HM Treasury

Indexation and equalisation of GMP in public service pension schemes:

response to the consultation

January 2018

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Contents

Executive summary

The government is announcing its response to the consultation on guaranteed minimum pension (GMP) indexation and equalisation in public service pension schemes. The government consulted between 28 November 2016 and 20 February 2017.

This consultation was about **how government should continue to meet its obligations to index (price protect) and equalise (make equal payments to men and women)** the pension entitlements of a certain group of public servants with an occupational pension known as a GMP.

In 2016 the government introduced the new State Pension (nSP), which hugely simplified the pension system but removed the mechanism whereby public service schemes could continue to equalise and index pension payments.

The government consulted **on three options to resolve these issues** and remained open to further suggestions on how it could meet its obligations.

This consultation received a low number of responses, mostly of a technical nature, from **private individuals, pension advisers, scheme administrators/public service schemes, local government bodies/pension funds, representative groups, scheme advisory boards, trade unions and private sector bodies.**

The government has been implementing an "interim solution" between 6 April 2016 and 5 December 2018. The outcome of this consultation is that this solution will be extended for a further two years and four months. During this period, the government will investigate the possibility of an alternative long-term methodology, known as "conversion".

Chapter 1
Background

The guaranteed minimum pension

1.1 On April 6 2016, the government introduced the new State Pension (nSP), designed to radically simplify pension provision, while ensuring that pensioners have security in retirement. This simplification removed layers of complexity from the system, harmonised the rate of National Insurance contributions (NICs) paid by employees and employers, and is promoting private saving by giving people a better understanding of the amount of support they can expect to receive from the State when they reach State Pension age (SPa).

1.2 Among the layers of complexity removed was the Additional Pension (AP) – a complex earnings related element of the old state pension. With the removal of the AP, the government needed to consider how public service pension payments for a specific group of members should be increased in future. Specifically, those who were in ‘contracted-out’ employment during the period 6 April 1978 to 5 April 1997 and accrued a guaranteed minimum pension (GMP) from their public service pension scheme.

1.3 Under the arrangements that previously applied the public service pension and the AP system worked in tandem. This provided a mechanism that equalised and fully indexed pension payments (of both state pension and occupational pension) for public servants, in line with commitments made to these members by previous governments. These included statutory provisions legislated for in 1979 that provided for the GMP earned during membership of a public service scheme to be increased by the scheme when it was not in effect being increased through the AP. However, with the removal of the AP, that particular mechanism no longer works. An estimated 2 million members of public service schemes with GMPs, who reach their SPa until 2050, may be affected.

1.4 If the government does not act, men and women would be treated differently and GMP pension payments would no longer be in effect indexed.

The interim solution

1.5 On 1 March 2016 the government announced it would continue to price protect the GMP of public servants who reach SPa after 5 April 2016 and before 6 December 2018 (when State Pension ages are equalised). This eases the transition to the new State Pension for those less able to build up nSP and continues the government's approach of using a Treasury direction[1] to ensure that past indexation commitments are met and public service pension payments to men and women are not made unequal.

1.6 Individuals reaching SPa between these dates will have, or have had, their GMP price protected by the public service pension schemes for life. This will lead to the GMP of over 100,000 members of public service pension schemes being fully price protected and their overall pension payments will continue to be equalised as before.

[1] Made under section 59a of the Social Security Pensions Act 1975.

Chapter 2

Government GMP indexation and equalisation consultation

2.1 The government consulted between 28 November 2016 and 20 February 2017 about a longer-term solution to GMP indexation and equalisation in public service pension schemes.

2.2 The consultation aimed to address two issues, namely:

- How best to avoid the introduction of unequal payments to men and women in public service schemes resulting from the abolition of the AP. Previous arrangements were designed to deliver equalisation by taking into account increases to GMPs paid in effect through the AP.
- Whether, following the introduction of the new State Pension, the public service schemes should pay full indexation on all the GMP earned while a member of a public service scheme, for someone who reaches SPa after 5 December 2018.

2.3 The government consulted with an open mind on to the best way to meet its obligation to index and equalise GMP benefits. There are long-standing commitments that such members' pensions would be fully indexed whether or not a GMP was being increased, in effect, through the State Pension.

