



## BRIEFING PAPER

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# Guaranteed Minimum Pension (GMP) increases

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## Summary

### The old State Pension

The State Pension for people who reached State Pension age before 6 April 2016 had two tiers:

- The basic State Pension – to which people built entitlement on the basis of their National Insurance record; and
- The additional State Pension – which was partly earnings-related.

From the time the additional State Pension was introduced in 1978, it was possible to contract-out of it into a pension scheme that meets certain criteria. Where an employee was contracted-out scheme, they and their employer paid a reduced rate of National Insurance (NI), designed to reflect the cost of providing the benefits foregone. Between 1978 and 1997, contracted-out schemes were required to provide a Guaranteed Minimum Pension (GMP). Since 1997, a different test has applied but contracted-out schemes still have to provide a GMP for rights accrued between 1978 and 1997.

Pension schemes are required to index GMP rights accrued between 1988 and 1997, in line with prices, subject to a 3% cap. There is a link between the GMP and the additional State Pension in that, when a person reaches pensionable age, the total amount of GMP is subtracted from the total amount of additional state pension built up between 1978 and 1997, and any net amount is paid. This is referred to as a 'contracted-out deduction'. It reflects the fact that reduced National Insurance (NI) was paid during the period of contracting out in return for meeting legislative requirements. This calculation is performed each year that the pension is payable. The effect of these arrangements is that, although schemes are not required to provide increases on the GMP on rights accrued between 1978 and 1988 (or in excess of 3% on rights accrued between 1988 and 1997), the additional State Pension built up during that period is subject to increases. When the contracted-out deduction is subtracted from the additional state pension, the remaining additional state pension includes an increase linked to prices. The effect is that, an amount broadly equivalent to the GMP, but which is in fact additional state pension is subject to an increase ([HC Deb, 6 January 2014, c51W](#)).

The increase required by schemes each year is provided for in a Statutory Instrument - the *Guaranteed Minimum Pension Increase Order*. This is subject to the [affirmative procedure](#) in Parliament – which means it must be actively approved by both Houses. It specifies the percentage by which GMPs must be increased is therefore described as an “entirely technical matter” ([HC Deb 5 Feb 2018 c1257](#)). However, on occasion, it is used to raise related issues, such as GMP equalisation ([HL Deb 14 February 2019 c1956](#)). For more detail, see Library Briefing Paper CBP 8427 [GMP equalisation](#).

The [Draft Guaranteed Minimum Pensions Increase Order 2020](#) provides for an increase of 1.7% with effect from 6 April 2020 (in line with the increase in the Consumer Prices Index over the year to September 2019).

### The new State Pension

Under the [Pensions Act 2014](#), a new single-tier State Pension (nSP) was introduced for future pensioners from 6 April 2016. The NAO described the implications for people who had been contracted-out as follows:

- 9 The new state pension ends contracting out. From April 2016 the government will replace the basic and additional state pensions with a new single state pension.

Employers will no longer be able to contract their pension schemes out of the state pension scheme. Working-age people will have their existing state pension entitlement adjusted for previous periods of contracting out and transferred to the new state pension scheme. Occupational pension scheme providers will continue to revalue any Guaranteed Minimum Pensions that people have built up (paragraphs 2.6 to 2.11).

10 For people retiring after 6 April 2016, the government will no longer take account of inflation increases to Guaranteed Minimum Pensions when uprating people's new state pension. Scheme providers will continue to uprate occupational pensions – including part of Guaranteed Minimum Pensions – in accordance with scheme rules and statutory requirements. The changes mean any Guaranteed Minimum Pensions that people have accrued between 1978 and 1988 will not be uprated, and the scheme provider will only uprate Guaranteed Minimum Pensions built up between 1988 and 1997 to a maximum of 3% each year. People who have already started claiming their state pension will be unaffected (paragraphs 2.19 to 2.21). (NAO, [The impact of state pension reforms on people with Guaranteed Minimum Pensions](#), HC 907, March 2016).

It concluded that the impact on of these reforms on individuals would depend on a number of factors:

17 The uprating of Guaranteed Minimum Pensions is a complicated area. The impact of reforms on individuals will depend on a number of factors including their age, employment history, earnings and future inflation. Some people are likely to lose out and they have not been able to find the information they need.

18 We are concerned that the Department has limited information about who is affected by the impact of pension reforms on Guaranteed Minimum Pensions. It is now seeking to improve how it communicates the impact of pension reforms, and will need to help people identify how they are affected and provide them with accurate and more complete information so that they can make informed decisions about their future pension arrangements (ibid).

## Public service pensions

The arrangements in place before 6 April 2016 ensured that public servants received indexation on their GMP, while preventing double increases. ([HM Treasury guidance, May 2001](#)).

