HM Treasury

Public Service Pensions: Guaranteed Minimum Pension indexation consultation:

Government response to consultation

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Executive summary

1.1 Between 7 October 2020 and 30 December 2020 the government consulted on three options to ensure that it continues to meet past commitments made to public servants regarding the full indexation of public service pensions, including any GMP element related to membership of a public service pension scheme, beyond 5 April 2021.

1.2 In 2016 the government introduced the new State Pension (nSP). This greatly simplified the State Pension system, but in doing so removed the mechanism whereby public service schemes could continue to equalise and index pension payments for those who reached their State Pension age (SPa) from then onwards.

1.3 An 'interim solution' has been in place since 2016, which has ensured that the government continues to meet past indexation commitments made to those public servants with a GMP related to membership of a public service pension scheme who reach SPa between 6 April 2016 and 5 April 2021. In addition, the 'interim solution' ensures the great majority of men and women who reach SPa during this period will receive equalised pension payments.

1.4 This consultation received 31 responses, from private individuals, pension advisers, public service pension schemes / scheme administrators, local government bodies / pension funds, trade unions and other representative organisations and private sector organisations.

1.5 The majority of respondents favoured the permanent extension of full indexation for those public servants with a GMP reaching State Pension age (SPa) from 6 April 2021, which was in line with the preferred stated policy of public service pension schemes.

1.6 Respondents highlighted a number of reasons for this, most of which were set out in the consultation. These include public service pension schemes' limited capacity to undertake additional non-compulsory work; outstanding technical issues relating to conversion; as well as the diminishing benefits of conversion as the numbers of members below SPa with a GMP reduce.

1.7 The government has based its decision on the responses received to the consultation, along with further considerations such as those set out in the consultation document, including public service pension schemes' stated preferred policy option.

1.8 With this in mind, the government has decided to discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for public service pension schemes.

Chapter 2
Introduction

Box 2.A: Glossary of terms

Contracting out: From 1978 to 1997 employers which offered defined benefit occupational pension schemes could "contract-out" their employees from the additional State Pension (AP) provided the scheme took the responsibility for paying a Guaranteed Minimum Pension (GMP) that was broadly equivalent to the AP to which the member would otherwise have been entitled, had they not been contracted out. Because they were not going to receive a full AP entitlement from the State Pension system, workers who were contracted out paid a reduced rate of National Insurance contributions.

The AP receives full inflation protection when it is in payment and the conditions for increasing UK state pensions are met. However, many occupational pensions did not increase once in payment, so inflation protection for GMPs was in effect provided through the AP. Under general occupational pensions legislation, pension schemes do not have to provide inflation protection for GMPs earned between 1978 and 1988 once they are in payment; and GMPs earned between 1988 to 1997 must be price protected by 3 per cent or price inflation, whichever is less, with inflation above that 3 per cent level being in effect provided through the AP.

Conversion: In the case of public service pension schemes, conversion would see the GMP converted into a normal scheme benefit, usually equating £1 of normal scheme benefit for every £1 of GMP. This method has a similar outcome to full indexation, but public service schemes would no longer need to apply GMP legislation for members whose GMPs have been converted.

Equalisation: Pensions accrued in respect of pensionable service rendered after 16 May 1990 have to be equal between men and women. However, GMPs give rise to inequalities between men and women for a number of reasons, including different GMP ages and accrual rates for men and women. Under the old State Pension system, public service pensions and the AP operated together to provide a mechanism that equalised public service pension payments.

Full indexation (interim solution): This is the current policy in place (so far under an "interim solution"), which requires public service pension schemes to directly meet the cost of indexing the GMP for most members who reach State Pension age (SPa) after 5 April 2016, but not for those reaching SPa after 5 April 2021. This also reduces the likelihood of inequalities being introduced between men and women by the abolition of the AP. Full indexation ensures that no individual is worse off as a result of no longer in effect receiving indexation on their GMP through the AP. Indexation of the total public service pension, including any GMP, is provided for in the combined effect of the GMP Increase Orders (made by DWP), the Pensions Increase (Review) Orders (made by HM Treasury) and the Treasury Direction under Section 59A of the Social Security Pensions Act 1975. Full indexation also applies to the benefits of survivors, ensuring that they receive full increases on their inherited GMP.

Indexation: In this particular context, indexation means adjusting pension payments by reference to a prices index, to maintain purchasing power after allowing for inflation.

Old State Pension: The State Pension system, providing for a Basic Pension and a Second Pension, that applies to people reaching their State Pension age (SPa) before 6 April 2016. It was replaced for most people reaching their SPa from 6 April 2016 onwards by the new State Pension.

Background

2.2 On 6 April 2016 the government introduced the new State Pension (nSP) for people reaching their State Pension age (SPa) from that date onwards. The reforms simplified state pension provision, but it removed the additional State Pension (AP) for this group of people[1].

2.3 Between 6 April 1978 to 5 April 1997, salary-related defined benefit occupational pension schemes could be "contracted-out" from the AP[2], provided the scheme took the responsibility for paying a Guaranteed Minimum Pension (GMP)from age 60 for a woman or 65 for a man. On reaching this age, members would generally have built up a GMP of a broadly similar amount to the AP to which they would otherwise have been entitled, had they not been contracted out.

2.4 Because they were not going to receive a full AP entitlement from the State Pension system, workers who were contracted out paid a reduced rate of National Insurance contributions.

