Merseyside
PENSION FUND

Consultation on Indexation and Equalisation of
GMP in Public Service Pension Schemes,
Workforce, Pay and Pensions Team,
HM Treasury,
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Direct Line: 0151 242 1390

Please ask for: Yvonne Caddock

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Dear Sirs

Consultation on Indexation and Equalisation of GMP in Public Service Schemes

I refer to the above mentioned consultation document and I am responding to the invitation for comments on behalf of Wirral Council in its capacity as the Administering Authority for Merseyside Pension Fund (MPF).

The Fund is part of the Local Government Pension Scheme (LGPS) and the 4th largest of the 88 funds in England and Wales, with assets of £7bn. MPF undertakes the LGPS pension administration and investments on behalf of the five Merseyside district authorities, over 170 other employers on Merseyside and elsewhere throughout the UK. The Fund has over 130,000 active, deferred and pensioner members.

1/ Objectives of the Consultation

The consultation takes a joint approach in addressing the issue of equalisation and indexation of GMPs culminating in a number of inter-linked factors which have cost implications for funds and employers as follows:

- Operational cost and complexity – the immediate and ongoing costs associated with the additional administration burden of the proposals.
- Immediate financial/funding cost – the impact on current funding levels of the proposals
- Future financial exposure – the additional exposure to inflation linked to the removal of the 3% cap on post 1988 GMPs

2/ Correlation of Public Service Pension's and State Pension Scheme

The correlation between the public sector and state pensions is a complex issue and there is no obvious solution to unwind the historic synergies and any proposal will ultimately result in a trade-off between the above factors.

The consultation description explains that *"the new State Pension (nSP) was designed to simplify pension provision, while ensuring that pensioners have security in retirement*".

To ensure members' continued security in retirement and retain the confidence of employees and pensioners within the public sector, it is essential a method is agreed that maintains the level of promissory provision through a combination of the occupational and state pension scheme.

However, the method also needs to address fairness between the loss of member payments, the increase in employer costs, simplicity of administration and ease of member understanding.

3/ Impact of Proposed Options on Funding & Administration Costs

In order to honour historic government commitments to fully index the GMPs of public sector employees, it appears that HM Treasury is passing on the payment obligations to public service schemes and the associated employers (including private sector companies) without any additional funding to cover the cost. It is also ambiguous as to whether all participating employers in the LGPS are obliged to fulfil the government's previous promises e.g. universities, housing associations and community admission bodies.

As such the proposals generate material funding implications, administrative complexity and increased operational costs to varying degrees.

a/ Proposal One – A Case by Case Approach

This proposal would limit payment top-ups to circumstances where there has been a monetary loss from the introduction of the nSP; and any consequential adverse impact due to the loss of indexation on pension entitlement as related to a member's gender.

Operational Impact [SEVERE]

The multiple assessments required to calculate any loss of indexation under the old/new state pension system, together with the gender comparison will involve a huge administration burden, to establish entitlement to top ups, which will continue for decades. The complexity inherent within this approach will require significant investment in administration systems. GMP data for all members would first have to be reconciled under HMRC's Scheme Reconciliation Service and then subsequently tested each year under the two stage process.

This proposal is also contrary to the principle of simplicity as it will be difficult for members to forecast pension entitlement and administrators would also need to retain a detailed knowledge of GMPs long after the abolition of contracting out.

Estimated Operational Cost

Actuarial advice indicates that costs could be in excess of £75 per member in respect of full member GMP reconciliation and rectification, plus additional costs in relation to the 'no-worse-off test'; this will result in the largest operational impact of the three proposals.

Funding Impact [MATERIAL]

There will be an additional funding cost incurred by employers, associated with uprating the benefits of those members who lose out under the new state pension scheme along with any gender equalisation. The cost of the additional liability cannot be specified without full details of the two stage process, but will be less than the other proposals.

Impact on Members

It is noteworthy that a significant proportion of LGPS retired members receive a relatively small pension, less than £100 per week, and they would be disproportionately affected if the GMP element of their pension is not subject to indexation.

As the GMP forms a significant part of their income, any failure to ensure this sum is indexed in pace with inflation will have a detrimental impact on their living standards. This would be particularly unfortunate as they have taken the opportunity to contribute to an occupational pension in order to secure their financial future in retirement.

b/ Proposal Two – Full Indexation for <u>all</u> Members

Under this proposal, all members who reach State Pension Age (SPA) after 5 April 2016 would receive the promised full indexation on GMPs upholding the commitments made by successive governments. Therefore, as the full pension would be increased in line with CPI inflation (including GMPs), the benefits for males and females would be effectively equalised for all members.

For members who reached SPA before 6 April 2016, the state will continue to pay the difference on GMP increases above 0% (pre 1988 GMP) and 3% (post 1988 GMP) up to CPI (if CPI is higher) effectively equalising pension provision within the public sector pension schemes.

