Workforce, Pay and Pensions Team,
HM Treasury,
1 Horse Guards Road,
London
SW1A 2HQ

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Consultation on indexation and equalisation of GMP in public service pension schemes

Hymans Robertson LLP is pleased to provide its response to HM Treasury consultation dated 28 November 2016 on indexation and equalisation of GMP in public service pension schemes.

The Annex to this letter sets out our formal response to the specific questions set out in the consultation.

About Hymans Robertson LLP

Hymans Robertson has grown up with the LGPS. The firm was founded to provide advice to the LGPS in 1921, just as the first funds were being created. Whilst our business has developed over the decades, working with the public sector remains at the heart of what we do.

We have a specialist public sector actuarial team, which employs over 60 people exclusively advising on the LGPS. Alongside our actuaries there is a team of 15 investment consultants providing investment advice and a team of benefit/governance consultants providing benefit and governance advice to our LGPS clients.

We believe that we are well placed, therefore, to respond to the questions posed by HMT in this latest consultation paper.

Yours faithfully

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Question 1: Which pension schemes (public and private) follow the PIA 1971 and SSPA and therefore may be affected by a policy change?

We have no comments to make under this section.

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?

The case-by-case approach would address the issue of gender inequality that the abolition of additional state pension would otherwise create.

We consider, however, that the case-by-case method introduces a significant degree of additional long term complexity into the system, both for administrators and more importantly scheme members and their dependants; complexity that, to some extent, the nSP was designed to do away with.

The case-by-case approach hinges on making an annual comparison between an individual's nSP entitlement and the notional "old style" state pension they would have received, had the system not changed. This would involve carrying out historical state pension calculations for 2 million members of public service pension schemes for many decades to come. This will only get more difficult as we get further away from the introduction of nSP and knowledge of the old state pension system is lost through natural wastage. Is the expectation that this task passes to the schemes themselves, with all the attendant cost or will DWP be suitably resourced to provide this information?

In order to make the comparison, it will also be necessary for public service schemes to obtain annual values for a member's nSP. This would require the development of robust systems that could effectively and securely provide public service schemes with accurate information relating to the members in their scheme for whom the test is required.

The third piece of information required for the case-by-case approach is the value of a member's GMP (and the equivalent GMP for an otherwise identical member of the opposite sex). This would require a complete reconciliation between the GMP records held by the schemes and HMRC. This exercise alone is one of formidable complexity for schemes as large as those in the public sector but when attempted at the same time as the development of new IT systems and processes designed to cater for the above point, it is daunting indeed.

Finally, we make reference to the government's 2013 white paper, "The single-tier pension: a simple foundation for saving[1]". The paper states that;

A key objective of reform is to move to a simpler pension system that gives people clarity over what their state pension will be worth when they retire

We would fully endorse the sentiment that simplicity and clarity should be at the heart of pension policy but would suggest that the case-by-case approach fails to deliver these laudable aims. If this approach is adopted, members of public service schemes will have no way of anticipating from one year to the next by how much the GMP element of their pensions will increase. Similarly, public service schemes attempting to explain how a given year's increase has been arrived at are likely to be met by bewildered members.

[1] The single-tier pension: a simple foundation for saving - Publications - GOV.UK

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?

We have already outlined our concerns over the practicalities of the case-by-case basis under question 2, but we are also not convinced that this approach would properly honour the long standing commitment to fully index GMP.

The commitment made by successive governments was that members of public service schemes should receive full indexation of the GMP element of their pension. The case-by-case basis proposes a situation whereby a member will only receive indexation of GMP if their public service pension without indexed GMP and their nSP, taken together, place them in a worse position than they would have been in had the state pension system not changed. It follows then, that members who are better off under nSP will have their GMP indexation offset by the extent to which they are better off, in total, under nSP.

Members affected would surely have reason for complaint as they might justifiably feel that at no point during the introduction of the nSP was it made clear that any additional benefit that might apply to them as a consequence of the move to a single tier state pension would later be recycled in order to make good a previous pension commitment.

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?

Yes, full indexation would avoid the inequalities between men and women that would otherwise occur following the abolition of AP.

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?

In our view, full indexation of GMP has a number of reasons to commend it as a method of meeting past indexation pension commitments.

