Pension Correction Approach following GMP Changes

Approach document and decisions for
Kent County Council

Victoria Franklin
February 2023

itm

Solution delivered…

Contents

1 Introduction

1.1 Background

A project to rectify pension benefits following reconciliation of guaranteed minimum pensions (GMPs) is being undertaken for Kent County Council ("the Client") in respect of the Kent Pension Fund ("the Fund").

The reconciliation confirmed the GMP figures the Fund will use for members going forward following reconciliation with HMRC. The rectification part of the project is the process of making corrections to the pension record where the confirmed GMP figures differ to those that have been used in the administration process. This includes correction of the GMP data sets; the pension elements currently in payment and calculating any historic under or over payments.

ITM has developed a standardised approach to GMP rectification based on its experience of other similar exercises. This will enable the Fund to carry out pension corrections in a cost effective manner, and to leave a clear audit trail of the decisions taken during that process, for example treatment of past over payments. This approach is described in this document.

1.2 Purpose of document

The purpose of this document is to set out the proposed high level approach for GMP rectification of pensioners and dependant pensioners, and to obtain the Client's feedback and subsequent agreement to that overall approach.

It should be noted that ITM cannot give legal or actuarial advice, and the Client should consider whether it wishes to obtain legal or actuarial advice on some or all of the areas covered in this document, prior to taking decisions. Specifically, there are a number of decisions flagged in Section 3 regarding the scope of the population to be submitted for rectification for which the input of the legal advisers may be required, together with notes as to whether those decisions need to be taken up front, or can wait until more data is available later in the project.

This approach document is designed to take account of the specific requirements for the Fund at a high level. Further technical detail will be captured and then reflected in a later *Specification* document, for example details of calculation methods for interest on underpayments. *Test cases* will then be provided to demonstrate the full workings of the rectification calculation method, for review by the Client and external advisers as required.

itm
Solution delivered...

2 ITM rectification approach

2.1 How GMP impacts pension benefits

A summary of the ways in which GMP can impact pension benefits in defined benefit pension schemes is shown in the table below. Rectification can address the impact of each of these as a result of any change to the GMP record following GMP reconciliation:

Impact of GMP on typical DB scheme benefits	Impact for the Fund
GMP can impact the level of initial retirement pension *(Generally more GMP = higher pension)*	This has no impact for the Fund, as no distinction is made between GMP and excess pension when undertaking revaluation of deferred benefits. Transferred in GMP is always converted to Section 148 revaluation if accepted by the Funds.
GMP acts as a minimum pension level payable from GMP age *(more GMP = higher underpin)*	This does apply for the Fund. GMP acts as a minimum pension at GMP Age, noting this is still 60 for females, not the later State Pension Age.
GMP can impact pension in payment increase rates *(Generally more GMP = lower pension increases)*	Statutory GMP increases apply from State Pension Age (SPA) for members who reached SPA before 6 April 2016, except for periods where those members have been flagged as having "Additional Pension < GMP". GMPs receive full indexation for those who reach SPA on or after 6 April 2016.

2.2 Rectification populations

ITM's proposed GMP rectification approach is set out in the diagram below, split between whether members concerned are currently "no liability" (for example, transfers out or deceased), deferred members, pensioner members (split under / over GMP age) or dependant pensioners:

The diagram above segments the work involved into four bands of increasing complexity, with Band 1 requiring no rectification at all, and Band 4 requiring the most complex rectification work.

The Bands are described in more detail below for pensioners over GMPA and dependants:

▶ **Band 1 – No rectification required**, where the GMP reconciliation has confirmed that the GMP held on Fund records is correct, or so close to being correct that there is no need to apply rectification. For pensioners and dependants this typically includes members where GMP differences are simply due to pension increase rounding rules.

▶ **Band 2 – HM Treasury easement for within £2 pw**, which is based on the advice given in the letter from HM Treasury to the Department for Communities and Local Government on 2 February 2016, that set out a recommendation that all public service pension schemes could take the approach of accepting their scheme records of GMP for pensioner members where the differences between the scheme record and HMRC's record is within the £2 per week tolerance level. ITM has interpreted this recommendation as applying also to dependant pensioners.

▶ **Band 3 – No change to total pension in payment**, where the revised GMP is updated into the member's record so it will form the basis of future pension increases. For pensioners and dependants in Band 3 it should be noted that no change is made to the overall total pension level in payment, instead the GMP and excess pension elements are simply re-split ready to be used in the next annual pension increase (pensioners under GMP age in this band would have their contracting-out data updated to record the GMP values agreed with HMRC).

