

ALLEN & OVERY

GMP ROUND-UP: WHERE ARE WE NOW?

Guaranteed minimum pension (GMP) rights present a variety of issues for schemes with any history of contracting-out of UK state pension arrangements. This briefing provides an update on the latest developments in a number of areas – to discuss any of these issues further, please get in touch with your usual Allen & Overy adviser.

1. GMP RECONCILIATION DEADLINE: PLAN AHEAD

In theory, schemes have until December 2018 to complete their GMP reconciliation activity. However, the real timescale is shorter than that: HMRC has emphasised that there will be no facility to raise queries via the Scheme Reconciliation Service (SRS) after October 2018, and some believe this cut-off date could be brought forward due to the number of queries HMRC is receiving. This means that any initial queries need to be submitted significantly before that date in order to:

- receive a response from HMRC;
- consider that response, and
- submit any follow-up queries by October 2018.

How long does it take to get a response from SRS? Lead times vary; HMRC has announced a target turnaround time of about six weeks, but this applies from the point at which your scheme's query is actioned by HMRC – so there's no guarantee that you will receive a response this quickly, especially if there is a surge in queries before the deadline.

When you do receive a response from SRS, it's important to review it promptly. If you don't respond to

SRS within six months, SRS will consider the query to have been resolved and any follow-up would have to be dealt with as a new query.

HMRC has now conducted a 'closure scan' of members who were in contracted-out employment as at 6 April 2016 (when DB contracting-out ended), producing new data for schemes to reconcile with HMRC records. Again, it's important to check this data – the same deadline applies as above.

The latest closure scan only picks up members who were still contracted-out as at the abolition date. Members who became deferred after the effective date of your first SRS scan, but before the abolition date, won't be listed in either set of data. Schemes can ask for a rerun of SRS data, including members who left service during this period, or raise separate queries about the data for these members.

After December 2018, HMRC will only provide limited support for scheme queries in relation to individual members.

2. GMP EQUALISATION

The government's view is that equalisation is required in relation to the effect of GMPs; it recently consulted on a new methodology for achieving this. This has not yet reached the stage of formal guidance or legislative amendments, and although the approach is more streamlined than previous suggested methods, it has been greeted with little enthusiasm in the industry. One reason for this is that the government has confirmed that it will not provide a 'statutory safe harbour' for trustees using its proposed methodology – so schemes which implemented it would remain exposed to the risk of a challenge that benefits were not properly equalised.

The government has also left itself room to consider its position in light of forthcoming court action in relation to the Lloyds Banking Group pension schemes. This case seeks answers from the court to the questions of whether GMP equalisation is in fact a legal requirement and, if it is, how it should be implemented. In the absence of a driver such as a buy-in or buy-out, our experience is that most schemes are adopting a 'wait and see' approach – but of course, accurate GMP data from the wider reconciliation exercise will also be foundational for equalising GMPs, if this is required later on.

3. FAILURE TO RECONCILE – WHAT ARE THE ISSUES?

Of the three million queries raised under SRS up to January 2017, HMRC says that 60% related to incorrect member data, such as members attributed to differing schemes on HMRC and scheme records. Errors at this level could potentially lead to member queries/complaints and increased scheme liabilities, so it's important to resolve any outstanding issues as soon as possible.

It's also vital for individual members that their GMP information is accurate on HMRC records, as this information is used to calculate their new State Pension entitlement. Any discrepancies could result in their 'starting amount' for the new State Pension being calculated incorrectly.

- The starting amount calculation compares the amount of state pension a member would have got under the pre-April 2016 rules with what they would get under the new single-tier system, based on a member's National Insurance record as at 6 April 2016. The higher of these two amounts is the member's starting amount under the new state pension system.
- Members who have had any period of contracted-out service will also have a 'Contracted Out Pension Equivalent' (COPE) amount (broadly representing the equivalent of the additional state pension relating to their period(s) of contracted-out service – in theory, the amount they could receive from their scheme(s) rather than the state as a result of having been contracted-out). The COPE amount is based on the member's NI contribution record, and will be deducted when working out the individual's starting amount. You can read more about the COPE amount [here](#).
- An individual's COPE will not change (unless changes are made to their NI record for years before 6 April 2016), and will always be stated as at that date. Members will be able to check their COPE amount online or see it on state pension statements.
- Incorrect data about periods of service (or the revaluation method applied by the scheme) could lead to errors in the calculation of the COPE and the individual's starting amount. The starting amount is revalued each year under the new system, so any error would be replicated in the calculation of the member's state pension entitlements year on year.
- Failure to reconcile, leading to incorrect information being sent to members about their pension rights, could also increase member queries and, potentially, complaints – see section 4 below.