It is simple to administer, being in effect an extension of the existing temporary solution applied to the indexation of GMP for public service pensioners who reach GMP age between 6 April 2016 and 5 December 2018. It requires no additional IT or systems development on the part of government.

It fully addresses issues of indexation and inequality and fully upholds the commitments on GMP indexation made by successive governments.

While it will remain necessary for schemes to hold a GMP figure for members, there is less of a requirement to carry out a full GMP reconciliation for such members. Schemes and individual LGPS funds would still need to establish that the populations of members holding a GMP entitlement on their records matched that of HMRC, but there would be less need to quantify discrepancies in GMP records and challenge the figures held by HMRC where there are differences. Schemes could simply accept the value of GMP held by HMRC in respect of a member at retirement and fully index that value in addition to fully indexing the excess pension over and above the GMP value.

One 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. However, by far the biggest objection to this approach is that of cost. As advisers to over half the Local Government Pension Scheme funds in the country, the following comments are framed in the context of the funded LGPS, however, some of the points are to a greater or lesser extent still relevant to the unfunded pension schemes. Assuming full indexation was at a level of around 2% - 2.5% p.a., calculations carried out on a sample of LGPS funds and extrapolated across the whole of the LGPS estimate the cost to be £2 - £2.5bn.

At higher levels of inflation, such as indexation of 5% p.a., the cost may be £8 - £9 bn. across the whole of the LGPS. This is potentially a significant cost to the LGPS funds, however the case by case solution does not deliver the desired outcome and is extremely complex resulting in potentially high administration costs. We would expect the government to provide additional funding or some level of compensation, given the cuts to local authority budgets that have been made already.

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?

Yes. Conversion of GMP to main scheme pension on a 1:1 basis would avoid the inequalities between men and women that would otherwise occur following the abolition of AP.

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?

In our view, conversion on a 1:1 basis shares many of the advantages of the full GMP indexation approach. In addition there is a further advantage to this approach in that it once and for all draws a line under the issue.

Although the consultation refers to the need for a "significant undertaking and would require, at a member by member level, data to have been reconciled as part of the HMRC-led Scheme Reconciliation Service" it is our view 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 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, but this in itself will have no impact on the amount of the pension entitlement in the Scheme anyway.

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

The 1:1 approach has the further advantage of being a one off exercise. Once the conversion has been carried out, neither the schemes nor 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 same as that discussed under full GMP indexation, namely, the additional cost that passes to the schemes. We would expect this approach to result in the same additional cost as the full-indexation method. See our response to Q.5 for more detail.

Question 8: Under this methodology, how should government treat those in receipt of a public service pension but below SPa?

Where an individual is in receipt of a public service pension, has a GMP entitlement, but has not yet reached SPa, the scheme will be applying full indexation to that GMP. This is because the member is either below GMP age, in which case no GMP is payable or they have reached GMP age but because they are not yet at SPa, an Additional Pension less than GMP notice applies.

In such cases, the conversion of the member's GMP to main scheme pension should be carried out as part of the same exercise as all other affected members. The member's GMP entitlement should be converted to main scheme pension and fully indexed by the scheme with immediate effect.

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?

We agree. The commitment was for the full amount of the GMP to receive indexation. Given the intrinsically unequal nature of GMPs between men and women any attempt to convert GMP to main scheme benefits on anything other than a straight one-to-one basis would result in men and women with otherwise identical pension and earnings histories receiving indexation on a different amount than originally promised.

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?

Although no solution is perfect, in our view, on balance, the conversion of GMP to main scheme pension best meets the criteria set out in section 1.2.

Question 11: Are there alternative methodologies the government could consider?

None of which we are aware.

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?

Questions 12 to 16, all broadly cover the impact and potential read across of adopting the policies outlined in the consultation. Our general thoughts on this topic are set out below.

There may be an issue for several private-sector, or wider public sector schemes given that different schemes will find themselves mirroring public sector indexation rules for different reasons, involving matters of history and choices made in legal draughtsmanship. Consequently 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.

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?

See our response to Q.12

Question 14: Should the government take action to avoid any read across between private sector schemes and any policy announced?

See our response to Q.12

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?

See our response to Q.12

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?

See our response to Q.12

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?

We have no comments to make under this section.