



## Need to know

### Equalisation of guaranteed minimum pensions

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This *Need to know* addresses the impact of a recent ruling regarding equalisation of guaranteed minimum pensions payable under UK defined benefit schemes. It is equally relevant to those reporting under IFRS and FRS 102.

- Defined benefit pension schemes that used to contract out of the State Earnings Related Pension Scheme before 1997 had to provide guaranteed minimum pensions (GMPs).
- A High Court ruling on 26 October 2018 establishes that schemes are required to equalise benefits to address inequalities in GMPs between men and women.
- The ruling establishes suitable methods to calculate the equalisation obligation, with impacts typically between 0 and 2 % of defined benefit obligations.
- For periods ending prior to the ruling a non-adjusting post balance sheet event should be disclosed where the effect is material.
- For periods ending after the ruling, most employers will recognise an equalisation liability for the first time and record a past service cost in profit or loss.

#### Background

Up to 1997, UK pension legislation created a State Earnings Related Pension Scheme (SERPS). It was possible to contract out of SERPS such that employers and employees would pay reduced National Insurance contributions and employees would have a reduced state pension entitlement.

For those that did contract out of SERPS the company pension needed to provide a guaranteed minimum pension ("GMP"). GMP is typically one element of the overall pension benefit provided to employees and was designed to ensure that the pension would not be lower than the extra state pension which employees had foregone as a result of contracting out.

For more information please see the following websites:

[www.ukaccountingplus.co.uk](http://www.ukaccountingplus.co.uk)

[www.deloitte.co.uk](http://www.deloitte.co.uk)

The law required that GMP entitlements were payable from age 60 for women and age 65 for men (reflecting the different state pension ages which prevailed at that time). Further, women earned GMP at a faster rate reflecting that their working life was five years shorter. A 1990 court case (the Barber judgment) ruled that pension benefits provided by employers had to be equalised between men and women going forward. Company pension schemes therefore changed their rules as necessary so that men and women earned pensions payable from the same normal retirement age. However, the GMP element of the overall pension continued to be payable from different ages, reflecting a continued mismatch in state pension ages, and in accordance with the Government's prescribed approach to calculating GMP.

A ruling by the High Court, relating to the Lloyds Banking Group pension scheme, on 26 October 2018 means that schemes and their sponsoring employers now need to adjust benefits to equalise for the effect of GMPs between men and women. The judgment applies to GMPs earned between 17 May 1990 (the date of the Barber judgment) and 5 April 1997 (when all GMPs ceased accrual). Further guidance is expected from the Department for Work and Pensions, although trustees would be advised to investigate changing benefits as soon as possible.

Historically a few schemes tried to introduce provisions to remove these GMP inequalities. But, for very many schemes, the complexity and lack of guidance as to how to adjust for the inequalities meant no reliable corrective estimation was undertaken and employers will now need to recognise additional estimated liabilities.

### Reporting periods impacted

For employers with defined benefit schemes impacted by the ruling, if the reporting period (annual or interim) ends before 26 October 2018 a non-adjusting post balance sheet event will need to be disclosed together with an indication of the financial impact, assuming the effect is material.

For reporting periods ending on or after 26 October 2018 defined benefit obligations recorded by employers will need to reflect a liability for equalisation of GMP entitlements.

### Recording liabilities for equalisation

Employers that had not previously reflected an equalisation adjustment in their pension obligation need to adopt a method to amend the benefits due and/or paid. This will result in a past service cost, which will be reflected in profit or loss at the date of the ruling, together with an additional liability. The impact for individual pension schemes will vary; at the current time it is estimated that, in nearly all cases, the potential impact of the ruling will be between 0-2% of the defined benefit obligations of a scheme.

The financial impact arises from both changes required to pension payments going forward, but also the cost of payment arrears for pensions paid in the past. For many pension schemes, potential payment arrears will be limited to a period of six years under their rules, however employers should ask their trustees to confirm their proposed approach to back-payments.

The few employers that had previously recognised a past service cost and an equalisation adjustment in their pension obligation also need to consider the impact of the ruling. Consideration should be given to whether the methodologies used and estimates made previously remain appropriate in light of the conclusions on the various methodologies in the ruling. In such instances the ruling represents additional evidence to be taken into account in estimating the pension costs and any changes to the previous estimates will be reflected in other comprehensive income.

### Measuring the equalisation liability

A number of complex methodologies for calculating equalisation were considered as part of the ruling, with some ultimately regarded as appropriate and others as inappropriate. Importantly, the court ruled that, out of the permissible methods, the trustees should adopt "Method C2" which leads to the 'minimum interference' with the rights of any party. However, if the impacted party agrees, an alternative approach may be possible.

Method C2 is however a complex approach and pension schemes may incur significant costs in updating administration and valuation systems to reflect this method. Employers need to be ready to assess whether their trustees' proposed approach strikes the right balance between cost and complexity. If previous buy-ins and buy-outs included provisions regarding future GMP equalisation, the impact of these should also be considered.

### Further information

If you have any questions about GMP equalisation, please speak to your usual Deloitte contact.



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