

Pensions Client  
Directorate

**Consultation Document**

The Occupational Pension  
Schemes (Contracting-out)  
(Amendment) Regulations 2009

September 2008

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## **Preface**

This consultation document seeks views on the draft Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009. The draft Regulations:

- Specify how actuarial equivalence must be determined in order to convert the Guaranteed Minimum Pensions of members into scheme benefits.
- Set out conditions under which, and period for which, survivors' benefit must be provided post-conversion.

Your comments on any aspect of the draft Regulations would be welcomed. This document is on the Department's website at:

<http://www.dwp.gov.uk/consultations/2008/>

## **How to respond to this consultation**

The consultation period began on 2 September 2008 and will run until 28 October 2008. Please ensure that your response reaches us by that date.

Please send your responses, preferably by email, to:  
[ContractingOut@dwp.gsi.gov.uk](mailto:ContractingOut@dwp.gsi.gov.uk) or by post to:

**Maureen Rafferty**  
**Department for Work and Pensions**  
**3<sup>rd</sup> Floor**  
**Adelphi**  
**1-11 John Adam Street**  
**London WC2N 6HT**

Tel: 020 7962 8742

When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of a larger organisation please make it clear who the organisation represents, and where applicable, how the views of members were assembled. We will acknowledge your response.

We have sent this consultation document to people and organisations who have already been involved in this work or who have expressed an interest. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

The information you send us may need to be passed to colleagues within the Department for Work and Pensions and published in a summary of responses received, and referred to in the published consultation report.

## **The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009**

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information which is provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this. We cannot guarantee confidentiality of electronic responses even if your IT system claims it automatically.

If you want to find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact: Charles Cushing, Department for Work and Pensions, Adjudication and Constitutional Issues, Information Policy Division, Freedom of Information Unit, Adelphi 1-11 John Adam Street, LONDON, WC2N 6HT (Tel: 020 7962 8581, [charles.cushing@dwp.gsi.gov.uk](mailto:charles.cushing@dwp.gsi.gov.uk) or [carol.smith14@dwp.gsi.gov.uk](mailto:carol.smith14@dwp.gsi.gov.uk))

More information about the Freedom of Information Act can be found on the website of the Department of Constitutional Affairs.

### **The consultation arrangements**

The Cabinet Office Code of Practice on Consultation advises that a minimum of 12 weeks is appropriate for public consultations, unless there are good reasons for a shorter period. In this case, the consultation document is of a technical, specialised nature and of interest to a limited number of stakeholders. The Minister has therefore agreed that a limited consultation of 8 weeks is appropriate.

### **Feedback on this consultation**

We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator: Roger Pugh, Department for Work and Pensions' Consultation Coordinator, Room 2A, Britannia House, 2 Ferensway, Hull HU2 8NF (01482 609571, [roger.pugh@dwp.gsi.gov.uk](mailto:roger.pugh@dwp.gsi.gov.uk)).

In particular, please tell us if you feel that the consultation does not satisfy Cabinet Office Code of Practice on Consultation. Please also make any suggestions as to how the process of consultation could be improved further.

If you have any requirements that we need to meet to enable you to comment, please let us know.

### **What will we do after the consultation?**

A Government Response to the consultation will be published. We will aim to publish this summary within three months of the consultation closing. The summary of responses will be available on the Department's website: <http://www.dwp.gov.uk/consultations/2008/>

## The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009

### Introduction

1. Sections 24A to 24H of the Pension Schemes Act 1993 (inserted by section 14 of the Pensions Act 2007) contain a facility to allow contracted-out occupational pension schemes to convert members' Guaranteed Minimum Pensions (GMPs) into ordinary scheme benefits on the basis of actuarial equivalence. Trustees and sponsoring employers may choose this facility in order to simplify their benefit structures provided certain conditions are satisfied. By converting members' GMPs into scheme benefits, schemes will no longer need to separately track and monitor GMPs and consequently, with streamlined processes in place, members should be able to understand their pension rights more easily.
2. During passage of the Pensions Act 2007 through Parliament, at Commons Committee Stage, Mr Plaskitt, the Parliamentary Under-Secretary of State for Work and Pensions, gave a commitment to consult on the Regulations under sections 24A to 24H. The draft Regulations referred to are attached at Annex A.

