

GUARANTEED MINIMUM PENSION (GMP) CONVERSION

Government response to the consultation

THE OCCUPATIONAL PENSION SCHEMES (CONTRACTING-OUT)(AMENDMENT) REGULATIONS 2009

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DWP Department for
Work and Pensions

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1. EXECUTIVE SUMMARY

1.1 In September 2008 the Government began consultation on draft regulations which will have the effect of permitting the trustees of defined benefit contracted-out occupational pension schemes to convert their scheme's Guaranteed Minimum Pension (GMP) liabilities into ordinary scheme benefits which are of at least equal actuarial value. The proposed legislation would also permit conversion of an individual's GMP on transfer out of the scheme, with the individual's consent.

1.2 The intention of the regulations is that by converting members' GMPs into scheme benefits, schemes will no longer need to separately track and monitor GMPs and consequently, with streamlined processes in place, members should be able to understand their pension rights more easily. The consultation ended on 28 October 2008.

1.3 We received 34 responses to the consultation. A list of respondents is at **Annex A**. The Government is very grateful to all who contributed to the consultation. The comments have been very helpful in finalising the draft regulations.

1.4 The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009 will be laid shortly and are expected to come into force in April or May 2009.

1.5 The regulations will be available on HMSO's website at <http://www.legislation.hmso.gov.uk/stat.htm/2008>

1.6 This document is available on the Department's website at <http://www.dwp.gov.uk/consultations/2008/index.asp>

1.7 A paper copy of this document can be obtained from:

Maureen Rafferty
Department for Work and Pensions
3rd Floor
Adelphi
1-11 John Adam Street
London WC2N 6HT
Email: Contractingout@dwp.gsi.gov.uk
Tel: 020 7962 8742

2. INTRODUCTION

2.1 This document considers the responses to each of the questions asked in the consultation paper in turn and also provides a response to supplementary issues raised during the consultation.

3. RESPONSES TO THE CONSULTATION AND THE GOVERNMENT'S RESPONSE

3.1 Allowing GMPs to be converted whilst retaining the requirement to provide survivor benefits

Your responses

Some respondents expressed disappointment that the requirement to provide for a survivor benefit after conversion was being maintained. One respondent considered that the regulations were insufficient to allow a trustee to convert a survivor's GMP; the position regarding provision of survivor benefits after the GMPs has been converted was also thought to be unclear. Three respondents suggested that the regulations should require the survivor benefits to be linked to post 1997 contracted out rights in order to allow schemes to apply the same rules across the whole of the member's service.

The Government's response

Removing the requirement to provide for a survivor benefit could give rise to a challenge in the European Court of Human Rights. This is because members would be given something to compensate them for the loss of their GMP rights, whereas widows, widowers and civil partners would not. Hence the requirement to provide for a survivor benefit post conversion has been retained.

The meaning of "pre-conversion benefits" is set out in Section 24A of the Pensions Schemes Act 1993 and is defined as benefits provided under the scheme immediately before conversion (disregarding money purchase benefits). The regulations do not seek to put constraints on trustees, who can, if it is preferable, bring the converted benefits into line with the post 1997 benefits. However the circumstances in which a survivor benefit has to be paid from the post-conversion benefits are wider than those which are applicable under the Reference Scheme test. Trustees will need to bear this in mind when considering the conversion facility.

3.2 Roles of the Trustee and Actuary

Your responses

Twenty respondents considered that trustees would be unable to provide a considered judgement on actuarial equivalence and assumptions adopted. One respondent thought the regulations did not need to state that the trustees are responsible for determining actuarial equivalence as this added nothing to

the legislation but could cause confusion. Another respondent thought that on obtaining advice from an actuary, trustees should be legally required to discuss that advice.

The Government's response

Trustees are currently expected to make a considered judgement, relying on actuarial advice, when considering the calculation of transfer values. Therefore, this legislation is not introducing a new concept but has merely been drafted in a way which puts it beyond doubt - that ultimate responsibility for determining actuarial equivalence rests with trustees. It would be unusual for legislation to require an actuary and trustees to discuss advice, hence the legislation has not been amended to take this comment on board. Nonetheless the onus rests with trustee to ensure that they seek and discuss actuarial advice as necessary in order to determine how actuarial equivalence can be achieved.

3.3 The GMP conversion date

Your responses

Twenty respondents commented on whether the conversion date needs to be more specifically defined. The majority of respondents thought that the conversion date needs to be more specific and in particular one respondent stated "it was not clear to us that the draft regulations gave any indication of what the conversion date was". Other comments received suggested that the conversion date should be "made clearer" in stating that actuarial equivalence need only be demonstrated on the conversion date and not at any future point.