▶ **Band 4 - Corrections from GMP Age, or Date of Member's Death ("DOD") for a dependant,** where the previous pension increases awarded on the incorrect GMP are unwound back to GMP age or for a dependant back to Date of Member's Death ("DOD"), and then the correct increases are applied using the reconciled HMRC GMP figures. Any step up required at GMP age would also be corrected to use the reconciled GMP figures. Any period after SPA for which the member was flagged as "Additional pension < GMP" is also taken into account as the member would have received full indexation on GMP during that period.

2.3   Rectification calculation method

In summary the rectification calculation method for Band 4 is as follows:

▶ The pre-88 GMP and post-88 GMP pension elements currently in payment are "rolled-back" (i.e. reversal of pension increases) to State Pension Age (or date of retirement (DOR) should this be later than State Pension Age).

▶ A GMP delta at the later of GMP age and DOR (reconciled GMP – original GMP) is calculated.

▶ A pre-97 delta at the later of GMP age and DOR is also calculated that is equal and opposite of the GMP delta.

▶ Pension increases from the later of State Pension Age and DOR to the rectification date are applied to the reconciled GMP and the pre-97 delta to produce a reconciled GMP and a pre-97 delta at the rectification date. Increases to the pre-97 delta will be pro-rated where retirement occurred during the increase year.

▶ It should be noted that GMP elements receive full indexation until the individual reaches SPA. If the individual reaches SPA on or after 6 April 2016 then full indexation will continue to apply to GMP elements. In addition, there are periods where an individual may be flagged as "Additional Pension < GMP", during which full indexation will also be applied to any GMP elements.

▶ The current pension elements are adjusted using the rolled-forward GMP pension elements and the rolled-forward pre-97 delta.

▶ Any historic underpayment due to the member is also calculated along with interest.

▶ A check is performed that the rectified pre-97 excess pension is not negative. Where the pre-97 excess pension is calculated to be negative then it will be adjusted to zero and any historic underpayment recalculated accordingly.

▶ An additional check is performed to ensure that the pension payable from GMP age to state pension Age is at least equal to the GMP. Where this is not the case then the pension payable from GMP age will be uplifted to meet the minimum pension due.

2.4 Rationale and assumptions behind method

The ITM calculation method has been devised with the following rationale:

▶ Pension in payment histories are unlikely to be available in a reliable form going back as far as would be required to support GMP rectification, therefore the best approach is to project the current pension elements back to SPA/GMP Age/Date of Death using the assumed pension increase rates, make the correction, then roll forward – subject to a number of additional assumptions and tests as set out below. This approach also has the key advantage of not allowing the project's scope to extend out to an audit of the historic application of pension increases in any wider sense.

▶ For dependant pensioners, the roll back is only implemented to the deceased member's death. The logistics of reliably calculating a pension correction in respect of GMP for the deceased member (whose GMP records may of course have been entirely correct), and hence a possible further adjustment to the dependant's initial pension level, are very difficult. ITM clients have to date been comfortable to accept this standard method, however a decision (D6) is listed in Section 3 below to cover this.

A number of assumptions and special cases need to be considered:

▶ It is possible that statutory GMP increases have been triggered earlier than was required for some members, for example at GMP Age for a female whose SPA is later. ITM can screen for these cases and a decision made on how to treat them.

▶ The rectification method takes account of periods of "Additional pension < GMP" where they are held on Altair following receipt of form RD614, however it is assumed that there are no other sources of data held at Kent that confirm an individual is actually claiming state benefits, therefore statutory GMP increases will be assumed to apply in all other circumstances.

▶ The rectification method set out above assumes that GMP will be offset against the excess pension as local authorities do not split the pre-97 and post-97 pension. Where the excess pension is insufficient to cover the reconciled GMP but there remains other pension elements (e.g. AVCs) then the rectification calculation will not offset GMP against these pension elements. Where the excess pension is insufficient to be offset against the reconciled GMP then such an approach would generally result in a higher rectified pension than if GMP had been offset against post-97 benefits. The detail of this can be agreed at the later *Specification* stage.

▶ Special treatment is required for GMP only pensions where the GMP is confirmed to be at a lower level than was previously used in the administration process, because it is necessary to establish why the pension became GMP only to then decide whether to reduce the overall pension, or create an excess element, or both.

2.5   Historic underpayment and interest

The historic under or overpayment will be calculated for each pension increase year as follows:

Underpayment = (Reconciled GMP – Original GMP) – Excess Delta

The reconciled GMP, original GMP and Excess Delta above have all had pension increases applied up to the pension increase year in question.

A positive value is an underpayment while a negative value is an overpayment.

