Pension Protection Fund

Consultation Document

Consultation on the calculation of PPF compensation and FAS assistance in the context of equalisation for schemes contracted-out on a GMP basis

January 2011

Note:

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Foreword

This is our second consultation on the subject of GMPs. We first set out our thinking on equalising for GMPs in April 2008 and in our October 2009 consultation response we re-affirmed our commitment to finding an appropriate calculation method.

Since that time we have sought further legal advice on our statutory obligations and undertaken a detailed examination of the most appropriate calculation methods for the treatment of GMP for both PPF compensation and FAS assistance.

This document aims to advise on the Board's proposed approach for the treatment and equalisation of GMP for PPF compensation and FAS assistance (Chapter 2). In addition, it considers and invites responses on the implementation issues for schemes in assessment (Chapter 3) and for FAS schemes (Chapter 4).

We have set out in detail in Appendix A a summary of our legal advice covering these issues which confirms the most appropriate treatment of GMP for PPF compensation and FAS assistance is an 'underpin' approach. Finally, Appendix B illustrates using worked examples how the underpin calculation would apply in practice and how it differs from other possible methodologies.

It remains clear that there continues to be little consensus across pension schemes and industry on the 'best' approach to deal with GMP equalisation. It is unlikely therefore that our approach will be popular with everyone. We understand that, but hope that respondents will appreciate that we have listened to the range of debate and that it has informed our views.

In addition we wish to make it clear that our proposals should only be viewed in the light of our statutory obligations. We appreciate that schemes outside the PPF or FAS may take a differing view of their responsibilities.

I would like to thank you in advance for your responses.

Martin Clarke
Executive Director of Financial Risk

Chapter 1 – Executive summary and introduction

Introduction

1.1 The Board of the Pension Protection Fund (the Board) is a statutory corporation established under the provisions of the Pensions Act 2004, and became operational on 6 April 2005. The Pension Protection Fund (PPF) has been established to pay compensation to members of certain occupational defined benefit and hybrid pension schemes, following an insolvency event of the sponsoring employer(s) and where there are insufficient assets in the pension scheme to pay PPF levels of compensation.

1.2 In July 2009, the Board became the Scheme Manager of the Financial Assistance Scheme (FAS). The FAS was originally designed to help those who had suffered significant losses to their pensions as a consequence of employer insolvency where the pension scheme commenced wind-up between 1 January 1997 and 5 April 2005. It was first announced on 14 May 2004 but, since then, has been successively extended a number of times, covering more people and offering increased benefits.

1.3 The Board has been considering the treatment of Guaranteed Minimum Pensions (GMPs) for both PPF compensation and FAS assistance.

Executive summary

1.4 This consultation considers the fundamental question of how PPF compensation and FAS assistance should be calculated for schemes contracted-out on a GMP basis. Although intertwined with the issue of equalisation, these proposals should be viewed as separate and distinct from the issue of equalising PPF compensation and FAS assistance in relation to GMP.

1.5 The issues considered in this consultation first arose as part of the Board's development of an approach to equalise in respect of GMPs. The Board is aware that the 'best' method(s) for equalising in respect of GMPs remains an issue for schemes and for the wider pensions industry. The range of debate is something that the Board has always been conscious of when considering its own approach to its obligations.

1.6 Since our first consultation in April 2008 the Board has examined a range of possible implementation methods for PPF compensation. As part of this work, the Board has been looking in detail at how GMP is treated for PPF compensation and FAS assistance and as a result has altered its approach.

1.7 Based on Counsel's advice, the Board has concluded that the most appropriate method for the treatment of GMP for PPF compensation and FAS assistance is an 'underpin' approach. It is the Board's view that this method correctly reflects the interaction between the relevant preservation and contracting-out legislation and the legislation which applies for the purposes of calculating PPF compensation and FAS assistance.

1.8 Given the complexities of the topic, this document aims to set out the context and the reasoning behind the Board's intended implementation method in as clear a manner as possible by:

- explaining how the underpin approach operates for both PPF compensation and FAS assistance;
- explaining the implications of the underpin approach for GMP equalisation; and
- asking stakeholders whether they believe that the Board's proposals on how to implement the required changes to PPF compensation and FAS assistance payments are appropriate.

1.9 The Board proposes to take steps to apply this approach to PPF schemes which have already transferred, and certain schemes currently in assessment. The majority of schemes in assessment will be required to adopt the underpin approach when determining benefit payments and performing an s143 valuation. The Board recognises the additional work this will involve and aims to provide guidance and support for affected schemes following the consultation period.

1.10 In its capacity as FAS Scheme Manager the Board proposes to take steps to apply this approach to schemes that have already provided 'final' data to the FAS Scheme Manager. Data provision requirements will change for those schemes yet to provide data. The Board intends to work with FAS schemes to assist them to meet the new requirements.

1.11 Whilst the calculation of PPF compensation and FAS assistance has an impact on the implementation of equalisation in relation to GMP, the Board has reached a settled view on the principle of equalisation and is not consulting on the requirement to equalise such payments. The Board is also not seeking views on the role of comparators in equalisation. For completeness, the Board's views on equalisation requirements are set out in Appendix A.

1.12 The Board is not seeking views on DWP's guidance on equalisation of FAS assistance in respect of GMP or the ministerial statement

addressing comparators and the requirement to equalise in respect of GMP, since these documents are the responsibility of DWP.

1.13 The Board is aware that schemes outside the PPF and FAS may take a differing view of their own obligations. The Board is not seeking to comment on those arrangements.

Timetable for consultation

1.14 The publication of this consultation document will be followed by an 8 week consultation period ending on 21 March 2011

1.15 The views of scheme trustees, sponsoring employers and their advisers on the proposals in this consultation document are important to the Board. Details on how to respond can be found in Chapter 6.

1.16 The Board intends to publish a summary of consultation responses in due course.

Chapter 2 – Proposed treatment of GMP

2.1 Within this chapter we set out a summary of the Board's obligations, the development of its view and its proposed treatment of GMP. A detailed examination of the legal issues is set out in Appendix A.

2.2 In this section, for ease of understanding, we adopt the following terms:

- "NPA" is used to describe normal pension age for the purposes of the PPF/FAS legislation.
- "scale pension" is used to describe the normal pension which the member would be entitled to under the rules of the scheme, disregarding the GMP requirements/provisions;
- "scheme NPA" is used to describe the age at which pension would be payable unreduced under the rules of the scheme, disregarding the GMP requirements/provisions;
- "excess" is used to describe the amount by which the scale pension exceeds the GMP; and
- "NRA" or "FAS NRA" is used to describe the age at which the member would normally retire under the scheme rules (his normal retirement age).

The Board's obligations and timelines

2.3 The issue considered in this consultation is the calculation of PPF compensation and FAS assistance in respect of GMPs. Although this issue is distinct from the question of equalisation in respect of GMPs, it has arisen as a result of work conducted on this issue. We have therefore set out a brief summary of actions and decisions to date in relation to equalisation.

2.4 Under the Pensions Act 2004[1], the Board has a duty to pay PPF compensation on a basis that is no more or less favourable to a woman (or man) than it would be to a comparable man (or woman), in respect of pensionable service on or after 17 May 1990. The Board has received legal advice that, in meeting this requirement, it must take into account any differences in scheme benefits that have arisen due to differences in the calculation of GMPs for men and women.

[1] Section 171, though see paragraph 2.7 regarding comparators.

2.5 In April 2008, the Board published a consultation setting out a proposed methodology for equalising compensation in relation to GMPs. In October 2009, the Board published a response to the consultation confirming that it would adopt the proposed methodology. This methodology will be referred to as "modified method 2" in this consultation document. The Board does not intend to change this approach. The response also confirmed that, following feedback from stakeholders, it would continue to explore the calculation requirements for equalising for GMP.

2.6 In July 2009, the PPF became the FAS Scheme Manager. As such, it is now responsible for making FAS assistance payments. Because FAS assistance is based on scheme rules, this includes ensuring that assistance payments meet all statutory requirements in relation to equality.

2.7 In January 2010, Angela Eagle, then Minister of State for Pensions, published a statement which clarified the Government's position on equalisation. This stated the Government's view that European law requires that any relevant inequality in scheme rules which results from the legislative provisions governing GMPs should be removed, whether or not a person can show that a comparator exists. Government has recently re-affirmed this position and its intention to bring forward amending legislation later this year.

2.8 In April 2010, DWP published guidance to assist schemes to provide expected pension data in a way that ensures FAS assistance is calculated on an equalised basis (DWP's equalisation guidance).

The Board's thinking

2.9 The Board recognises that sponsoring a test case through the courts could potentially achieve better certainty on the appropriate treatment of GMPs. However, this would probably prove to be a costly and lengthy approach and would be expensive for levy/tax payers. It would also create uncertainty in the interim for members and schemes. The Board's preference has therefore always been to base its decision on Counsel's opinion, so as not to burden levy/tax payers with a test case and delay implementation.