One respondent suggested that legislation should allow for actuarial equivalence to be at an effective date which is at least three months before the date on which the benefits are actually converted. Another respondent considered that an actuary would not be able to certify actuarial equivalence on the conversion date as the basis and date would have been determined prior to this.

One respondent asked whether a conversion could be carried out retrospectively as at a conversion date.

The Government's response

The conversion date is defined in Section 24A(d) of the Pensions Act 1993 (as amended by the Pensions Act 2007) as "the date on which that amendment takes effect". The legislation does not allow for the effective date to be anything other than the conversion date. Therefore actuarial equivalence needs to be determined on the "conversion date" only. From the conversion date, a GMP will no longer exist as it will be deemed to be scheme benefits.

In practice, this means that trustees will need to decide the conversion date and the assumptions to be used in advance of the conversion date. If conditions then change significantly before the conversion date, the assumptions may need to be revisited. This process is similar to that used for Section 67 (of the Pensions Schemes Act 1995) transfers which requires actuarial equivalence to be on the date the modification is effective.

The regulations would allow for changes to be made after the conversion date in order to reflect the true position on the 'conversion date'.

3.4 Views on whether employers and trustees will use the GMP conversion facility

Your responses

There was a general welcome for the introduction of legislation which would allow GMP conversion as an alternative to holding these accrued rights for many years to come. However, there were a number of respondents who cited the uncertainty associated with equalisation of scheme benefits and the continued requirement to provide for a survivor benefits as deterrents in using the GMP conversion facility.

The Government's Response

The Government recognises that contracted out salary related schemes offer good benefits for members and therefore has sought to meet requests from the pensions industry to remove the complexities associated with GMPs. The GMP conversion facility, if used, will offer employers certainty over future GMP liabilities, whilst also allowing for administrative easements.

In the short term many schemes may not wish to use the conversion facility, but in the longer term this optional measure may be beneficial for schemes restructuring their pension arrangements. There are no current plans to make conversion of GMPs a statutory requirement.

3.5 Extending the scope of conversion regulations

Your responses

Eighteen responses were received on this issue. Most considered that the regulations allowed schemes to convert as many or as few members as they wish. Six respondents thought it would be helpful if contracted out defined contribution schemes could be permitted to use the GMP conversion facility where there is a GMP underpin or promise.

The Government's response

The GMP conversion facility only permits the GMP to be converted into defined benefits. Allowing the "guaranteed amount" (the GMP underpin or

promise) to be converted on a money purchase basis would remove an element of protection which would be unacceptable to scheme members.

3.6 Restrictions on onward transfers

Your responses

Twenty one responses were received on the question as to whether additional restrictions should be put on onward transfers from schemes which have converted their GMP liabilities. All stated that there should be no restrictions on the 'converted benefits'. One respondent sought confirmation as to whether a GMP could be transferred into a 'converted scheme'.

The Government's response

Given this unanimous view, there are no plans to introduce legislation which would put restrictions on onwards transfers for scheme benefits derived from GMPs. When a scheme has converted GMPs, it will be for the trustees to decide whether they are willing to accept a GMP transfer into the scheme or alternatively whether they seek to convert the GMP on entry into the scheme.

4. OTHER POINTS MADE

4.1 Section 67 of the Pensions Act 1995

Your responses

Four respondents considered that GMP conversion is, in effect, a scheme modification and should be approached in the same way as for Section 67 transfer valuations. Hence in undertaking GMP conversion, a respondent queried whether a member could be deemed to leave pensionable service immediately on conversion.

The Government's response

The precise impact of GMPs can be very dependent on when the member leaves service. Therefore, in converting GMPs, the choice of the date on which current members are assumed to leave service could have a significant effect on the calculations. It will be for trustees to adopt an approach that they consider to be appropriate.

4.2 Equalisation of benefits

Your responses

Eighteen respondents commented on the equalisation of benefits. Whilst schemes have already equalised pension ages and overall scheme benefits, many schemes appear not to have yet equalised GMPs. Converting GMPs would require trustees to equalise overall scheme benefits (including the

GMP) at the conversion date, thus incurring immediate rather than future costs. This was considered to be a deterrent for many schemes.