### Background

3. Between 6 April 1978 and 5 April 1997, defined benefit occupational pension schemes could be contracted out of the State system if they promised that the pension they provided would not be lower than a specified minimum, calculated in a given manner (the Guaranteed Minimum Pension).
4. Although some employers calculate their GMP liabilities on a regular basis, it does not have to be calculated unless the individual leaves contracted out employment. The calculation should be undertaken when the individual reaches State Pension age, stops working for the sponsoring employer in contracted out employment or when they die. The calculation can be quite complex depending on the type of case.
5. The draft Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009 set out the conversion conditions which schemes need to adhere to in order to achieve actuarial equivalence. It will be for the trustees (or where there are no trustees, the scheme managers) of a contracted-out, defined benefit pension scheme to decide whether or not to use GMP conversion in order to streamline their benefit structure and administrative processes.

## Employer and Member consultation

6. It should be noted that trustees cannot convert the GMPs until they have the consent of the employer and have taken all reasonable steps to consult with affected members. All affected members should be given an explanation of the conversion and have an opportunity to make representations to the trustees, before the trustees make the final decision on whether or not to go ahead with the conversion.

## Actuarial Equivalence

7. The concept of actuarial equivalence has been in existence for some time and is often used in occupational pension schemes. Where the trustees of an occupational pension scheme decide on GMP conversion, the legislation requires them to make the conversion by means of actuarial equivalence.
8. In order to achieve actuarial equivalence, it is necessary to compare the actuarial value of members' rights before and after a proposed change to an occupational pension scheme and ensure that the value does not fall as a result of the change.
9. The attached draft Regulations specify how actuarial equivalence must be determined in order to convert the Guaranteed Minimum Pensions of members into scheme benefits.
10. Post-conversion, current GMP legislation would cease to apply to the pension rights accrued from 1978 to 1997. Legislative provisions (such as the revaluation requirements) that applied to scheme benefits for the period in question should continue to apply to the benefits that replace the GMP.
11. It is important to note that the legislation cannot be used to change from a defined benefit to defined contribution scheme.

## Survivors' Benefits

12. Currently half of all GMP rights accrued:
  - From 1978 to 1997 must be used to provide a survivor's benefit for a widow
  - From 1988 to 1997 must be used to provide a survivor's benefit for a widower or surviving civil partner
13. Where a scheme chooses GMP conversion, there is still a requirement on the scheme to provide a survivor's benefit. The payment of survivors' benefits is subject to the conditions, and for the periods, that are prescribed in the draft Regulations.

## Regulatory Impact Assessment

14. As the Regulatory Impact Assessment (RIA) for the Pensions Act 2007 included details of the impact of GMP conversion, and as adoption of GMP conversion is voluntary, it is not proposed to prepare a further RIA. An extract from the RIA for the Pensions Act 2007 is at Annex D.

## Commentary on draft Regulations

### Regulation 1

A general provision setting out the date the Regulations are to come into force.

### Regulation 2

#### **Conversion of guaranteed minimum pension into other benefits: actuarial equivalence**

Regulation 2 inserts a new regulation 69A into The Occupational Pension Schemes (Contracting-Out) Regulations 1996. The new Regulation specifies how actuarial equivalence is to be determined for the purpose of GMP conversion. It provides that the trustees are responsible for determining actuarial equivalence having obtained advice from the actuary about what assumptions should be used.

The actuary will make the actuarial equivalence calculations and the new regulation specifies that the actuary should do this, using the assumptions chosen by the trustees and ignoring the value of certain benefits (such as benefits that have been surrendered, commuted or forfeited). The new Regulations also provide that the actuary must certify when actuarial equivalence has been achieved.

#### **Conversion of guaranteed minimum pensions into other benefits: survivors' benefits**

Regulation 2 also inserts a new regulation 69B into The Occupational Pension Schemes (Contracting-Out) Regulations 1996.

