Pension Fund Committee

16 March 2023

Pension Fund – GMP Rectification

Report of Paul Darby, Corporate Director of Resources

Purpose of the Report

1 This report highlights the need for the Pension Fund to complete a rectification of LGPS pensions in payment due to the implications arising from a reconciliation of Guaranteed Minimum Pension data held by the Fund and HMRC.

Executive Summary

2 Guaranteed Minimum Pension (GMP) is an element of pension accrued by scheme members in respect of service prior to April 1997. The amount of GMP is calculated by HMRC based upon service records held by HMRC and UK pension funds. Following the closure of HMRC's GMP support, all defined benefit schemes in the UK were required to undertake a reconciliation of the GMP data held locally with the corresponding record held by HMRC. As the value of GMP affects the rate of annual pension increase enjoyed by pensioners, discrepancies in this data can lead to both under and overpayments.

3 Having carried out its reconciliation, the Pension Fund has identified 1,282 pensioners whose pension needs to be corrected due to discrepancies between the data held by the Fund and that held by HMRC. Correcting the pensions in payment will result in the Fund paying an estimated £247k in arrears due to underpayments. It is also proposed that overpayments totalling £250k are written off.

Recommendation(s)

4 The Committee are recommended to:

(a) Note the report and agree that the Corporate Director of Resources commits the additional resources necessary to bring to a conclusion the GMP Rectification,

(b) Note the approach taken by the Fund in reconciling its GMP liabilities, and the setting of a £2 per week reconciliation tolerance,

(c) Agree to the correction of all under / overpaid pensions going forward,

(d) Agree to payment of all arrears that have accrued due to underpayments, with interest paid at 1% above the Bank of England Base Rate; and,

(e) Agree to write off overpayments that have resulted from the GMP Reconciliation.

Background

5 From 6 April 1978 to 31 March 2016 the State Pension was made up of a basic element and an additional element known as the State Second Pension – known previously as State Earnings Related Pension Scheme or 'SERPS'. Occupational pension schemes were able to 'contract out' of SERPS, and in return their members could pay reduced National Insurance contributions.

6 Like all other public sector pension schemes the Local Government Pension Scheme (LGPS) contracted-out of SERPS. As such, the public sector schemes, including the LGPS, were required to ensure that their scheme members were paid a pension at least equal to that which would have been due under SERPS. This amount is known as the Guaranteed Minimum Pension (GMP). GMP accrued in two distinct periods – that which was earned before April 1988 ('pre-88 GMP'), and that which was earned after April 1988 ('post-88' GMP). Accrual of GMPs ceased in April 1997.

7 GMP that has accrued becomes payable from State Pension Age (SPA), and pension funds must check the value of the GMP against the pension currently in payment. The value of the LGPS pension payable almost always exceeds the GMP. On rare occasions where an LGPS pension is less than the GMP however, then that pension must be uplifted to the value of the GMP on and from SPA.

The Impact of GMP

8 In addition to checking the level of pension in payment at SPA against the value of GMP, the Pension Fund must also take the GMP into account when calculating annual increases for the Fund's 21,346 pensioners. For pensioners who attained SPA before 6 April 2016, the Fund pays lower increases to those pensioners who have accrued a GMP. As set out below, the Fund is not responsible for all of the increases due on GMPs:

Tranche of pension	**Who pays increase?**
Pre-88 GMP	DWP, through State Pension
Post-88 GMP	LGPS Fund, up to 3% DWP, through State Pension, increase in excess of 3%
Pension in excess of GMP	LGPS Fund

9 The Fund is not responsible for paying any increase on the pre-88 GMP – the increase on this amount is paid as part of the State Pension. Additionally, for pensioners who attained SPA before 6 April 2016 and who also have a post-88 GMP, the process is more complicated. The Fund has responsibility for the first 3% of any increase on the post-88 GMP, with any increase in excess of 3% paid as part of the State Pension. An example of how this works is shown in the table below, reflecting the application of the 2023 annual increase of 10.10%:

