

Pension Fund Committee

7 March 2017



Guaranteed Minimum Pension Reconciliation Exercise Between Pension Fund Records and Her Majesty's Revenue and Customs

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Purpose of the report

- 1 To make Members aware of the requirement for the Pension Fund to carry out an exercise to reconcile its records with those held by HM Revenue and Customs (HMRC), and to explain the potential costs and consequences associated with this.

Background

- 2 Up until April 2016 contributing members of the Local Government Pension Scheme (LGPS) paid lower rate National Insurance contributions as they were "contracted out" of the Additional State Pension (previously known as S2P, the State Second Pension or the State Earnings-Related Pension (SERPS)). LGPS employers also paid reduced rate National Insurance contributions in respect of their employees who were in the LGPS. Contracting-out ended from 6 April 2016 as part of the Government's introduction of a single-tier basis state pension.
- 3 Between 1978 and 1997 contracting out of the Additional State Pension was done on a Guaranteed Minimum Pension (GMP) basis. This meant contracted out pension schemes had to offer pension benefits for the period of contracting out that were worth at least as much as the benefits the additional state pension would have provided. Contracted out pension schemes had to record the relevant contracted-out earnings for that period and supply HMRC with details of these. HMRC retains a record of contracted out earnings and GMP entitlement for each individual and HMRC then advise pension schemes of GMP entitlements when the individuals reach state pension age.
- 4 GMP affects the way pension increase is applied each year. For individuals who reached state pension age before 6 April 2016, all pension increases on GMP earned before April 1988, and pension increases up to 3% on GMP earned after April 1988 are paid for by the

state. This means the Pension Fund currently pays lower pension increases to those individuals with a GMP.

- 5 Contracting-out ceased in April 2016, and as part of this change, HMRC announced that it will stop offering a GMP reconciliation service after 2018 but has now made full information on GMP liabilities available to former contracted-out pension schemes to allow a GMP reconciliation exercise to take place.

Guaranteed Minimum Pension Reconciliation

- 6 GMP reconciliation allows pension schemes to check their contracted out records against those held by HMRC in order to resolve any differences between the two sets of records. HMRC has set up a Scheme Reconciliation Service to assist pension scheme administrators to reconcile their records for all non-active members (which includes; leavers with deferred benefits, pensioners, widows, widowers/civil partners) against HMRC records.
- 7 HMRC has also made data available to all pension schemes from February 2017 for reconciling GMP information for active members. HMRC will also be writing to all individuals with a GMP liability in December 2018 telling them which pension scheme holds their liability.

Why carry out a Guaranteed Minimum Pension reconciliation?

- 8 There are a number of reasons to carry out GMP reconciliation including:
 - Compliance with the Pensions Regulator's data quality checking guidance
 - To ensure members' benefits are accurate
 - To provide for more accurate actuarial valuations
 - To ensure that scheme liabilities are correctly recorded.
- 9 There are also significant risks to the Pension Fund if reconciliation activity is not carried out. These include:
 - The GMP amounts held by HMRC will automatically apply and this could have material implications on the Fund's liabilities
 - Individuals the Fund may not be aware of will request their GMP entitlement after 2018
 - GMP amounts we are unaware of will lead to incorrect valuations of the Funds scheme liabilities
 - Incorrect pension amounts being paid to members
 - Member complaints and reputation risk.