2.4 In considering which methodology to adopt, the government said it would apply the following key policy tests:

- Does the policy proposal ensure that affected members and their survivors are at least as well off as they would have been, had the nSP not been introduced?
- Does the policy proposal consider fairness to taxpayers in general?
- Does the policy proposal avoid the unequal payments to men and women that would otherwise result from the abolition of AP and minimise future legal risk to public service pension schemes?
- Is the policy proposal cost-effective and does it minimise future fiscal risk to public service pension schemes from data and administrative errors?
- Is the policy proposal a long-term solution that supports the government's principles of transparency and greater understanding of pension saving?

2.5 Current and former public sector employees in the following workforces will be affected by the outcome of this consultation:

- the armed forces
- the fire and rescue services
- the police force
- the judiciary
- local government workers
- the NHS
- teachers
- civil servants

2.6 There may also be a number of wider public service and public sector organisations that are affected. This could be because their pensions are 'official pensions' as defined in s. 5(1) of the Pension (Increase) Act 1971 ('PIA 1971'). This may also be because historically their pension scheme has, through its own scheme rules, followed the treatment of the major public service pension schemes regarding the indexation of GMPs.

2.7 The government is aware that some private sector occupational pension schemes will be affected. Such schemes include those whose Trust Deeds and rules explicitly require them to follow the indexation treatment of the public service pension schemes, including the provisions of the PIA 1971 and the Social Security Pensions Act 1975 ('SSPA').

Consultation options

2.8 The consultation examined the options available to government in order to meet its obligations to index and equalise GMPs for those members of a public service scheme reaching SPa on or after 6 December 2018. The options consulted on do not cover public servants reaching SPa after 5 April 2016 and before 6 December 2018, who are already covered by the interim solution.

2.9 Possible solutions were discussed in depth in the consultation, along with worked examples and costings provided by the Government Actuary's Department (GAD)[1]. A summary of these solutions is below:

Case-by-case

- This method compares the total income that would be received by the pensioner each year from public and state pension provision, under the old and new systems. This method does not provide full indexation to all members. Where the member's total income from these sources that year is lower than it would have been under the old system, the member would be compensated that year. This compensation would only be up to the value of the loss of GMP indexation.

[1] https://www.gov.uk/government/consultations/indexation-and-equalisation-of-gmp-in-public-service-pension-schemes/consultation-on-indexation-and-equalisation-of-gmp-in-public-service-pension-schemes#solutions-to-indexation-and-equalisation-of-the-gmp

- To equalise the benefit, this annual comparison would also include the same calculation for an equivalent, theoretical member of the opposite sex. The scheme would then pay the pensioner the higher of any male or female top up GMP indexation benefit.
- It would, however, be very administratively complex and costly, would be required for many decades and would require significant changes in administrative systems for all public service pension schemes, State Pensions and National Insurance and major increases in the costs of running such systems.

Full indexation

- The second method, full indexation for those attaining SPa on or after 6 December 2018, would carry forward the interim policy announced on 1 March 2016. This policy requires the public service pension schemes to directly meet the cost of indexing the total GMP.
- This prevents inequalities being introduced between male and female public service pensioners by the abolition of the AP and ensures that no individual is worse off as a result of no longer in effect receiving indexation on their GMP through the AP.
- Full indexation is administratively much less complex than case-by-case as it is a continuation of current government policy through the interim solution.

Conversion

- The final option, conversion, converts the GMP into a scheme benefit. As consulted on, this would convert a GMP into ordinary scheme benefit on a 1:1 basis. This would apply to all active and deferred members of schemes reaching SPa on or after 6 December 2018, but would not apply to those who have reached SPa before 6 December 2018.
- Conversion would mean that public service schemes would no longer need to abide by existing GMP legislation for these members. This is because their entitlement would be delivered through an alternative route.

Summary of questions

2.10 The government asked 17 questions in its consultation, listed below:

- **Question 1:** Which pension schemes (public and private) follow the PIA 1971 and SSPA and therefore may be affected by a policy change?
- **Question 2:** Do you consider the case-by-case method to be an appropriate method to ensure that the abolition of AP does not create new gender inequality?
- **Question 3:** Does the case-by-case method adequately honour the previous commitment by government to fully index the GMP of public service scheme members?