Historic under or overpayments will be pro-rated where the "increase year" is not a full year, e.g. the year in which the member reaches GMP age or retired if after GMP age and the "increase year" in which the rectification date occurs.

Interest will be applied using the interest rate defined in the relevant regulations, or separately agreed with Kent County Council where they have leeway to do so – this will be agreed at the later *Specification* stage.

Where a member receives underpayments in some years and overpayments in others then these would normally be offset against each other (typically can occur where there is a GMP only pension involved). In such circumstances interest will be applied to both the underpayments and overpayments to enable a net calculation to be produced.

itm
Solution delivered…

3 Decisions on population in scope

The table below sets out ITM's proposals for the criteria to be used in deciding which rectification "band" a member is treated under, and hence whether they are in scope for rectification processing. The table flags where decisions can be made now, or are better considered at a later stage of the project. Some of the decisions relate to formal acceptance of ITM's standard rectification approach, which is the basis on which the original proposal was set out to the Client – these are marked with the text "*ITM standard approach*" in the table below.

Relevant band	Applies to	Proposed allocation criteria	Justification	Decisions to be considered	Date decision required
Band 1 – No Rectification Required	**Pensioner over GMP age Dependant**	It is proposed that members will be included in Band 1 when: • identified during Stage 2 as having suspect HMRC data that cannot be successfully challenged, and hence will not be rectified • the member has a "no liability" status.	In addition to the challenge of confirming the existence and address for no liability members, it is not appropriate for the Fund to contact no liability members who no longer have an on-going relationship with the pension scheme.	**D1** – is it acceptable that members who are "No liability" are entirely excluded (and hence treated as if they are also in Band 1)? *(ITM standard approach)*	After review of this document
Band 2 – HM Treasury easement for within £2 pw	**Pensioner over GMP age Dependant**	It is proposed to accept the HM Treasury easement to accept Fund records where GMP differences are within £2 pw at the point of comparison, for pensioners and dependant members. This point of comparison will be GMP age or Date of Death for pensioners and dependants respectively.	This is consistent with the approach being taken in reconciliation to not investigate differences below the £2 pw tolerance.	**D2** – is it acceptable to apply the easement and remove these members from the population that are submitted for rectification processing?	After review of this document

itm
Solution delivered...

Relevant band	Applies to	Proposed allocation criteria	Justification	Decisions to be considered	Date decision required
Band 3 – No change to total pension in payment	**Pensioner over GMP age Dependant**	ITM propose that a "trivial threshold" is set based on review of the full set of draft rectification results. If the size of the correction to a member's current pension is below the trivial threshold then the member would then be treated as a Band 3 – Trivial Adjustment member. Typically public sector clients have chosen trivial thresholds of £12 pa, applying to both under and overpayments. There have been a couple of clients who have chosen no threshold or a higher threshold of £60 pa.	The use of a trivial threshold hugely reduces the number of members that need rectification adjustments communicating and applying to the administration system. This applies even when the HM Treasury easement is applied, for example changes in respect of Post 88 GMP that are greater than £2 per week at the point of comparison can still result in trivial under/overpayment results, due to the similarity of Post 88 GMP increases and the increases applied to the excess pension.	There are some issues that can be considered now in respect of the use of a trivial threshold for allocating members to Band 3: **D3 -** Is it acceptable to operate a trivial threshold at all? **D4 -** Is it acceptable to operate a trivial threshold in respect of underpaid members?	Late in Phase 1 of the project after full draft results are produced

Relevant band	Applies to	Proposed allocation criteria	Justification	Decisions to be considered	Date decision required
Band 4 – Standard Corrections from GMP Age / Date of Death	**Pensioner over GMP age Dependant**	All pensioner members who are over GMP age and dependant members, that do not fall into Bands 1 to 3 above, will require a Standard Correction.	This is the standard rectification correction of incorrect pension increases as a result of incorrect GMP, and in exceptional cases the uplift of the pension from GMP age (for pensioners) or Date of Death (for dependants) to meet the GMP minimum. For a dependant member, only the dependant's GMP will be corrected, i.e. no attempt will be made to assess if the deceased member's pension was impacted by incorrect GMP, which in turn could have resulted in the initial level of dependant's pension being incorrectly calculated. This is because: • A dependant's GMP being incorrect does not necessarily mean the member's GMP was incorrect • Data availability is usually too poor to enable the deceased member's pension to be reliably corrected	There are some issues that can be considered now in respect of the Standard Correction process: **D5 –** Is it acceptable to not attempt to take account of the impact of incorrect GMP on a deceased member's pension, and hence on the dependant's initial pension level, for the reasons set out in the column to the left? *(ITM standard approach)*	After review of this document

itm
Solution delivered...