The Government's response

Schemes should have already equalised their benefits, taking account of the GMP rules, where necessary. It has always been the Government's position that the *Barber* judgement requires schemes to ensure overall benefits that arise from rights accrued from 17 May 1990 are the same for men and women. It is the Government's position that the GMP is not a separate pension but a calculation factor in determining overall benefits and thus does not have to be separately equalised.

The draft regulations do not specify the method for GMP conversion, as this needs to reflect scheme rules currently in place and the profile of the membership. It will be for trustees and the employer (with advice from the scheme actuary) to decide what benefits should be offered to replace the GMP benefits. The actuary will then decide a method of converting current rights into new scheme benefits. Trustees will have to agree that the method chosen is fair and members should be given the opportunity to comment on it before it is adopted. The outcome must, of course, comply with the relevant equality legislation.

4.3 Role of the Pensions Regulator (TPR)

Your responses

Seven respondents commented specifically on the role the Pensions Regulator would play in providing guidance, giving advance clearance for a conversion exercise and the provision of a "stop date" after which time a scheme would not be required to "unpick" a GMP which had been converted.

The Government's response

The provision of actuarial advice is outside the remit of the Pensions Regulator (TPR). The Board for Actuarial Standards is responsible for issuing technical actuarial standards in the UK. The Actuarial Profession is responsible for the regulation of its members in their professional capacity.

TPR does not intend to adopt a "clearance" role for GMP conversions. If the decision has been taken to effect a GMP conversion, it is for the trustees or scheme managers and their professional advisers to ensure that all the legislative requirements are met. TPR has no plans to monitor conversions or oversee the process or outcomes. TPR is a risk based regulator. Any non compliance issues will be dealt with as they are now having regard to severity and risk to members' benefits. As the legislation in Section 24H of the Pension Schemes Act 1993 suggests, the Regulator will only consider the use of its powers in "very extreme" circumstances, there are no plans to adopt a more draconian role.

Finally, turning to the issue of schemes being required to potentially “unpick” a GMP conversion. No two schemes are identical and as such TPR does not consider it appropriate to introduce a “stop date” after which schemes cannot be required to “unpick” a “conversion”. It also is not appropriate for TPR to confirm the legitimacy of conversions. In cases of serious conversion disputes or fraudulent activity ultimately only the courts can decide the outcome of such cases and the extent of any “unpicking”.

4.4 Board for Actuarial Standards

Your responses

Two respondents suggested that actuarial guidance, possibly provided by the Board for Actuarial Standards, might be given on the terms of reference for the assumptions to be used to assess actuarial equivalence.

The Government’s response

The Board for Actuarial Standards (BAS) is responsible for setting technical actuarial standards. It is likely that these will be written in a manner which favours principles rather than prescriptive rules and that the standards should be for the benefit of the users. We understand it does not currently intend to issue guidance or set prescriptive assumptions to be used for the purposes of determining actuarial equivalence for schemes seeking to convert GMPs.

The BAS will be undertaking a consultation over the coming months on the standards actuaries would be expected to comply with when advising pension scheme trustees on a range of issues.

4.5 Preservation and revaluation of scheme benefits and post conversion benefits

Your responses

One respondent sought reassurance that the preservation requirements would be overridden when GMPs have been converted into scheme benefits and another respondent considered that it would be helpful to know that the converted scheme benefits could be increased in line with ordinary scheme benefits. Another respondent sought clarification as to what revaluation, escalation and commutation should be applied post conversion.

The Government’s response

Post conversion, GMPs will no longer exist as they will become scheme benefits. The current legislation governing the revaluation and protection of increases on GMPs would no longer be applicable. Section 24G of the Pensions Schemes Act 1993 permits schemes to amend their scheme rules accordingly. Post conversion, it is the current rules governing defined benefit schemes which will be applicable.

4.6 Reconciliation of GMPs

Your responses

Three respondents thought it would be necessary to undertake a data cleansing exercise with the National Insurance Contributions Office (NICO) before the conversion of GMPs could commence. This was considered to be a factor which would add to the costs of converting GMPs into scheme benefits. One respondent asked whether NICO would produce guidance and notification procedures.

The Government's response

The Pensions Regulator endorses good record keeping and the extent of any data cleansing exercise will depend on how well a scheme has maintained their records.