- Question 4: Do you consider full indexation to be an appropriate method to avoid the unequal pension payments to men and women that the abolition of the AP would otherwise lead to?
- Question 5: Do you consider full indexation to be an appropriate method through which to meet past indexation commitments to men and women in employment in the public services between 1978 and 1997?
- Question 6: Do you consider conversion on a 1:1 basis to be an appropriate method to avoid the unequal pension payments to men and women that the abolition of the AP would otherwise lead to?
- Question 7: Do you consider conversion on a 1:1 basis an appropriate method through which to meet past indexation commitments to men and women in employment in the public services between 1978 and 1997?
- Question 8: Under this methodology, how should government treat those in receipt of a public service pension but below SPa?
- Question 9: Do you agree that conversion on an actuarial equivalent basis does not meet past indexation commitments to men and women in employment in the public services between 1978 and 1997?
- Question 10: Which of the three policy options outlined in section 3 best match the criteria set out in the third paragraph in section 1.2?
- Question 11: Are there alternative methodologies the government could consider?
- Question 12: How could the delivery of any of the policies in the consultation impact wider public sector or private sector schemes who are not ‘official pensions’ under the PIA 1971?
- Question 13: If wider public sector or private schemes who are not ‘official pensions’ are impacted by any policy set out in the consultation, why were the pensions designed to mirror official pensions originally?
- Question 14: Should the government take action to avoid any read across between private sector schemes and any policy announced?
- Question 15: Are there actions the government could take to restrict the impact on wider public sector or private sector pension schemes who are not ‘official pensions’ under the PIA?
- Question 16: Why should government allow for members of schemes whose rules mimic/mirror those in the public services, to be deprived of the benefit of those rules?
- Question 17: Are there wider issues relating to the GMP that are not mentioned here and which should be considered when the government decides its policy?

Chapter 3

Responses to consultation

3.1 The consultation ran between 28 November 2016 and 20 February 2017. In total, the government received 62 responses to this consultation.

3.2 Responses were received from private individuals, pensions advisers (representing private sector schemes impacted by this policy, as well as local government), public service pension schemes and their administrators, local government and local government pension funds, representative groups (such as those representing the interests of public service pensions), scheme advisory boards, trade unions and private sector pension schemes.

Private individuals

3.3 The majority of responses from private individuals stated that indexation or conversion would be the best solution (as opposed to case-by-case). The most common reason stated was that the state had made explicit commitments to index public service pensions and that no public servants should subsequently be deprived of fully indexed pension benefits. Separate concerns were raised by ex-public servants in private sector organisations who pointed out that they had also been commitments given to full indexation. Concern was also raised that public servants should not be treated more generously than individuals in private sector schemes.

Pension advisers

3.4 Pension advisers, some of whom represented private sector organisations impacted by this policy as well as local government, also responded to the consultation. Pension advisers representing local government raised concerns about the ending of contracting-out, and the subsequent increase in costs for public sector employers from meeting the obligation to fully index GMPs. Some advisers representing private sector organisations impacted by the decision to end contracting-out raised concerns about extra costs falling on schemes. Some suggested alternative methodologies. The impact of this decision on private sector schemes is discussed in full in a later section of this response.

3.5 Some advisers pointed out that the government could choose to convert on an actuarially equivalent basis, as set out in the other consultation on this issue which is available below[1].

[1] https://www.gov.uk/government/consultations/occupational-pensions-draft-regulations-legislative-review-and-guaranteed-minimum-pensions-equalisation-methodology

3.6 This proposed method was based on actuarial equivalence. This methodology was designed to solve equalisation issues, and many private sector schemes do not have the same obligation to fully index benefits as public service schemes. The reasons why the government does not believe this would be sufficient to compensate public service scheme members for any lack of indexation are described in full in the government's original consultation.

3.7 Some responses, however, pointed out that public service pension schemes are still undergoing a reconciliation exercise with the HMRC scheme reconciliation exercise. This is due to complete in December 2018[2].

3.8 The majority of pension advisers responding to this consultation considered the case-by-case solution to be the most challenging to administer and implement. As this method would be complex and would involve annual calculations across State and public service pensions, it was pointed out that members may find it difficult to understand how their benefits were derived. The case-by-case solution would rely on an annual calculation. Therefore, members could not be told how their pensions would increase in a way that would be simple to understand or easy for schemes to forecast.