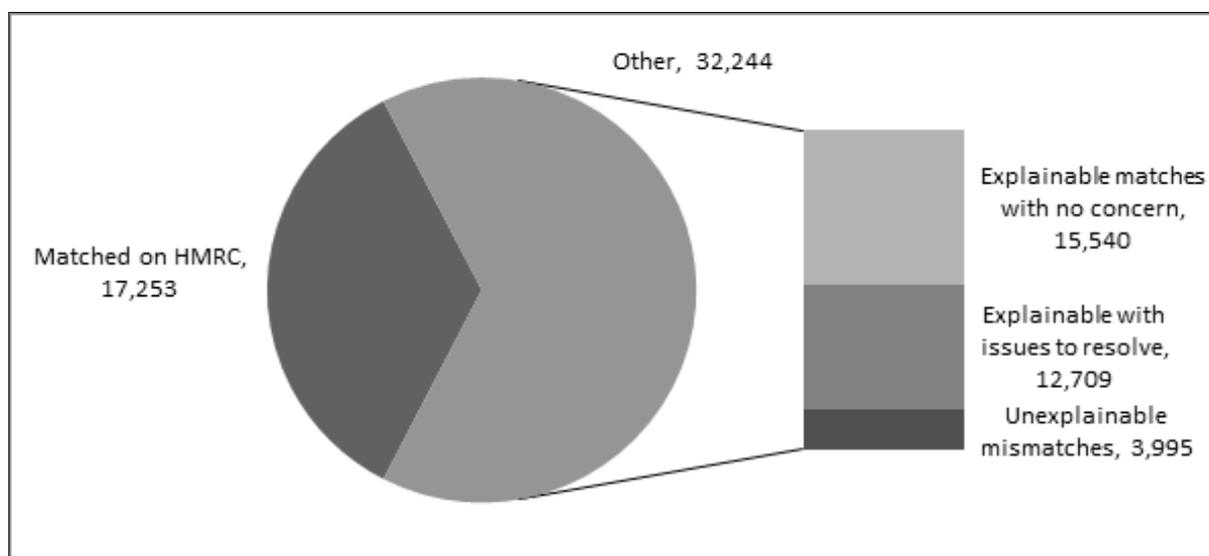
The Reconciliation Exercise

- 10 GMP reconciliation is the process of comparing a pension scheme's GMP information with that held by HMRC. It investigates any discrepancies between the two sets of figures so that both parties end up with consistent GMP data and benefit records. HMRC's starting position is usually that its data is automatically considered to be correct (although this is not always the case) unless the pension scheme can prove otherwise, which puts all the investigative responsibility back onto the pension scheme. The reconciliation will potentially involve detailed investigative work, reviewing decades of data and benefit accrual.
- 11 The Pension Fund has registered with HMRC's scheme reconciliation service and has received a data file which lists the contracted-out periods and GMP data for members who have left contracted-out employment. There are 20,845 lines of data - 20,401 in respect of Local Government Pension Scheme members and 444 in respect of members of the Firefighters' Pension Scheme.