2.5 The AP receives full inflation protection when it is in payment and the conditions for increasing UK state pensions are met. However, many occupational pensions did not increase once in payment, so inflation protection for GMPs was in effect provided through the AP. Under general occupational pensions legislation, pension schemes do not have to provide inflation protection for GMPs earned between 1978 and 1988 once they are in payment. However, schemes must price protect GMPs earned between

[1] There are a few cases where someone attaining SPa after 5 April 2016 may still be entitled to an AP because they are receiving widowed mother's allowance or widowed parent's allowance or widow's pension

[2] Whilst employees effectively gave up their right to most elements of the AP, they still had an entitlement to receive indexation of their AP as part of their State Pension, to the extent that the indexed AP was equal to or greater than their GMP.

1988 to 1997 by 3 per cent or price inflation, whichever is less, with inflation above that 3 per cent level being in effect provided through the AP.

2.6 Under these arrangements, public service pensions and the additional State Pension system worked together to provide a mechanism that fully indexed and equalised most public service pension payments, in line with commitments made to members by previous governments. However, the removal of the AP meant that public service pension scheme members who reached their State Pension age from 6 April 2016 onwards no longer automatically have their pension payments fully indexed and equalised.

The Interim Solution

2.7 On 1 March 2016, the government introduced an 'interim solution', full indexation, to ensure that those public servants who reached SPa after 5 April 2016 and before 6 December 2018 continued to have their GMPs earned in public service fully indexed by their public service pension scheme.

2.8 Between November 2016 and February 2017, the government consulted on a long-term solution to GMP indexation and equalisation. The consultation considered three methodologies, including 'full indexation' and 'conversion'. On 22 January 2018, the government published its response to the consultation and announced the extension of full indexation until 5 April 2021. This ensured that those public servants who reach their SPa on or before this date would have their GMPs fully indexed by their public service pension scheme[3].

2.9 As part of the consultation response, the government also said that it would review the rationale for implementing the alternative methodology of conversion as a long-term solution and its feasibility before April 2021. It agreed that HM Treasury (HMT) would consult with other government departments and public service pension schemes to decide whether a suitable conversion methodology and legislation could be brought forward to enable conversion to take place in the future. In addition, the government agreed to take account of any feasible alternative solutions that might meet indexation and equalisation requirements.

GMP indexation consultation

2.10 As set out in the consultation document, the Government Actuary's Department (GAD) were appointed to establish a possible methodology for GMP conversion. The methodology set out that conversion for public service pension schemes, in the majority of cases, should be based on a "£1:£1 conversion", where the GMP would be converted into an equal amount of 'normal' scheme pension, which is fully indexed in line with the PIA 1971. The methodology only considered those public servants yet to reach SPa, as the old State Pension system, where the AP and public service pensions

[3] The HM Treasury Direction that provided for this also provided for full indexation for those pensioners who had not yet reached their SPa but had reached their GMP age

worked together, provided for full indexation and equalisation for the great majority of pensioners who reached SPa before April 2016.

2.11 As part of a series of technical working groups, the government, with scheme administrators, considered GAD's proposed conversion methodology. In addition, the benefits of adopting conversion over full indexation were considered, along with the desire to adopt conversion in the context of existing pressures and schemes' capacity to deliver conversion by April 2021.

2.12 Following the working groups, it was the government's view that full indexation must be extended as it would not be possible to deliver conversion by April 2021. GAD's proposed conversion methodology, along with attendees of the technical working groups, highlighted the implications of adopting a new long-term methodology and raised a number of equalisation issues that require further consideration before conversion could take place.

2.13 Following this, on 7 October 2020, the government published the consultation titled: *GMP indexation consultation: Proposal to extend full indexation.* The consultation sought views on the options available to ensure that the government continues to meet past commitments made to public servants regarding the full indexation of public service pensions, including any GMP element related to membership of a public service pension scheme.

2.14 This document sets out the government's response to that consultation, which closed on 30 December 2020.

Chapter 3

Government GMP indexation consultation

Consultation summary

3.1 The consultation considered the following three options:

- **Option 1a:** The extension of full indexation to cover those reaching SPa up to 5 April 2024.
- **Option 1b:** The extension of full indexation to cover those reaching SPa up to a date beyond 5 April 2024.
- **Option 2:** Discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for public service pension schemes

3.2 These indexation options would be delivered by way of direction made under Section 59A of the Social Security Pensions Act 1975 (SSPA 1975), as has been the case for the delivery and extension of full indexation to date[4]. Each option would result in a different outcome but would ensure that members of public service pension schemes who reach their SPa between 6 April 2021 and a set date after this, or any date beyond 6 April 2021, would continue to have their GMP fully indexed. In addition, all options would minimise the payment of unequal benefits between men and women. However, there would remain a small number of instances where inequalities are not removed, which would need further consideration beyond this consultation. This process is likely to be complex, and time and resource intensive.

3.3 Under Options 1a and 1b, conversion would not be discounted. Conversion would remain a long-term policy option for those public servants due to reach SPa beyond the date of the extension. However, under Option 2 conversion would be discounted, with full indexation being made the permanent solution.

3.4 While conversion would result in a reduction in administrative complexity for schemes in the long-term once conversion has been undertaken, the process of undertaking conversion in the short-term would be administratively complex. Consequently, conversion would only be worthwhile if the net impact of conversion was a reduction in administrative complexity.

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[4] Such Directions have also been made (from 1979 onwards) to provide for full indexation of the GMP for significant numbers of other public service pensioners, whose pensions would not be indexed and equalised in effect under the provisions for indexing a member's AP within their (old) State Pension, for example because the pensioner's GMP was greater than their AP.