	2022 Starting pension (£ p/a)	**Increase on pre-88 GMP paid by LGPS**	**Increase on post-88 GMP paid by LGPS**	**Increase on excess over GMP**	**2023 Increased Pension**
Pensioner, with no GMP	£1,000	n/a	n/a	£1,000 x 10.10% = £101	£1,101.00
Pensioner, with £100 pre-88 GMP only	£1,000	£zero	n/a	£900 x 10.10% = £90.90	£1090.90
Pensioner, with £100 pre and £100 post-88 GMP	£1,000	£zero	£100 x 3% = £3	£800 x 10.10% = £80.80	£1083.80

10 On 6 April 2016, a new State Pension was introduced, replacing the two-tier system which included the State Second Pension. The change caused uncertainty over responsibility for the ongoing increases (known as indexation) to GMP. This led to an interim solution for members attaining SPA on or after 6 April 2016, whereby LGPS funds took responsibility for paying all of the increase on both pre-88 and post-88 GMPs. In 2021, the interim solution was made permanent. The Pension Fund therefore pays full increases to all pensioners attaining SPA after April 2016.

Problems with GMP data

11 In 2008 the Government announced that £126m of overpayments had been made to 95,000 pensioners in the five centrally managed public service pension schemes (the NHS, Teachers, Armed Forces, Judicial and Civil Service schemes). The overpayments had arisen due to the incorrect recording of GMP values, which had been reconciled against values held by HMRC. The inaccuracies had led to the incorrect application of pensions increase over a 30-year period.

12 The sources of the errors leading to the £126m overpaid in the centrally managed public sector schemes was not always the same for each individual. The interaction between the State Pension system and occupational pension schemes is noted as being complex, with shared responsibility for GMP indexation as noted previously. The historic, paper-based, administrative process for establishing and transacting GMP accrual was complex and fragmented, vulnerable to error. Indications in 2008 were that the locally managed public service pension schemes, such as the LGPS, were not affected to the same extent as the centrally managed schemes.

13 In a December 2008 statement to the Commons, the Minister for the Cabinet Office announced the Government's decision not to recover monies already overpaid to pensioners in the centrally managed schemes, but to correct ongoing payments on and from April 2009. It was noted that it was not cost-effective to seek recovery of historic overpayments. Those pensioners who were underpaid, were paid full arrears with interest.

14 Subsequently, following the end of the State Second Pension and Contracting-Out in 2016, HMRC announced its intention to stop supporting the reconciliation of GMP. Ahead of the cessation of its GMP support, HMRC would make full information on GMP liabilities available to all former contracted-out pension schemes to allow pension funds to undertake a full reconciliation. It was a requirement in both the public and private sectors for all Defined Benefit pension schemes, like the LGPS, to carry such a reconciliation with HMRC.

The Need for GMP Reconciliation

15 GMP reconciliation is the process of comparing a pension fund's GMP data with that held by HMRC. The process seeks to investigate any discrepancies between pension fund data and HMRC data, with the aim of achieving consistent GMP data and benefit records. HMRC's approach placed the investigative responsibility for all reconciliation queries back onto the individual pension fund.

16 Following HMRC's requirement to undertake such a reconciliation exercise, the Pension Fund registered with HMRC's scheme reconciliation service and received an initial data file listing the contracted-out periods and GMP data for members who had left contracted-out employment.

17 When the Pension Fund Committee considered the GMP Reconciliation in March 2017 it was noted that not all variances were to be investigated, and that a tolerance would be set. An HM Treasury

working group provided the following recommendation on how any discrepancies should be dealt with:

"*Where discrepancies are small, for example if a service period discrepancy is less than a year, or if the discrepancy in weekly GMP amount is no more than £2, schemes should use the data provided by HMRC in respect of any individuals who have not reached state pension age, or the data held by the scheme in respect of any individuals who have reached state pension age*."

18 Following agreement of the Pension Fund Committee to commit the necessary resources to carry out the GMP Reconciliation, the Fund worked with its software supplier Civica, to carry out the GMP Reconciliation. This was a significantly protracted process, with many delays due to changes in HMRC delivery dates.

19 The subsequent reconciliation involved detailed investigative work, reviewing decades of data and benefit accrual. Ultimately, the Fund's GMP and membership data was compared to that which was held by HMRC. Where service could be matched within the recommended tolerances, the GMP value provide by HMRC was accepted to be correct. Where service did not match this was queried with HMRC.

