Department for Work & Pensions

A proposed methodology for equalising pensions for the effect of GMPs

Response from The Pensions Management Institute
Response from the Pensions Management Institute to DWP consultation “A proposed methodology for equalising pensions for the effect of GMPs”

Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 6,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

PMI is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement benefit arrangements for which they are responsible.
Chapter 1: The draft Pensions (Schemes that were Contracted-out) (Miscellaneous Amendments) Regulations 2017

Question 1

Do you agree that the draft changes to give HMRC discretion to extend the notification and payment periods for contributions equivalent premiums will deliver the policy intent?

We believe it does so in relation to scheme reconciliations. Our members’ experience is that in many schemes it is very time consuming and ultimately a fruitless task to resolve cases of members with a short period of contracted-out service who appear on HMRC’s records and are either considered by a scheme to have no liabilities or are not known to a scheme.

We note that HMRC will retain a discretion over such payments, and we think this is important. It is also important that HMRC should issue guidelines to ensure that the schemes only use this approach where intended, ie to resolve queries where the existence of a liability was otherwise in dispute. Otherwise there is a risk that the service will be used to settle contracted-out liabilities where a member is known to a scheme, but where a scheme chose not to pay CEPs when a member left service. To allow CEPs in such cases could have a material impact on an individual’s overall State/scheme benefits.

The consultation document and draft regulations refer directly to a scheme reconciliation. There would be equal merit in adopting a similar approach where a scheme is using the cessation route for GMP reconciliation.

Question 2

Do you agree that the proposed changes will now correctly reflect the policy intention as outlined in paragraph 1.14 above?

These amendments appear to reflect the policy intent as set out in the consultation document,

Question 3

Do you agree that the changes we have made to regulations 21 and 22 make it clear in which circumstances an inheritable GMP should be paid following the introduction of the new BSP?

These amendments appear to reflect the policy intent as set out in the consultation document,

Question 4

It would be helpful to know, from your experience, approximately what percentage of schemes are likely to provide an inheritable GMP regardless of the survivor’s circumstances (for example as their scheme rules require that this is paid to everyone), and what percentage will provide an inheritable GMP by following the statutory requirements of section 17 of the 1993 Act (for example by checking
that the appropriate State benefit is in payment or that the survivor has reached the appropriate age). We believe that the latter approach will represent a minority of schemes but we are seeking some quantification.

(i) For a scheme that provides an inheritable GMP regardless of the survivor’s circumstances (the former approach), will there be any costs associated with the change to regulations? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).

(ii) For a scheme that provides an inheritable GMP by following the statutory requirements for each member (the latter approach), what additional costs might the scheme incur from updating their administrative processes to take account of the change, e.g. changing guidance, making staff aware of the new requirements? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).

We have no information on which to provide the quantification requested. Certainly in the private occupational pension scheme sector our experience is that a pension benefit would normally be paid under the Scheme’s rules irrespective of the survivor’s circumstances (ie without reference to the statutory requirements).

The only exceptions to this general observation relates to scheme rules which restrict payments (often at trustees’ discretion) in the cases of marriages within 6 months of a member’s death, possibly estranged partners, and possibly where there was more than one dependant eligible for a benefit under a scheme’s rules. In all of these circumstances benefits may sometimes be limited to a GMP, or possibly to a strict definition of an inheritable GMP assessed by reference to the circumstances of the spouse immediately following the member’s death.

In the circumstances outlined, where a strict definition is applied, we do not anticipate that the change will add an onerous administration requirement since this will simply be adding a further evidence of proof of entitlement to an existing procedure.

Question 5

Do you agree with the underlying earnings increase assumption proposed by GAD?

Others are better placed to comment on the derivation of the assumption by GAD than the PMI, although we would note that, over the last 30 years the GAD has consistently over-estimated future earnings growth.

Question 6

Is it correct to adopt a medium term view on earnings assumptions?

Others are better placed to comment on the derivation of the assumption by GAD than the PMI.
Question 7

Do you agree that DWP should continue to apply the 0.5% premium for fixing the rate or are there good arguments to remove or adjust the premium?

Fixed rate revaluation was intended as an alternative approach available for pension schemes to manage their risks; the margin can be considered as a premium for the “underwriting provided by SERPS (although in practice SERPS has consistently benefited from fixed rate revaluation since earnings growth has fallen below fixed rate revaluation), which in some circumstances would also benefit members. It could be argued that this margin was offset elsewhere, for example in the contracting-out rebates provided.