Regulation 69B sets out the circumstances and period in which a converted scheme must provide a survivor's benefit. This is achieved by cross-referring to the existing survivors' benefit requirements in Section 17(1), (4A) and (5) of the Pension Schemes Act 1993 and Regulations 57 and 58 of The Occupational Pension Schemes (Contracting-Out) Regulations 1996.

The intention is that the converting scheme should provide survivors' benefits in the same circumstances and for the same period as currently applies under legislation governing GMP survivors' benefits

## Consultation questions

1. You are invited to comment on whether you think the draft Regulations will allow GMPs to be properly converted into ordinary scheme benefits (accrued from 1978-1997) whilst retaining the requirement for the converting scheme to pay a survivor's benefit.
2. You are also invited to comment on whether you consider the roles of the trustee and actuary to be clearly defined and correctly balanced for the purposes of achieving actuarial equivalence.
3. In considering the draft regulations, is it clear that the value of the post and pre conversion benefits should be actuarially equivalent on the conversion date? Should the regulations be more specific in setting out the conversion date?
4. Do you, as an employer or trustee consider that you will simplify your administrative processes by converting GMPs into scheme benefits? If so, when do you envisage this will happen?
5. Please tell us whether you think GMP conversion should be extended further. For example, should it be available in individual cases of early or ill health retirement?
6. The provisions introduced by the Pensions Act 2007 include powers to make Regulations placing restrictions on onward transfers from schemes which have converted their GMPs. We are not planning, at this stage, to use this power because:
  - In the case of an individual transfer, the scheme member would be able to choose whether or not the transfer should take place and could choose not to transfer his rights if the receiving scheme did not provide acceptable benefits.
  - In the case of bulk transfers, although individual consent is not required, the benefits in the receiving scheme must be certified as "broadly, no less favourable" by the actuary, providing protection to the benefits to be transferred.

Do you think additional restrictions should be placed on onward transfers from schemes which have converted their GMP liabilities? For example, to require the receiving scheme to provide survivors' benefits on the same basis as the transferring scheme?

## ANNEX A

*Draft Regulations laid before Parliament under section 186(3)(a) of the Pension Schemes Act 1993, for approval by resolution of each House of Parliament.*

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D R A F T   S T A T U T O R Y   I N S T R U M E N T S

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### 2009 No. [consultation]

## PENSIONS

### The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009

*Made* - - - -

*Coming into force* - -

*6th April 2009*

The Secretary of State for Work and Pensions makes the following Regulations in exercise of the powers conferred by sections 24B(5), 24C, 181(1), 182(2) and (3) and 183(1) of the Pension Schemes Act 1993<sup>(1)</sup>.

[In accordance with section 185(1) of that Act<sup>(2)</sup>, the Secretary of State has consulted such persons as he considers appropriate.]

A draft of these Regulations has been laid before Parliament in accordance with section 186(3)(a) of that Act<sup>(3)</sup> and approved by a resolution of each House of Parliament.

#### Citation and commencement

1. These Regulations may be cited as the Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009 and shall come into force on 6th April 2009.

#### Amendment of the Occupational Pension Schemes (Contracting-out) Regulations 1996

2.—(1) The Occupational Pension Schemes (Contracting-out) Regulations 1996<sup>(4)</sup> are amended in accordance with this regulation.

(2) After regulation 69 (miscellaneous provisions affecting section 51 of the 1993 Act), insert—

#### “Conversion of guaranteed minimum pensions into other benefits: actuarial equivalence

**69A.**—(1) Actuarial equivalence for the purpose of Condition 1 in section 24B of the 1993 Act (the conversion conditions) is to be determined in accordance with this regulation.

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<sup>(1)</sup> 1993 c.48. Sections 24B and 24C were inserted by section 14(3) of the Pensions Act 2007 (c.22). Section 181(1) is cited for the meaning it gives to “prescribed” and “regulations”. Section 183(1) was amended by paragraph 79 of Schedule 5, and paragraph 15(a) of Schedule 6, to the Pensions Act 1995 (c.26).

