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Dear Sir/Madam

CONSULTATION ON INDEXATION AND EQUALISATION OF GMP IN PUBLIC SERVICE PENSION SCHEMES

Background

1. HM Treasury issued a consultation on 28 November 2016 that sought views on options to address the indexation and equalisation of Guaranteed Minimum Pensions (GMP) for public service pensions going forward from December 2018.

1.1 The introduction of the new State Pension from April 2016 removed the existing structure that provided annual indexation of GMPs paid to public service scheme members. This complex process which continues to apply to those GMPs in payment prior to April 2016 relies on part indexation being met by the member's State Additional Pension and part by the member's public service scheme. An interim solution was introduced to provide full indexation from the scheme on a member's GMP for those who reach State Pension age between April 2016 and December 2018. This interim solution allows full indexation and equalisation of benefits to continue for the lifetime of those members it applies to. The consultation seeks views on a long term solution from December 2018 that will address both the indexation and equalisation of GMPs for those members reaching State Pension age from that date.

1.2 SPPA undertakes the day to day role of Responsible Authority and Scheme Manager of the devolved public service schemes and it is in that role that this response is made. In considering its reply SPPA issued the consultation to the devolved scheme Pension Boards, Advisory Boards and the STUC. It also invited representatives of those bodies to a presentation on the consultation in Edinburgh on 16 January 2017 provided by HM Treasury and provided a short paper on the consultation to each of its four unfunded scheme Advisory Board meetings during January and early February. Advisory Board members were encouraged to reply to the consultation and this response includes comments provided by members of the Teachers' Advisory and Pension Boards.

1.3 This response concentrates on the 3 options set out in the consultation namely, case by case calculations, extension of the interim solution applied from April 2016 and the conversion of the GMP to a scheme benefit.

Option 1 - Case by case calculations

2. This option manages the indexation of GMPs by comparing the member's position against any gains provided to him/her by their new State Pension. It therefore does not meet the requirement for full indexation but ensures that the member is no worse off by offsetting any gains received by the member via the separate State Pension. It can be argued that this option does not meet previous Government commitments to fully index a GMP as it only provides indexation where the member's gain from the new State Pension is less than the indexation amount.

2.1 The calculation process is then repeated using a theoretical member of the opposite sex whose service etc is identical with the higher amount being paid to the member. This double calculation would be performed annually to ensure the offset and equalisation requirements are met. GAD estimate that this option would add £1.5bn across all public service schemes and as a rough estimate based on 2015/16 payroll this would add 0.1% to the current employer contribution rates for the NHS (+£5m) and Teachers (+£2.2m) schemes in Scotland.

Opinion

2.2 Whilst this clearly is the least costly option there are significant associated costs and complexities.

2.3 Pension administration systems would need to be developed to allow an annual double calculation process. In addition that process would need to incorporate robust data on the member's State Pension entitlement and provide sufficient timing between confirmation of annual indexation rates for both State and public service pensions. It also relies on easy access to pre 2016 "old style" State Pension entitlement being available from DWP and that that information would be readily and easily available over the significant period this information is required. Like GMP maintenance would this be a task that would be simply passed to the schemes from DWP once the dust had settled? There is clearly a precedence of central Government GMP costs simply being passed to schemes without any supporting resource transfer.

2.4 The quality of GMP data both at the start of the process and going forward at each annual increase is critical to this option. It is assumed that by December 2018 schemes will have strong and accurate GMP data following their reconciliation exercise and have systems in place to maintain and update that data both before and after the member reaching State Pension age. This option unavoidably creates risks to consistent and accurate data being produced. It also requires administrators to retain a fully informed working knowledge of GMPs for the next forty or so years.

2.5 What is already a complex issue becomes even more complex both in administrators understanding the process and, more importantly, members understanding how their benefits are calculated. It is highly improbable that a simple, customer friendly explanation could be scripted to aid members' understanding of increases applied to their pension under this option. This contradicts the policy supporting the introduction of the new State Pension where greater simplicity aims to provide a better understanding so that people know what their retirement incomes might be. The requirement to annually assess the scheme pension to ensure both the offset and equalisation calculations are met will result in members and their dependants finding it very difficult, if not impossible, to forecast payments they may receive in the future. Significant investment in communications would be required by administrators as the process would be required for the next four decades or as long as members retain a GMP entitlement in their scheme pension.

