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

The LGA is a politically-led, cross-party membership organisation that works on behalf of councils to ensure local government has a strong, credible voice with national government. In total, 435 local authorities are presently members of the LGA.

The Local Government Pensions Committee (LGPC) is a committee of councillors constituted by the Local Government Association (LGA), the Welsh Local Government Association (WLGA) and the Convention of Scottish Local Authorities (COSLA). The LGPC considers policy and technical matters affecting the Local Government Pension Scheme (LGPS) in the UK, a scheme which has over 5 million members.

Scope of response

This response addresses the consultation only in respect of those members of the Local Government Pension Scheme (LGPS) who reach State pension age after 5 December 2018 and who may be affected, and as such makes no comment on the wider implications either for other Public Service Pension Schemes (PSPS) or private sector schemes.

Accordingly this response addresses only questions 1 through 11.

Summary

- The consultation considers how Guaranteed Minimum Pension (GMP) elements for public service pension scheme members reaching state pension age on and after 6 December 2018 should be treated.
- This is needed to address two issues:
    - the indexation of GMP elements so that members will be at least as well off as they would have been before the introduction of the new State Pension, and
    - the equalisation of GMPs to eliminate gender inequality.
- The consultation document proposes three methods for doing this, with varying costs and administrative implications.
- In the view of the LGA, of the three options proposed, the third option (converting the GMP into pension) is the most appealing due to the simplification it would introduce in the longer term.
- Nevertheless, the LGA believe that all three options are to a degree inherently unfair as they convert a central Government promise to a local government responsibility, which will ultimately need to be met by the local taxpayer.
- Given this, an alternative would be for any additional payments that need to be made to meet the stated objectives to be added on to individuals' new State Pension.

The issue addressed by the consultation

The introduction of the new State Pension (nSP) in April 2016 replaced the previous arrangements which included the payment of Additional State Pension (AP) to those individuals who were members of contracted-out pension schemes.

LGPS pensions receive annual increases in accordance with indexation orders made under The Pensions Increase Act 1971 and The Pension Schemes Act 1993. Members of the LGPS during the period 6 April 1978 to 5 April 1997 built up a Guaranteed Minimum Pension (GMP). The indexation of pensions for those members who built up a GMP and have reached State Pension Age (SPA) was delivered by a combination of:-

- An increase to the pension in excess of the value of the GMP in line with Pension Increase (Review) Orders
- An increase to the GMP element built up after 5 April 1988 by the amount of the GMP Increase Order (maximum increase 3%)
- Net AP - calculated by increasing the gross AP by the percentage increase in prices (currently CPI) and subtracting a Contracted-out Deduction which broadly equates to the pensioners GMP

The consultation states that the abolition of AP after 5 April 2016 introduces an inequality in the payment of public service pensions between men and women as well as no longer providing a mechanism to fully index pension payments.

The consultation seeks to address that inequality and loss of full indexation in respect of scheme members who reach SPA after 5th December 2018.Those who reach SPA on or after 6th April 2016 and prior to 6th December 2018 receive full indexation on the GMP element[1] of their pension under transitional arrangements (the interim solution) announced by Government in March 2016.

The options put forward by the consultation

The consultation puts forward three options to address the issues, these being

Case by Case

Under this option two phases of calculations would be undertaken annually for each member once they reach SPA.

The first phase would estimate whether the member is expected to receive a higher or lower income in any single year from the combination of their nSP and LGPS pension, than under the old system.

- The new system –LGPS pension (increased under PI Act 1971 and PSA 1993 as described previously) plus nSP

[1] Excluding GMP Increments paid under section 15 of the Pension Schemes Act 1993

- The old system –LGPS pension (increased under PI Act 1971 and PSA 1993 as described previously) plus old State Pension (including Net AP)

With the greater amount being payable

The second phase would repeat the above calculation using the opposite sex of the member with the higher amount being paid.

The Government Actuary's Department (GAD) have estimated that the total cost across all PSPS would be £1.5b (or 0.15% of liabilities) over the next 40 years. For the LGPS those assumptions would result in a cost of between £0.45b[2] and £0.6b[3] over 40 years.

LGA comment on this option

Although this option appears to provide the lowest cost solution it is easily the most complex option and has the potential for unknown additional costs resulting from increased administration, member challenge, mistakes and incorrect initial assumptions.

The multiple annual calculations would require significant changes to systems and ongoing regular communication with members who will no doubt be confused by the potential for changes to the level of increase to their pension each year.