Following the introduction of the new State pension the position is different. Revaluation will no longer have an impact on State benefits. The margin will become an additional benefit to Scheme members when they leave pensionable service, rather than an “insurance premium” to the State.

We expect most schemes will choose to retain fixed rate revaluation on the grounds of administrative ease, rather than on any financial grounds. If a margin is retained, this, will lead to a windfall gain to members who are in schemes where the financing is often already stretched. On these grounds we suggest that the margin is removed.

If the Government believes that a margin remains necessary, the Government should review whether 0.5% pa remains reasonable, or whether it should be reduced, recognising the shorter period of the risk, and also that retention of a 0.5% pa margin would otherwise represent a larger relative variance in what is anticipated to be a lower wage inflation environment.

Chapter 2: Reviews

Question 8

Do you have any concerns relating to regulation 3 of the 2013 Regulations which the Department is not already aware of?

We have no particular concerns.

Question 9

Apart from the issues mentioned, do you have any concerns about regulation 4 and bulk transfer arrangements?

No. However, we would urge the Department to resolve this continuing problem at the earliest opportunity as this is now a real barrier to transfers as described, with possible adverse consequences for members’ benefits.
Question 10

Are there any issues that you think the Department needs to be aware of in relation to the transitional arrangements?

We have no particular concerns.

Chapter 3: GMP Equalisation

We are pleased that the Government has brought equalisation for the effects of GMPs back onto agendas as the requirement to equalise and, if necessary, how this should be achieved does need to be addressed.

We note that it is the Government’s view that it is necessary to equalise benefits for the effects of GMPs earned after 17 May 1990, although it is not clear to us that the reference in 3.38 achieves the clarity sign-posted in 3.6. It would be helpful to understand whether and how the Government’s position would change once the UK is no longer a full member of the EU. Otherwise, many trustee boards and scheme sponsors may choose to delay any action pending resolution of this point.

As an organisation PMI is not in a position to comment on the requirement or otherwise of scheme to equalise for the effects of GMPs. That is a matter for the legal profession. We have therefore based our response on the assumption that pension schemes must equalise for the effects of GMPs, and addressed the question of how this should be achieved.

We suggest that in due course either the Government or the Pensions Regulator issues guidance on the timescales in which it would expect a scheme to have equalised for the effects of GMPs.

Question 11

Is the proposed methodology the best approach? What, if any, other methods should we consider?

We consider that a value-based methodology for assessing future payments in conjunction with an aggregation of past payments is an appropriate way to equalise for the effects of GMPs which provides a fair balance between the interests of members receiving benefits and those meeting the cost. A value-based method:

- leads to a more logical outcome than the previous method on which the Government consulted, which in many cases would have led to the conclusion that both male and female members in an identical position had suffered discrimination and should receive an additional benefit.
- is the typical approach that is being used by trustees where schemes are having to address equalisation when winding up and securing members’ benefits with annuities. As such, it has found the support of insurers who have been prepared to provide insurance cover against the risk that the agreed approach has subsequently proved inadequate.
However, we should note that the value methods used to date would not typically have been based on a GMP conversion, because of the difficulties identified under the legislation, but also because of the additional member communication this would have entailed, at a time when there would typically several other important messages to share with members.

We feel the consultation document strikes a fair balance allowing schemes to choose their own method, on advice, to best suit their circumstances, while providing an example approach which the Government itself supports.

We are supportive of the method put forward by the Industry Working Party, and believe that this has the potential of being the best approach in many circumstances. Combining the use of unisex factors and a GMP conversion will clearly provide an identical benefit for a member at retirement in relation to service from 17 May 1990, and avoids the complication of this becoming a GMP (although we note that the adoption of unisex demographic assumptions is likely to have only a second order impact and may add to the costs of equalising benefits as it would not be the typical approach used in other value calculations/comparisons.)