3.5 The consultation also set out why it is not feasible for the government to undertake conversion by April 2021. Scheme administrators are currently undertaking a large volume of work, including work that is required to meet the pensions remedy work in response to the McCloud judgment, as well as other court rulings. The high volume and intensity of this work, which is expected to continue until the middle of the present decade, means the government is unable to undertake conversion by April 2021. Indeed, given the volume of work currently being undertaken by schemes, it is unlikely that conversion could be implemented until April 2024 at the earliest.

3.6 In addition, the consultation highlighted that existing legislation is not appropriate for public service pension schemes to undertake conversion.

3.7 Furthermore, the consultation highlighted that there is a steadily diminishing number of public servants with a GMP who are yet to reach SPa, as no further GMPs were accrued after 5 April 1997. A further extension of the interim solution significantly reduces or even removes the benefits of implementing conversion. Evidence provided by respondents supports this assessment. With regard to the public service pension schemes in question, approximately two thirds of public service pension scheme members with a GMP will have reached SPa by 5 April 2024. Beyond this, about four fifths of such scheme members with a GMP are expected to have reached SPa by 6 April 2030.

3.8 This consultation was primarily concerned with those public servants who will reach SPa after 5 April 2021. However, as set out in the consultation, the government is aware that its decision will also have consequences for some other pension schemes, potentially including a limited number in the private sector which index some or all pension payments in line with the government's arrangements for indexing specific public service pensions. Consequently, the government sought the views of those organisations that are not public service pension schemes but do nonetheless consider themselves to be affected by the consultation response.

Consultation response

3.9 HM Treasury received 31 responses from a range of respondents. Of these, 3 responses received from private individuals were not relevant to the consultation. The 31 responses were from the following categories:

- Trade Unions and Representative Organisation – 9 responses
- Private individuals – 7 responses
- Local Government bodies / pension funds – 5 responses[5]
- Pension advisers – 5 responses
- Public service pension schemes / scheme administrators – 4 responses
- Private sector organisations – 1 response

[5] One Local Government body / pension fund did not provide its own response to consultation. Instead, they submitted a representative organisation's response and confirmed that they supported the response given and did not have further comments to add.

Extension duration

3.10 The government conducted the consultation with an open mind regarding the key questions it set out. However, on the basis of the evidence available at the time of the consultation, public service pension schemes had made clear that their preferred policy option was to discount conversion and make full indexation the permanent solution.

3.11 Questions 1, 2 and 3, which are listed below, sought respondents' views on the three proposed extension options for those public servants reaching SPa from 6 April 2021.

Question 1: Do you consider an extension of full indexation until April 2024 to be appropriate to ensure that the government can meet its existing commitments, re-evaluate conversion as a long-term solution and resolve the handling of those cases where conversion could not be undertaken on a £1:£1 basis?

Question 2: Should the government consider an extension of full indexation to cover those reaching SPa beyond 5 April 2024? If so, how long should the government extend full indexation for, and why?

Question 3: Should the government consider making full GMP indexation the permanent solution for all members due to reach SPa after 5 April 2021? If so, why do you think this is the most appropriate solution?

Responses received

3.12 In total, questions 1 – 3 each received the following number of responses:

- Question 1: 25 responses
- Question 2: 23 responses
- Question 3: 25 Responses

3.13 Of those that responded to at least one of the above questions,17 favoured Option 2 - to discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for public service pension schemes. Of these 17, approximately seven of the responses received were from Trade Unions and other representative organisations, four from Local Government bodies / pension funds, four from public service pension schemes / scheme administrators and two from pension advisers. Whilst there were differing reasons for this view, some of the 17 respondents considered the process of undertaking conversion, along with associated costs, to be disproportionate to the benefits gained.

"Yes, [a scheme administrator] is supportive of the proposal to extend full indexation indefinitely, on the grounds that this appears to be the most efficient approach from an administration perspective. In our view, the longer-term simplicity afforded by conversion is outweighed by the immediate administration burden to implement the change."

3.14 In addition, approximately 10 of the 17 respondents considered the existing volume of work to be a barrier to undertaking conversion. They felt that it would be administratively simpler to make full indexation the permanent solution, as this would avoid the need to undertake conversion and establish new processes at a time with significant competing priorities. This would also avoid the costs of undertaking conversion. They also felt that members are likely to better understand the continuation of the existing system. Furthermore, respondents cited the diminishing benefits of conversion over time as those members with a GMP begin to work their way out of the system.

"Yes. Like our colleagues in the other public service pension schemes across the UK we are facing a challenging time due to the extra administration brought about by the implementation of the remedy for the McCloud/Sargeant cases. With that in mind we support the most administratively simple solution at present which is to discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for the public service pension schemes." [Scheme administrator]

"Yes, we believe the interim solution should be made the permanent solution for all members due to reach SPa after April 2021. This is because the main cost of conversion is the administrative cost of implementing it.

Whether the interim solution is extended to 5 April 2024 or 5 April 2030 the benefits of conversion diminish over time, and the less value there is in adopting conversion as a long-term solution. The cost of conversion is significant regardless of the numbers converted, so we believe there will be no net benefit of conversion." [Representative organisation]

3.15 Whilst the majority of respondents favoured Option 2 (17 respondents), six other respondents expressed a preference for Option 1a, the extension of full indexation until 5 April 2024.

