

The Actuarial Profession
making financial sense of the future

Conference title: Pensions – the End Game
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RECAP ON THE LEGAL POSITION

Why there is a problem

- Inequalities between males and females resulting from :
 - Different GMP payment dates
 - Higher accrual rate for females than males
 - Anti-franking requirements
 - Different rates of increase applying to GMP / excess over GMP
- Because of different “moving parts”, no scheme can provide a single equalised benefit structure inclusive of GMPs.

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RECAP ON THE LEGAL POSITION

Relevant law

- Article 157 Treaty on the Functioning of the European Union (TFEU)
- Ss66-71 Equality Act 2010 (previously ss62-66 Pensions Act 1995)
 - Apply where “a person (A) is employed on work that is equal to the work that a comparator of the opposite sex (B) does” (s64(1)(a))
 - In the case of an OPS, implied sex equality rule has the effect that “if a relevant term is less favourable to A than it is to B, the term is modified so as not to be less favourable” (s67(2)(a))
 - Sex equality rule has no effect if the trustees show that the difference is “because of material factors which is not the difference of sex” (s69(4))
- S171 Pensions Act 2004
 - Applies to compensation payable by the PPF.

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RECAP ON THE LEGAL POSITION

Is there an obligation to equalise?

- Possible defences:
 - State benefits argument
 - Material difference in circumstances argument (objective justified)
- PPF’s position (based on advice from Andrew Simmonds QC):
 - Scope for state benefits defence is now extremely narrow (see Pirkko Niemi [2002] Pens.L.R.459)
 - No material factors other than difference of sex – inequality results from unjustifiably discriminatory provisions of the state scheme.

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PPF CONSULTATION PROCESS

Development of the PPF's position

- April 2008 – first consultation launched
- October 2009 – response to consultation published
- January 2011 – consultation on final proposals
- November 2011 – publication of statement on equalisation for GMPs and the application of a statutory minimum to PPF compensation for schemes in a PPF assessment period
- November 2012 – conclusion of PPF pilot study and announcement that proposed approach will be adopted.

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GOVERNMENT'S POSITION

Background

- **March 1995**
Government rejected a move to amend Pensions Bill to confirm equalisation not required for GMP's
- **January 2010**
Parliamentary statement by Angela Eagle MP regarding Government's view
 - There is an obligation to equalise for the effects of GMP; and
 - There is no need for a comparator (applying Allonby v accrington and Rossendale College and Others [2004] I.C.R.1328)
- **April 2011**
Government view confirmed in letter to pensions industry bodies from Steve Webb MP.

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RECENT DEVELOPMENTS

January 2012 – DWP consultation on draft amending Regulations

- Consultation on draft Occupational Pension Schemes and Pension Protection Fund (Equality) (Amendment) Regulations published, including draft guidance on “one possible method” for equalising pensions for the effect of GMPs
- Draft regulations:
 - Introduce new sub-section 64 (3):
 - Allows ss66 to 68 and 70 to be relied on without the need for a comparator “where a person is or has been in pensionable service under an OPS
 - Introduces a “special” equality rule (new ss67(2A) and (2B))
 - If by virtue of the guaranteed minimum pension provision, a relevant term is less favourable to A than it would be if A were of the opposite sex, the term is modified so as not to be less favourable”

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RECENT DEVELOPMENTS

APL response of 12th April 2012 and Counsel's opinion

- Effect of the draft regulations as drafted is to remove the available defences to the proposition that benefits should be equalised for the effect of GMPs
 - Any argument that GMP rules are not “terms” for the purpose of s67 because they merely replicate state benefits can no longer be run because a term derived from the application of GMP provisions is deemed a “term” for these purposes
 - Not clear whether s69 material difference defence intended to be available and the way in which s69 is presently drafted assumes the existence of a comparator
- Drafting also potentially enshrines the DWP year on year “better of” test
- Suggested alternative drafting operates by deeming a comparator to exist, so seeking to limit the effect of the amendment to the removal of the need for a comparator
- Other points raised include the question of what time limits are intended to apply to claims.

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POSSIBLE APPROACHES TO EQUALISING FOR THE EFFECTS OF GMPS

Different contexts

- PPF approach for equalising PPF compensation and FAS assistance
- Pension scheme wind-ups and buy-outs
- Ongoing schemes
 - DWP suggested method
 - GMP conversion option

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LEGAL UNCERTAINTIES (1)

Basic principles

- What must be equalised, the GMP or the overall benefit?
- What is the nature of a GMP, is it a pension, or part of a pension, in its own right or an underpin? (Bridge case – held that it was an underpin)
- What time limits apply to claims (if any)?
- Can GMP rights be offset against post-1997 accrual (PO determination in Biggs (27 March 2007, Q00303) suggests not)?
- Should the effect of State benefits be taken into account?