4. INFORMATION TO MEMBERS ABOUT STATE PENSION RIGHTS

The government issues state pension statements on request to individuals aged 55 or over; these include (for members who have had any period of contracted-out service) a statement of the individual's aggregate COPE amount. Members can also access information via the online checker; in addition, the government may write to members from December 2018 onwards, informing them about their entitlements under the new state pension arrangements.

It's possible that COPE information could give rise to an increase in member queries – for example, where:

- a contributions equivalent premium (CEP) was paid to 'buy back' the member's state scheme rights following a short service refund, but this was not recorded by HMRC and the issue has not been resolved by the end of 2018;
- the member has commuted (cashed out) their pension rights, but HMRC records show them as having contracted-out rights still held by an occupational or personal pension scheme (HMRC does this for the purposes of calculating state scheme rights, but the reference may cause members to ask you for proof that they have already cashed them out);
- the member wants to confirm that their GMP entitlement under the scheme is equal to or greater than the estimate given by HMRC; or
- the member has had periods of contracted-out service in different schemes, but only the aggregate amount is shown.

5. INCREASES TO PRE-88 GMPs

Another feature of the transition to the new state pension system is that elements of the state pension which were previously recalculated annually as part of the state pension arrangements will be ‘locked in’ at their 6 April 2016 values.

Under the old state pension system, when an individual reaches state pension age, their GMP amount for all or part of the period 1978/79 to 1996/97 is subtracted from the total amount of additional state pension the member would otherwise have earned over that whole period. The state pays any difference between the two amounts. This calculation is carried out annually, and the contracted-out deduction is subtracted from the (index-linked) additional state pension (i.e. the additional state pension is increased each year before the deduction is made).

The key issue here relates to increases to GMPs which accrued before 6 April 1988, which is the date from which occupational schemes were required by law to uprate GMP rights, subject to a 3% cap. There has never been a statutory requirement for schemes to pay increases on pre-88 GMPs or to provide increases on post-88 GMPs above the 3% cap – but as a result of the annual calculation described above, increases to GMP rights which accrued between April 1978 and April 1988, and any increases in excess of 3% on rights accrued between 1988 and 1997, were effectively provided via the additional state pension.

However, this element of the state pension, which reflects these GMP increases, is lost under the new system, in which the starting amount (which will always be based on the difference between the GMP and hypothetical state scheme rights as at 6 April 2016) is

revalued annually. No allowance will be given for any amount by which the value of state scheme rights might outpace the value of GMP rights over time. The government is aware of the issue, and has already put in place transitional measures to rectify it for members of public sector schemes, in its capacity as a large employer and because of ‘historical commitments made by previous governments’ in relation to official pensions. The transitional measures will last until December 2018 and the outcome of a consultation into further protection after that date is still awaited. However, these transitional measures will not benefit members of private sector schemes.

We are already aware that members of various private sector schemes have identified this missing element as a potential loss and have raised it – including by way of a formal complaint via internal dispute resolution procedures or to the Pensions Ombudsman. Who, if anyone, has responsibility for any shortfall? One potential problem is that the distinction between the scheme’s responsibility and the state’s responsibility for increases may not always have been made clear to members – for example, if the scheme booklet makes a simplified statement such as ‘your GMP will be fully price-protected by the scheme’. Even in these circumstances, the booklet is likely to say that the scheme rules are overriding, and most standard contracting-out rules will provide for statutory revaluation only. It’s important to check that current statements – by schemes and by employers – are accurate regarding the increases that will be provided by the scheme; if you have any concerns about historic member communications, please get in touch with your usual Allen & Overy adviser.

6. TECHNICAL CHANGES TO CONTRACTING-OUT RULES

Under regulations which came into effect on 6 April 2017, HMRC now has discretion to allow schemes to pay a late CEP in respect of a member (for example, where a short service refund has been paid, or on winding-up). HMRC’s discretion will also cover situations where trustees elect to pay a late CEP (for example, to resolve outstanding data issues).

We expect the government to consult in autumn 2017 on a way around the current barrier to making transfers without member consent from formerly contracted-out schemes to schemes which have never been contracted-out. This is a particular problem on scheme mergers.

OUR TEAM



Maria Stimpson

Partner
Tel +44 20 3088 3665
maria.stimpson@allenoverly.com



Dána Burstow

Partner
Tel +44 20 3088 3644
dana.burstow@allenoverly.com



Neil Bowden

Partner
Tel +44 20 3088 3431
neil.bowden@allenoverly.com



Jane Higgins

Partner
Tel +44 20 3088 3161
jane.higgins@allenoverly.com



Helen Powell

PSL Counsel
Tel +44 20 3088 4827
helen.powell@allenoverly.com



Jessica Kerslake

Counsel
Tel +44 20 3088 4710
jessica.kerslake@allenoverly.com



Andrew Cork

Counsel
Tel +44 20 3088 4623
andrew.cork@allenoverly.com