

**Draft Occupational Pensions
Schemes and Pension Protection
Fund (Equality) (Amendment)
Regulations 2012:
a response by the National
Association of Pension Funds**

April 2012

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Executive summary

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- The NAPF strongly advises the DWP to withdraw its proposed new Regulations on equalisation of Guaranteed Minimum Pensions (GMPs).
- It is not clear that an obligation to equalise GMPs actually exists under EU law. The DWP should publish the legal advice that underpins its view that equalisation is required and that there is a need for new Regulations. This would improve the transparency of the Government's policy-making and would help the industry to make a constructive contribution to the policy process.
- The proposed legislation is unlikely to remove the uncertainty that surrounds GMP equalisation in the absence of a test case. In fact it is likely to put trustees in a difficult position. The advice to many trustees is likely to be not to equalise – even though they might then be exposing themselves to a claim under the UK legislation.
- The situation is likely to become further confused, with some schemes equalising and others not doing so - and with no certainty about the method to be used. The DWP should recognise these issues and sponsor a test case.
- The Government is about to embark on a far-reaching programme of State Pension reform. Although the NAPF supports those proposals, (which are closely based on the NAPF's Foundation Pension concept), we recognise there will be many complex issues to tackle, not least in relation to the abolition of contracting-out for defined benefit (DB) pension schemes. Getting State Pension reform right should be the key focus – not GMP equalisation.
- The DWP's draft methodology for equalisation would serve no useful purpose. It would have no legal status and would provide no protection to any scheme that uses it. It should be withdrawn.
- GMP equalisation could affect public sector pension schemes. Slaughter and May estimate a cost of around £4.6 billion in extra benefits to be paid by public sector schemes.¹ The Government should set out the full position in relation to public sector schemes and should take full account of the extra costs and administrative burdens on the public sector.
- The Joint Working Group estimates² that £13 billion of extra liabilities could result from this policy. This would completely outweigh the potential benefits of the Government's 'Red Tape Challenge' for pensions. The administrative costs could be of the order of £300 million. The GMP equalisation plan should be subject to a full impact assessment.

¹ *Pensions and Employment: pensions bulletin*, Slaughter and May, January 2011

² Letter from JWG to Steve Webb MP, 12 April 2012

About the NAPF

1. The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate 1,200 pension schemes. They provide retirement income for nearly 15 million people and have almost £800 billion of assets under management. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

The NAPF's approach to GMP equalisation

The legal case for new legislation

2. **DWP legal advice should be published.** The Government's decision to act on GMP equalisation stems from legal advice to Ministers that new Regulations are needed to bring UK law into line with EU law as a result of the *Allonby* judgement in the European Court of Justice. The NAPF understands that Ministers are, in fact, reluctant to legislate in this area, but feel that legal advice has left them with no other option.
3. The NAPF strongly urges the Department to place this legal advice in the public domain. Not only would this strengthen the transparency of the DWP's policy-making, it would also help the industry to make a constructive contribution to the process.
4. **Unclear whether new legislation is needed.** The *Allonby* case does not definitely require a change to the rules whereby an individual can bring an equal treatment claim for GMP equalisation under the Equality Act 2010. *Allonby* only applies if GMP equalisation is required as a matter of EU law, and although there are reasons to believe that the ECJ would rule that GMP equalisation is required by the equal treatment and equal pay provisions of the EU Treaty there are also reasons for thinking that it might not.
5. The NAPF is concerned that the draft Regulations would 'gold-plate' the Treaty obligations by making it easier to bring a claim asserting a right to equalised GMPs when that is not an established right under the EU Treaty at all. If DWP has had legal advice from leading counsel that the right to equalised GMPs is so clearly a right under European Law that the High Court, if asked, would not refer the question to the ECJ, then it should, as we suggest above, publish that advice.
6. **Amending primary legislation by statutory instrument.** It appears that the DWP is seeking to amend the relevant primary legislation by way of statutory instrument under the special legislative powers conferred by section 2(2) of the European Communities Act 1972. This provision allows amendments to be made in this way 'for the purpose of implementing any *EU obligation*' (emphasis added). Given that it is unclear whether GMP equalisation is actually an 'EU obligation', then the validity of this exercise of legislative power must also be in doubt.