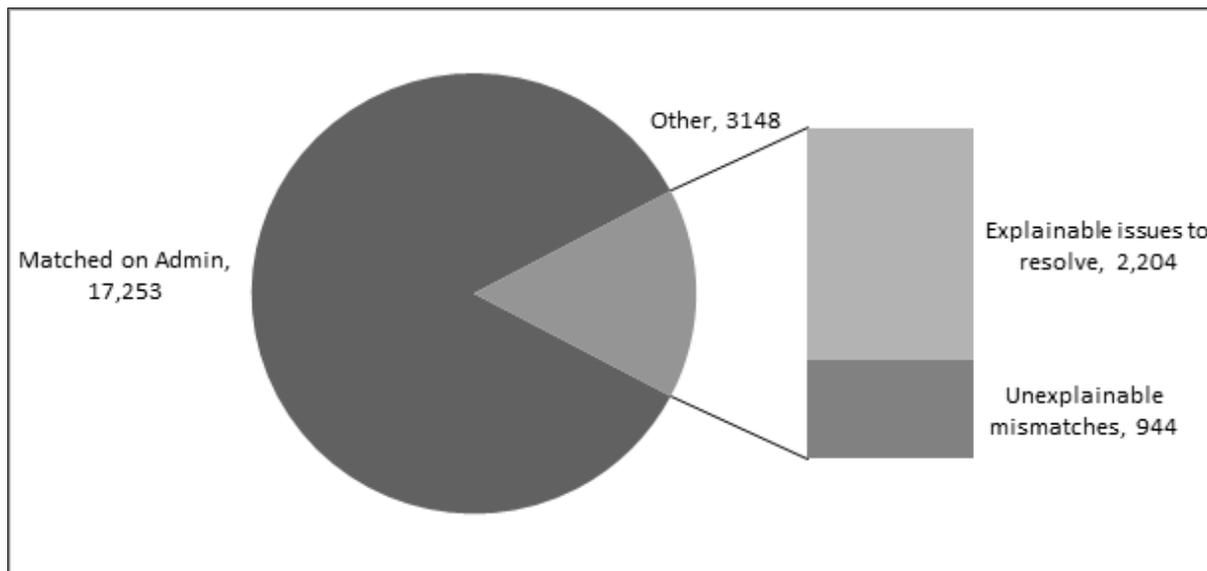
Initial Investigations

- 12 ITM – the company that successfully dealt with the data transition from the old to the new pension administration software system in 2015 - also provides a service assisting Funds with GMP reconciliation. ITM was commissioned to carry out an initial scoping analysis and categorisation exercise. Their initial report in respect of the LGPS identified a significant number of discrepancies between the GMP information held by HMRC and the Pension Fund. The charts below show the differences between the overall numbers of individuals shown on HMRC's records and those held on the Pension Fund's records

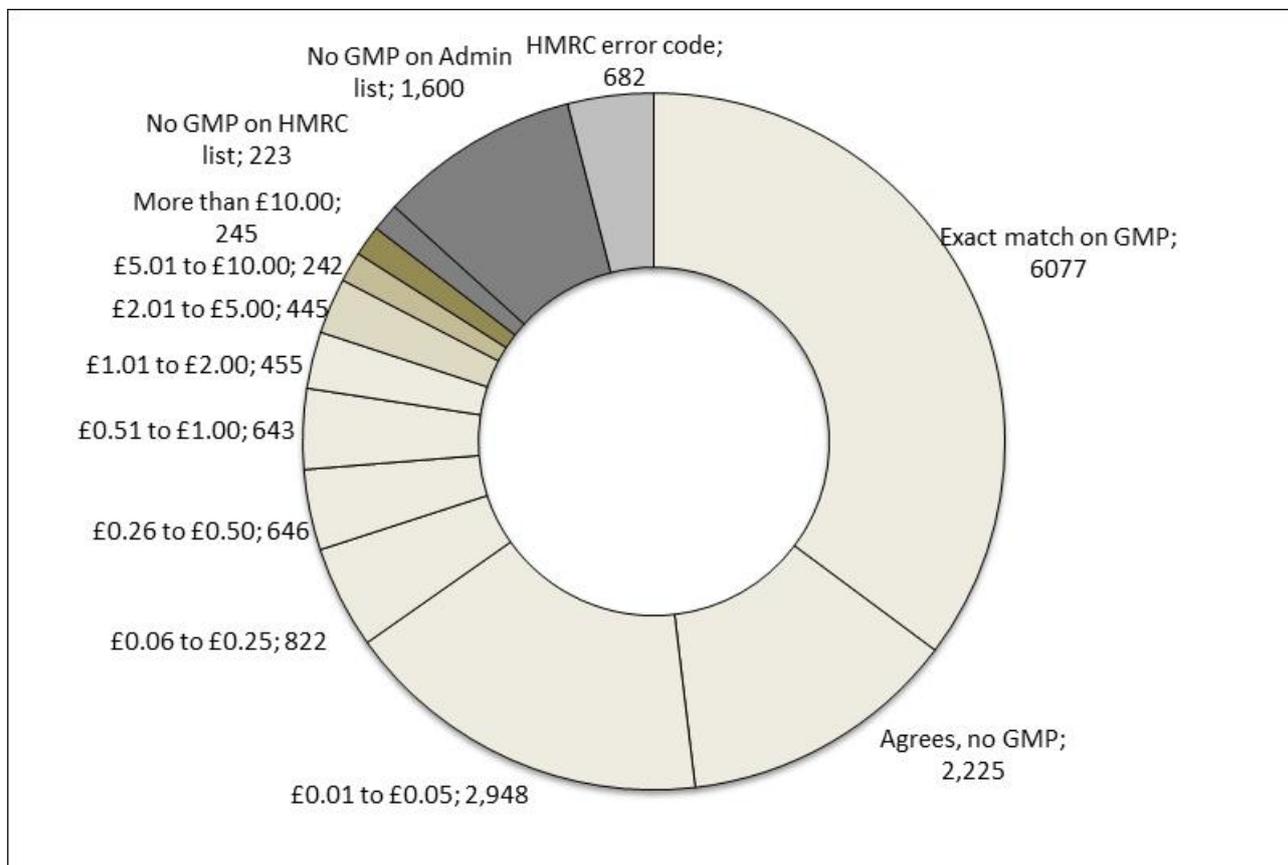
Analysis of 49,497 records held on Pension Fund database