2.10 Following responses to the April 2008 consultation, in particular comments on the generosity of the intended approach, the Board decided that there were issues around the calculation of compensation itself that needed to be addressed, as well as the issue of equalisation in respect of GMPs. Furthermore, the Board's appointment as FAS Scheme Manager meant that the Board required clarity on the calculation of FAS assistance. The Board therefore consulted Counsel on the appropriate method of calculating PPF compensation and FAS assistance, as well as the obligation on the Board to equalise.

2.11 Having received firm advice from Counsel on the obligation, considered with Counsel the range of methods and received advice from Counsel as to the most appropriate method, the Board has concluded that there is an obligation on it to equalise and that the most appropriate method for the treatment of GMP for PPF compensation and FAS assistance is an 'underpin' approach.

2.12 The previous consultation by the Board (and other communications with stakeholders) suggested that a tranching approach should be used in respect of GMPs. As adopting the underpin approach represents a change in approach to calculating PPF compensation and FAS assistance, the Board believes that it is appropriate to communicate this change and explain in detail how the underpin approach operates. Whilst the intention of the Board is to implement Counsel's advice on the correct approach, the Board welcomes views on the underpin method.

Calculation approach

2.13 The distinction between GMP and excess falls away immediately before the assessment date (usually the date of the insolvency event) / the day before the wind-up date respectively for the purposes of PPF compensation or FAS assistance. This is because, following these dates, GMP and excess receive the same revaluation and indexation. However, the calculation of both PPF compensation and FAS assistance is based on underlying scheme benefits. As such, where scheme benefits include GMPs, an appropriate allowance must be made. This allowance must be made for active, deferred and pensioner members of schemes qualifying for the PPF and FAS.

2.14 Following advice from Counsel, the Board has adjusted the way it considers GMPs should be treated for the purposes of calculating PPF compensation and FAS assistance. These changes will have an impact on payments received by some beneficiaries. This change in approach also has implications for equalisation of compensation and assistance in respect of GMP. To reiterate, the Board is proposing to change the ways in which PPF compensation and FAS assistance are calculated. This is independent of the requirement to ensure that compensation and assistance are equal in respect of GMPs. However, changing the treatment of GMP in compensation and assistance calculations naturally has a knock-on effect on equalisation in respect of GMP.

2.15 After considering the evidence derived from its own experience, information provided through past consultations and subsequent discussions with stakeholders, the Board identified three possible calculation approaches for PPF compensation and FAS assistance:

- Approach (a) – Always Tranche
- Approach (b) - Statutory Underpin

- Approach (c) - Scheme NPA

2.16 In turn, the Board sought Counsel's opinion on these approaches. A summary of the advice can be found in Appendix A. A number of example calculations using the proposed approach can be found in Appendix B.

2.17 The three approaches differ in how they divide the total pension into different benefit elements, and how they assign a normal pension age (NPA)[2] to each of these elements.

2.18 The legislation governing both PPF compensation and FAS assistance makes allowance for benefits being paid at different dates. There can therefore be different elements of PPF compensation/FAS assistance which each have their own NPA. This may differ from the way in which many schemes have been administered. In the case of PPF compensation, elements with different NPAs are paid at different dates. In the case of FAS assistance, elements with different NPAs are aligned to a single FAS NRA using actuarial factors and put into payment on one date. The relevant legislative provisions[3] for both PPF compensation and FAS assistance define NPA as, broadly, the earliest age at which the relevant benefits can be taken unreduced as of right.

2.19 Approach (a) – *Always Tranche*

Under approach (a), GMP and excess benefits are always treated as entirely separate elements of pension. Each element will have its own NPA which will depend on contracting-out requirements and scheme rules. In effect this means that the NPA for GMP is the lower of GMP age (60 for women and 65 for men) and the scheme NPA relating to the period when the GMP accrued. The GMP for females accrued during any period when the scheme NPA was over 60 moves to being payable at 60 and sits on top of (does not frank[4]) the excess pension otherwise payable at 60.

2.20 Approach (b) - *Statutory Underpin*

Under approach (b), the GMP and other statutory requirements operate as an underpin, but it is recognised that females have the

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[2] In the case of the PPF, Schedule 7 para 34 (2) of the Pensions Act 2004, and in the case of FAS, Schedule 2 para 4B (1) of the Financial Assistance Scheme Regulations 2005

[3] In the case of the PPF, Schedule 7 para 34 (1) of the Pensions Act 2004, and in the case of FAS, Schedule 2 para 4B (2)(b) of the Financial Assistance Scheme Regulations 2005

[4] Franking is using pension in excess of GMP to provide statutorily required increases on GMP

right to draw their GMP at age 60. For females, GMP accrued in a period when the scheme NPA is over 60 does not move wholesale to be payable at age 60. Instead it is used (or "borrowed") to assess whether the pension payable at 60 covers the full GMP. In addition, other statutory requirements (in respect of revaluation and, in particular, anti-franking) are allowed for. This approach is explained further in Appendix A.

2.21 Approach (c) - *Scheme NPA*

Under approach (c), the scheme NPA is treated as the earliest age at which the scale pension can be paid unreduced. Some schemes only permit members to take all scheme benefits at one date; hence in order to take their GMP, they would need to take excess benefits simultaneously. A reduction factor would be applied to reduce benefits to GMP age. This means that the NPA for GMP will be the same as the overall scheme NPA and hence the statutory check that GMP is covered only takes place at this (scheme NPA) age.

2.22 Summary of Counsel's opinion

Counsel's opinion is covered in greater depth in Appendix A. However, in short, his view of the options is that the statutory underpin approach provides the best solution, since it reflects the fact that GMP acts as an underpin and also allows correctly for the interaction of PPF and FAS legislation with contracting out and other overriding legislation. Furthermore, it takes into account a female's statutory right to take GMP unreduced from age 60.

2.23 Respondents should be mindful that Counsel has considered this question specifically in relation to the interaction between PPF and FAS legislation, contracting-out legislation and preservation legislation. The approach is therefore specific to FAS and the PPF. As such, it is only when schemes are calculating or providing data in respect of PPF compensation or FAS assistance that the Board would require this method to be adopted.

Questions on Chapter 2

Question 2.1

Based on the information provided above and in accompanying Appendices, do you require any further clarification on the calculation method of the underpin approach?

Question 2.2

Having considered the examples set out in Appendix B, do you believe that there are any alternative methods which could be used to calculate PPF compensation and/or FAS assistance which would also be consistent with Counsel's opinion?

Chapter 3: Impact on schemes that qualify for the PPF

3.1 Implementing the underpin approach will have an impact in a variety of ways on schemes that qualify for the PPF. The Board would welcome views from stakeholders on whether its proposals and plans to implement the required changes to PPF compensation are appropriate.

Benefit payments during assessment

3.2 The Board proposes to implement the underpin approach. As a result the Board will expect schemes in assessment to adjust scheme benefits accordingly to comply with the statutory obligation in Section 138 of the Pensions Act 2004. This will affect both members who have not yet reached their NPA, and those who have passed their NPA.

3.3 Following completion of the consultation, the Board will set out a timetable for schemes in assessment to implement any changes. We anticipate that schemes will start being required to implement changes within six months of notice being provided by the Board. The Board will also provide guidance on when during the assessment process schemes should be addressing this issue. The Board expects that schemes will be required to address this as part of a combined exercise, alongside equalising in respect of GMPs. This should make most efficient use of synergies between the different issues.

3.4 The Board expects that schemes at a very advanced stage in their assessment period will not be required to make adjustments to scheme benefits. Similarly, the Board expects that such schemes will not be required to undertake equalisation in respect of GMPs. However, they may need to provide the PPF with additional data to enable the correct compensation to be calculated.

Schemes which have already transferred to the PPF

3.5 As the Board has previously announced, where schemes have transferred to the PPF (and for certain schemes still in their assessment period), the Board will take responsibility for ensuring compensation is equalised in respect of GMPs. As part of this exercise, members' compensation will also be corrected where necessary to deal with GMPs and equalise, applying the underpin approach.

Valuations

3.6 Section 143 of the Pensions Act 2004 requires that schemes in assessment conduct a valuation to assess whether or not they can enter the PPF (s143 valuation). The liabilities for s143 valuations are based on PPF compensation. Therefore schemes will be required to adopt the underpin approach when conducting an s143 valuation.

Since schemes in assessment should already have adjusted benefits in payment in line with Section 138 by the time they come to conduct an s143 valuation, the Board does not expect that this should present many additional difficulties. Following completion of the consultation, the Board will set out a timetable for schemes in assessment to adopt this approach.

3.7 Under Section 179 of the Pensions Act 2004, schemes which are eligible for the PPF are also required to conduct ”s179 valuations" on a regular basis. These valuations are used to help assess the PPF levy schemes pay. The liabilities for an s179 valuation are based on the scheme benefits, taking into account key features of the levels of compensation paid by the Board. The valuation is a simplified one and hence the Board proposed as part of its response to the April 2008 consultation on equalising in respect of GMPs that it would not be compulsory for schemes to undertake equalisation for GMP at all when assessing liabilities for the purposes of an s179 valuation. Similarly, the Board proposes that there will also be no requirement on schemes to adopt the underpin approach for the purposes of an s179 valuation. Furthermore, the Board proposes that when the actuary certifies that the s179 liabilities are unlikely to have been understated, there is no requirement to consider the application of the underpin approach. The Board intends to keep this policy under review.

