

LLOYDS 3: HISTORIC TRANSFERS AND GMP EQUALISATION

Introduction

The judgment has now been handed down in the third of the Lloyds hearings, which looked at transfers out from formerly contracted-out defined benefit schemes. Mr Justice Morgan decided that statutory cash equivalent transfers back to 1990 should have reflected equalised benefits and members may have a right to seek a top-up transfer payment. He noted that the trustees should now reconsider historic statutory transfers that did not reflect equalised benefits and decide what to do. The position for non-statutory individual transfers may be different, and little was said about bulk transfers.

Whilst the judgment gives some helpful clarifications, a number of questions remain, particularly as to what schemes should now do in practice in relation to re-investigating and addressing past transfers.

Background

The first Lloyds decision, in November 2018, established that the trustees of formerly contracted out schemes were obliged to adjust members' benefits for the unequal effects of guaranteed minimum pensions (**GMP equalisation**). In that hearing, transfers were briefly considered. The parties accepted that the trustees of a defined benefit scheme receiving a transfer had to equalise for the effect of unequal GMPs transferred in. But questions about whether transferring trustees were liable where past transfers had not reflected such equalisation, and the effect of statutory or scheme discharges, were deferred to this later hearing.

Past statutory transfers

The latest judgment establishes that, from 1990 onwards, where a member requested a statutory transfer of their cash equivalent, trustees should have made transfer payments that were correctly calculated and

reflected the member's right to equalised benefits. Where a cash statutory transfer payment was lower than it should have been because it did not reflect equalised benefits, there was a breach of this duty, and trustees remain liable for this to the transferring member.

There was no discharge of this liability by statute, scheme rules or the discharge documentation signed by the member. There are no time limits on claims, either under the Limitation Act 1980 or the specific forfeiture rules of the schemes in question.

In terms of remedies, members can ask the court to order the trustee to make a transfer top-up payment of the shortfall due at the date of transfer, together with interest at 1% over base. Trustees are also able to do this without a court order.

Some points to note are:

- This is a statutory duty to pay transfer values that reflect equalised benefits and so applies whenever a cash equivalent transfer is made.
- The trustee can be required to provide a top-up to the transfer payment (there is no right to a residual benefit) but it would be open to the trustee and member to agree an alternative approach.
- A scheme rules discharge provision cannot take away a right conferred by the cash equivalent legislation, which is overriding.
- In principle discharge documentation signed by the member could have taken away a right to a top-up. However, the Judge reviewed a range of Lloyds discharge documentation, and found none of these released the trustee from the liability to make a top-up transfer payment - if such a

release had been intended then the language would need to be clear and specific.

- The Judge reviewed a range of Lloyds forfeiture rules when considering time limits on claims, and found none of them applied to a claim for a top-up transfer payment - and noted it might not be possible for a forfeiture rule to apply in that way since the cash equivalent legislation is overriding.
- The Judge did not give any guidance on dealing with scenarios such as where the receiving scheme no longer exists or will not accept a transfer payment, or the individual is no longer a member of the receiving scheme, or there are conflicting claims from the receiving scheme and the transferring member.
- The position may be more complicated where the transfer was only of the excess over the GMP (and the GMP was retained): the Judge took the view that a top-up payment would provide equal treatment. This does not address the trustee's obligation if, for example, it is not possible to make a top-up payment.
- Whilst the case deals with calculation errors relating to failure to recognise GMP equalisation in the calculation of the transfer amount, the same reasoning would apply to any other error in a cash equivalent calculation.

The Judge noted that there was a breach of fiduciary duty when the inadequate transfer payment was made: trustees do need, proactively, to consider their obligations, remedies available to members, the fact there is no time bar to claims and then decide what to do.

Non-statutory individual transfers

Non-statutory individual transfers, such as partial transfers or transfer applications made in the 12 months before normal pension age is reached, which were made under scheme rules and preservation legislation, were treated differently. The Judge found that, as the power to transfer had been exercised, a transferring member no longer has rights under the transferring scheme. The member may be able to ask the court to set aside the transfer decision on the grounds that the trustee committed a breach of duty when exercising the transfer power, but otherwise the member cannot require the trustee to come to a different decision on the amount of the transfer payment. This would require an investigation into all of the relevant circumstances.

Bulk transfers

The consideration given to bulk transfers in this case was limited. The Judge agreed that where a transfer is made on mirror image terms, complies with the preservation of benefit legislation and all of the members' "short service" benefits are transferred, the transferring trustee is discharged from any obligation to equalise.

What next?

The judgment establishes some clear legal principles, but leaves open the question of how to apply these in practice, and some difficult questions remain.

Scheme specific documentation

There may be room for a different result in relation to statutory transfers, if scheme or member specific discharges or scheme forfeiture provisions were sufficiently broadly drafted, although the Judge found that none of the Lloyds provisions under consideration assisted.

Initial transfer audit

There will be real practical problems in trustees considering the appropriate way to deal with statutory transfers out over the past 30 years. As an initial step, if this has not already been considered in the context of a GMP equalisation exercise, trustees could identify:

- what records they hold relating to transfers out,
- whether they can identify individual transfers made on a statutory basis,
- whether they can identify the type of receiving scheme (defined benefit or money purchase),
- whether details of the underlying benefits are still available.

Other no further liability cases

As part of this exercise, trustees may want to consider and take advice on other types of no further liability cases - ie payment of lump sums (such as small lump sums, trivial commutation and serious ill-health lump sums).

Potential remedies

Where top-up payments to past unequalised transfers are required, it is inevitable given the period of time elapsed that it will be impractical in many cases to make a payment to the original receiving scheme, so alternative

ways of providing value will need to be explored, including direct payments to the member from either the scheme or the employer.

Transfers in

It remains the case that defined benefit schemes that have received transfer payments are required to provide equalised benefits, including in relation to benefits that accrued in the transferring scheme before the transfer. The interaction of the legal obligations of the transferring trustee with the receiving trustee's obligation will need specific consideration. In the case of bulk transfers, it would be necessary to re-examine the transfer documentation to determine whether the receiving trustee is able to require any further transfer payment from the transferring trustee.

Impact on buy-ins/outs

There are different considerations depending on whether a scheme is at the post buy-out winding-up stage,

between buy-in and buy-out or pre buy-in. Care is needed both on the benefit specification insured, any specific insurer obligation to effect GMP equalisation and on the terms of any residual risks insurance and trustee run-off insurance. We would expect that the GMP equalisation position on past transfers out would typically not be insured, but this will depend on the policy wording. In any case there are important practical considerations as to who would run calculations and implement any additional payments, and the timing of both. Schemes will also need to consider whether there are any claims for top-ups relating to transfers in.

GMP equalisation exercises

Where GMP equalisation exercises are already under way, consideration should now be given as to how and when to manage past transfers out and to what extent a different approach is needed, particularly where the underlying data is not available.

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