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LEGAL UNCERTAINTIES (2)

Methodology

- When should a comparison be made with the benefit payable to the (notional) other sex comparator?
- Is it possible to use a lifetime or value approach?
- To what extent is it necessary to address other areas of compliance or non-compliance with statutory requirements, e.g. anti-franking/ GMP pensionable age?
- Should benefits be paid from a single date or is a split pension (Foster Wheeler) approach more appropriate?
- Would a broad-brush approach be workable/ effective/politically achievable?
- How to correct for the past?
- How to deal with inadequacy of data?

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PPF METHODOLOGY

(1) Method for equalising for GMP formula

- Possible methods
 - *Method 1*: comparison over expected lifetime
 - *Method 2*: comparison when pension comes into payment and thereafter annually (or more frequently) (“annual true-up” or “best of breed” approach) and pay higher overall pension
 - *Method 3*: as for method 2 but pay total of higher GMP and higher excess
 - *Method 4*: include the amount of the State additional pension in the comparison
- Modified method 2 adopted by PPF
 - For pensioners – benefit is recalculated using method 2 and back payments are made
 - For active and deferreds – accrued pension is recalculated at date of leaving service using female GMP formula and “statutory minimum” is then applied

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PPF METHODOLOGY

Effect of applying “statutory underpin” approach (assuming NPA 60 and 65 for different parts of the pension)

- Compare the amount of scale pension payable at 60 accrued to date of leaving service with the full equalised GMP (in each case ignoring revaluation)
- If the scale pension payable at age 60 **is not** sufficient to meet the GMP, the “Statutory Minimum” will be the revalued GMP (“**scenario 1**”)
- If the scale pension **is** sufficient to meet the GMP, the Statutory Minimum will be as prescribed by anti-franking, i.e. (i) scale pension payable at age 60, plus (ii) revaluation on the equalised GMP, plus (iii) revaluation on the excess of scale pension payable at 60 over the equalised GMP (“**scenario 2**”)
- Compensation is then calculated on basis of higher of the Statutory Minimum and the revalued scale pension at age 60
- Remaining elements of pension with appropriate revaluation are paid from age 65
- **NB.** To avoid “double counting”, in scenario 1, scale pension at age 65 is reduced to reflect the amount by which the pension payable at 60 has been increased to meet the Statutory Minimum

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WHERE DO WE GO FROM HERE?

DWP suggested method for equalising

- “Builds on” methodology adopted by PPF (i.e. method 2, annual or more frequent review)
- Two tests:
 - at what age would a pension start to be paid to the member’s opposite sex notional comparator
 - what is the amount of the overall pension the member would be paid if they had been a member of the opposite sex
- “Ratchet” effect – members of both sexes treated more favourably
- Examples only illustrate straightforward cases
- No consideration of inter-relationship between equalisation and general contracting-out and anti-franking requirements
- No reference to possible reduction in pension at age 65 to avoid “double counting” where pension at 60 has had to be increased to meet GMP

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DWP Method - Example

Age	Total pension Male calculation	Total pension Female calculation
60	£1,500	£1,600
65	£1,950	£1,850
70	£2,100	£2,150

- Pay female benefit 60-65
- Pay male benefit 65-70
- Pay female benefit 70+
- Both males and females receive an increase in benefit

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PPF method – example Male member, deferred at assessment date

Male calculation basis

NPA	Total at DOL	Post 88 GMP at DOL	Non GMP at DOL	Total at NPA 60	Total at NPA 65
60	£1,234	£392	£841	£1,631	
65	£954	£303	£650		£1,261
Total	£2,188	£695	£1,491	£1,631	£1,261

Female calculation basis

NPA	Total at DOL	Post 88 GMP at DOL	Non GMP at DOL	Total at NPA 60	Total at NPA 65
60	£1,234	£462	£771	£1,662	
65	£954	£358	£596		£1,284
Total	£2,188	£820	£1,367	£1,662	£1,284

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PPF method – example

Male member, deferred at assessment date

- Take higher benefit:
 - NPA 60 = £1,662
 - NPA 65 = £1,284
- But female MBT at 60 = £1,820
 - Pre 97 pension with NPA 60 +
 - GMP revaluation on female GMP +
 - revaluation on revised XS with NPA 60
- Pension after GMP equalisation:
 - NPA 60 = £1,820
 - NPA 65 = £1,126
 - Note $£1,126 = £1,284 - (£1,820 - £1,662)$

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Equalising in practice

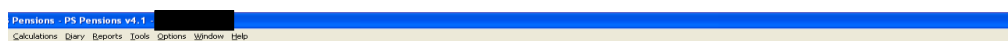
- Data – addressing its absence
- A possible simplification?
- The NRA double-count
- Legal input
- GMP conversion – an example



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Actual screenshot of data-capture



Cash taken seems to be
nil!