Questions on Chapter 3

Question 3.1

How should the Board determine which schemes in assessment would be required to apply the underpin approach themselves, and which would be adjusted by the PPF?

Question 3.2

What would be a reasonable timeframe for the proposed adjustments to benefit payments under Section 138 of the Pensions Act 2004 for schemes already in assessment?

Question 3.3

What would be a reasonable timeframe for the proposed adjustments to benefit payments under Section 138 of the Pensions Act 2004 for schemes entering assessment in the future?

Question 3.4

Can you see any operational or data issues for schemes in assessment performing the underpin calculation?

Question 3.5

Do you agree that the underpin approach should not be compulsory for s179 valuations?

Question 3.6

If “yes” to the above, should the actuary’s ”unlikely to have been understated” certification encompass the potential impact of adopting the underpin approach on protected liabilities?

Chapter 4: Impact on FAS qualifying schemes

4.1 Implementing the underpin approach will have an impact in a variety of ways on FAS qualifying schemes. The Board would welcome views from stakeholders on the proposal and whether plans for implementing the required changes to FAS assistance are appropriate.

4.2 FAS assistance is calculated in a different manner to PPF compensation. A key difference is that the Board requires PPF schemes to provide data as at the assessment date, hence schemes must apply preservation and contracting-out legislation themselves, whereas for FAS the FAS Scheme Manager performs these calculations. For this reason, the Board proposes that the FAS Scheme Manager will conduct the necessary calculations to implement the underpin approach, whereas schemes in a PPF assessment period will need to perform these calculations themselves.

4.3 The data collected to date for FAS schemes is insufficient for calculating assistance using the underpin approach. The Board therefore intends to update its guidance on providing data via the S1 form (the form used to provide individual member data to the FAS Scheme Manager) to ensure that the necessary data is collected. We expect that the main change will be that schemes will be required to break GMP down by service periods.

4.4 Some schemes have already provided final data to the FAS Scheme Manager. Where this is the case, the Board proposes not to recollect data from these schemes. Instead, the FAS Scheme Manager will determine the necessary adjustments to assistance based on data already provided. We believe that this approach will reduce the workload for administrators of FAS schemes and hence minimise delays in transferring schemes to the FAS.

4.5 In order to calculate the necessary adjustments, the FAS Scheme Manager may need to make some approximations (as although the data provided to date can be used to approximate the full, correct data, it will not always be sufficient). The Board does not anticipate than such approximations will have a significant impact on final assistance payments. The alternative to making certain approximations would be to recollect data for these schemes. However, the Board is mindful of the increased costs and delays which would be incurred were schemes required to provide further data,

and the impact that this would have on assistance for some groups of members.[5] The Board therefore believes that it is preferable for schemes not to have to resubmit data. The Board intends to undertake analysis on affected members to ensure that any impact of approximations is minimised.

4.6 For valuations conducted for the purposes of asset share calculations, the Board proposes to allow schemes to take any reasonable approach for these purposes, bearing in mind the obligation to equalise and the contracting-out legislation. This approach is also intended to minimise the administrative burden given that many FAS schemes will already have conducted their valuations for asset share purposes.

Questions on Chapter 4

Question 4.1

Do you agree with the proposal for the FAS Scheme Manager amending FAS assistance where data has already been submitted?

Question 4.2

Do you agree that FAS schemes should provide the additional required data going forwards? Do you see any problems with providing this data?

Question 4.3

Is it reasonable for the FAS Scheme Manager to make approximations when calculating the adjustment?

Question 4.4

Do you have any suggestions for the approach to take to making approximations when calculating the adjustment?

Question 4.5

Do you agree that schemes should be permitted to adopt any reasonable method when allowing for GMPs for the purposes of producing FAS valuations and asset share calculations?

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[5] Where FAS schemes are transferring assets to Government, a valuation is conducted to determine individual's asset shares. In some cases, assistance is based on these asset shares, for example where members are eligible to commute FAS assistance for tax free cash. Any reduction in scheme assets will therefore reduce some individuals' asset shares.

Chapter 5 – Implications for equalisation

5.1 The proposed approach to GMP has implications for the implementation of equalisation on FAS and the PPF.

PPF

5.2 The Board still intends to implement equalisation for GMP for the PPF using modified method 2 (as described in previous consultation documents and Appendix A). This method means that benefits calculated on male and female bases are compared at the Relevant Time (the day before the assessment date) and PPF compensation payments are based on the higher of the two.

5.3 As with the underpin implementation the Board will take responsibility for equalising benefits of schemes that have transferred to the PPF. The Board will also take a pragmatic approach to implementation for certain schemes in assessment. Following completion of the consultation, the Board will set out which schemes in assessment will themselves be responsible for ensuring that benefits are equal in respect of GMPs.

5.4 Following this consultation the Board will publish revised guidance on the PPF process.

FAS

5.5 “Modified method 2” will also be used to implement equalisation for GMP in relation to FAS assistance. For FAS, the appropriate date for comparison is the date of scheme wind-up, rather than the Relevant Time.

5.6 DWP’s equalisation guidance relating to providing data to the FAS Scheme Manager to facilitate the calculation of ”expected pension” can continue to be used for FAS schemes that are transferring assets to Government. We expect that the new approach will require some minor amendments to this guidance. However, we do not expect these amendments to materially increase the work involved for schemes in effecting equalisation for GMP.

Generosity of approach

5.7 Section 171 of the Pensions Act 2004 requires that, where the Board is taking action to eradicate inequality in relation to PPF compensation, the modifications should do no more than is necessary to ensure equality.

5.8 The Board received responses to its consultation on equalisation stating that the proposed method was excessively generous. We expect that our proposal to adopt the underpin approach to calculating compensation will address some of these concerns.

5.9 No requirement such as Section 171 exists within FAS legislation. However, the Board nonetheless takes the view that it should adopt this approach to calculating ‘expected pension’ bearing in mind that the FAS is funded by the public purse.

Chapter 6 –The consultation process

Responding to the consultation

6.1 The Board of the Pension Protection Fund welcomes your views on the proposals included in this consultation document.

Arrangements for submissions

6.2 The consultation period begins on 24 January 2010 and will end on 21 March 2010. Please ensure that your response reaches us by that date. If you would like further copies of this document it can be found at the Pension Protection Fund website at www.pensionprotectionfund.org.uk.

6.3 Please email all consultation responses to gmpconsultation@ppf.gsi.gov.uk

6.4 Please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear who the organisation represents and, where applicable, how the views of the members were assembled.

6.5 The requirements of the Freedom of Information Act (2000) state that all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purpose of the public consultation exercise it is understood that a respondent consents to its disclosure and publication. If this is not the case, the respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with the Freedom of Information Act (2000) obligations and general law on this issue. Queries should be sent to Paul Reynolds, whose contact details may be seen in section 6.10 below.

6.6 Further information on the Freedom of Information Act (2000) can be found on the website of the Ministry of Justice.

6.7 In the event of any queries, please contact:

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Publishing a summary of responses

6.8 The Board will publish a summary of the responses it receives and set out the approach it chooses to adopt.

6.9 The consultation is being carried out in line with the Code of Practice on Consultation. The code can be accessed at http://www.cabinetoffice.gov.uk/regulation/consultation/

6.10 The Board would welcome any feedback on the effectiveness of this consultation process. If you have any comments then please contact:

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Summary of questions

Question 2.1

Based on the information provided above and in accompanying Appendices, do you require any further clarification on the calculation method of the underpin approach?

Question 2.2

Having considered the examples set out in Appendix B, do you believe that there are any alternative methods which could be used to calculate PPF compensation and/or FAS assistance which would also be consistent with Counsel's opinion?

Question 3.1

How should the Board determine which schemes in assessment would be required to apply the underpin approach themselves, and which would be adjusted by the PPF?

Question 3.2

What would be a reasonable timeframe for the proposed adjustments to benefit payments under Section 138 of the Pensions Act 2004 for schemes already in assessment?

Question 3.3

What would be a reasonable timeframe for the proposed adjustments to benefit payments under Section 138 of the Pensions Act 2004 for schemes entering assessment in the future?

Question 3.4

Can you see any operational or data issues for schemes in assessment performing the underpin calculation?

Question 3.5

Do you agree that the underpin approach should not be compulsory for s179 valuations?

Question 3.6

If "yes" to the above, should the actuary's "unlikely to have been understated" certification encompass the potential impact of adopting the underpin approach on protected liabilities?

Question 4.1

Do you agree with the proposal for the FAS Scheme Manager amending FAS assistance where data has already been submitted?

Question 4.2

Do you agree that FAS schemes should provide the additional required data going forwards? Do you see any problems with providing this data?

Question 4.3

Is it reasonable for the FAS Scheme Manager to make approximations when calculating the adjustment?

Question 4.4

Do you have any suggestions for the approach to take to making approximations when calculating the adjustment?