This solution would require the teams within LGPS administrative authorities to create and maintain knowledge of and access to DWP records, GMP data for both sexes and nSP amounts. In particular they will have to use a broad range of assumptions to arrive at a notional old state pension figure for comparative purposes which would mean keeping track of historical social security rules for four or five decades after the policy had changed.

The level of assumption and the potential for mistakes in calculations could lead to challenge and dispute from members who feel they should have received a higher increase.

Finally the GAD estimate is based on a number of broad assumptions which result in an estimate of only 30% of members receiving an additional payment. The actual cost to LGPS employers would be determined by the actuarial firms who undertake fund valuations who may well take a more prudent view.

Extending the interim solution

Under the option the interim arrangements for members reaching SPA after 5th April 2016 and prior to 6th December 2018 would be continued for those reaching SPA

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[2] Assuming total liabilities of £300b

[3] Assuming LGPS is 37% of the total PSPS membership source The Pensions Regulator Public service pension schemes A summary of governance and administration September 2013

after 5th December 2018. GMP records would be maintained and full indexation applied to the pension including the GMP element[4].

The Government Actuary's Department (GAD) have estimated that the total cost across all PSPS would be £5b (0.5% of liabilities) over the next 40 years. Using the same assumptions on the relative size and liabilities of the LGPS results in an estimate of between £1.5b and £1.8b over 40 years.

LGA comment on this option

This option appeals due its continuation of a practice already in place within the scheme. It would not require changes to systems or procedures but would need communicating to those affected.

However this solution does require the maintaining of the GMP record and the administration of all legislation related to GMP for the next four or five decades.

By applying the increase in all cases it places a cap on the cost, although at a higher estimated level than the case by case option, and significantly reduces both the additional administrative burden and the potential for challenge and dispute when compared to that option.

Converting the GMP

Under this option the GMP element of the pension would be converted into scheme benefit on a 1:1 basis. GMP records would no longer be required following conversion with indexation applied to the full pension.

The Government Actuary's Department (GAD) have estimated that the total cost across all PSPS would be £5b (0.5% of liabilities) over the next 40 years. Using the same assumptions on the relative size and liabilities of the LGPS results in an estimate of between £1.5b and £1.8b over 40 years.

LGA comment on this option

This options appeals due its relative simplicity once in place. Although there would be an initial burden for implementation, the resulting record sets and calculations should be clean and straightforward for the affected members.

The conversion for these members will result in fewer GMP records having to be maintained and shorten the period over which the administration of all legislation related to GMP will be required.

Furthermore if these GMP records are to be removed then the burden of reconciliation should be significantly reduced for this tranche of members.

As for the second option applying the increase in all cases places a cap on the cost, although at a higher estimated level than the case by case option, and significantly

[4] Excluding GMP Increments paid under section 15 of the Pension Schemes Act 1993

reduces both the additional administrative burden and the potential for challenge and dispute when compared to that option.

Overall LGA comment on cost estimates

Fund actuaries have indicated that in some cases full PI is already assumed in actuarial calculations. Applying any of the above options in those cases should therefore result in a foregone future saving rather than an immediate increase to employer contributions.

Response to questions put by the consultation

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

This response addresses the LGPS only which does follow PIA 1971 and the Social Security Pensions Act 1975

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?

Partially –the level of complexity and assumptions necessary for the calculation of old state pension and potential for changes to nSP could result in outcomes which have the opposite effect to that desired

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?

No –as full indexation is not part of the calculations proposed

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, however it does not address full ‘Barber’ equalisation due to the potential for difference in the treatment of GMPs prior to SPA.

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?

Yes

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, however it does not address full ‘Barber’ equalisation due to the potential for difference in the treatment of GMPs prior to conversion.

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?

Yes

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

GMP’s for these members should also be converted on a 1:1 basis

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?

Yes

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?

Conversion of the GMP

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

All of these options place all of the cost burden for indexation of pensions on the employers of the LGPS. The arrangements prior to April 2016 shared the cost between LGPS employers and the government through the AP element of state pension.

It is arguable that in the main both of those sources of funding consist of public entities and therefore moving the source from both to one will not impact as it all falls within the public purse.

However with the majority of affected LGPS members having been employed by local authorities, there is also an argument that the source of funding is being moved from general to local taxation. Furthermore it would seem inequitable that the full cost of indexation is now falling on those employers within the LGPS who have no public funding either direct or indirect.

We would therefore ask government to consider dealing with this issue via an addition to nSP rather than putting the burden on the LGPS. Alternatively we ask that government provide funding to enable LGPS employers to meet this additional burden

20 February 2017