NICO calculation services are available if, as part of the conversion exercise, schemes need to reconcile their GMP records. There is no need to wait until April or May 2009 to request GMP calculations. The Accrued GMP Liability Service (AGLS) at <http://www.hmrc.gov.uk/pdfs/nico/ca19.pdf> provides details of accrued GMP liability based on an individual's contributions/earnings information. Alternatively you can request a GMP/Premium calculation by completing form CA1604 which can be obtained from HMRC's website at: <http://www.hmrc.gov.uk/nic/forms/ca1604.pdf>

4.7 Consultation with members being converted

Your responses

Five respondents made comments on the consultation process. One respondent sought further clarity around whether every avenue needed to be exhausted in order to consult with those whose GMPs are to be converted. Another respondent queried whether trustees need to disclose, to members, that GMP conversion is an available option (even though the trustees may not permit GMPs to be converted).

The Government's response

Under Section 24E of the Pension Schemes Act 1993, trustees must take all reasonable steps to consult the earner in advance of conversion. It will be for trustees to satisfy themselves that this has been the case. A reasonable step could for example, in the case of deferred members, be to write to the last known address in order to satisfy this requirement.

The ultimate decision on whether a scheme allows GMPs to be converted into scheme benefits is a matter for trustees. Where a scheme offers the GMP facility it would be reasonable to let members know it is an available option where, for example, the member is seeking to transfer their GMP.

4.8 Reinstatement into the state system

Your responses

One respondent suggested that GMPs should be brought back into the state system with any balance then transferred into a contracted in scheme. This was considered to be a solution to the current inability to move small amounts of contracted out defined benefit rights. Another respondent asked whether it would be possible to buy-back scheme benefits derived from GMPs into the state system.

The Government's response

There are currently no plans to permit small amounts of GMPs to be brought back into the state system. It is HMRC rules which govern the treatment of small pension pots and those rules are currently under review. HMRC will make any changes considered necessary on completion of that review.

4.9 The contracted out deduction

Your responses

Two respondents sought an explanation as to how the contracted out deduction would work if a scheme converts its GMPs.

The Government's response

It is not an individual's actual amount of GMP payable at GMP pensionable age which is used to determine the contracted out deduction to be applied to the State Earnings Related Retirement Pension (SERPS). It is the GMP "entitlement" as recorded by HM Revenue & Customs which is and will continue to be used to determine the contracted out deduction to be applied to SERPS at state pension age. SERPS is the additional state pension payable for the period when GMPs accrued.

4.10 Errors and corrections

Your response

One respondent suggested that the regulations need to allow for practicalities and gave an example where an incorrect rate of benefit was initially used until administrative procedures and records were updated.

The Government's response

Updating records would form part of a scheme's administrative duties on undertaking a GMP conversion exercise. The regulations have not been extended to allow for such an administrative easement as records should be amended within a reasonable administrative timescale.

4.11 Actuarial Certificate

Your response

One respondent considered that it would be onerous and expensive for a certificate to be sent for each and every member where a conversion has been undertaken. It was suggested that the draft regulations should be amended to allow an actuary to supply tables (which they certify) to the trustees showing them how the post-conversion benefits will be actuarially equivalent to the pre-conversion benefits.

The Government Response

The calculation of a member's cash equivalence on GMP conversion will need to be undertaken in a manner approved by an actuary. It will be for the trustees and actuary to decide whether actuarially certified tables are appropriate. Were an actuary to provide tables to be used, he or she would need to be satisfied that calculations have been completed correctly and that the post-conversion benefits are actuarially at least equivalent to the pre-conversion benefits before providing the trustees with a certificate. The certificate issued after the conversion exercise could be for one or several scheme members, obviously this would depend on how many scheme members were included in the conversion exercise.

5. THANKS

The Government would once again like to thank everyone who took the time to comment on this consultation document. Views have either helped to firm up solutions to issues and problems, or helped to highlight areas of potential difficulty.

List of respondents

AON Consulting
AEGON
Association of Consulting Actuaries
Association of Pension Lawyers
Axa Sunlife
Barnett Waddingham
Board for Actuarial Standards
Capita Hartshead
Electricity Supply Pension Scheme
Eversheds LLP
Financial Services Authority
Freshfields Bruckhaus Deringer
Hewitt Associates Ltd
HBOS Financial Services
HBOS plc
HM Revenue & Customs
Jardine Lloyd Thompson
Lloyds TSB
Mercer
NAPF
Norwich Union
Pensions Ombudsman
Punter Southall
Scottish Widows
Skandia
Sacker & Partners
Tesco Pension Trustees Ltd
The Pensions Regulator
The Society of Pension Consultants
The Actuarial Profession
The Pensions Management Institute
The Law Society of Scotland
Watson Wyatt
Wolseley plc