Question 4.5

Do you agree that schemes should be permitted to adopt any reasonable method when allowing for GMPs for the purposes of producing FAS valuations and asset share calculations?

Note:

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This document contains a summary of the Board's position, which is informed by the legal advice it has received. In providing this document to you, the Board does not intend to waive legal professional privilege ("Privilege") and confidentiality in relation to any of that legal advice.

To the extent there has been any waiver of Privilege and confidentiality, that waiver is strictly limited to the contents of this document, and does not extend in any respect whatsoever to the contents of any other communication or document

Appendix A – Summary of the Board of the Pension Protection Fund's Position Following Counsel's Advice and the Ministerial Statement

Calculation of PPF compensation and FAS assistance in the context of equalisation for GMPs

1 Introduction

1.1 This document aims to explain, in as clear terms as is possible given the complexity of the issue, the Board's position on guaranteed minimum pensions ("**GMPs**") and equalisation in the context of them.

1.2 We start by explaining why we have concluded that steps must be taken to equalise PPF compensation and FAS assistance to take account of differences between men and women arising out of the calculation of GMPs ("**Equalisation for GMP**").

1.3 Next, we address the impact on our original analysis in relation to the need for comparators, of the ministerial statement made by Angela Eagle, then Minister of State for Pensions and the Ageing Society, on 28 January 2010 (the "**Ministerial Statement**"). Government has recently re-affirmed this position and its intention to bring forward amending legislation later this year.

1.4 We then consider the method of Equalisation for GMP that the Board proposes to use. It is worth noting from the outset that there are some inextricably linked issues to consider in this context.

1.4.1 First, how are GMPs treated in the PPF compensation calculation generally? Up until now, the calculation of PPF compensation has not generally involved any separate consideration of GMP. This is because the Board was aware that there were complex issues involved in relation to GMP, not least, equalisation; and it took the view that it should deal with all the issues together. Equally, the question of equalisation for GMP raises questions on the nature of GMP itself. Accordingly, the Board has thus far taken the approach of separately identifying elements of compensation only in order to deal with the issue of *Barber* equalisation[6] and to separate the post-6 April 1997 element, in respect of which pension increases are payable.

1.4.2 Secondly, how should the overall benefits/compensation be equalised to take account of the differences in the calculation of GMPs?

1.5 So, in calculating PPF compensation and FAS assistance, in order to properly account for the complex nature of GMPs, including equalisation needed in respect of them, it is necessary to consider the following issues:

1.5.1 Is GMP a pension, or part of a pension, in its own right and does that mean it should always be treated as a separate tranche; or is it, in fact, more notional in nature, serving as a minimum, or underpin?

1.5.2 If GMP is an underpin, what impact does the age at which the GMP is payable under statute and/or the scheme rules have in the context of the PPF/FAS legislation and what impact do the other statutory requirements connected with GMPs (e.g. anti-franking) have?

1.5.3 What method should be used to equalise for other inequalities caused by the GMP formula?

1.6 The Board recognises that these issues are extremely complex and is grateful for the input it has received from external stakeholders in testing its analysis.

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[6] Many, if not most schemes have different normal pension ages for different periods of scheme service, owing to the European court's decision in *Barber v Guardian Royal Exchange (1990)* and subsequent cases.

2 Why does the Board need to undertake Equalisation for GMP at all?

2.1 The Board sought advice on this question some time ago from Andrew Simmonds QC. Andrew remains the Board's Counsel in relation to this issue and has approved the legal aspects of this note. The Board has always recognised that another option would be to sponsor a test case through the courts. However, such a case would likely be protracted (as it would likely be referred to the European courts) and expensive for levy payers. Accordingly, the Board took the view that, provided the opinion received was suitably firm, it would not wish to burden levy payers with the costs of a test case, nor delay the task of implementing any necessary Equalisation for GMP.

2.2 In the event, Counsel's advice on the central issue - of whether the Board was required to equalise for GMP - was firm. In summary, he advised that:

2.2.1 Trustees of occupational schemes are obliged to equalise pensions payable insofar as GMP entitlements create inequality.

2.2.2 The way in which section 171 and the associated regulations are drafted strongly suggests that Parliament's intention was, in principle, to replicate in the PPF the obligations of trustees of occupational schemes under Article 157[7]/section 62. Accordingly, the Board is obliged to equalise pension compensation to a similar extent.

2.2.3 In relation to the FAS, whilst s171 does not apply to it, he was satisfied that there is an obligation to equalise for GMP. This was based on the fact that section 62 applies indirectly in relation to the FAS because of its effect on the scheme rules (i.e. it imports an equal treatment rule into them) which then form the basis for FAS assistance.

2.2.4 Consistently with *Barber*, the obligation to equalise applies only to GMP entitlements in respect of service from 17 May 1990.

2.2.5 However, so far as the Board is concerned, this conclusion is subject to a major qualification in relation to the need for comparators[8].

2.3 Counsel considered the two key counter-arguments against Equalisation for GMP. In summary, his advice was as follows:

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[7] of the Treaty on the Functioning of the European Union. This article was previously article 119 of the EEC Treaty and 141 of the EU Treaty.

[8] See paragraph 3 in relation to this point.

2.3.1 The first key counter-argument is the social security substitute argument. This suggests that, as a substitute for SERPS, GMPs cannot be "pay" for the purposes of Article 157. This argument was rejected on the grounds that both the *Barber* judgment itself (see in particular paragraphs 77 and 82-83 of the PLR report) and the more recent case of *Pirkko Niemi* [2002] PLR459 (see in particular, paragraphs 41, 45 and 47-52) show that the scope of this exception is now extremely narrow, such that GMPs would be considered to be "pay" for these purposes. In *Pirkko Niemi* the Court held in that case that benefits payable under a Finnish statutory scheme, administered by the Finnish State Treasury, which compulsorily covered all who worked in the public and private sectors, were “pay” for Article 157 purposes. At paragraph 41 the Court stated:

2.3.2 “The pension scheme at issue in the main proceedings is determined directly by statute. While that fact undoubtedly indicates that the benefits paid under that scheme are social security benefits…it is not in itself sufficient to exclude such a scheme from the scope of Article 119 of the Treaty…”…

2.3.3 The second key counter-argument is objective justification. This is a defence which relies upon the difference in treatment being genuinely due to a material difference (other than sex) between the man's case and the woman's case. However, given that the reference level to which the GMP is directed is one determined by the unjustifiably discriminatory provisions of the state pension scheme, Counsel did not consider that to constitute a material factor which is not the difference of sex. The case of *Birds Eye Walls Ltd v Roberts* which is sometimes suggested to lend support to the objective justification argument in this context is, in fact, concerned with a bridging pension designed to <u>eliminate</u> inequality between the sexes. There is no analogy with GMPs which instead <u>replicate</u> the inequalities inherent in SERPS.

3 Comparators

3.1.1 As set out in the Board's original consultation document[9], Counsel advised the Board that, given that s171 expressly provides that it only comes into play where comparators exist and that the Board's payment functions are only modified so far as "necessary" to prevent discrimination, where the Board was undertaking Equalisation for GMP, it could only do so where a comparator existed. In the context of schemes still in the

[9] April 2008 consultation on the requirement under Section 171 of the Pensions Act 2004 to equalise compensation to allow for differences in the GMP formula.

assessment period, however, an alternative approach involving an amendment to the scheme rules was considered to be a viable alternative in most cases.

3.2 However, since this time the Department for Work and Pensions ("**DWP**") has issued the Ministerial Statement. This stated, so far as relevant, as follows:

3.2.1 Where a scheme member has accrued entitlement to a GMP after May 1990, European law requires that any inequality in scheme rules which results from the legislative provisions governing GMPs should be removed, whether or not a person can show that a comparator exists.

3.2.2 The Government intends to bring forward amending legislation when Parliamentary time allows.

3.2.3 In the meantime, it is the Government's opinion that, in order to ensure full compliance with European Law, trustees and others should act as if existing domestic legislation requires equalisation in respect of differences resulting from GMPs whether or not real comparators exist.

3.3 The Board understands that the conclusions set out in the Ministerial Statement were driven primarily by the *Allonby* case. In addition, the Board understands that the Government's view is that the same principles apply to the Board in exercising its payment functions under the Pensions Act 2004 and therefore, the amendments the Government intends to bring forward will apply not only to the sex equality rule provisions of the Equality Act 2010, but also to s171 of the Pensions Act 2004.

3.4 Accordingly, in the light of the Ministerial Statement, the Board has decided to effect Equalisation for GMPs, even in the absence of comparators[10].

4 The Method of Equalisation for GMPs

4.1 In this section, for ease of understanding, we adopt the following terms:

- "scale pension" is used to describe the normal pension which the member would be entitled to under the rules of the scheme, disregarding the GMP requirements/provisions;

[10] Note that DWP is aware of this decision.

- "scheme NPA" is used to describe the age at which pension would be payable unreduced under the rules of the scheme, disregarding the GMP requirements/provisions;

- "excess" is used to describe the amount by which the scale pension exceeds the GMP; and

- "NRA" or "FAS NRA" is used to describe the age at which the member would normally retire under the scheme rules (his normal retirement age).