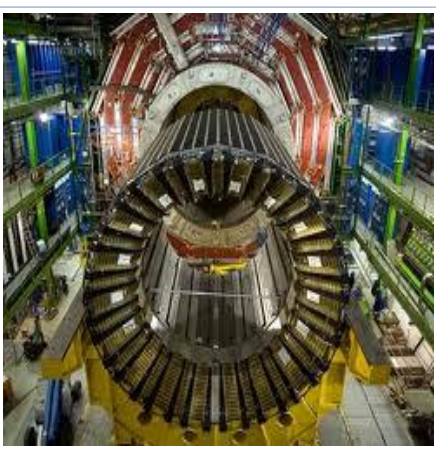
But, sadly, no spouse's
pension
and no "original pension"
details

We do have a nice set of
service dates

Although, separately, we do
seem to have something
that looks like pre and post
commutation pension.

But....

That's the data – so what's the plan?



- Now, given the limited data – you can't work from the bottom up – so we must work from the top down – travelling back through time to get to the "offending period".

The plan

- Step 1 Split the pension into tranches
- Step 2 Roll back to retirement
- Step 3 Unwind any cash commutation impact
- Step 4 Undo any early or late retirement factors
- Step 5 Strip out revaluation back to leaving
- Step 6 Switch to opp-sex GMP
- Step 7 Roll back up

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Step 1 – splitting into tranches

- We need Philip's service dates
- If need be, we can use the NICO GMP data to fill these in
- **Assumptions and limitations**
 1. Uniform accrual (eg not works to staff)
 2. No break in service
 3. TV in
 4. AVC slice
 5. Part time service
 6. And if you do have to use NICO dates, only goes to 1978

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Step 2 – roll back to retirement

- If you don't have the full pension history, then use the scheme's rules
- **Assumptions and limitations**
- Anti-franking!!!
- One-off discretionary increases / inflation catch-ups

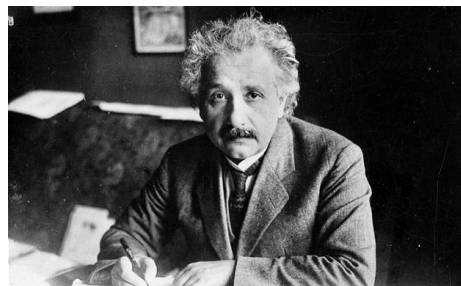


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Step 3 – cash commutation

- To get back to scale pension, need to strip out cash
- **Assumptions and limitations**
- The classic assumption is $\frac{1}{4}$ cash
- What factors were used?
- Pre or post '97 commuted first?
- Were AVCs used?

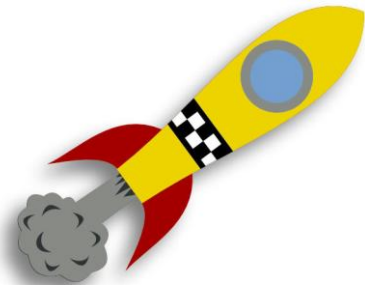


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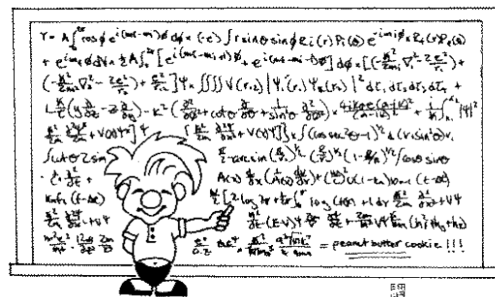
Step 4 – erfs and lrfs

- After this step, you have worked yourself back to “scale plus revaluation”
- **Assumptions and limitations**
- What factors were used over time?
- How was (NRA) equalisation addressed?
- Augmentation - were erfs waived (eg redundancy)



Step 5 - revaluation

- After this step, you have scale pension at leaving
- **Assumptions and limitations**
- Anti-franking again!!!



Step 6 – sub in the opp-sex GMP

- The whole point
- **Assumptions and limitations**
- You could attempt to do this from c-out earnings history (NICO)
- Or you can just pro-rate the GMP
- Take care about “service after 60”



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Step 7 – roll back up again

- To get the result!
- **Assumptions and limitations**
- All repeated in reverse.