<sup>(2)</sup> Section 185(1) was amended by paragraph 46 of Schedule 3, and paragraph 80(a) of Schedule 5, to the Pensions Act 1995.

<sup>(3)</sup> Section 186(3)(a) was inserted by section 14(12)(a) of the Pensions Act 2007.

<sup>(4)</sup> S.I. 1996/1172.

- (2) The trustees are responsible for determining actuarial equivalence.
- (3) In determining actuarial equivalence, the trustees must—
  - (a) obtain advice from the actuary about what assumptions should be used,
  - (b) decide, having considered that advice from the actuary, what assumptions will be used, and
  - (c) arrange for the actuary to calculate the actuarial value of the post-conversion benefits and the pre-conversion benefits in accordance with paragraph (4).
- (4) In calculating the actuarial values mentioned in paragraph (3)(c), the actuary must—
  - (a) use the assumptions chosen by the trustees under paragraph (3)(b), and
  - (b) ignore the value of any—
    - (i) benefits that have been surrendered, commuted or forfeited,
    - (ii) amounts that have been paid in respect of any benefits,
    - (iii) amounts in respect of any benefits that, before the conversion date, became due to be paid, and
    - (iv) discretionary benefits that might be awarded in the future.
- (5) When the actuarial values mentioned in paragraph (3)(c) have been calculated, the actuary must send the trustees a certificate if the post-conversion benefits are actuarially at least equivalent to the pre-conversion benefits.
- (6) The certificate must state that—
  - (a) the calculations have been completed, and
  - (b) the post-conversion benefits are actuarially at least equivalent to the pre-conversion benefits.

#### **Conversion of guaranteed minimum pensions into other benefits: survivors' benefits**

**69B.**—(1) For the purposes of Condition 4 in section 24B of the 1993 Act (the conversion conditions), the circumstances and period in which the converted scheme must provide survivors' benefits are prescribed in this regulation.

(2) The circumstances for widows are those mentioned in section 17(1), (4A) and (5) of the 1993 Act (minimum pensions for widows and widowers)<sup>(5)</sup>.

(3) The circumstances for widowers and civil partners are those mentioned in—

- (a) section 17(1) and (4A) of the 1993 Act, and
- (b) regulation 57<sup>(6)</sup>.

(4) The periods for widows are determined in accordance with section 17(1), (4A) and (5) of the 1993 Act.

(5) The periods for widowers and civil partners are determined in accordance with—

- (a) section 17(1) and (4A) of the 1993 Act, and
- (b) regulation 58<sup>(7)</sup>.

Signed by authority of the Secretary of State for Work and Pensions.

*Name*  
Minister of State,

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<sup>(5)</sup> Section 17(1) was amended by S.I. 2005/2050, section 17(4A) was inserted by paragraph 1(1) of Schedule 5 to the Child Support, Pensions and Social Security Act 2000 (c.19) and amended by S.I. 2005/2050 and section 17(5) was amended by paragraph 1(2) of Schedule 5 to that Act.

<sup>(6)</sup> Regulation 57 was amended by S.I. 2005/2050.

<sup>(7)</sup> Regulation 58 was amended by S.I. 2005/2050.

## The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009

Date

Department for Work and Pensions

### **EXPLANATORY NOTE**

*(This note is not part of the Regulations)*

These Regulations amend the Occupational Pension Schemes (Contracting-out) Regulations 1996 (S.I. 1996/1172) (“the 1996 Regulations”).

Guaranteed Minimum Pensions (“GMP”) can be converted into other pension benefits under new provisions introduced by section 14 of the Pensions Act 2007 (c.22). These Regulations relate to two conditions in connection with that conversion.

Regulation 2(2) inserts a new regulation 69A into the 1996 Regulations. It makes provision for how trustees are to determine whether a pension scheme member’s benefits after the conversion of their GMPs are actuarially at least equivalent to what they were before the conversion. The trustee must take advice from the actuary and decide the assumptions to be used. The actuary must use the assumptions and ignore certain amounts to determine the actuarial values of the benefits. If the benefits are actuarially at least equivalent, the actuary must send the trustees a certificate.