Scheme administrators & public service schemes

3.9 Scheme administrators and public service schemes unanimously considered case-by-case to be administratively burdensome, expensive to implement and unfeasible in that it requires the government to implement systems that are not currently available. They made the point that the case-by-case methodology, as consulted on, could not distinguish between different periods of employment, self-employment or benefits obtained through the payment of voluntary National Insurance contributions. However, information distinguishing between GMPs earned in different forms of employment would be required to operate this solution. A case-by-case solution would have to be based on accurate data on the National Insurance contributions and related State Pension entitlements. Scheme administrators pointed out that these systems do not currently exist.

3.10 Some scheme administrators also pointed out that there would also be data protection issues for schemes. Schemes would potentially be unable to handle data relating to periods of members' employment that were unrelated to a public service scheme.

3.11 An extension of the current interim solution, or conversion, was therefore favoured by scheme administrators. However, it was noted that data reconciliation would have to be complete and accurate in order for conversion to work correctly.

2 https://www.gov.uk/guidance/nispi-pension-schemes-reconciliation-services

Local government bodies and local government pension funds

3.12 Local government bodies and local government pension funds responding to the consultation emphasised that the ending of contracting-out has resulted in additional costs being placed on local government employers. Some of these bodies asked for funding to be made available to cover these costs.

Representative groups

3.13 A small number of representative groups responded to the consultation. These representative groups represented the interests of retired public servants. The majority of these respondents stated that case-by-case was too complex and challenging for members to understand. For this reason, these groups preferred conversion or indexation as a solution. Some of these representative groups reiterated the view that no public servants transferred to the private sector should lose out on indexation, on account of the ending of the previous method of indexing and equalising public service pensions.

Scheme advisory boards

3.14 Two scheme advisory boards responded to this consultation. They shared the same view that case-by-case was excessively complex as a solution. Indexation or conversion was favoured. However, conversion was seen to carry additional advantages in terms of being less burdensome to administer in the longer-term.

Trade unions

3.15 Several trade unions responded to the consultation. The consensus view favoured conversion over indexation, from the point of view of ease of implementation. Some trade unions suggested that the government should centrally meet the additional employer costs of indexation and equalisation.

Private sector organisations

3.16 As noted above the government has heard either directly, or indirectly through pension advisers, from some wider private sector organisations that are affected by this policy. This is where Trust Deeds and rules explicitly require them to follow the indexation treatment of public service pension schemes.

3.17 Two private sector schemes with indexation provisions linked to public service schemes also responded. As noted, there are private sector schemes that have rules requiring them to confer on their members the same indexation that members of public service schemes receive under the pensions increase provisions which apply to public service schemes.

3.18 One consultee noted that they would honour the requirements of their Trust Deed and rules to provide full increases to GMP where this is not (in effect) provided by the state.

3.19 The other consultee requested that the government should craft its response in such a way as to avoid the read across from public service schemes to their private sector scheme. However, the government believes that it would not be appropriate to act in a way that would deprive members of indexation, to which they would otherwise be entitled. Acting to do so would also raise legal questions, including whether there was a legitimate aim to justify such an interference in the property rights of scheme members. In addition, some of the mechanisms suggested by the consultee to avoid this impact are outside the scope of the government's statutory powers.

3.20 Some pension advisers suggested that the government should remove indexation obligations from private and public service schemes. Instead the government should revise new State Pension legislation and systems to boost new State Pension foundation amounts for pensioners who were members of contracted-out schemes. Such an approach would reverse fundamental aspects of the new State Pension system and is not in scope of this consultation.

Chapter 4

Government response

Case-by-case approach

4.1 Based on the detailed responses received in this consultation, the government does not believe that a case-by-case solution should be implemented. Although, if deliverable, the additional liability to public service schemes is less than the cost of full indexation or conversion it would be both challenging and costly to implement and administer. In addition, the government does not believe this could be shown to precisely deliver obligations to index public service pensions.

4.2 Case-by-case would be a very complex solution for schemes to implement, and differs significantly from the interim solution currently in place. Running a case-by-case solution would require ongoing work, for many years, in order to calculate whether a member would be better off under the old or new system.