4.2 Method of equalising for GMP formula

4.2.1 As set out in the Board's original consultation document[11], the Board's approach to equalising PPF compensation (and, now, FAS assistance) for the unequal effect of the GMP formula follows the approach of a partial application of method 2. Method 2 results in members receiving the higher of the (overall) pensions payable to two individuals who are equal in every respect except that one is male and the other female.

4.2.2 Usually, Method 2 would involve a yearly assessment once the pension is in payment. The alternative, of taking a “lifetime” approach, would not fit with the way pensions are normally assessed (a member generally becomes entitled to a pension for life, increased on an annual basis).

4.2.3 However, given that rates of revaluation/increases in PPF compensation and FAS assistance will not vary after the assessment date for PPF (the date when the qualifying insolvency event occurs), or the winding up date for FAS, the comparison need only be made once, immediately before the assessment date/winding up date. This is sometimes referred to as "Modified Method 2".

4.2.4 The Board has compiled tables which set out the conversion factors to convert male GMP into female GMP (and vice versa) for members based on their date of birth.

4.2.5 However, this only deals with the inequalities in the accrual rate. The test also needs to deal with the inequality in retirement ages between males and females. This involves consideration of whether GMP should be treated as a separate tranche.

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[11] See Appendix B (p24) of the April 2008 consultation on the requirement under Section 171 of the Pensions Act 2004 to equalise compensation to allow for differences in the GMP formula

4.3 A Separate Tranche? Legislative requirements

4.3.1 Section 173(3) of the Pensions Act 2004 (the "**Act**") contains an exhaustive list of what can be paid or transferred out of the Pension Protection Fund. Section 173(4) provides that "No other amounts are to be paid or transferred out of the Pension Protection Fund".

4.3.2 Section 171 of the Act requires that where the Board exercises a payment function that is less favourable to either gender, "that function has effect **with such modifications as are necessary** to ensure that the provision is not less favourable." [Emphasis added].

4.3.3 The effect of these provisions is that, so far as the PPF is concerned, the Board is required to adopt the method that does no more than is necessary to effect equalisation.

4.3.4 This does not apply to the FAS (as s171 was not applied in relation to the FAS). However, this does not mean that it is not the right approach.

4.3.5 As referred to at 1.4 above, the first question to address is how GMPs are to be treated in the PPF compensation calculation generally. As to this, paragraph 34 of Schedule 7 to the Pensions Act 2004 states that:

"(1) In this Schedule "normal pension age", in relation to the scheme and any pension or lump sum under it, means the age specified in the admissible rules as the earliest age at which the pension or lump sum becomes payable without actuarial adjustment (disregarding any admissible rule making special provision as to early payment on the grounds of ill health or otherwise).

(2) **Where different ages are specified in relation to different parts of a pension** or lump sum:

(a) this Schedule has effect **as if those parts were separate pensions** or, as the case may be, lump sums, and

(b) references in relation to a part of the pension or lump sum to the **normal pension age** are to be read as references to the age specified in the admissible rules as **the earliest age at which that part becomes payable** under the scheme without actuarial adjustment (disregarding any

special provision as to early payment on grounds of ill health or otherwise).

(3) In any case where the Board is satisfied that it is not possible to identify the normal pension age from the admissible rules of the scheme, it may, having regard to those rules, determine how the normal pension age is to be determined."

(emphasis added.)

4.3.6 The admissible rules of the scheme, to be taken into account for the purposes of calculating PPF compensation, include any legislative overrides, in particular the GMP legislation (which is expressly overriding by virtue of regulation 55 of the Occupational Pension Schemes (Contracting-out Regulations) 1996). Scheme rules should, therefore, be taken to include the right of a member to payment of a minimum of the GMP at GMP age (subject to a limited exception discussed at 4.5.1 below). In certain circumstances, this can give rise to two different parts of a pension for the purposes of paragraph 34 of Schedule 7. A good example of this would be the case of a female whose scheme NPA is, and has always been, 65. Notwithstanding this, the overriding GMP Appendix in the rules reflects the statutory provisions and entitles her to a GMP at age 60. This example could be analysed as creating two tranches of compensation because, as paragraph 34 specifies, different ages are specified in relation to the payment of her GMP and the excess.

4.3.7 The position is similar for the FAS - see paragraph 4B of Schedule 2 to the Financial Assistance Scheme Regulations 2005 (the **FAS Regulations**). The FAS differs from the PPF in the key respect that assistance is only paid from one age (the age at which the member would normally retire - NRA[12]). However, if GMP is a pension, or part of a pension, under the rules of the scheme, payable at an age other than the member's NRA, it would be a separate pension for FAS purposes and would have an actuarial factor akin to a late retirement factor applied to align it to the FAS NRA.

4.4 Possible calculation approaches

Three main approaches to calculating PPF compensation or FAS assistance for a member with GMP have been identified. For simplicity, we assume that the member only has post 17 May 1990 service, though it should be noted that whilst all female GMP is payable from

[12] Regulation 2(1A) of the Financial Assistance Scheme Regulations 2005

age 60, the only male GMP payable from 60 is that accrued after 17 May 1990.

4.4.1 Approach (a): Always Tranche

Under approach (a), the GMP and the excess are always treated as two separate tranches, so that when equalisation is effected, all GMP is paid at age 60 (whenever it was accrued) in addition to the excess payable at that age. The GMP accrued during any period when the scheme NPA was 65 moves to being payable at 60 (to reflect equalisation) and sits on top of (does not frank) the excess pension otherwise payable at 60;

4.4.2 Approach (b): Statutory Underpin

Under approach (b), the GMP and other statutory requirements operate as an underpin, but it is recognised that females have the right to draw their GMP at age 60. The GMP accrued in a period when the scheme NPA is 65 does not move wholesale to be payable at age 60. Instead it is used (or "borrowed") to assess whether the pension payable at 60 covers the full GMP (after equalisation). In addition, other statutory requirements (in respect of revaluation and, in particular, anti-franking) are allowed for. This approach is explained further at 4.5.6 - 4.5.8 below.

4.4.3 Approach (c): Scheme NPA

Under approach (c), the scheme NPA is considered to be the earliest age at which the scale pension can be paid unreduced and so a check that the GMP is covered only needs to be made at that age.

4.5 The Board's position on the possible calculation approaches

Approach (c)

Counsel does not consider that Approach (c) can be correct for the following reasons.

4.5.1 First, because the effect of the contracting-out legislation is that (in the vast majority of cases) a member must be entitled to take their GMP at GMP age. Therefore, a female member is entitled to take her GMP at 60 (see section 13 of the Pension Schemes Act 1993). As a result, scheme rules will (or at least should) include a provision which entitles the female member actually to draw that pension at 60. There is a limited exception where the member remains in employment to which the scheme relates after that age or where she consents. However, in a PPF/FAS scenario, this is difficult to envisage.

4.5.2 Secondly, both the PPF and FAS legislation expressly provide for the recognition of pension payable at different ages and neither the PPF nor FAS is restricted by any historic HMRC requirements.

It is recognised that, in practice, schemes do sometimes adopt the approach of not paying the female GMP at age 60 (or, if they do, of reducing it along with the rest of the scale pension). However, in the face of the express words of the legislation (both contracting-out and PPF/FAS), and a line of *Barber* equalisation cases that, albeit in a slightly different context, confirm the right actually to draw certain benefits (e.g. *Barber* window benefits) from age 60[13], the Board finds this approach difficult to support.

Approach (a)

4.5.3 Approaches (a) and (b) therefore remain. Due to the complexity of the exercise, the summary explanations of the approaches which follow should be read together with the worked examples in Appendix B. Approach (a) is a strict tranching approach in all cases. Ultimately, Counsel does not favour this approach. This is because, in practice, it will not always be appropriate to treat the GMP as having a different payable age to other parts of the scale pension.

4.5.4 For example, in the case of a female member who is entitled to draw some pension at age 60 (as well as some at age 65) and that amount (at age 60) is sufficient to cover the GMP in full, the GMP has the same payable age as the scale pension payable at 60 and would therefore form part of that pension.

4.5.5 More generally, adopting an approach where GMP is treated as a separate tranche would not appropriately reflect the intrinsic nature of a GMP which is an underpin (a minimum benefit which must be provided in order to allow the scheme to contract out of SERPS on a GMP basis[14]) as embodied in approach (b). The examples in Appendix B show that if Approach (a) is applied, it could mean that, for females and, post equalisation for males, a higher level of benefit is payable from age 60 than Approach (b).

Approach (b)

4.5.6 Approach (b) (the underpin) works by calculating a statutory minimum amount payable at 60 (the "**Minimum**"). The

[13] e.g. *Hodgson v Toray Textiles Europe, Trustee Solutions v Dubery, Foster Wheeler v Hanley*

[14] See, for example, s13(1)(b) of the Pension Schemes Act 1993

applicable Minimum depends on whether the scale pension payable at 60 accrued to the date of leaving service (i.e. ignoring any revaluation) is sufficient to meet the equalised GMP (again, ignoring revaluation). If it is not sufficient (scenario 1), the Minimum will be the revalued equalised GMP. If it is sufficient (scenario 2), the Minimum will be that prescribed by the anti-franking legislation (ss.87-92 Pension Schemes Act 1993) namely: (i) the scale pension payable at 60, plus (ii) revaluation on the equalised GMP, plus (iii) revaluation on the excess of scale pension payable at 60 over the equalised GMP (at the higher of the rates payable under the scheme rules and statute).