Regulation 2(2) inserts a new regulation 69B into the 1996 Regulations. It prescribes the circumstances in which, and the periods during which, survivors’ benefits must be provided after conversion. The circumstances and periods are the same as requirements for survivors’ benefits in existing legislation on GMPs.

## **Annex B**

### **List of those consulted**

Age Concern  
Association of British Insurers  
Association of Consulting Actuaries  
Association of Independent Financial Advisers  
Association of Member-Directed Pension Schemes  
Association of Pension Lawyers  
British Chambers of Commerce  
Confederation of British Industry  
Consumers Association  
DBERR  
EBS  
Engineering Employers Federation  
Equality and Human Rights Commission  
Fawcett Society  
Federation of Small Businesses  
Financial Services Authority  
Government Actuaries Dept  
Help the Aged  
Hewitt  
HM Treasury  
HMRC  
HSBC  
Institute and Faculty of Actuaries  
Institute of Chartered Accountants  
Institute of Chartered Accountants in Scotland  
Institute of Directors  
Lane Clark & Peacock  
Law Society  
Law Society of Scotland  
Legal & General  
Linklaters  
Northern Ireland  
Norwich Union  
NAPF  
National Consumers Council  
Office of Fair Trading  
TPAS  
Pensions Management Institute  
Pensions Policy Institute  
Pensions Ombudsman  
Pension Protection Fund  
Premier Pensions Management  
Price Waterhouse Coopers  
Prudential  
Punter Southall  
Scottish Equitable

**The Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009**

Scottish Life  
Scottish Executive  
Scottish Widows  
Technical Connection  
Society of Pension Consultants  
Standard Life  
The Pensions Regulator  
Trades Union Congress  
Watson Wyatt  
Welsh Assembly

## **Annex C**

### **Simple guide explaining how Guaranteed Minimum Pension (GMP) conversion could work**

#### **1. Introduction**

1.1 Under the new provisions introduced by section 14 of the Pensions Act 2007, contracted-out defined benefit occupational pension schemes will be permitted to convert their statutory Guaranteed Minimum Pensions (GMPs) into scheme benefits by way of actuarial equivalence.

1.2 It should be noted that while the conversion of GMPs will allow schemes to discharge their liability for paying GMPs, legislation that governs scheme benefits in general (eg. revaluation, equality, etc) will apply to the converted benefits.

1.3 This Annex describes how the conversion process might work. It is not a guide to the legislation or an instruction manual and should not be taken to have any force in law. The final interpretation of the law lies with the Courts, not with the Department.

#### **2. Background**

2.1 Legislation permitted employees to contract-out of the state Additional Pension (then the State Earnings Related Pension Scheme - SERPS) between 1978 and 1997 provided certain criteria were met.

2.2 Defined benefit (DB) occupational pension schemes which provided benefits broadly equivalent to the Additional Pension (SERPS) could be contracted out. Employees who were members of a contracted-out occupational scheme paid reduced National Insurance contributions and had, as a consequence, a reduced entitlement to SERPS. The employers of members who were contracted out also paid reduced National Insurance contributions.

2.3 In order for a DB scheme to be contracted out between April 1978 and April 1997 the sponsoring employer had to ensure that the scheme's rules produced a pension at least as good as a statutory minimum - the Guaranteed Minimum Pension (GMP). While GMPs no longer accrue since 1997, past rights still exist.

#### **3. How GMPs could be converted**

##### **Initial activity**

3.1 The trustees will have to decide as a matter of principle that they want to convert the GMPs provided by the scheme. Given that a conversion exercise initiated by the trustees cannot go forward without the employer's

consent, we assume that this matter will have been discussed with the employer before the trustees reach their decision.

3.2 The trustees will need to decide **which liabilities will be converted**. They could decide to convert all the GMP liabilities, or to convert only those causing the most administrative difficulties. For instance, they could decide to convert liabilities for deferred members only; or everyone except pensioners (although when making this decision they will have to bear in mind the effect of various anti-discrimination laws and should consider whether they need to take legal advice).

