion plus simplification creates the potential for material:
  - member winners/losers
  - extra costs for the company
- Simplification can aid member understanding, buy-out and administration

How much is it reasonable to reshape benefits to address a nil/trivial benefit increase for most members when other options are available?

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