Because the mechanism in the old State Pension for providing full indexation of GMPs, is not part of the new State Pension, the Government had to consider how to deliver on commitments by previous governments that public service pensions would be fully indexed. In March 2016, it announced that those reaching State Pension age (SPA) between 6 April 2016 and 6 December 2018 would receive a fully-indexed public service pension for life. ([HM Treasury press release](#), 1 March 2016).

In November 2016, it launched a [consultation](#) on whether public service schemes should pay full indexation on GMP for people reaching SPA after 5 December 2018. On 22 January 2018 it announced that the interim solution (full-indexation of GMPs earned in public service) would be extended for a further two years and four months, covering people who reach SPA on or after 6 December 2018 and before 6 April 2021. The arrangement would be the least complex administratively of the options considered and would avoid the introduction of unequal payments to men and women in public service schemes that would otherwise result from the abolition of the additional State Pension (section 3). During this period, the Government would “investigate the possibility of an alternative long-term methodology, known as conversion.”

The issue of overpayments due to incorrect payments of GMP is discussed in CBP-4919 [Public sector pension overpayments](#) (April 2018).

# 1. The current system

## 1.1 Contracting-out

The current State Pension has two tiers: <sup>1</sup>

- the basic State Pension (BSP) – which is a contributory flat-rate benefit. People reaching SPA from 6 April 2010, need 30 qualifying years for a full BSP (£115.95 pw in 2015/16).
- the additional State Pension – which depends on the earnings or deemed earnings during their working life since 1978. People accrued entitlement through the State Earnings Related Pension Scheme (SERPS) between 1978 and 2002 and the State Second Pension (S2P) from 2002 onwards.<sup>2</sup>

When the State Earnings Related Pension Scheme (SERPS) was introduced in 1978, employers could contract employees out into an occupational pension scheme which met certain conditions. Where an individual is contracted-out, they and their employer pay a lower rate of National Insurance in recognition of the fact that they are foregoing additional State Pension rights for that period.

The amount of this reduction – the “contracted-out rebate” – is set by the Government on the advice of the Government Actuary’s Department and is designed to reflect the cost of providing the benefits foregone.<sup>3</sup> In 2015/16, the rebate was 1.4% for employees and 3.4% for employers.<sup>4</sup>

## 1.2 What is a GMP?

Initially, members of contracted-out schemes had to be provided with an individually calculated defined benefit known as the Guaranteed Minimum Pension (GMP). Until April 1988, this was the only contracting-out method. The schemes that provided GMPs were usually of the defined benefit type (i.e. provided specified pension benefits, usually based on salary and length of service). However, defined contribution schemes (in which the level of pension depends on contributions made, how these are invested and the annuity purchased) could also contract out by providing a GMP as a defined benefit underpin.

A Department of Health and Social Security (DHSS) leaflet, *New Pensions: a more secure future*, (NP34), issued in January 1978, shortly before the new scheme came into force, explained how it would work:

The new state pension will operate in partnership with good occupational schemes... if your employer operates such a scheme he can apply to contract you out...of the state scheme’s

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<sup>1</sup> [Social Security Contributions and Benefits Act 1992](#), s44

<sup>2</sup> Ibid s44, 44A-C and 45

<sup>3</sup> Pensions Commission, “[Pensions: Challenges and Choices: The First Report of the Pensions Commission](#)”, October 2004, Appendix F, p158; This issue is covered in more Library Standard Note SN/BT 2674, State Second Pension: Contracted-out Deductions

<sup>4</sup> HMRC, [Rates and allowances: National Insurance contributions](#) 6 April 2015

additional pension and you would then pay lower contributions to the state scheme ... Your basic pension would then be provided by the state scheme and your additional pension by your employer's occupational scheme, with inflation-proofing after the pension is in payment provided by the state (...)

#### **Guaranteed minimum pensions**

A contracted-out occupational pension scheme must provide you with at least a guaranteed minimum pension, to match the additional pension you would have earned from the state scheme ... Your occupational pension may, of course, be much higher than the guaranteed minimum pension, particularly if you are already a member of a scheme.

The *Pensions Act 1995* abolished the future accrual of GMPs with effect from 6 April 1997, but ensured that rights to GMPs accrued at any time from 6 April 1978 until that date had to be fully protected.<sup>5</sup> The *Pensions Act 2007* included provision to allow pension schemes to convert GMPs to scheme benefits, from 6 April 2009.<sup>6</sup>

### **1.3 Interaction with the State Pension**

Defined Benefit occupational schemes are required to annually increase GMP rights accrued between 6 April 1988 and 5 April 1997 in line with prices, capped at three per cent.<sup>7</sup>

In addition, the amount of an individual's GMP entitlement is deducted from the additional State Pension they would have accrued had they remained contracted-in and the net amount is paid.<sup>8</sup> This calculation is done annually.