This approach – rolling backwards and forwards again – minimises the impact of incorrect assumptions

At worst, the answer you get will be self-consistent with his current pension

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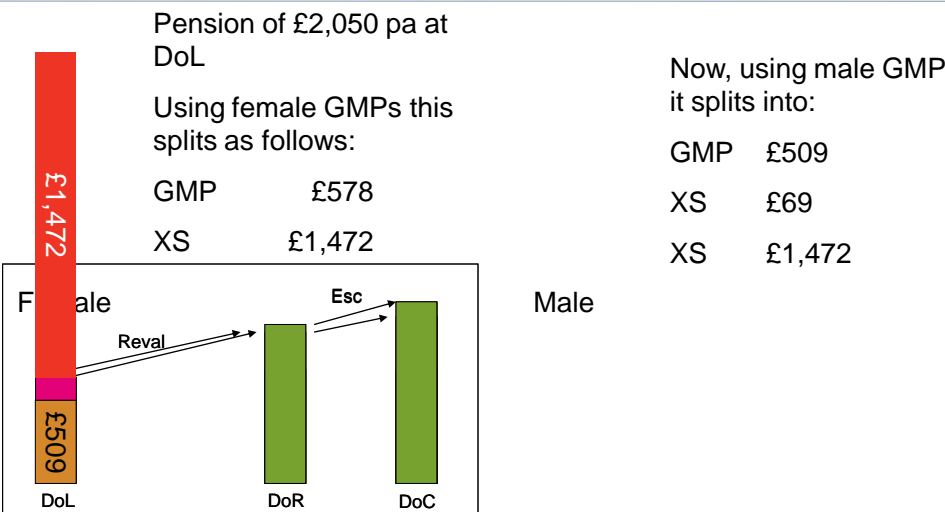
Such a lot of guesswork – why not just equalise the GMP?

- The problem is “the more GMP, the less XS”.
- So you cannot just look at the extra GMP
- But – the slice above the female GMP is XS pension on either footing...

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A Simplification?



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Advantages and disadvantages

Advantages

Much (?) simpler

- You still need to define closely
 - Revaluation
 - Antifranking
 - Escalation
 - Erf / Irf
- But you don't need to worry about
 - Non-uniform accrual
 - AVC elements
 - Etc

Disadvantages

Rolling back from now to leaving is a good test on how good the data is

- On one scheme we “discovered” 5% fixed reval rather than s21

What if GMP > Scale pension?

Assuming you have already equalised NRA, then just looking at GMP is a sort of doubling up...

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But don't forget the legals...

- Anti-franking
 - Rules often “silent” or “standard”
 - What happened in practice – are pension increases “smooth”?
 - Should whatever happened be unwound? (eg the scheme where we found 5% reval)
- Transfers in
 - Unless you can isolate these, you are implicitly equalising TV-'d in GMP
- Scope generally
 - Deaths, TV outs, etc
- Scheme GMP v NICO GMP
 - Which / how far back? What if smaller?
- Seeking info from members
 - How persistent?
- No possibility of accrual after NRA under the Rules
 - In the “as female” calcs, do you turn off accrual in the window?

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Conversion of GMP into other benefits

Legal background

- New sections 24A-H introduced into PSA93 by Pensions Act 2007 to allow facility for schemes to convert GMP rights into rights to an ordinary scheme pension
- Safeguards include:
 - Post-conversion benefits must be certified by an actuary to be at least equivalent to the pre-conversion benefits
 - The amount of any pension in payment cannot be reduced
 - Post-conversion benefits must not include money purchase benefits
 - Survivors' benefits must be payable of at least half the value of the relevant member's pension in the same circumstances and on the same conditions as the pre-conversion GMP survivors' benefits
 - There must be consultation with the members

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Conversion of GMP into other benefits

In practice

- DWP expected 25-50% of schemes with GMPs to convert.
- Not aware of any doing so
- Why not?