3.3 The trustees will also need to decide **what the GMPs will be converted into**. The legislation allows changes to scheme rules to be made where they are needed, or desirable, to accommodate the conversion of the GMP. The type of change envisaged under this rule are:

- (a) amending any scheme rules which would effectively require the GMP to still be paid;
- (b) omitting any obsolete reference to a GMP in any of the other scheme rules; or
- (c) removing any element of double provision in the scheme rules caused by the conversion.

3.5 In complying with the GMP conversion process it is important to note that:

- Post-conversion benefits must be actuarially at least equivalent to the pre-conversion benefits (though this does not affect the ongoing accrual of benefits after the conversion process is completed).
- Where a pensioner's GMP is converted, the trustees must ensure the pension in payment does not go down at the point of conversion.
- The trustees of the scheme will not be permitted to change accrued DB benefits into Defined Contribution benefits.
- The scheme must still provide a pension for a surviving spouse or civil partner.
- There are procedural requirements that must be followed. These concern: employer consent; consultation with scheme members and notifications to scheme members and HMRC.

3.6 The trustees will have to decide **what actuarial assumptions** should be made in determining actuarial equivalence, after seeking advice from their actuary, generally the scheme actuary, on mortality levels; rates of future inflation etc.

3.7 Once these decisions have been made, trustees will then need to seek the sponsoring employer's formal consent to these proposals. The conversion cannot go ahead without that consent.

## **Survivors' Benefits**

3.8 The legislation requires the scheme to continue to provide survivors' benefits and the provisions mirror the existing legislative requirements. The benefits provided must be at least half the entitlement accrued from 1978 to 1997 where the member leaves a widow. Where the member leaves a widower or surviving civil partner, the benefits must be at least half the entitlement accrued between 1988 and 1997.

3.9 Section 17 of the Pension Schemes Act 1993 sets out that a survivor's GMP is payable where there is entitlement to one of the following state benefits:

- A Category B retirement pension
- A Bereavement Benefit
- A Widowed Parent's Allowance

Or where the survivor was aged over 45 when bereavement benefit ended, and the survivor has not:

- remarried or entered into another civil partnership or
- begun living with someone as if they were married or in a civil partnership.

## **Consultation**

3.10 Trustees must take all reasonable steps to conduct a consultation exercise before going ahead with any conversion, unless the scheme is in wind-up when the conversion process begins.

3.11 The legislation says that the scheme must take reasonable steps to consult affected members and survivors.

3.12 The term "reasonable steps" is there to assist schemes which, after making reasonable attempts, are not able to contact an individual member. The term reasonable steps is not defined, as they will differ depending on the circumstances.

3.13 It may be helpful for the consultation to include an estimate of the converted benefits for each member so as to make the effect of conversion clear.

3.14 After the end of any consultation period the trustees will have to consider the responses received and make a decision whether to proceed with GMP conversion or not. It may be necessary to make a final calculation to produce the final figures.

## **Conversion**

3.15 To begin the conversion, the scheme will have to establish each affected member's GMP entitlement. It is assumed that part of this exercise will involve the scheme requesting reconciliation of the scheme records with the information held by HM Revenue and Customs (the National Insurance Contributions Office - NICO).

3.16 The actuary will, using the actuarial assumptions agreed by the trustees, calculate the value of the current accrued rights and convert that value into rights under the new structure of scheme benefits. The trustees must ensure that, on an individual level, the rights obtained after conversion are at least of the same actuarial value as the rights before conversion. The actuary must advise the trustees whether those rights do have at least the same actuarial value.

3.17 The actuary may use the same method for GMP conversion as the scheme uses for calculating transfer values. However, where an individual is an active member on the day of conversion, the trustees will need to specify an assumption for when that individual will leave pensionable service, since this is likely to affect the results of the actuarial equivalence calculation.

3.18 Once actuarial equivalence has been achieved, the actuary will certify that fact to the trustees and conversion can then take place. The scheme will notify each affected member within a reasonable length of time of the conversion having taken place. It is expected that members will be notified of their new rate of benefit and HMRC notified of the details of members whose benefits have been converted.

3.19 On conversion, trustees will be discharged of their liability to pay a GMP, provided the conversion has been done in accordance with the legislation.