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7. **Trustees unlikely to act without a test case to clarify the law.** The proposed legislation is unlikely to remove the uncertainty that surrounds GMP equalisation in the absence of a test case. In fact it is likely to put trustees in a difficult position.
8. Where the scheme is in deficit and the employer covenant is weak, it cannot be in the best interests of members to embark on the expensive exercise of equalising GMPs in circumstances where it is unclear whether this is what European law requires. As a result, the advice to many trustees is likely to be not to equalise – even though they will then be exposing themselves to a claim under the UK legislation.
9. The situation is likely to become further confused, with some schemes equalising and others not doing so - and with no certainty about the method to be used. This situation seems very likely to lead to the test case that the Government is so anxious to avoid.
10. The NAPF's view is that, in order to end uncertainty for trustees, schemes and employers, the Government should 'bite the bullet' and sponsor a test case. It would, of course, be wrong to assume (as the current draft Regulations do) any particular outcome from such a case.
11. **Previous DWP statements.** The DWP has previously stated that schemes do *not* have to carry out a separate equalisation of GMPs. In a response to a consultation exercise on GMP conversion in 2009, the DWP stated:

'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'.³
12. It is not clear that this is consistent with the DWP's current position. The Department should clarify the situation and explain whether its legal advice takes account of its own previous statements on GMP equalisation.
13. **Maintaining trust and confidence.** The Government's proposals on GMP equalisation effectively rewrite a contract between individual employees and the State about the benefits that the Government will provide. The Government would need to 'future-proof' any decision about the abolition of contracting-out for DB schemes in order to ensure it is not subsequently undermined by policy on GMPs.

³ *Guaranteed Minimum Pension Conversion – Government response to the consultation*, DWP, January 2009, para 4.2

State pension reform should be the focus

14. The NAPF strongly welcomes the Government's commitment, as set out in the Chancellor's recent Budget statement, to press ahead with its plans for reform of the State Pension system. The NAPF has consistently advocated a Foundation Pension – a simpler, more generous state pension that would combine the State Retirement pension and the Second State pension⁴ - and we are pleased to see the Government adopting our proposals as the basis of its approach.
15. Although the NAPF strongly supports State Pension reform, we do not pretend it will be easy. There are a number of complex issues to be tackled, notably in relation to the abolition of contracting-out for defined benefit pension schemes.
16. These issues should be the DWP's primary focus, rather than equalisation of GMPs.

No value in example methodology

17. The DWP has published a draft method for GMP equalisation alongside the consultation paper. The NAPF notes that this method would have no legal status and would provide no comfort to pension schemes that they have equalised GMPs in a manner that would protect them from subsequent legal challenge.
18. For this reason, the NAPF's view is that the draft method would serve no useful purpose and should be withdrawn.
19. If the Government wishes to give its proposed method some value for schemes, then the method would need to have 'safe harbour' status.
20. In any case, the draft method is one of the most expensive that could be chosen. By comparing the value of each instalment of a pension, rather than the *overall* value of the pension, it could easily lead to higher pensions for both men and women.

Impact on public sector pensions

21. The Government should give a clear explanation of the status of public sector schemes in relation to GMP equalisation.
22. Other groups with specific legal expertise will explore this important point in greater detail, but the NAPF's understanding is that the requirement to equalise is not entirely removed by the 'standard' argument that differences in state pension provision for men and women compensate

⁴ See, for example, *Fit for the Future: the NAPF's vision for pensions*, NAPF, March 2010

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for differences in GMPs. Anti-franking still applies to public sector schemes, and this means that GMPs would have to be equalised.

23. Some commentators, such as Slaughter and May, have argued that public sector schemes are just as much 'in scope' as those in the private sector. Indeed, Slaughter and May point out that 4.2 million of the 8 million people with contracted-out employment on a GMP basis during the relevant period (17 May 1990 to 5 April 1997) are in public sector employment. So roughly half of the total costs would have to be met from the public purse.
24. Slaughter and May estimate that the public sector could face £4.6 billion of extra pension liabilities.
25. The situation in relation to public sector schemes appears unclear and a statement of DWP's understanding of the law in this area would be a useful contribution.