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Conversion of GMP into other benefits

Obstacles to GMP conversion

- Uncertainty over the need to equalise GMPs feeds through to uncertainty about whether value of 'converted GMP' must reflect equalisation
- No generally recognised methodology for equalising GMPs, and so no recognised way to value converted, equalised GMP
- Reluctance to incur material administrative and advisory costs at times of financial hardship
- Detail: for pensioners the conversion would be forward looking only, implying that equalisation of past payments would need to be dealt with separately, and requirement that survivors' benefits must be paid on the same conditions complicates the conversion process

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Issues to overcome

If conversion leads to a “step-up” in pension

- Lifetime allowance implications?
- Annual allowance?
- Loss of protection?
- “Pre 2006 accrual” defence?
 - Certainly not for DC

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Issues to overcome

If conversion *should* lead to a reduction in pension

- e.g. to allow for “new pension” being Pre 97 XS with possibly higher in-payment increases
- But reduction prohibited by Legislation...
- ...so either forced to convert to a higher value pension
- Or simply convert to a level pension, i.e. on a different basis to current scheme benefits
- Pension Increase Exchange style communications?

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Issues to overcome

Certainty of process

- Trustees must
 “decide what assumptions are appropriate at the conversion date and, if the trustees later think it is necessary, change that decision”



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GMP conversion

- Let's assume Philip earned a pension of £2,050 pa between 1990 and 1997
- We need to equalise for GMPs before we convert
- We want to avoid the NRA double-count
- We will need to look at each period of benefit accrual separately:
 - Pre Barber Out of scope
 - 1990 to 1994 NRA and GMP differences
 - 1994 to 1997 GMP differences only
 - 1997 onwards No difference

“Tranching” the pension at date of leaving

	Male benefits	Female benefits
1990-1994		
GMP	309	351
XS	<u>916</u>	<u>874</u>
Subtotal	1,225	1,225
1994-1997		
GMP	200	227
XS	<u>625</u>	<u>598</u>
Subtotal	<u>825</u>	<u>825</u>
Total	2,050	2,050

Valuing the male benefit structure

Pension at leaving	Male benefits	Process	Value
1990-1994			
mGMP	309	Project to 65, apply annuity and discount	
mXS	<u>916</u>	Project to 65, apply annuity and discount	
Subtotal	1,225		36,645
1994-1997			
mGMP	200	Project to 65, apply annuity and discount	
mXS	<u>625</u>	Project to 65, apply annuity and discount	
Subtotal	825		24,454

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Valuing the female benefit structure

Pension at leaving	Male benefits	Process	Value
1990-1994			
fGMP	351	Project to 60, apply annuity and discount	
fXS	<u>874</u>	Project to 60, apply annuity and discount	
Subtotal	1,225		45,147
1994-1997			
fGMP	227	Project to 65 WITH LRF , annuity / discount	
fXS	<u>598</u>	Project to 65, apply annuity and discount	
Subtotal	825		26,477

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Side-by-side value comparison

Period	Male benefits	Female benefits	Outcome
1990-1994	36,645	45,147	Female
1994-1997	24,454	26,477	Female

Choosing the better (female) benefit for each distinct period of service, the overall value of the fully equalised pension is £71,624

If we had used unisex (mortality) factors, the value of this equalised pension would have been identical for a man and a woman

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Finally, convert back

- Now we need to “choose” the structure of the post-conversion benefits
- Assume NRA 65 throughout
- Assume LPI max 5 throughout
- Use the same actuarial valuation basis (again assumed here to be unisex)



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Converting to NRA 65, LPI 5

				Pre	Value	Post
'90-'94	fGMP	NRA60	LPI 3	351	18,987	839
'90-'94	fXS	NRA60	LPI 5	874	26,159	1,155
'94-'97	fGMP	NRA'60'	LPI 3	227	12,944	572
'94-'97	fXS	NRA 65	LPI 5	<u>598</u>	<u>13,535</u>	<u>598</u>
Total				2,050	71,624	3,164

Pension at date of leaving goes up to reflect
now wholly payable from 65
does not attract fixed rate (7% pa) revaluation
the revised escalation terms in payment

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To summarise the conversion process

- We took identical leaving service pensions of £2,050 pa
- We looked at the composition and terms on male and female benefit structures
- We decided female was more valuable in both the separate benefit windows
- Since we chose to use unisex factors, the value of the equalised benefit is identical, regardless of gender
- We took that value and turned it into a pension of £3,164 pa. Again, since we used unisex factors, the post conversion pension is identical whether the member is male and female

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Further points on conversion

- If we had adopted the DWP method, the value of the benefit rises by c.£800
- No requirement to use unisex factors
- In this example, we granted “LPI 5” on the post conversion benefits. In practice, to ensure no pensions in payment ever decrease in level, probably have to grant a non-escalating pension
- Probably have to protect the right to go at 60 (albeit reduced) on part of the pension
- Still have all the data problems on retrospective GMP equalisation
- But you do end up with a “clean” pension going forwards

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What happens next?

- Further action on GMP equalisation delayed until Spring 2014
- More from the DWP over conversion?
- Test case?



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