3.16 Of these, two respondents preferred Option 1a, with conversion to be adopted at the earliest opportunity. Following this, their view was the next best alternative would be a further short extension of full indexation. The respondents, which were a private organisation and a representative organisation (industry association), were of the view that if public service pension schemes or the affected private sector organisations were to undertake conversion for those members yet to reach SPa, this could potentially avoid the mirroring obligation that is triggered via the s. 59A Direction. They considered that the employer could then make its own assessment of any commitments that may have been made regarding full indexation in respect of its own workforce as part of the conversion process. Alternatively, by extending the coverage of full indexation in stages this could mitigate a one-off large increase in recognised liabilities for these private sector schemes and employer sponsors. This would reduce the up-front financing cost to these organisations, thereby minimising the diversion of funds and the effect on their ability to invest in organisational priorities e.g. capital expenditure. In addition, further advantages of conversion were highlighted, which were previously set out in the Government's response to the original GMP indexation and equalisation, namely increased transparency and clarity for members. Furthermore, one respondent was of the view that it would be helpful for a future Pension Bill (for private and public sector schemes alike) to include such necessary amendments to the Pension Schemes Act 1993 to enable wide scale GMP conversion.

"A short extension of full indexation followed by conversion at the earliest opportunity would likely have the least potential adverse impact on private sector schemes via the unintended liability increase mentioned above. It is also possible that private sector schemes may seek to convert accrued GMP benefits into normal scheme benefits. If this did occur then it would be open to an employer to make its own assessment of any commitments that may have been made regarding full indexation in respect of its own workforce as part of the conversion process" [Representative organisation]

"If Option 1a was implemented followed by the implementation of conversion for members reaching SPa after 2024, this would clearly be the 'best' option (of those referenced in the consultation) for [a private sector respondent]"

3.17 A further four respondents expressed a preference for Option 1a. However, only one of these respondents expressed a view on conversion as a long-term solution. Two of these respondents were private individuals, along with one pension advisor and one representative organisation. One respondent was of the view that more time is required to evaluate a long-term policy solution, therefore a short extension is the most appropriate outcome. A further respondent was of the view that there are advantages to making full indexation the permanent solution, despite considering conversion to be the best long-term solution and preferring an extension until 2024 in the first instance. The two private individuals welcomed the extension of full indexation until 2024, both of whom will have their GMPs' price protected by option 1a. Neither of these individuals expressed a preferred policy beyond April 2024.

"[We] support the extension of the interim solution to cover those reaching SPA in the period to and including 5 April 2024 as this is necessary to ensure

that members receive their promised increases on their GMP. However, we believe that this should only be extended beyond 2024 if an alternative solution is under serious consideration and is likely to be put in place in the future, otherwise consideration should be concluded and a decision made to use full indexation within this timeframe.

With regard to the use of indexation as a long term solution, we support this as a pragmatic solution which will significantly reduce the administration burden" [Pension adviser]

3.18 3 respondents considered Option 1b, the extension of full indexation beyond 5 April 2024, to be the best outcome. Two responses received were from pension advisers, and the remaining response was from a Local Government body / pension fund. One of these three respondents considered the continued existence of GMPs under full indexation to go against the government's principles of transparency and promoting greater understanding of pension savings. However, until a solution can be found that delivers equalisation to all members, full indexation should continue. A second respondent was of the view that an extension beyond 2024 should be considered, but only if conversion remained a long-term policy option. Due to the complex nature of GMPs, it will take significant time, expertise and resource to address the issues properly, which is unlikely to happen before April 2024. The remaining respondent considered that it would not be feasible to undertake conversion by April 2024, instead preferring an extension until April 2030.

"If conversion remains on the table, then an extension will be required beyond 2024. The many complexities around GMP will take significant time, expertise and resource to address the issues properly, taking into account each of the public service schemes' own unique features." [Pension Adviser]

Equalisation

3.19 The consultation set out that full indexation ensures that the great majority of men and women that reach SPa between 6 April 2016 and 5 April 2021 will receive equal pension payments. However, it highlighted that there remains a small number of members whose benefits are not equal after full indexation.

3.20 Question 4, set out below, considered the issue of GMP equalisation and sought respondents' views on this.

Question 4: Do you consider full GMP indexation to be an appropriate method in most cases to avoid unequal pension payments to men and women?

Responses received

3.21 Question 4 received 18 responses. 15 respondents agreed with the assessment that in the great majority of cases full indexation ensures equalisation. Some respondents considered that the resources saved by making full indexation the permanent solution, as opposed to undertaking conversion, could be focussed on these remaining cases which need to be equalised. Some felt that further action was required to resolve the remaining cases.

> *"Yes. In the majority of cases, full GMP indexation will avoid unequal pension payment to men and women. For the minority where this is not achieved, the government will need to formulate a solution" [Trade Union]*
>
> *"Yes, it is the most straightforward method and is currently in place." [Representative organisation]*
>
> *"Yes. [Pension Adviser] consider full GMP indexation to be an appropriate method in most cases to avoid unequal payments of benefits to men and women. Our concern, as detailed in the consultation document, is that there will remain a group of members whose benefits will not be fully equalised"*

3.22 However, three respondents, of which two were representative organisations and one a Local Government body / pension fund, were of a different view. The Local Government body / pension fund did not provide its own response to consultation, it instead resubmitted a representative organisation's response (one of the above representative organisations) and confirmed that it agreed with their response. Two respondents, who submitted the same consultation response, provided examples of where inequalities are likely to remain. One respondent considered the issue of equalisation to be a reason to further consider conversion as a long-term solution. They considered conversion to be a more appropriate methodology to resolve equalisation.

> *"Full indexation on its own is highly unlikely, in our view, to provide equality between male and female members in all cases (e.g. due to the application of anti-franking tests step-ups, as acknowledged in the consultation document). The inequalities that arise in entitlement to and value of GMPs at different ages are varied and are not all addressed by indexation. This is one of the reasons why conversion, combined with equalisation, is worthy of consideration." [Representative organisation]*

Impact on the wider public and private sector

3.23 Questions 5 – 9 focused on the issue of those wider public sector or private sector schemes which are not providing 'official pensions' under the Pension Increase Act 1971 (the "PIA 1971"), but are still affected by the outcome of this consultation and any extension of full indexation by way of a direction made under s. 59A of the SSPA 1975.