2.6 Comments received from an Advisory Board member considered:

- this method would be too administratively bureaucratic and complex. Moreover, individual cases could easily 'slip through the net' and need time-consuming and costly adjustments at a future date. As the consultation document states, '*the case by case method would add significant complexity to the work of pension administrators and goes against one of the core principles of moving to the new State Pension – simplicity.*

- It was not acceptable that, if a teacher were to benefit from the implementation of the new State Pension, this should be set against the value of their GMP indexation.

- That the UK Government should maintain the promises to public service workers which it has made in the past and that HM Treasury should meet the cost in full of GMP indexation.

- If the UK Government does not meet the cost in full of indexation, this should continue to be provided by the public service pension schemes, with the cost met by employers under the cost-sharing arrangements established by the Public Service Pensions Act 2013 and the Public Service Pensions Act (Northern Ireland) 2014.

2.7 In addition the Scottish Teachers' Pension Board provided the following general view which included a specific opinion on the case by case option:

- *"The Pension Board of the Scottish Teachers' Pension Scheme considered the consultation on 14 February 2017. It noted, yet again, the significant additional administrative burden, for example GMP reconciliation, now being passed to pension schemes by the UK Government. The Board also noted that it would be important for any solution to indexation and equalisation to reduce the opportunity for errors and the associated risk of scheme members receiving the wrong entitlement. Of the options provided, while it did not believe it was its role to choose between "indexation" and "conversion", it considered that the "case-by-case" option appeared to be far and away the least manageable from the perspective of the additional administrative effort, cost and risk of error involved. The Board would therefore not support the choice of that "case-by-case" option.*

- *The Board also regretted that the UK Government did not appear to have listened to requests for it to establish a more realistic timetable that would enable pension scheme managers to address this fundamental change in their responsibilities and workload in the most efficient and effective manner."*

2.7 Whilst this is the least costly option it clearly fails to deliver full indexation promises provided by previous Governments and relies on gains from the new State Pension to cover that expectation. The SPPA believes that the unavoidable additional administrative

costs involved would be significant and that the additional complexities would create real challenges in communicating this process to members and assuring them that their benefits were correct.

2.8 Any decision to implement this option must be based on a detailed and accurate analysis of the arising additional administrative and communication costs.

Option 2 - Extension of the interim solution.

3. This option would continue the process put in place for members reaching State Pension Age from April 2016. Put simply, public service schemes index all of the member's pension and have no separate process to recognise GMPs or which element of GMP should be automatically indexed. Prevailing GMP legislation requires schemes to (a) maintain GMP entitlements and (b) be aware of any cases where a GMP may exceed the pension in payment from the scheme.

3.1 It would add costs to the scheme and GAD estimate these to be an increase in liabilities of £5bn across all public service schemes and as a rough estimate based on 2015/16 payroll would add an additional 0.3% to the Scottish NHS scheme employer contribution rate (£15m) and 0.4% to the Teachers employer rates (£9m). However it fully addresses indexation and equalisation issues and provides the commitment to fully index GMPs made by successive governments.

3.2 A much less complex system which pension schemes will already have in place but as this captures all members reaching State Pension age after December 2018 the ratio of members gaining from the new State Pension will increase as time progresses. The consultation document reports DWP estimates that by 2030 80% of UK pension scheme members with GMPs who transition to the new State Pension will receive higher State Pension payments than under the old system over their lifetime. It is not clear how accurately this applies to work patterns of those public service workers who retire at a protected pension age and do not pay national insurance contributions or claim national insurance credits from that date through to their State Pension age.

Opinion

3.3 The comments provided by an Advisory Board member supported the retention of this option as a long term solution.

- The Government's promise of full GMP indexation should be underpinned by legislation and that GMP legislation should continue to apply to public service pension schemes. This is more secure for public service pension scheme members than converting GMP indexation into a public service pension scheme benefit.

3.4 Again the requirement for schemes to maintain and update where applicable accurate and reliable data remains a crucial element of this option. It is assumed that this is achieved as a starting base by the successful reconciliation of GMP data by December 2018. However, there could be some savings generated from the GMP reconciliation where full analysis could be given to the lower number of cases where GMP exceeds the member's occupational pension or is within an agreed tolerance figure over which HMRC GMP figures could simply be accepted going forward.