4.5.7 A check is made as to whether or not the Minimum is covered by the scale pension already payable at 60. If that scale pension is already greater than the Minimum, no further adjustment is required as the underpin has been covered. If it is lower than the Minimum, the Minimum must be paid. Where appropriate, the 90%[15] adjustment is applied to both elements in the comparison exercise.

4.5.8 The remaining elements of pension with appropriate revaluation (at excess rate) are then paid from the later NPA. To avoid double counting, in scenario 1, scale pension payable at 65 is reduced to reflect the corresponding amount by which the pension payable at 60 has been increased to meet the Minimum.

4.6 It is acknowledged that the legislation does not provide clear guidance on the approach to be adopted. However, in circumstances where more than one approach appears possible, the Board takes the view that it is not appropriate to pay more than is necessary to comply with the Equality Act/s171. In relation to the PPF, because s171 uses that wording, to adopt a more generous approach such as Approach (a) may be unlawful. In either case, the Board considers that this will generally be the best policy approach, as it is in the interests of the levy/tax payers respectively, who would ultimately bear the cost of paying any higher level of compensation.

5 The Board's View

The Board's view is as follows:

5.1 In relation to the PPF: Schemes in assessment which are:

- required by section 138(2) of the Act to reduce benefits in payment to a level that does not exceed PPF compensation; and

[15] E.g. in a PPF context, to the extent that normal pension age has not been reached

- required to co-operate with the Board in the production of the s143 valuation,

should also be calculating PPF compensation by applying the underpin approach (Approach (b)) as described above.

5.2 In relation to the FAS: the calculation of "expected pension" under Schedule 2 to the FAS Regulations, should be calculated by applying the underpin approach (Approach (b)) as described above.

January 2011

Note:

In receiving, accessing and/or reading this document, including its appendices ("this document"), you accept and agree to the following:

This document contains a summary of the Board's position, which is informed by the legal advice it has received. In providing this document to you, the Board does not intend to waive legal professional privilege ("Privilege") and confidentiality in relation to any of that legal advice.

To the extent there has been any waiver of Privilege and confidentiality, that waiver is strictly limited to the contents of this document, and does not extend in any respect whatsoever to the contents of any other communication or document.

Appendix B – Example calculations

This Appendix sets out a number of example calculations to illustrate the three possible methods of calculating PPF compensation and FAS assistance considered by Counsel. These were:

(a) Always Tranche
(b) Statutory Underpin
(c) Scheme NPA

The examples should be read in conjunction with Appendix A and have been developed to illustrate when and why the different approaches result in a different level of PPF compensation or FAS assistance being payable.

Initially the examples consider the differences in the methods prior to the application of GMP equalisation. However, as the Board intends to adopt approach (b) – the statutory underpin approach, the Appendix also illustrates the application of equalisation for GMP to PPF compensation and FAS assistance using the Board's proposed statutory underpin approach.

These examples are intended to be illustrative only and do not cover all possible scenarios.

The examples are intended to illustrate calculation methods for PPF compensation and FAS assistance. They are therefore based on the interaction between PPF and FAS legislation, contracting-out legislation and preservation legislation. The approach is therefore specific to FAS and the PPF.

Contents

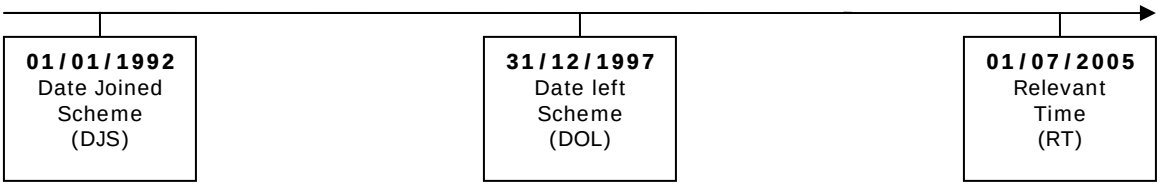
Example 1: Male member's PPF compensation

Example 2: Female member's PPF compensation

Example 3: Male member's FAS assistance

Example 1 – PPF: Male deferred pensioner at Relevant Time

Membership Details



Date of Birth = 5 December 1946

The scheme NPA is 60 for the period from 1 January 1992 – 20 December 1994, and 65 thereafter.

Pension at date of leaving = £2,494.37 *pa* which has been split into elements with scheme NPA 60 and NPA 65 (based on service dates):

Summary of benefits at date of leaving				
Service Dates	**NPA**	**Total Pension at date of leaving**	made up of:	
			Post 88 GMP	**Excess pension**
01/01/1992 – 20/12/1994	**60**	**£1,233.74 *pa***	£392.41 *pa*	£841.33 *pa*
21/12/1994 – 05/04/1997	**65**	**£953.76 *pa***	£303.35 *pa*	£650.41 *pa*
06/04/1997 – 31/12/1997	**65**	**£306.87 *pa***	n/a	£306.87 *pa*
Total	n/a	**£2,494.37 *pa***	£695.76 *pa*	£1,798.61 *pa*

1 (a) Always Tranche

The scheme would treat this member as having 2 scheme NPAs: NPA 60 for service between 1/1/1992 and 20/12/1994, and NPA 65 for service after 20/12/1994. Under the tranching approach the GMP is treated as a separate tranche and the assumed payable age for the GMP tranche is the lower of scheme NPA during the relevant service period and GMP payable age.

The scheme provided revaluation on the pension in deferment between the date of leaving and the Relevant Time at the following rates:

- Fixed Rate Revaluation on GMP (in this case 6.25% *pa*)

- Statutory revaluation on excess pension

Note that we need to allow for 90% compensation multiplier on all benefits since the member is below both of the scheme NPAs at the Relevant Time.

Therefore, PPF compensation, before equalisation considerations, at the Relevant Time is:

NPA 60 element

$$= \begin{pmatrix} 392.41 * 1.0625^{8} + \\ 841.33 * 1.181 \end{pmatrix} * 90\%$$

$$= £1{,}467.86 pa$$

NPA 65 element

$$= \begin{pmatrix} 303.35 * 1.0625^{8} + \\ 650.41 * 1.181 + \\ 306.87 * 1.181 \end{pmatrix} * 90\%$$

$$= £1{,}460.92 pa$$

where 1.181 = statutory revaluation on the excess pension
= minimum ($RPI_{Sept\ 2004}$ /$RPI_{Sept\ 1997}$ = 188.1/159.3; 1.05^{7})
= minimum (1.181, 1.407)

1 (b) Statutory Underpin

Statutory requirements in relation to GMP are not applied until the male reaches his GMP age of 65.

Therefore, absent equalisation, there is no need to apply an underpin calculation to the NPA 60 element. The NPA 60 element is calculated in the same way as per example 1(a).

As regards the NPA 65 element, the underpin and tranching approaches are effectively the same in this (male) example.

Under the tranching approach, GMP is assigned a payable age of the lower of GMP age and the scheme NPA applicable over the period the GMP was accruing. The statutory underpin in respect of the NPA 65 element is calculated as the sum of the corresponding GMP and excess pensions, each revalued to the Relevant Time and reduced by application of the 90% multiplier. This replicates the calculation set out in 1(a) above and illustrates that in these circumstances and before allowance for equalisation in respect of GMP, the underpin and tranching approaches are effectively the same for males. This is because the GMP payable age is equal to or higher than the scheme NPAs.

Therefore PPF compensation at the Relevant Time is:

NPA 60 element = £1,467.86 *pa*

NPA 65 element = £1,460.92 *pa*

1 (c) Scheme NPA

When providing data for the purposes of calculating PPF compensation, the scheme would treat this member as having two different elements with different scheme NPAs: NPA 60 for service between 1/1/1992 and 20/12/1994, and NPA 65 for service after 20/12/1994. GMP is not recognised as having a separate payable age.

In this example this means that the calculation of compensation will be the same as per example 1(a)

Therefore PPF compensation at the Relevant Time is:

NPA 60 element = £1,467.86 *pa*

NPA 65 element = £1,460.92 *pa*

Summary

-This example illustrates that, for males, the current approach to calculating PPF compensation is usually correct (ignoring equalisation in respect of GMPs)
-The underpin, tranching and scheme NPA approaches are in most circumstances the same for males. This is because the male GMP payable age is generally equal to or higher than scheme NRA.

Example 1: Equalisation using the underpin approach

Once the correct compensation has been calculated for the male, we then need to consider equalisation in respect of GMP.

In order to ensure benefits are equal, we apply the following steps:

1. calculate benefits for an equivalent member of the opposite sex to account for differences in the GMP accrual rate

2. calculate opposite sex compensation at the Relevant Time using the underpin approach (this accounts for differences in the GMP payable age)
3. compare the opposite sex compensation to compensation based on the true sex

The compensation paid be based on whichever sex is most beneficial to the member at the Relevant Time.

