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

## Consultation

This paper updates Scheme Advisory Board members on a government consultation, seeking views on how to address the implications of State Pension reforms for guaranteed minimum pensions of public servants below State Pension age.

**https://www.gov.uk/government/consultations/indexation-and-equalisation-of-gmp-in-public-service-pension-schemes**

## Background

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.

Firefighter pensions receive annual increases in accordance with indexation orders made under The Pensions Increase Act 1971and The Pension Schemes Act 1993. Members of the Firefighters Pension Scheme 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


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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 for each year the pension is in payment for each member once they reach SPA.

1. 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 Firefighters pension, than under the old system.

The higher amount of a or b would be payable to the member

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

2. 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.

**Comment on this option**

Although this option appears to provide the lowest cost solution to the Firefighters Pension Fund, 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.

Administration of the pension scheme for the 44 English Fire Authorities is currently spread over 30 different administrators, and at least three different software providers.  This means a 'one size' solution could not be implemented across the Firefighters Pension Scheme, as this solution would require each Scheme Manager to ensure their pension administrator had the necessary knowledge, software and access to DWP records, GMP data for both sexes and nSP amounts. In particular

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


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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.

As an unfunded scheme the costs of this highly complex solution would fall directly to the employer, which are likely to be phenomenally high. Also for the reasons listed above there would be no consistency in these costs to each employer and would depend on their pension administration provider.

In addition 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.

- **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 after 5th December 2018. GMP records would be maintained and full indexation applied to the pension including the GMP element[2].

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.

**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.

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


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- **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.

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

## 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 Firefighter Pension Schemes 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 mean that the certainty for equality cannot be established.

**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?**


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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

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

All of these options place the cost burden for indexation of pensions fully on the Firefighters Pension Scheme, and will increase the schemes liabilities.  In addition as an unfunded scheme, the significant extra costs for administration of these options would be placed on the Fire and Rescue Authorities.

The arrangements prior to April 2016 shared the cost between The Firefighters Pension Scheme and the government through the AP element of state pension.

I would therefore ask government to consider dealing with this issue via an addition to nSP rather than putting the burden on the FPS, and seek to fund the employers to provide the additional administrative processes needed to support the option chosen

**Action for board members**

1. The board are asked to note the response.

Board Secretary
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