> **Question 5:** How could the delivery of any of the policies outlined in this consultation, by way of a direction made under s. 59A of the SSPA 1975, impact on wider public sector or private sector schemes which are not providing 'official pensions' under the PIA 1971?
>
> **Question 6:** If wider public sector or private sector schemes which are not providing 'official pensions' are impacted by any of the policy options set out in this consultation, why were their pensions originally designed to mirror official pensions?
>
> **Question 7:** Should the government take action to avoid any read across, from its decision following this consultation in respect of public service schemes, to any wider public sector or private sector schemes that are not delivering 'official pensions' under the PIA 1971?
>
> **Question 8:** What considerations should the government take into account when deciding whether to take such action? In particular, why should government act so that the members of these schemes do not receive the benefits which they would otherwise receive under the scheme rules?
>
> **Question 9:** Are there actions the government could lawfully take to avoid any read across, from its decision following this consultation in respect of public service schemes, to any wider public sector or private sector schemes that are not delivering 'official pensions' under the PIA 1971?

Responses received

3.24 In total, questions 5 – 9 each received the following number of responses:

- Question 5: 9 responses
- Question 6: 7 responses
- Question 7: 6 Responses
- Question 8: 5 Responses
- Question 9: 6 Responses

3.25 Of the 11 respondents that responded to at least one of the above questions, six were Trade Unions and other representative organisations, three were pension advisers, one was a Local Government body / pension fund and one was a private sector organisation. Respondents were of the view that there are likely several pension schemes that might be affected by the outcome of this consultation, including British Telecom (BT), the University Superannuation Scheme (USS) and Royal Mail[6]. Beyond these organisations, no further organisations were named. As to why elements of these organisations' pension schemes would have been designed to mirror 'official pensions', one respondent was of the view that this likely related to the provision of public sector equivalent roles, Fair Deal policy and privatisation. In the case of privatisation, the respondent considered it likely that elements of the Water Authorities' pension schemes would also be required to be increased in accordance with the PIA 1971. A further respondent was of the view that it was normal for the government to ensure the provision of comparable pensions when facilitating the change of control from the government to the private sector[7].

> *"These businesses were previously publicly owned, and so their pensions developed along the same lines and at the time of privatisation assurances were given to the staff concerned that the pension schemes would replicate or be "broadly comparable" to the original public sector scheme arrangements." [Representative organisation]*

3.26 4 respondents, all of which were Trade Unions and other representative organisations, were of the view that the government should not take action which would diminish or remove existing pension benefits. In addition, the government should not act against members' financial interests or prioritise the financial interests of employers over those of scheme members, arguing that any solution must ensure that members' benefits are retained.

> *"The government should not be acting against members' financial interests or prioritising the financial interests of employers over those of scheme members therefore any solution must ensure that the members of private sector schemes whose pension benefits are uprated in line with public sector schemes, are unaffected." [Trade Union]*
>
> *"To renege on those assurances would doubtless start complex and time-consuming legal action at significant cost to the taxpayer." [Representative organisation]*

3.27 However, 2 respondents, a pension advisor and a representative organisation, were of the view that the government should take action where possible that would enable those schemes which mirror indexation

[6] The Royal Mail Statutory Pension Scheme provides for historic liabilities up to March 2012 and is a public service pension scheme. The scheme is not an "official pension" but it indexes in line with official pensions. The private sector Royal Mail Pension Plan, providing for liabilities from April 2012, indexes differently to official pensions.

[7] The government is not of this view. Most wider public sector schemes and previously privatised schemes have never had links to the PIA for indexation purposes. Only a minority of such schemes both had and maintain such links.

provisions to make their own assessment of the necessity or desirability of following the public service schemes. In addition, these respondents consider that these commitments related to historic choices made at a set point in time. One respondent was of the opinion that employers could not have foreseen the PIA 1971 regime being used to provide for full indexation in the manner that it currently is.

"It would be preferable if the Government could find a way to let those schemes make their own assessment of the necessity or desirability of following the public sector's lead, as appropriate to that diversity of circumstances." [Pension Adviser]

Wider considerations for the public and private sector

3.28 Question 10 sought views on whether there were any wider issues which should be considered by the government when deciding its response to the GMP indexation consultation.

Question 10: Are there wider issues relating to the GMP that are not mentioned here and which should be considered when the government decides its policy?

Responses received

3.29 Question 10 received 17 responses. Respondents raised a number of issues under this question which they felt should be given consideration. The majority of these were not within scope of the consultation, but the government nevertheless remains aware of these issues in responding to the consultation.

3.30 Some of these issues include outstanding matters related to the pre-2016 GMP retirees (raised by a trade union) and the recent *Lloyds* judgment on the requirement of defined benefit pension schemes to equalise GMPs for members who transfer out their benefits from the scheme. Those 3 respondents that raised the latter point (a scheme administrator and two pension advisers) were of the view that any solution regarding the equalisation of GMPs in the public service pension schemes must recognise the consequences of the High Court ruling.

3.31 The effect that the abolition of the Payable Uprated Contracted-out Deduction Increment (PUCODI) had on the equalisation of pensions in payment to members reaching State Pension age between 6 April 2012 and 5 April 2016 was also raised. PUCODIs were the top-up amount to the State Pension to cover indexation increases on GMP increments for those members. The respondent, a pension adviser, said that this issue had not been addressed by the consultation and PUCODIs should be reinstated.