Better regulation

26. The NAPF is very concerned that the GMP initiative threatens to outweigh – by a very significant margin – the potential benefits of the Red Tape Challenge, which is due to turn its 'spotlight' onto pension schemes shortly.
27. The DWP has argued that, as there is (strictly speaking) no *new* legal obligation to equalise GMPs, there is no requirement to produce a regulatory impact assessment. Given that pension schemes now face extra liabilities estimated (in figures given by the Joint Working Group) at around £13 billion, plus £300 million of extra administrative costs, this argument seems out of kilter with the spirit of the Government's Better Regulation agenda.
28. The GMP equalisation plan should be subject to a full impact assessment, which should take account of (i) the increased benefits that would arise and (ii) the administrative costs involved in checking whether each beneficiary's benefits need to be adjusted in order to ensure they are equalised.
29. The impact assessment should take account of the opportunity cost that will arise from lost investment in the economy; if employers incur extra costs as a result of GMP equalisation, then they will have less money available for investment in expanding their businesses and creating new jobs.

Responses to questions in consultation paper

Q1. Do you think the draft Regulations achieve the intended outcome?

30. Yes – in the narrowest sense. We accept that the Regulations would remove the requirement for an opposite sex comparator when seeking to equalise GMPs.
31. However, the Department should have regard to the many other outcomes that could result from these Regulations.
32. First, there would be an increase in liabilities. As discussed above, the Joint Working Group identifies around £13 billion of extra liabilities and £300 million of extra administrative costs.
33. In summary, the outcome of these Regulations would be major extra burdens on DB schemes.

Q2. Do you have any comments on the proposed methodology?

34. The methodology is one of the most expensive that could be chosen. By comparing the value of each instalment of a pension, rather than the more practical alternative of looking at the *overall* value of the pension, it could easily lead to higher pensions for both men and women.
35. Schemes frequently limit the amount of tax-free cash a member can take by commutation of pension at retirement so as to ensure that sufficient pension remains to cover the GMP payable from SPA. It is unclear how the suggested equalisation of GMPs will be dealt with in determining the maximum tax free cash at retirement.

Q3. The Government would be interested in whether respondents think publication would be of assistance to schemes

36. Publication of the methodology would be of no assistance to schemes. The methodology would have no legal status and would, therefore, provide no comfort to pension schemes that they have equalised GMPs in a manner that would protect them from subsequent legal challenge.
37. In fact, publication of the methodology could actually make matters. Its ambiguous status – published by government but with no legal force – would cause confusion for schemes and their members.
38. For these reasons, the NAPF's view is that the draft methodology should be withdrawn.

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39. As argued above, it would be far better for the Government to sponsor a test case to clarify the law.

Q4. The Government would be interested in any other suggestions as to what it could do to assist schemes in dealing with their equalisation duties.

40. As argued above, the NAPF's strong advice to the Government is that State Pension reform should be the key focus. Getting the details of this policy right – particularly the complex issues involved in ending contracting-out for DB schemes – would do far more to assist schemes than requiring them to equalise GMPs.

41. The other very useful contribution that the Government should make would be to initiate and pay for a test case that would seek to end the current uncertainty for trustees, schemes and employers.

Q5. The Government would be interested in whether anyone thinks there could be an adverse impact on the position of disabled people from these changes.

42. The NAPF has no information on this issue.

Q6. The Government would be interested in whether anyone thinks there could be an adverse impact on the position of men or women from these changes.

43. The suggested methodology could lead to pension uplifts for both men and women. This is one of the reasons why it would be so expensive.

44. However, in many cases, the uplift for an individual will be relatively trivial, although the combined uplifts across a scheme will be costly. Therefore, if these changes were to lead - as the NAPF would expect – to further scheme closures, members of both genders would lose out.

45. There is a risk that the proposals would create a further inter-generational transfer from the young to old as the costs of equalising GMPs for older members will affect the ability of employers and schemes to provide good quality pension outcomes for their younger workers.