However, there will be circumstances in some schemes that would be better addressed using other value-based approaches (or, if it is expedient, a GMP conversion that “converts” the GMP into an identical benefit to the GMP). For example:

- Where a scheme has secured some (or all) members’ benefits through annuity policies, there may be merit in equalising for the effects of GMPs by leaving the existing benefits intact and providing an additional free-standing pension.
- The position would be similar where a member had a GMP underpin to a DC benefit and their benefits were secured by purchasing an annuity at retirement. Here, often it might be appropriate to pay out benefits to the former member as an additional lump sum.
- Where trustees believe that their existing scheme structure and/or administration is complicated, and too difficult to adjust, or they do not wish to disrupt the balance between existing different levels of indexation. In all these cases the better outcome may be to leave existing benefits untouched, and to provide an additional “GMP”.

As noted above, a GMP conversion approach is likely to be harder to communicate than a value method which did not rearrange existing benefits.

Paragraph 3.24 of the consultation document emphasises that the GMP conversion method is not being mandated and 3.25 identifies that the onus is on the trustees to take appropriate action for their scheme. We suggest it would be helpful for the industry and individual trustee bodies if the Government considered and acknowledges the legitimacy of other approaches, which may be more appropriate in certain circumstances. Alternatively, it is likely to be as helpful if the Government identified approaches that it did not find acceptable and the reasons why that is the case.
Question 12

Is there anything about the proposed process that raises concerns or might not work – if so, what needs to be done?

The Industry Working Party note provides a good clear example of how benefits might be equalised for the effects of GMPs. We believe it achieves the objectives as set out in the introduction to the process. It should be noted that the example illustrated is a simple case. The note highlights the complications likely to be found in practice, and we believe these will be substantial. We expect other complications will be identified in individual schemes.

We believe the biggest obstacle in most exercises will relate to the accessibility of sufficient data in a suitable form, and definitive documentation related to historic practices. This is because the data required for this exercise goes beyond that necessary for the day to day administration of the scheme. In almost all schemes there will be cases that cannot be resolved without recourse to a manual calculation based on a member’s historic data file; there will also be cases where the information no longer exists (such as for survivors’ pensions as highlighted in the Working Party paper).

We think it would be helpful if the Working Party’s paper is extended:

- To include further example cases (for example for a pensioner)
- To put forward a pragmatic approach to cover situations where sufficient data is not available or would require a disproportionate effort to access
- To address situations where there are no longer benefits in payment from the scheme

We therefore encourage the DWP to continue to engage with the Industry Working Party (with which the PMI is happy to continue to participate).

Question 13

What are the potential administration costs from using the proposed methodology? How might these costs be reduced?

We expect that the costs of any value-based methodology are likely to be substantial, and driven more by the availability of sufficient, suitable data for the exercise, rather than the actual detailed methodology. However, we expect this cost will be only a small percentage of the additional value of the benefits provided to affected scheme members.

We agree that, while there are opportunities for actuarial firms to build core processing systems with some automation, a generic fully-automated and comprehensive model is unlikely to be achievable. However, the adoption of an industry-standard approach would lead to some savings, for example it would streamline the production of member communications, and may facilitate a smoother transfer of data from scheme administrators to those completing the calculations as data requirements are likely to be broadly similar in many cases.
Because of the overlap, we think the most significant cost reduction could be achieved if pension schemes are able to run a GMP rectification exercise (following reconciliation of their GMPs with HMRC) and a GMP equalisation/conversion exercise in tandem. This would have the following advantages:

- Affected members benefits would only need to be re-calculated once
- Scheme records and payroll systems would only need to be updated once
- It would be more straightforward to offset past over-payments arising from a GMP discrepancy against an under-payment from GMP equalisation
- There would only need to be a single member communication covering what for most individuals is an obscure and technical matter (and where what will really matter is the effect on their benefits).

We also believe that for some schemes there would be merit in not completing an equalisation / conversion exercise for deferred pensioners and members in service until their retirement (or earlier death / transfer). This would mean that existing procedures could be retained and their position could be addressed as a “business as usual” event.

Finally, technical obstacles (such as arising from the Annual Allowance, Lifetime Allowance, Benefit Crystallisation Events, and the tax treatment of lump sum back-payments) need to be addressed and removed across the board rather than addressed at a scheme level.

**Question 14**

*What do you think of the proposed changes to the GMP conversion legislation? (We would be particularly interested to hear from schemes that have already converted GMPs using the current legislation.)*

We have provided input directly to the Working Party on this. We believe that few schemes have converted GMPs under the current legislation.

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