Step 1: Calculate benefits for an equivalent member of the opposite sex

In this example, GMP can be converted into GMP on the opposite sex by applying a factor which reflects the different accrual rates for different sexes. The male to female factor to convert male GMP into female GMP for a member born on 5 December 1946 is 1.1786.

The female equivalent GMP is therefore:

$$392.41 * 1.1786 + 303.35 * 1.1786 = 462.49 + 357.53 = £820.02\ pa$$

Total pension at date of leaving is unchanged but the split between GMP and excess is different. The GMP elements increase and the excess elements correspondingly reduce.

Summary of opposite sex (female) benefits at date of leaving				
Service	NPA	**Total Pension at date of leaving**	made up of:	
			Post 88 GMP	Excess pension
01/01/1992 – 20/12/1994	**60**	**£1,233.74 *pa***	£462.49 *pa*	£771.25 *pa*
21/12/1994 – 05/04/1997	**65**	**£953.76 *pa***	£357.53 *pa*	£596.23 *pa*
06/04/1997 – 31/12/1997	**65**	**£306.87 *pa***	n/a	£306.87 *pa*
Total	n/a	**£2,494.37 *pa***	**£820.02 *pa***	**£1,674.35 *pa***

Step 2: Calculate opposite sex compensation at the Relevant Time using the underpin approach

In this example, the scale pension payable at age 60 at date of leaving service (i.e. ignoring revaluation) of £1,233.74 *pa* is **sufficient** to cover the

equalised GMP (again, ignoring revaluation) of £820.02 *pa*. Therefore, the Minimum is:

Scale pension payable at 60 + revaluation on equalised GMP + revaluation on "revised excess pension" with NPA 60, all with the 90% multiplier applied (See scenario 2 in Appendix A, para 4.5.6)

What is revised excess pension?

GMP accrued during a period with NPA 65 underpins benefits at the female GMP age of 60. When calculating the underpin, this NPA 65 GMP is effectively "borrowed" and becomes part of the GMP payable at 60. To ensure that the total benefits at NPA 60 remain the same, excess with an NPA of 60 must be correspondingly reduced to give a "revised excess pension". The amount by which the NPA 60 excess is reduced is attributed to the NPA 65 element instead.

How do you calculate revised excess pension?

In this example, the GMP of £357.53 *pa* accrued during a service period with scheme NPA 65 is "borrowed" and becomes part of the GMP payable at 60.

The excess pension with NPA of 60 (£771.25 *pa*) must be correspondingly reduced. The excess pension with NPA 65 must be correspondingly increased.

After application of the underpin, the total of the scheme NPA 60 and 65 elements, as well as the total pension, is unchanged. This is because in this scenario the excess with NPA 60 is larger than the GMP with NPA 65.

In some situations, the excess with NPA 60 may be smaller than the GMP accrued during a service period with scheme NPA 65. The full GMP is still borrowed and becomes part of the GMP payable from 60. The NPA 60 excess will be set to nil and the excess with an NPA of 65 only increases by the amount of the excess with an NPA of 60. This would mean that the benefit element with an NPA of 65 would reduce overall. The total pension remains the same.

Scale pension payable at age 60 = £1,233.74 *pa*
Revaluations on equalised GMP = 820.02 * $(1.0625^8 – 1)$ = £511.83 *pa*
"Revised excess pension" = 771.25 – 357.53 = £413.72 *pa*
Revaluations on "revised excess pension"
=413.72 * (1.181 – 1) = £74.88 *pa*

Statutory minimum amount payable at 60

= (1,233.74 + 511.83 + 74.88)*0.9

= £1,638.41 *pa*

Scale pension payable at 60 = $(462.49 * 1.0625^{8} + 771.25 * 1.181)*0.9$

= £1,495.81 *pa*

Therefore underpin bites

PPF compensation at the Relevant Time is:

NPA 60 element	**NPA 65 element**
= £1,638.41 *pa*	$= \begin{pmatrix} 953.76 * 1.181 + \\ 306.87 * 1.181 \end{pmatrix} * 90\%$ = £1,339.92 *pa*

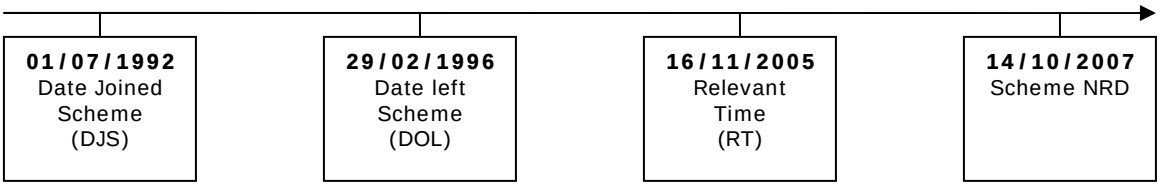
Step 3: Compare the opposite sex compensation to compensation based on the true sex

	Male benefits	**Female benefits**
NPA 60 element	£1,467.86 *pa*	£1,638.41 *pa*
NPA 65 element	£1,460.92 *pa*	£1,339.92 *pa*
Total	£2,928.78 *pa*	£2,978.33 *pa*

The NPA 60 element has increased by more than the reduction in the NPA 65 element, so the opposite sex calculation is more valuable. GMP equalisation would therefore be implemented by adjusting his compensation to the opposite sex calculation at the Relevant Time.

Example 2 – PPF: female deferred pensioner[16] at Relevant Time

Membership Details



Date of Birth = 14 October 1942

The scheme NPA is 60 for females for service prior to 30 June 1993, and 65 thereafter.

Pension at Date of leaving = £496.05 *pa* which has been split into tranches for NPA 60 and NPA 65 (based on service dates):

Summary of benefits at date of leaving				
Service Dates	**NPA**	**Total Pension at date of leaving**	made up of:	
			Post 88 GMP	Excess pension
01/07/1992 – 30/06/1993	**60**	**£138.43 *pa***	£69.91 *pa*	£68.52 *pa*
01/07/1993 – 29/02/1996	**65**	**£357.62 *pa***	£180.63 *pa*	£176.99 *pa*
Total	n/a	**£496.05 *pa***	£250.54 *pa*	£245.51 *pa*

2 (a) Always Tranche

The scheme would treat this member as having 2 scheme NPAs: NPA 60 for service between 01/07/1992 and 30/06/1993, and NPA 65 for service after 30/06/1993. Under the tranching approach the GMP is treated as a separate tranche and the assumed payable age for the GMP tranche is the lower of scheme NPA during the relevant service period and GMP payable age.

The scheme provided revaluation on the pension in deferment between the date of leaving and the Relevant Time at the following rates:

[16] NB this individual would be treated as a postponed pensioner in respect of their NPA 60 element and a deferred pensioner in respect of their NPA 65 element

-Fixed Rate revaluation on GMP (in this case 7% *pa*)
-Statutory revaluation on excess pension

Note that we need to allow for 90% compensation multiplier for the NPA 65 element but not for the NPA 60 element since the member is aged between 60 and 65 at the Relevant Time.

Therefore, PPF compensation at the Relevant Time is:

NPA 60 element

$$= \begin{pmatrix} 250.54 * 1.07^{6} + \\ 68.52 * 1.159 \end{pmatrix} * 1.3416 * 100\%$$

$= £610.98\ pa$

NPA 65 element

$$= \begin{pmatrix} 176.99 * 1.249 \end{pmatrix} * 90\%$$

$= £198.95\ pa$

where:

1.249 = statutory revaluation on the excess pension with NPA 65 between date of leaving and the Relevant Time
= minimum ($RPI_{Sept\ 2004}$ /$RPI_{Sept\ 1995}$ = 188.1/150.6; 1.05^{9})

1.159 = statutory revaluation on the excess pension with NPA 60 between date of leaving and age 60
= minimum ($RPI_{Sept\ 2001}$ /$RPI_{Sept\ 1995}$ = 174.6/150.6; 1.05^{6})

1.3416 = scheme late retirement factor on the NPA 60 tranche from age 60 to Relevant Time (applies to GMP and excess elements)
= $1.10^{3\ 1/12}$

Because the member is above the female GMP payable age, we also need to check that the scheme late retirement factor is sufficient to cover the statutory late retirement increase on the GMP.

Statutory GMP late retirement factor
= (1+(3*52+4)/700)*1.017*1.028*1.03
= 1.3230

The scheme late retirement factor is higher than this, so the statutory GMP increases are covered.

NB under the PPF the NPA 60 element comes into immediate payment (since the member is over age 60 at the Relevant Time)

2 (b) Statutory Underpin

In this example, the scale pension payable at age 60 at date of leaving service (i.e. ignoring revaluation) of £138.43 *pa* is **insufficient** to cover the GMP (again, ignoring revaluation) of £250.54 *pa*.