3.32 The issue of public service pension schemes being required to meet the cost of providing full indexation was also raised. A number of respondents raised this issue and highlighted the estimated additional cost to the Schemes to provide full indexation. This was raised by six respondents, of which two were public service pension schemes / scheme administrators, two were Pension advisers, one was a Local Government body / pension fund and one a Representative Organisation. There were also requests for HM Treasury to provide funding to offset the cost of providing full indexation.

3.33 Two respondents, both representative organisations, also requested that any indexation and equalisation solution be kept simple. A further two private individuals considered it inequitable that public servants that accrued a GMP whilst members of a public service pension scheme will continue to have their GMP price protected, whilst those that accrued a GMP while members of a private sector pension scheme do not receive the same protections. A further private individual raised their concern about the perceived lack of communication on GMP reform in general. In addition, one respondent, a private sector organisation, was of the view that the consultation did not mention the advantages of conversion, namely transparency and clarity for members, which were highlighted in the Treasury's consultation response to its earlier consultation on GMP indexation and equalisation.

Chapter 4

Government response to consultation

Extension duration

4.1 Following consideration of the views expressed through the consultation, the government has decided to discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for public service pension schemes.

4.2 The government is of the view that this is the most practical solution to GMP indexation. This is because before conversion could be undertaken, schemes would need to ensure that they have accurate reconciled data, along with a finalised methodology to convert those GMP benefits where conversion on a £1:£1 basis would not result in equalisation. This is likely to be resource intensive at a time when public service pension schemes do not have the capacity to undertake conversion until at least 2024. There remains a chance that conversion might not be feasible by then. In addition, existing legislation is not appropriate for public service pension schemes to undertake conversion.

4.3 Furthermore, the benefits of converting the GMPs of those public servants who have not yet reached their SPa diminish over time as the number of these members is steadily reducing[8]. The impact assessment considers this issue in more detail. However, reflecting information based on the responses received to the consultation, it is evident that the majority of public service pension scheme members with a GMP will have reached State Pension age by 5 April 2024. Approximately two thirds of the scheme's members with a GMP will have reached SPa by 5 April 2024. Beyond this, about four fifths of such scheme's members with a GMP are expected to have reached SPa by 6 April 2030.

4.4 The consultation set out the benefits of undertaking conversion, which include a reduction in administrative complexity in the long term regarding those public servants yet to reach SPa. In addition, respondents also highlighted additional benefits of undertaking conversion, some of which were noted in the government's response to the GMP indexation and equalisation consultation, for example that it should make the system more transparent and make it easier for members to see how their benefits have been derived. In addition, the consultation highlighted that some private sector pension scheme rules require them to follow indexation provisions for

[8] As set out in the consultation, only those public servants with a GMP yet to reach SPa are within scope, as the old state pension system, where the AP and public service pensions worked together, provided for full indexation and equalisation for those that reached SPa before April 2016.

some or all official pensions. Despite this, the government does not consider these benefits to outweigh the befits of making full indexation the permanent solution.

4.5 On the basis of the points set out above, such as capacity constraints; outstanding technical issues relating to conversion; legislative requirements; the diminishing numbers of members below SPa with a GMP; and that the majority of consultation respondents expressed a preference for the permanent extension of full indexation, the government is of the view that full GMP indexation should be made the permanent solution for public service pension schemes.

Annex A
Impact Assessment

Options available to government

A.1 The government previously identified two viable methodologies for the continued full price protection of GMPs for public service pension scheme (PSPS) members, namely the 'full indexation' and 'conversion' methodologies set out above. Whilst they have different implications for the perspective of pension schemes and scheme administrators, both of these methodologies would ensure that pension scheme members continue to have the value of their pension's GMP element fully indexed, and also ensure that GMPs are equalised between men and women in great majority of cases, with a few specific exemptions which the government is considering further. The consultation from 7 October 2020 to 30 December 2020 sought views on the following options:

- **Option 1a:** The extension of full indexation to cover those reaching SPa up to 5 April 2024.
- **Option 1b:** The extension of full indexation to cover those reaching SPa beyond 5 April 2024.
- **Option 2:** Discount conversion as a long-term policy solution and make full GMP indexation the permanent solution for public service pension schemes

A.2 Importantly, the consultation did not seek views on a potential commitment to switch from full indexation to conversion at any point in the future. Instead, the government sought views on whether conversion should be permanently discounted as a methodology in favour of full indexation and, if not, for how long full indexation should be extended before the methodology would be reconsidered. An assessment of the impacts of the different options thus needs to compare the impacts of permanent extension of full indexation against those of a further extension of full indexation followed by a review with the potential to then adopt conversion, rather than comparing the impacts of full indexation and conversion.

A.3 As set out above and in the consultation document, the government is committed to ensuring the continued price protection of the GMP element for PSPS members' pensions. Furthermore, the government is of the view that PSPS members have a legal right to the continued indexation of their GMP, obligating the government to provide for full indexation. The options identified in the consultation can thus not meaningfully be compared against a 'do nothing' option.

A.4 In light of consultation responses received, the government's policy objectives and the available evidence, the government has decided to implement Option 2, making full indexation the permanent approach to price protecting GMPs.

Available evidence

A.5 GMPs are a highly technical aspect of PSPSs and wider (occupational) pensions policy, and the government is not aware of data or wider quantitative information on GMPs being routinely published by public service or private sector pension schemes. The government has carefully considered the responses to the consultation. As set out in Chapter 2, consultation responses were received from 31 stakeholder organisations and private individuals. The overwhelming majority of responses received provided qualitative arguments setting out the rationale for respondents' preferred approach. However, one large private sector organisation provided quantitative estimates of the impact the different indexation and resulting legislative approaches could have on its pension scheme's recognised liabilities, which it requested to remain unpublished. The government was not able to assess the robustness of the estimates provided, but they have been taken into account as part of the government's considerations.