Operational Impact [MATERIAL]

A potentially reduced GMP reconciliation exercise would need to be done for those members who reached SPA after 6 April 2016. GMP data for only those members who reached SPA prior to 6 April 2016 would have to be reconciled by way of HMRC's Scheme Reconciliation Service, materially reducing the amount of administration required.

Our understanding of the way that this proposal has been drafted is that all members would receive full GMP indexation (whether from the Fund alone or from the Fund and state combined) and therefore a 'no-worse-off test' is not required.

A major disadvantage of this approach is that it requires the continued administration of GMPs, requiring processes and systems that can cope with GMP for many decades; long after the original concept of GMP has ceased to have any real relevance.

Estimated Operational Cost

It is difficult to quantify at this stage but the costs will be significantly lower than under proposal one. Ultimately, as an extension to the interim solution for public service pensioners who attain GMP age between 6 April 2016 and 5 December 2018, it requires no additional IT or systems development.

Funding Impact [SEVERE]

There will be a funding cost associated with the impact of providing full CPI indexation on GMPs for all members who reach state pension age after 5 December 2018.

In addition, there will be a future risk of inflation increasing above the 3% cap that would mean additional funding strain compared to current financial commitments. Actuarial analysis has indicated that the combined valuation deficit at 31 March 2016 across all LGPS funds could increase by c.£1billion under this proposal.

c/ Proposal Three – GMP Conversion

This proposal would mean converting the GMP on a simplified basis into scheme benefits. MPF is mindful that conversion on a 1:1 basis shares many of the advantages of the full GMP indexation approach. In addition, this approach would remove the burden of GMP legislation from public service schemes.

It appears that this approach would likely be less onerous than full GMP indexation. Scheme GMP records would only need to be reconciled to the extent that the population and contacted out periods matched that of HMRC's records. Discrepancies between scheme and HMRC GMP values would not need to be addressed as schemes would take the HMRC GMP value and convert to main scheme pension at 1:1 ratio with no impact on pension entitlements.

Where an individual is in receipt of a public service pension, has a GMP entitlement, but has not yet reached SPA, the conversion of the member's GMP to main scheme pension should be carried out as part of the same exercise in respect of active and deferred members.

This proposal fully addresses issues of indexation and any inequality, and fully upholds the commitments on GMP indexation made by successive governments.

The approach has the further advantage of being a one off exercise. Once the conversion has been carried out, neither the schemes nor Department of Work & Pensions (DWP) will need to calculate or track GMP amounts going forward. This finality brings a stability and permanence to the solution.

The disadvantage of this approach is the full cost of GMP indexation passes to the schemes resulting in the same additional cost as the full-indexation method.

4/ Conclusion

The consultation highlights the obstacles in achieving the core objectives to equalise benefits and honour former commitments to fully index the GMP element of public sector pensions.

MPF is of the view that the full indexation or conversion of GMPs into main scheme benefits would deliver former government commitments and fully address the issue of gender inequality resulting from the abolition of the additional state pension scheme.

In terms of simplicity of administration and ease of member understanding, full indexation of GMPs by either route (Proposal Two or Three) is clearly preferable to an annual case by case approach.

Extending the current interim solution (Proposal Two) is clearly the least onerous in the short term, as it would not require any changes to systems or procedures - although it would require the ongoing maintenance of GMP records for the duration of the members and dependants time on pension. It is also recognised that GMP legislation for members who reach SPA post 5 December 2018 would also be required in order to extend the interim arrangements.

MPF's preferred approach is to convert the GMP into a scheme benefit (Proposal Three). Despite the initial administration and resource requirements to change the structure of the pension element, the conversion will result in fewer GMP records and shorten the period where Funds would be required to administer GMP related legislation.

However, this creates additional liabilities for the schemes and will be less of an immediate issue for the unfunded public service schemes, but would be reflected instantaneously in funding deficits for the LGPS.

Local Government is struggling to provide statutory services as local authority budgets are overstretched and the LGPS is grappling with resources as it addresses CARE changes, Auto Enrolment and an expanding employer base as a result of alternative delivery models and academy conversions.

The affordability and sustainability of the LGPS is paramount and costs inherent within the additional state pension provision <u>should not</u> be passed on to pension funds and its constituent employers. This is on the basis that the funding obligations and government commitment to pay

full indexation on the GMP element of public sector pensions should have been identified when the nSP was being considered and therefore additional funding should be made available to LGPS funds to offset the extra liability.

The outcome of the consultation will have an effect on the approach that funds take to GMP reconciliation and given the deadlines to complete the project by December 2018 an early government response to the consultation is essential.

Yours faithfully

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Yvonne Caddock
Principal Pensions Officer