Analysis of 20,401 records held on HMRC database



- 13 As shown above, there are around 5,000 mismatches where it is not immediately obvious why there is a discrepancy. Further investigation will be required on these cases.
- 14 Where there is a match, and the individual has a GMP record with both the Pension Fund and with HMRC, there are some records where there is a discrepancy between the GMP values held. The chart below shows the range of variances:



- 15 Not all variances will need to be investigated. The following guidance has been issued by a working group set up by HM Treasury on the general approach that LGPS Funds should take to GMP reconciliation:

The following members' data should be reconciled:

- Scheme members who have not yet reached state pension age who have any service between 6 April 1978 and 5 April 1997.
- Non-members who the pension scheme believe it has already discharged its liability (through, for example, transferring out their benefits to another pension scheme or receiving a refund of contributions).

- 16 The HM Treasury working group also provided the following recommendations on how any discrepancies identified through the reconciliation process should be dealt with:

- Pensioners that have been underpaid should receive their pension arrears in full, with interest in accordance with scheme rules.
- Cases where pensioners have been overpaid should be considered in the context of the overall extent of any overpayments, and a view taken over whether there will be value for money in recouping overpayments.
- 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.

- 17 The Local Government Pensions Committee (LGPC) has recommended the following approach to reconciling post 5 April 1997 contracted-out data:

- Where contracted-out records appear on HMRC records but no corresponding LGPS pension records exist within its fund, LGPS Administering Authorities should investigate all cases
- Where the dates of contracted-out service differ, each LGPS Administering Authority should only investigate those cases where in its view there is a significant risk to LGPS benefits or process.
- Where contracted out records do not appear on HMRC records but an LGPS pension record exists within its fund, each LGPS Administering Authority should notify HMRC of the discrepancy but only investigate those cases where in its view there is a significant risk to LGPS benefits or process.

The LGPS views this approach as representing a cost effective means of minimising risk of incorrect benefits while avoiding unnecessary and cost duplication of the work already undertaken to ensure records are accurate.

Next steps

- 18 ITM's initial work has identified areas where discrepancies exist. Further work is required to categorise the discrepancies identified, and make an assessment of the size of the issue, including what decisions should be made about materiality, and the process to follow in correcting any under or over payments identified.
- 19 It is likely that some further external expert assistance will be needed to carry out this work. The Pensions Team is working with procurement colleagues to ensure best value is achieved when commissioning any external assistance. Additional resource may also need to be allocated to the Pensions Team to carry out this GMP reconciliation exercise in order to ensure there is not a significant deterioration in service delivery as resource is allocated to the project.
- 20 The following areas should be viewed as a priority
 - Reconciling and agreeing the overall population under review – where possible, identifying reasons for the 5,000 member discrepancy between HMRC's data and the Pension Fund's data.
 - Investigating and resolving the discrepancies in GMP values above £2 a week for those individuals already in receipt of a GMP.
 - Categorising and prioritising the remaining discrepancy cases.

Recommendation

- 21 Members are asked to note the report and to agree that the Corporate Director Resources can commit additional resource to the GMP reconciliation exercise as necessary, which will be charged as a general Pension Fund administration expense.

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