A.6 Beyond the consultation process, the government has taken into account the views on deliverability and current competing delivery priorities of scheme administrators across the major PSPSs. The Government Actuary's Department (GAD) has provided a quantitative assessment of the remaining number of relevant PSPS members who will see their GMP price protected through the approach adopted, and how this number will decline over the coming years, based on data available for the Local Government Pension Scheme (LGPS) (England and Wales), which is the PSPS with the largest number of members.

Estimated financial impacts

Impact on PSPSs

A.7 Conversion and indexation are largely cost neutral for PSPSs in terms of scheme liabilities and resulting contribution levels because both methodologies have the effect of fully price protecting members' GMP entitlement. However, conversion and full indexation are different from an administration perspective. In the long-term, once conversion has been undertaken for those PSP members yet to reach SPa, conversion would result in a reduction in administrative complexity. However, the process of undertaking conversion in the short-term would be administratively complex and would involve up-front costs, which wouldn't be the case with the continuation of full indexation.

A.8 Conversion transforms the GMP into a regular scheme benefit, and thus removes the need for a separate indexation regime for members who have had their GMPs converted. However, conversion would require significant initial administrative effort, which could not be undertaken for implementation until April 2024 at the earliest, and possibly later. Furthermore, separate indexation regimes would still need to be maintained for those members with a GMP who reached SPa before April 2016, as well those that reached SPa between 2016 and the date conversion is first undertaken, meaning that PSPSs would need to maintain three different GMP indexation processes, and also maintain GMP records going forward.

A.9 Scheme members are no longer accruing GMPs, which means that the number of members with a GMP who would still be in scope of conversion diminishes with every year that the implementation of conversion is delayed. Conversely, having fewer members in scope would not significantly reduce the upfront administrative burden of implementing conversion. Any net reduction in administrative burden as a result of implementing conversion thus diminishes over time. While this is highly uncertain, GAD has extrapolated the potential number of PSPS members set to reach SPa after certain potential implementation dates in the table below.

Approximate number of members with a GMP who reached SPa before 6 April 2016	c.2 million
Approximate number of members with a GMP who reached/will reach SPa on or after 6 April 2016 but before 6 April 2024	c.1 million
Approximate number of members with a GMP who will reach SPa on or after 6 April 2024 but before 6 April 2030	c.1 million
Approximate number of members with a GMP who will reach SPa on or after 6 April 2030	c.1 million
Total[9]	**c.4 million**

A.10 Options 1a and 1b: Options 1a or 1b would, at a minimum, require public service pension schemes to reconsider the case for conversion in the relatively near future. Given the diminishing benefits of adopting conversion, this would have a high probability of still leading to full indexation being adopted as the permanent solution, thereby creating nugatory work compared to achieving the same outcome through Option 2. Should conversion be adopted for the remaining relevant PSPS members, the administrative effort of a further review and implementing conversion would need to be compared to any long-term efficiencies achieved by adopting conversion for remaining members.

A.11 Option 2: Impacts of Option 2 are the inverse of Options 1a and 1b. The permanent adoption of full indexation would avoid the need for a further review of the feasibility of conversion, and the potential upfront

9 The sum of the individual elements does not equal the amount in the Total row. This is due to the heavy rounding that has been applied. While all the figures are approximate, the individual elements are particularly uncertain. The figures assume that the LGPS(E&W) GMP profile is the same as other PSPSs. This might not be the case if historical patterns of recruitment and transferring-out of the scheme were significantly different between LGPS(E&W) and the other PSPSs.

administrative burden of conversion. Conversely, PSPSs would also forego any long-term administrative efficiencies of conversion.

A.12 Given the uncertainties around conversion and any issues that may be identified as part of the implementation process, the government does not hold quantitative information in terms of staff and other administrative costs for the process of conversion or a further review. However, consultation responses from PSPSs and views given in separate engagement with government across the UK, including Devolved Administrations and scheme administrators, before the formal consultation process were overwhelmingly of the view that the net administrative burdens of Options 1a and 1b would be larger than those of Option 2, with conversion effectively timed out from an efficiency perspective at this point in time.

Impact on private sector companies

A.13 The government's objective in responding to the consultation is to provide for the continued indexation of GMPs for PSPS members in the most appropriate way from a PSPS perspective. Implementation through a s.59A Direction will apply directly to official pensions as defined for purposes of the Pensions (Increase) Act 1971. However, as set out in the consultation, the government is aware that some private sector companies have made historical commitments to follow the indexation mechanism for GMPs adopted by PSPSs, whether in general or as applied to a specific PSPS.

A.14 One such business provided a detailed response to the consultation, arguing that undertaking conversion could limit the increase in liabilities that their pension scheme would have to recognise, thereby reducing the increase in total liabilities and the associated financing cost. Whilst this was not covered in detail in the response, they were of the view that if the government were to undertake conversion at a future date this would remove the need to apply GMP legislation for members whose GMPs had been converted, thereby breaking the link to the 'mirroring obligation' in its own relevant scheme rules. It would then be for this organisation to determine whether they index the GMPs for the relevant category of its scheme members. Contrary to the position applicable to PSPSs, this respondent maintains that a government decision to adopt conversion would have an effect on its scheme costs and member benefits. The respondent included quantitative information regarding the estimated impact on scheme liabilities if conversion was adopted in 2024 or at a later date, or if full indexation was made the permanent solution, but asked for this to remain unpublished. The trend in the estimated increase in liabilities broadly follows the trend in relevant PSPS members estimated by GAD, with the savings associated with conversion quickly diminishing if it is not adopted by April 2024.