4.3 New systems would be needed to make annual comparisons between actual and notional benefits and to deliver data on National Insurance contributions. These systems would need to take account of public service employment, state pension entitlements and public service pensions (including GMPs) related to that employment. Such a system would need to account for and separate out data on rights earned while in employment covered by public service schemes, other employments, through National Insurance credits (from periods of unemployment) and through voluntary National Insurance contributions. This would involve fundamental changes to HMRC and DWP systems, as well as public service schemes' rules and systems. The systems required to run this solution do not currently exist, and could not be easily designed.

4.4 The government will therefore not implement a case-by-case solution to resolve the issue of GMP indexation and equalisation. This solution would increase public service pension liabilities by less than alternative solutions, but does not meet the policy tests set out in the original consultation. Importantly, implementing a case-by-case solution would not make the system more transparent and easier to understand for members or adequately honour the commitment to fully index public service pensions.

Full indexation

4.5 Full indexation, or extending the current interim solution permanently, meets the key policy tests set out in the government's consultation. These tests are primarily ensuring that members are at least as well off as before introduction of the new State Pension and that pension payments made to men and women continue to be equal.

4.6 This policy, along with conversion, was generally favoured in responses to the consultation as a way to meet the government's obligations to index and equalise public service pensions.

4.7 However, despite meeting these tests, full indexation was noted in the consultation as a more burdensome way of meeting the government's obligations. Scheme administrators and pensions advisers pointed out that full indexation would leave in place current GMP legislation and underpins which are complex to administer.

Conversion

4.8 The option to convert guaranteed minimum pension benefit into normal scheme benefit was strongly supported.

4.9 In the original consultation, Government Actuary's Department provided estimates that the increase in schemes' liabilities of conversion would be broadly equivalent to that of full indexation. Both conversion and full indexation meet the test of ensuring that members and their survivors are at least as well off as they would have been, had the new State Pension not been introduced.

4.10 Conversion may be less burdensome administratively in the long-term than the full indexation (extending the current interim solution permanently). If implemented correctly, it should make the system more transparent and make it easier for members to see how their benefits have been derived.

4.11 Accurate reconciled data would be required in order to start the process of converting GMP. Public service schemes are currently reconciling GMP data with HMRC, to ensure members are able to receive accurate GMP payments. This exercise is due to complete in December 2018, and improved scheme data will help in determining longer-term policy.

4.12 To implement conversion properly would require an agreed methodology. A longer-term decision to convert would also need to be underpinned by suitable legislation.

4.13 The government remains prepared to consider conversion as an option in future, at a time where there is a legally and practically robust conversion methodology and when this can be underpinned by appropriate legislation. The government intends to continue to review this position, following the reconciliation exercise, and will investigate further whether conversion best meets the tests set out in the government's original consultation.

Equalisation issues

4.14 A decision in future to adopt conversion would need to ensure that it met equalisation requirements for both member and survivor GMPs. The government is aware of ongoing court cases relating to GMP equalisation. The government would wish to consider any possible implications of these court cases before implementing a conversion methodology in future.

Conclusion

4.15 In this response, the government is discounting the case-by-case method in future, for the reasons outlined above. The government believes that conversion may best meet the policy tests set out in the original consultation, but that methodology and legislative issues need further consideration.

4.16 The current interim solution is in place for members who reach SPa on or before 5 December 2018, and meets the obligations of government to index and equalise public service pensions.

4.17 **The government is announcing the extension of the current interim solution so that it applies to those who reach SPa on or before 5 April 2021. Members of public service pension schemes with guaranteed minimum pension entitlements, who reach SPa on or after 6 December 2018 and before 6 April 2021 will be covered by this extension of the interim solution**. The end date of 5 April 2021 is the day before annual guaranteed minimum pension increase orders are applied.

4.18 The additional liability created by this further extension of the current policy solution will be a proportion of the estimated cost of full indexation.

4.19 During this period, the government will review the possibility of implementing conversion as a longer-term solution. It will continue to consult with departments and schemes to decide whether a suitable methodology and legislation can be brought forward to enable conversion to take place in the future. The government will also continue to take account of alternative solutions that may also address this issue.

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