20 Following the completion of the reconciliation and closure of HMRC's Scheme Reconciliation Service, the Fund was issued with a final data cut from HMRC, based on the completion of all queries. There is no opportunity for pension funds to further query the data due to the Reconciliation Service closure. Following receipt of the final data cut, the Fund undertook a final rematching exercise against this data cut.

21 The rematching process identified 2,715 pensioners who had attained SPA as being in scope of rectification, based on the recommended £2 per week reconciliation tolerance. This population included a number of pensioners who reached SPA after April 2016, and are therefore entitled to, and have been receiving, full increase on their GMP. The estimated population of pensioners for whom rectification will impact the rate of pension increase is therefore reduced to 1,282.

LGPS Rectification

22 Following the completion of the Pension Fund's GMP Reconciliation, the Fund must now go through a process of correcting the data held and implementing an approach to pensions currently paid at the incorrect rate. This stage of the process is known as the GMP Rectification. Initial work has been undertaken with the Fund's software supplier to run results through it's GMP Rectification solution. The solution will provide bulk data correction, and calculation of arrears.

23 The results from this initial work have helped to verify the number of pensioners who require an adjustment to their pensions and helped to scope the scale of work required to rectify records for other membership populations. The GMP Rectification will facilitate the payment of correct pension benefits going forward and inform the delivery of member communications.

24 The Rectification exercise is necessary as pension schemes have a duty to pay the correct benefits to the right members at the right time. Additionally, the Pensions Regulator regards accurate record keeping as fundamental to good governance, falling within the statutory duty to establish and operate adequate internal controls. Inaccuracies in scheme data such as GMP can result in over or understatement of scheme liabilities.

25 As noted, this initial work following the final rematching exercise has revealed 1,282 pensioners who are in receipt of a pension paid at the incorrect rate due to the impact of incorrect GMP on the annual pension increase exercise. Of this population, 677 cases ran through the automated software solution without manual intervention. The results from these 677 cases provide an indication of the scale of over / under payments across the total population as estimated in the table below:

Under / Overpayment Range	**Estimated Number of Pensioners**	**Estimated Over/Under Payment Accrued**
Overpayment £3,000+	23	-£120,227
Overpayment £2000-£3000	11	-£26,402
Overpayment £1000-£2000	36	-£49,146
Overpayment £500-£1000	44	-£31,302
Overpayment £250-£500	32	-£11,645
Overpayment up to £250	282	-£11,374
No Change	670	£0
Underpayment up to £250	121	£2,844
Underpayment £250-£500	15	£5,137
Underpayment £500-£1000	8	£5,799
Underpayment £1000-£2000	17	£25,532
Underpayment £2000-£3000	8	£19,227
Underpayment £3000+	15	£189,073
Total	**1,282**	

26 The scale of over / underpayments is significantly lower than that experienced in other centrally managed schemes. Additionally, the corrected pensions that become due to the 1,282 affected pensioners is also lower – with no individual pensioner anticipated to see an increase or decrease of more than £10 per month to their pension. The impact on the Fund's pensioners is shown in the table below:

Monthly Pension Variance	**Estimated Number of Pensioners**
Reduction greater than £50	0
Reduction between £20 and £50	0
Reduction between £10 and £20	0
Reduction between £2 and £10	47
Reduction between £1 and £2	40
Reduction between £0.03 and £1	165
No material impact	933
Increase between £0.03 and £1	66
Increase between £1 and £2	17
Increase between £2 and £10	13
Increase between £10 and £20	0
Increase between £20 and £50	0
Increase greater than £50	0
Total	**1,282**

27 The approach to under / overpayments across the LGPS is still emerging, as Funds experienced significant delays in receipt of final data cuts from HMRC. HM Treasury's GMP working group made clear however that there is an expectation that pensioners who have been underpaid, should be paid their pension arrears in full, with interest. Payment of the arrears will incur an estimated cost to the Pension Fund of £247k + interest.

28 Treasury guidance also clarifies that in the case of the LGPS, decisions on whether and how to recover overpayments are a matter for the relevant local authority. As the Fund participates in the North of England Pension Officer's Forum (NEPOF) with 7 other LGPS Funds based in

the northeast; the Fund has been able to discuss progress with regional peers. Amongst those funds, only one has concluded their Rectification exercise to date. That fund took the decision to correct all pensions going forward, but to write off any past overpayments; consistent with the approach taken in the centrally managed funds.