A.15 The particular consultation response estimates that the difference in recognised liabilities between Option 1a and Option 2 would translate into an increase in employer contributions required to make good the associated increase in the scheme deficit[10]. The response does not specify for how long the estimated increase in employer contributions is assumed to apply.

A.16 Since a commitment to conversion at a future date was not one of the options under consideration in the consultation, and conversion would indeed become less viable for PSPSs the longer full indexation is extended on an "interim" basis, it is likely that the increase in liabilities estimated for Option 2 would still need to be recognised following a government decision some years into the future to discount conversion. However, the consultation response argues that even a more gradual shift towards full indexation as the permanent solution in the years following 2024 would generate overall savings for their scheme, as the lower recognised scheme liabilities in earlier years would mean a better financial position and more favourable financing costs for the business as a whole. However, if conversion is then ultimately discounted as a methodology by government, this might imply that financing costs, based on a continued possibility of government adopting conversion at some point in the future, had been underestimated.

A.17 The government is not in a position to assess whether a move to conversion for PSPSs would indeed allow those remaining private sector schemes with mirroring obligations to adopt less generous GMP uprating provisions, and is not aware of existing case law indicating the feasibility of such an approach. Only one private sector employer responded to the most recent consultation from 7 October 2020 to 30 December 2020. However, it is worth noting that another private sector scheme in a similar position responded to the 2016 consultation on GMP indexation and equalisation stating that its scheme members had an underlying right to the price protection of their GMP element, which was independent from the mirroring obligation. A decision by government to move to conversion would thus not have reduced scheme liabilities in practice for that organisation.

A.18 Mirroring provisions in private sector occupational pension schemes obligating them to follow certain aspects of PSP scheme rules are the result of historical commitments by the respective organisations, and subsequent decisions not to renegotiate these commitments. The government cannot rule out that similar mirroring provisions still exist for some elements of some pension schemes for which other private sector organisations are responsible beyond those two noted above, for example following some past privatisations. However, the absence of any engagement with this and previous consultations on GMP indexation may indicate that these organisations have since removed the mirroring obligations from their scheme rules, or that they do not expect significant numbers of members below SPa to remain in scope of GMP indexation.

A.19 The government does not have details of any small and medium sized businesses with commitments to mirror PSPS indexation of GMPs. However, it is possible that some commitments of this kind were made and still remain under 'Old' Fair Deal provisions for providing pensions for former public sector employees transferred as part of the contractorisation of functions.

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[10] As for scheme liabilities, the respondent provided a quantitative estimate but asked for this to remain unpublished

Under the New Fair Deal guidance published in 2013 continuing pension provision is instead provided through continued membership of the PSPS.

Impact on PSPS members

A.20 As set out above, PSPS members will see their GMP price protected under either conversion or full indexation, and either methodology would ensure gender equalisation in the great majority of cases. The period over which full indexation is extended should not make a significant difference for the majority of PSP members. However, the government remains aware of non-financial considerations, for example that a decision that did not commit either to full indexation indefinitely or to conversion plus full indexation from a specific date could represent a continuing uncertainty and concern for a significant proportion of the PSPS membership, while conversion at some point in the future may make pension benefits easier to understand for members affected.

Impact on PSPS employers

4.6 Since the benefit payments under conversion or full indexation will not have a significant impact on scheme members, this also means that the decision will have a minimal impact on the contributions that public service employers will pay to pension schemes.

Impact on private sector scheme members

A.21 Some members of private sector schemes that might be affected could see the value of their GMP reduce over time if conversion were adopted, as it would then be for scheme trustees and the relevant sponsor organisation to decide whether those GMP benefits should be fully indexed. However, as discussed in the section on private sector business impacts, the government would be likely to discount conversion following a further extension of full indexation. That would then leave the GMP indexation entitlements for these scheme members unchanged unless changes to the individual private sector scheme provisions were negotiated. Furthermore, as set out above, the government cannot assess whether a change in indexation rules reducing entitlement for these members would be legally defensible.

Annex B
Equalities Impact Assessment

B.1 The characteristics of PSP members affected will generally follow those of public sector workforces at the time when GMPs were being accrued.

B.2 Beyond this, GMPs are inherently unequal between men and women for a number of reasons related to historical differences in entitlements to State Pension, including the following: GMPs are payable at age 60 for women and 65 for men; the GMP accrual rate is the same as or higher for a woman than a man born on the same day; men could accrue GMPs between age 60 and 65 while women could not.

B.3 For the great majority of PSP members, the only difference in the total pension paid caused by these differences arises due to different pension increases payable on the GMP and non-GMP components. For these members, the commitment to fully index GMPs for those reaching SPa after 6 April 2021 therefore means that the total PSP payable is equal between men and women born on or after 6 April 1955[11].

B.4 In the great majority of cases, the continuation of full indexation will ensure equalisation between men and women. However, there will remain some narrow categories of cases where full indexation does not ensure equalisation between men and women. The Government will continue to work through these cases with PSPs and other government departments. Typically, this is due to the GMP being relatively large compared to the rest of the member's pension, meaning that the total amount of pension at retirement is affected by the GMP, rather than the GMP only affecting future pension increases. There are a few instances where this is likely to occur. Work on these instances will be taken forward with Departments.

[11] This is the category of public service pensioners not covered by the old GMP indexation provisions linked with State Additional Pensions (summarised in Annex A), the first "interim solution" to GMP indexation (implemented by s59A direction in 2016) or the second "interim solution"(implemented by s59A Direction in 2018).

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