3.5 It is also assumed that there are no significant system change costs given that the processes for this solution are currently in place. This option would maintain full indexation and equalisation of GMPs.

3.6 This option would require schemes to continue with the administration of GMPs going forward into the medium to long term to ensure GMP accrued rights were maintained. Communicating the change could use communication tools applied as part of the interim solution from April 2016 enhanced and extended as and where necessary. There would still be the existing challenge of explaining what GMPs are and how the revised indexation and equalisation approach delivers full indexation on accrued GMP rights.

3.7 SPPA recognises the greater cost related to this and the conversion option and comment below about the proposed approach to meeting that cost. However this option would be meeting both full indexation and equalisation and at the same time create a less complex process that would be easier to both administer and communicate effectively to the member. Whilst the Advisory Board member raises a pertinent point that this option provides continued protection afforded to GMP benefits, SPPA see the continued maintenance of GMPs and the application of current and future legislative GMP requirements as a continuation of the recognised complexity.

Option 3 - Conversion

4.1 This option would see the GMP entitlements of active and deferred members who reach State Pension age from 6 December 2018 converted to scheme benefits on a 1:1 basis. This option has similar outcomes to those set out above for Option 2 (the continued use of the interim solution) and would create costs similar to those outlined in paragraph 3.1 above.

4.2 The key to this option is the removal of future application of GMP legislation to this group of members and with it a greater simplicity regarding how member scheme benefits are indexed. That said, a continued application and understanding of GMPs would be required going forward for those members who reached State Pension age before 6 December 2018. As with option 2, full indexation and equalisation is maintained and there would need to be an administrative process that would convert GMPs into scheme benefits. However, as with option 2, there may be some easement possible around the current reconciliation exercise with any arising resource savings being diverted to conversion.

4.3 Schemes would need to provide communications to members that clearly set out why GMPs were being converted and how this change would ensure that they continued to receive full indexation and how a conversion would be treated in any transfer of accrued benefits prior to reaching State Pension age. The key to any message would be to highlight that there would be no losses and that it would provide greater clarity on scheme benefits payable in retirement.

Opinion

4.4 Comments received from Scheme Advisory Board members included:

- If GMP indexation is converted to a Teachers' Pension Scheme (TPS) benefit on a 1:1 basis, then GMP indexation should not be reduced for teachers who have taken their pension as actuarially reduced benefits.

- Their organisation recognised that all three options provide for the additional pension for pre-1988 service to be incorporated into the pension benefits but suggested option 3 "conversion" because this is clear in giving a pound for pound conversion, and because this issue cannot then be revisited in future years (as could happen in case by case situations). They considered that the "conversion" option would deal with the matter more cleanly and set out a clear process for this part of the pension benefit.

4.4 SPPA would support the conversion of GMPs although continues to have significant concerns on how costs for this and all options are managed (see below). In terms of removing substantial complexity and lack of understanding this option is the most preferred of the three. It compares with costs of continuing the present interim solution and will deliver full indexation and remove concerns around equalised benefits.

Conclusion

5.1 SPPA provides advice to Scottish Ministers on the 5 devolved schemes and administers the four unfunded schemes (NHS, Teachers, Police and Fire). It has considered the proposed options and has concluded that option 1 is not realistic given the added complexity, added risk of error and on-going additional costs of annual assessment. It also fails to deliver the UK Government's repeated guarantee to provide full indexation on GMPs. SPPA believe this would be subject to challenge if the indexation of benefits accrued up to 1997 were adjusted via potential increases arising from higher State Pension entitlements from 2016.

5.2 Options 2 and 3 deliver similar outcomes managing both full indexation and equalised benefits and result in similar additional costs to the scheme. These costs will be reflected in the scheme valuations and result in additional employer contribution costs and add to those already anticipated by the unfunded schemes as a result of the Budget 2016 change to the discount rate. Additionally employers already have to meet further costs resulting from State Pension reform because of the loss of the National Insurance contracted out rebate.

5.3 The costs arising from the eventual option applied come in addition to those already imposed by the interim solution. In both cases these were costs met centrally by DWP and have now been passed to schemes to absorb through higher employer contributions. SPPA firmly believe these costs should continue to be met directly by the UK Government rather than simply pushing them on to employers and ultimately impacting on public service delivery.

Yours faithfully

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