Therefore the Minimum will be the revalued GMP

GMP with statutory revaluations up to the Relevant Time

= Revalued GMP = 250.54 * 1.07^6 * 1.3230 * 100% = £497.44 *pa*

The scale pension payable at 60 is

$= (69.91 * 1.07^6 + 68.52 * 1.159) * 1.3416 * 100\% =$ £247.30 *pa*

As the scale pension does not cover the Minimum, the Minimum must be paid and the underpin bites.

Remaining compensation with NPA 65 = 496.05 – 250.54 = £245.51 *pa*
(this is all treated as excess pension)

Summary of benefits following application of underpin				
Service Dates	**NPA**	**Total Pension at date of leaving**	made up of:	
			Post 88 GMP	Excess pension
01/07/1992 – 30/06/1993	**60**	**£250.54 *pa***	£250.54 *pa*	Nil
01/07/1993 – 29/02/1996	**65**	**£245.51 *pa***	Nil	£245.51 *pa*
Total	n/a	**£496.05 *pa***	£250.54 *pa*	£245.51 *pa*

Therefore, PPF compensation at the Relevant Time is:

NPA 60 element

= £497.44 *pa*

NPA 65 element

$= 245.51 * 1.249 * 90\%$

$=$ £275.98 *pa*

2 (c) Scheme NPA

The scheme would treat this member as having two Normal Pension Ages when calculating PPF compensation. NPA 60 for service between 1/7/1992 and 30/6/1993, and NPA 65 for service after 30/6/1993. By calculating compensation in this way, the scheme would not recognise the female's right to draw all GMP at age 60.

Therefore, PPF compensation at the Relevant Time is:

NPA 60 element

$$= \begin{pmatrix} 69.91 * 1.07^6 + \\ 68.52 * 1.159 \end{pmatrix} * 1.3416 * 100\%$$

$$= £247.30\ pa$$

NPA 65 element

$$= \begin{pmatrix} 180.63 * 1.07^6 * 1.3230 + \\ 176.99 * 1.249 \end{pmatrix} * 90\%$$

$$= £521.73\ pa$$

where 1.3230 = statutory late retirement increase on the female GMP

The NPA 60 element comes into immediate payment (since the member is over age 60 at the Relevant Time)

Summary

-The scheme NPA approach is currently used to calculate compensation
-Therefore the current calculation of compensation for females is incorrect
-For females, GMP age is commonly lower than scheme NPA during certain service periods so tranching and underpin approaches will differ

Example 2: Equalisation using the underpin approach

Once the correct compensation has been calculated for the female, we then need to consider equalisation in respect of GMP.

In order to ensure that benefits are equal, we apply the following steps:

1. calculate benefits for an equivalent member of the opposite sex to account for differences in the GMP accrual rate
2. calculate opposite sex compensation at the Relevant Time using the underpin approach (this accounts for differences in the GMP payable age)

3. compare the opposite sex compensation to compensation based on the true sex

The member is paid compensation based on whichever sex gives higher compensation at the Relevant Time.

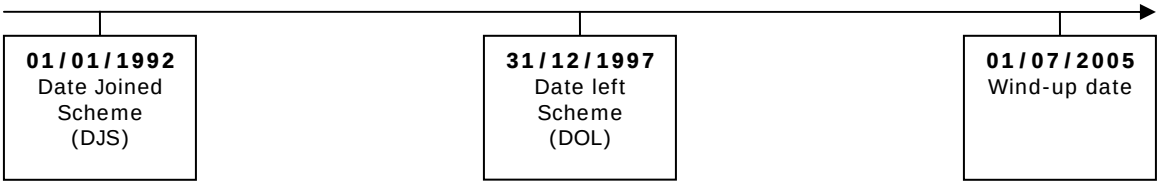
On an opposite sex (male) basis, this member would have less GMP and more excess. The scheme provides higher revaluation on GMP than on excess, so in general less GMP will lead to lower compensation. Therefore in this example we can state that compensation on a female basis will be more generous than compensation on a male basis without the need for any further calculations.

Note that, when performing opposite sex calculations, these only apply to the period after 17 May 1990. Therefore GMP and excess elements accrued before this date would remain unchanged.

Example 3 – FAS: male deferred pensioner at wind-up date

Membership details

This member has the same benefit details as the member in example 1. The calculations are similar to those set out in example 1. The main difference is that a tranching factor is used to align payments at an age other than FAS NRA.



Date of Birth = 5 December 1946

The scheme NPA is 60 for the period from 01 January 1992 – 20 December 1994, and 65 thereafter.

Pension at date of leaving = £2,494.37 *pa* which has been split into elements with NPA 60 and NPA 65 (based on service dates):

Summary of benefits at date of leaving				
Service Dates	**NPA**	**Total Pension at date of leaving**	made up of:	
			Post 88 GMP	Excess pension
01/01/1992 – 20/12/1994	**60**	**£1,233.74 *pa***	£392.41 *pa*	£841.33 *pa*
21/12/1994 – 05/04/1997	**65**	**£953.76 *pa***	£303.35 *pa*	£650.41 *pa*
06/04/1997 – 31/12/1997	**65**	**£306.87 *pa***	n/a	£306.87 *pa*
Total	n/a	**£2,494.37 *pa***	£695.76 *pa*	£1,798.61 *pa*

3 (a) Always tranche

The scheme would treat this member as having 2 scheme NPAs: NPA 60 for service between 1/1/1992 and 20/12/1994, and NPA 65 for service after 20/12/1994. Under the tranching approach the GMP is treated as a separate tranche and the assumed payable age for the GMP tranche is the lower of scheme NPA during the relevant service period and GMP payable age.

The member's FAS NRA is 65. All assistance is put into payment at this age. Elements with an NPA of 60 will be adjusted to the FAS NRA using a FAS tranching factor (in effect, a late retirement factor).

Therefore, FAS assistance at the wind-up date is:

NPA 60 element

$$= \begin{pmatrix} 392.41 * 1.0625^{8} + \\ 841.33 * 1.181 \end{pmatrix} * 90\% * 1.108$$

$= £1{,}626.39\ pa$

NPA 65 element

$$= \begin{pmatrix} 303.35 * 1.0625^{8} + \\ 650.41 * 1.181 + \\ 306.87 * 1.181 \end{pmatrix} * 90\%$$

$= £1{,}460.92\ pa$

Total assistance = 1,626.39 + 1,460.92 = £3,087.31 *pa*

where 1.108 = FAS tranching factor for an NPA of 60 and a FAS NRA of 65

3 (b) Statutory underpin

Statutory requirements in relation to GMP are not applied until the male reaches his GMP age of 65.

Therefore, absent equalisation, there is no need to apply an underpin calculation to the NPA 60 element. The NPA 60 element is calculated in the same way as per example 3(a).

As regards the NPA 65 element, the underpin and tranching approaches are effectively the same in this (male) example.

Under the tranching approach, GMP is assigned a payable age of the lower of GMP age and the scheme NPA applicable over the period the GMP was accruing. The statutory underpin in respect of the NPA 65 element is calculated as the sum of the corresponding GMP and excess pensions, each revalued to the Relevant Time and reduced by application of the 90% multiplier. This replicates the calculation set out in 3(a) above and illustrates that in these circumstances and before allowance for equalisation in respect

of GMP, the underpin and tranching approaches are effectively the same for males. This is because the GMP payable age is equal to or higher than the scheme NPAs.

Therefore FAS assistance at the wind-up date is £3,087.31 *pa*

3 (c) Scheme NPA

The scheme would treat this member as having 2 scheme NRAs, NPA 60 for service between 1/1/1992 and 20/12/1994, and NPA 65 for service after 20/12/1994.

This means that the calculation of compensation will be the same as per example 3(a)

Therefore FAS assistance at the wind-up date is £3,087.31 *pa*

Example 3: Equalisation

Once the correct compensation has been calculated for the male, we then need to consider equalisation in respect of GMP.

In order to ensure benefits are equal, we apply the following steps:

1. calculate benefits for an equivalent member of the opposite sex to account for differences in the GMP accrual rate
2. calculate opposite sex compensation at the Relevant Time using the underpin approach (this accounts for differences in the GMP payable age)
3. compare the opposite sex compensation to compensation based on the true sex

The member is paid compensation based on whichever sex gives higher compensation at the Relevant Time.

As per example 1, the male to female factor to convert male GMP into female GMP for a member born on 5 December 1946 is 1.1786.

The female equivalent GMP is therefore:

$$392.41 * 1.1786 + 303.35 * 1.1786 = 462.49 + 357.53 = £820.02 \; pa$$

As per example 1, scenario 2 applies and the underpin will bite.

Statutory minimum underpin = (1,233.74 + 511.83 + 74.88) * 0.9
= £1,638.41 *pa*

Therefore FAS assistance at the wind-up date is:

NPA 60 element	**NPA 65 element**
= 1,638.41 * 1.108	$= \begin{pmatrix} 953.76 * 1.181 + \\ 306.87 * 1.181 \end{pmatrix} * 90\%$
= £1,815.36 pa	= £1,339.92 *pa*

where 1.108 = FAS tranching factor for an NPA of 60 and a FAS NRA of 65

Total assistance = 1,815.36 + 1,339.92 = £3,155.28 *pa*