29 There is a possible reputational risk associated with either writing off overpayments, or conversely from trying to reclaim such overpayments from elderly scheme members. The context must be noted that the recipients of the overpayments are highly unlikely to have any awareness of having been overpaid, due to the complexity of the GMP calculation underlying the overpayment. Additionally, it would not be cost effective to seek to recover small overpayments from the Fund's pensioners who would have the right to appeal against the decision to do so.

30 The Pension Fund does, however, have an obligation to correct errors of which it has become aware. It is therefore proposed to correct overpaid pensions at the earliest opportunity, but to write off the overpayment that has accrued to date. This will write off an estimated £250k of overpayments from the Pension Fund and would be consistent with central government approach, and the emerging approach in the wider LGPS.

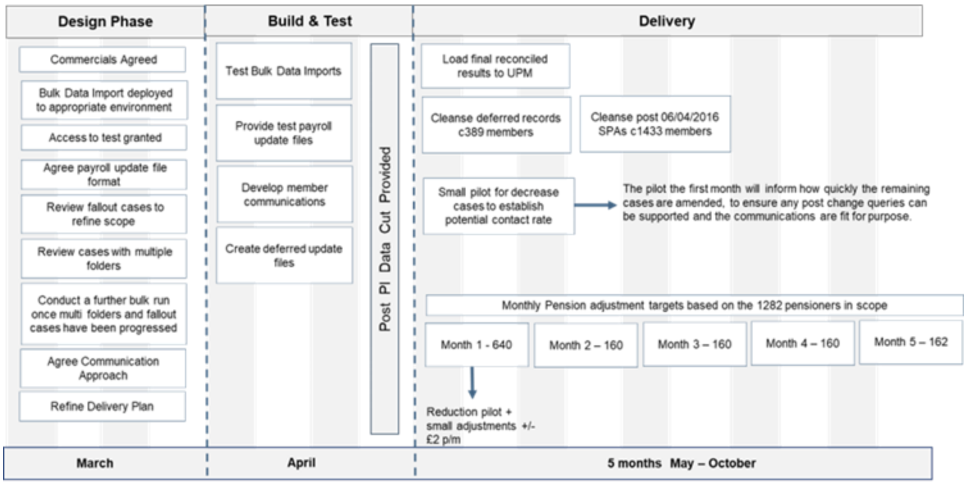
31 It should be noted that the modelling of impact at both pensioner and total fund level is based upon initial analysis only. Further quality checks will be undertaken, and the pattern seen in the 677 cases which did not require manual intervention has been applied to the whole population. The results could therefore be under / overestimated. Additionally, as the rectification will occur after the 2023 pensions increase exercise in April, the under / overpayments will be further exacerbated by CPI of 10.10%.

32 There is also significant further work to correct the records of those membership populations whose rate of pension is not affected by the exercise – including pensioners who attained SPA after April 2016, deferred members, and active members with membership before April 1997. Bulk Data Import (BDI) through the Fund's software supplier will be utilised to correct all records on the Fund's pension administration database. The proposed project delivery plan is shown below

33 Whilst it is initially planned that monthly pensions are corrected over a 5-month period May – October, due to the lower than expected over / underpayments, this period is likely to be shortened after reviewing the success of the pilot in May. Member communications will be developed ahead of the pilot, and it is proposed that a written notification is sent to all pensioners whose change in monthly pension would trigger a payslip

(i.e. a change of £5 or more) - consideration will be given to communications for smaller adjustments. Active and Deferred members will be kept informed through online Annual Benefit Statements.

Next Steps



34 It has been a protracted process to get to the stage where the Fund is able to progress its GMP Rectification. Subject to the Committee’s agreement to the proposed strategy, the Fund’s software supplier will be engaged to complete the Rectification through a Contract Change Notice. Communications will be developed, with the intention that all under / overpayments are corrected before October with pensioners notified of their own position as required. Both the Pension Fund and Corporate Risk Register will be updated as the project progresses.

Author(s)

Paul Cooper Tel: 03000 269798