## **Actuarial equivalence and equality**

3.20 The law requires the overall pension based on rights that accrued from 17 May 1990 paid to a man to be the same as that which would be payable to a woman in the same circumstances (and vice versa). The conversion of GMPs will not relieve trustees of this requirement.

## **4. Regulation of the process**

4.1 Individuals will retain their current right to complain to the Pensions Ombudsman if they believe they have suffered injustice as a result of maladministration, or have a dispute over fact or law. It is envisaged that most complaints would be from individuals who do not agree with the way conversion has affected their own position. For instance, that they were not consulted; should have been given longer to respond; the calculation of the GMP was inaccurate; the scheme benefits given to replace the GMP were calculated wrongly.

4.2 The Pensions Regulator has been given the responsibility for overseeing the conversion process and will be able to consider complaints from members about that process. There are two areas in particular that would be central to the Regulator's remit:

- The proper conduct of the consultation process; and
- The actual conversion on the basis of actuarial equivalence.

4.3 The Regulator will be able to prevent the conversion process going forward whilst concerns are investigated.

4.4 Subsequently, the Regulator will have general powers to, where appropriate, require schemes to make good any deficiencies. In extreme cases, the Regulator will be able to order the trustees to "unpick" the conversion.

## **5. Transfers**

5.1 Where an individual member leaves a scheme (because, for instance, the member has ceased to work for the sponsoring employer) and wishes to transfer their occupational pension rights, the legislation will permit the "old" scheme to convert that person's GMP on an individual level prior to the transfer. Where such transfers take place, the transferring scheme would need to notify NICO.

5.2 The "old" scheme does not have to offer the option of GMP conversion to the individual. In addition, the individual's consent to a transfer is required and, therefore, if the member so wishes, he/she may retain his/her accrued pension rights, including the GMP, in the original scheme.

## **6. The Contracted-out Deduction**

6.1 At present, where a person has a GMP entitlement, a deduction is made from his entitlement to certain social security benefits (Retirement Pension; Widow's Pension; Widowed Parent's Allowance; Widowed Mother's Allowance; Long Term Incapacity Benefit). This is to take account of the fact that the individual concerned has paid a reduced level of National Insurance contributions whilst in contracted out employment.

6.2 In effect the total GMP(s) applicable to the individual is/are deducted from the gross entitlement to the SERPS and the balance, if any, is paid. This comparison is made each year - as the GMP is indexed differently to the SERPS, the relationship between the two amounts can change.

6.3 When a scheme converts its GMP liabilities, the GMP will no longer exist. However, there will still be a need to make a reduction in the relevant social security benefits, in order to prevent the double provision that would otherwise occur.

6.4 A notional GMP will be calculated by NICO for those members who have been converted. This will basically be calculated in the same manner as if the person had not had his GMP converted.

6.5 Anyone who remains an active member of the converted pension scheme until retirement will have the same contracted-out deduction in respect of that scheme as would have been applied if the GMP had not been converted. Similarly, where someone leaves contracted-out employment and his accrued rights are retained in the converted scheme, NICO will apply the same revaluation rate to the contracted-out deduction as was previously used by the converting scheme.

6.6 Anyone who transfers their converted accrued rights will have their notional contracted-out deduction calculated using full rate revaluation (ie Section 148 Orders). The difference between this amount and the amount that would have been deducted had the GMP not been converted is unpredictable as it will depend on a number of factors, including where the converted amount is transferred and whether the transferred rights remain in that arrangement until retirement. Where such transfers take place, the transferring scheme would need to notify NICO.

## Example of Conversion of Guaranteed Minimum Pensions

### Deferred pensioner with Normal Pension Age of 60

#### Pension scheme details

Normal pension age	60
Increases to deferred pension	In line with prices up to a limit of 5% a year
Increases to the pension in payment, in excess of any GMP in payment	At a fixed rate of 2.5% a year
Increase to GMP before age 60 (women) or 65 (men)	At the statutory fixed rate (6.25% a year for leavers in the period 6 April 1997 to 5 April 2002)
Increases to the GMP in payment	In line with statutory rules (no increases for the GMP earned before 6 April 1988; increases in line with prices up to a limit of 3% a year for the GMP earned from 6 April 1988 to 5 April 1997)

#### Member details

Date of birth	1 January 1955
Gender	Male
Date of joining scheme	6 April 1992
Date of leaving scheme	6 April 1997
Age at leaving	42
Deferred pension at leaving	£975 a year
GMP at leaving	£215 a year

## Conversion of the GMP

### Step 1: Calculate the member's benefit entitlement

Sample Ages	42	60	61	62	63	64	65	70	80
Pension in excess of GMP (£ pa)	760	1,757	1,795	1,833	1,872	1,912	1,184	1,343	1,729
GMP element (£ pa)	215	-	-	-	-	-	769	829	962
Total (£ pa)	975	1,757	1,795	1,833	1,872	1,912	1,953	2,172	2,691

### Step 2: Conversion

It is assumed that the pension scheme wishes to convert the GMP so that the whole of the pension is treated in line with the scheme's standard benefit provisions.

For this purpose, the scheme's actuary makes the following calculations, based on a set of actuarial assumptions about future experience (eg investment returns, rates of price inflation and life expectancy). These calculations are made as at an assumed conversion date of 1 January 2007 (when the individual is aged 52).

- (i) Actuarial value at the conversion date of benefits including allowance for the GMP = £27,000<sup>8</sup>
- (ii) Actuarial value of £1 a year of deferred pension at the conversion date based on standard scheme benefit provisions = £19.5<sup>9</sup>
- (iii) Post-conversion deferred pension at the conversion date = 27,000 / 19.5 = £1,385 a year

Again assuming the deferred pension is increased by 2.5% a year up to age 60, the member's projected post-conversion benefits would be as follows:

Sample Ages	52 <sup>10</sup>	60	61	62	63	64	65	70	80
Post-conversion pension (£ pa)	1,385	1,687	1,729	1,772	1,817	1,862	1,909	2,160	2,764

**Note:** The figures given in this example are illustrative only and should not be interpreted as indicating any particular method or assumptions that would be appropriate for conversion exercises. The figures may not sum due to rounding.

<sup>8</sup> This is, in effect, the capital sum needed to be invested at the conversion date in order to provide an income stream equal to the equalised benefits shown in Step 1, assuming that the chosen actuarial assumptions are borne out in practice.

<sup>9</sup> £19.50 is the capital sum that would need to be invested at the conversion date in order to provide an income stream equal to that from a standard scheme deferred pension of £1 per annum at the conversion date, assuming the chosen actuarial assumptions are borne out in practice.

<sup>10</sup> At this age the figure shown in this table represents the deferred pension to which the member is entitled from age 60, ignoring any increase that would be applied up to that age.

## **Annex D**

### **Extract from RIA for the Pensions Act 2007**

#### **GMP conversion**

4.41 GMP conversion would be an option for schemes; no scheme would be required to convert. The proposal would only affect DB occupational pension schemes that were contracted-out prior to April 1997.

4.42 The proposed legislation includes a requirement for trustees to obtain the prior agreement of the scheme's sponsoring employer before undertaking a conversion exercise.

4.43 There would be a one-off cost for a scheme to go through the conversion procedure, resulting from the need to modify IT software and incur legal, actuarial and other administrative costs. Once converted, a scheme will be able to benefit from ongoing administrative economies as a result of having adopted a unified benefit structure. These savings would arise through no longer having to purchase actuarial advice for GMP calculations, no longer having to deal with queries from members on their GMPs, simpler awards of benefit when members reach pensionable age and simpler uprating of pensions in payment.

4.44 Whilst costs and benefits will vary significantly according to the circumstances of the particular scheme, for the purposes of making a broad indicative estimate of the possible effects of this reform, we have assumed an average initial cost of £7,000 for smaller schemes and £12,000 for larger schemes. Using an assumption that 25-50 per cent of schemes may choose to convert their GMPs, the total initial cost across all schemes is estimated to be between £11m and £22m, with a total annual cost saving of £6m to £13m.