The effect of these arrangements is that, although schemes are not required to provide increases on the GMP on rights accrued between 1978 and 1988 (or in excess of 3% on rights accrued between 1988 and 1997), the additional State Pension built up during that period is subject to increases. When the contracted-out deduction is subtracted from the additional state pension, the remaining additional state pension includes an increase linked to prices. In this way, an amount broadly equivalent to the GMP, but which is in fact additional state pension, is subject to an increase.

<sup>5</sup> IDS Pension Service, *Pension Scheme Design*, May 2010, para 8.43

<sup>6</sup> [Pensions Act 2007, section 14](#); [Pensions Act 2007 \(Commencement No. 3\) Order 2009 \(SI 2009/406\)](#); Pensions Bill Deb, 1 February 2007, c234

<sup>7</sup> [Pension Schemes Act 1993, s109](#)

<sup>8</sup> [Pension Schemes Act 1993, s46](#)

## 2. State Pension reforms

### 2.1 Treatment of periods of contracting out

The Coalition Government legislated for a single-tier State Pension for future pensioners from April 2016, combining the existing two tiers into one. This means that for future pensioners there will no longer be an additional State Pension (or an option to contract out of it).<sup>9</sup>

Employees contracted-out on 6 April 2016 will cease to be so. They will no longer be eligible for a 'contracted-out rebate' on their National Insurance (NI), so their NICs will increase to the standard rate.<sup>10</sup> In return, they will start to accrue State Pension rights on the same basis as other employees.

In addition, the new State Pension needs to deal with previous periods of contracting out. This will be done by applying a deduction to their State Pension to reflect the fact that while contracted-out, the individual paid a lower rate of NI. The rationale for the NI rebate was that people "receive an amount of pension from their contracted-out scheme at least as good as the state pension given up." The purpose of the deduction is to ensure that "all provision funded by the taxpayer, including that funded by the National Insurance rebate, is taken into account when calculating people's entitlement to the state pension."<sup>11</sup> To ensure individuals do not receive less than they would have done under the current system, a check is done. Where an individual would have received more under the current system, that higher amount forms their 'foundation amount' for the new State Pension.<sup>12</sup>

A person who has spent many years contracted-out may, therefore, find that their foundation amount is less than the full amount of the single-tier. However, they will be able to increase their single-tier pension up to the full level, at the rate of 1/35<sup>th</sup> of the full rate for each additional qualifying year they gain before reaching State Pension age.<sup>13</sup>

This led some commentators to note that gainers from the introduction of the single-tier State Pension will include some people who have been contracted-out. The Institute for Fiscal Studies, said:

Overall, 35% of men and 61% of women (43% of individuals) would see their pension income at SPA increased as a result of the proposed reform. Many of these individuals will be benefiting from the ability to 'work off' previous periods of contracting out.<sup>14</sup>

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<sup>9</sup> [Pensions Act 2014](#), Part 1

<sup>10</sup> DWP, [Single-tier Impact Assessment](#), October 2013, section 5.2

<sup>11</sup> DWP, [A state pension for the 21<sup>st</sup> century](#), Cm 8053, April 2011, chapter 2, p 32

<sup>12</sup> DWP, [The single-tier pension: a simple foundation for saving](#), January 2013, Cm 8528, p47; [Pensions Act 2014](#) - section 5 and schedule 1

<sup>13</sup> DWP, [The single-tier pension: a simple foundation for saving](#), Cm 8528, January 2013, p11, para 24; DWP, [The single-tier transition and contracting out](#), 2013

<sup>14</sup> IFS, [A single-tier pension: what does it really mean?](#), July 2013; see also [PPI, Single-tier series paper 4: the impact of the abolition of contracting-out](#), 19 February 2014

## 2.2 Implications for people with GMP rights

Pension schemes are liable for any statutory indexation of GMPs, and this liability will not change as a result of the single tier reforms. However, the way in which the GMP affects State Pension entitlement will change. Under the current system, an annual calculation is made (deducting the amount of any GMP from an individual's additional State Pension entitlement). Under the new State Pension this will be done once at implementation. However, an individual who was contracted-out on that date will cease to be so and will start to build up rights to the State Pension in the same way as other people. In addition, their single-tier pension will be uprated at least in line with earnings (and possibly according to the triple lock).<sup>15</sup>

In response to a question on the issue in January 2014, Pensions Minister Steve Webb said that the design of the transition to the single-tier would benefit many people who had been contracted out and that those who held GMPs were no more likely to have a lower outcome as a result of the reforms overall than the rest of the population:

### **Guaranteed Minimum Pensions**

**Teresa Pearce:** To ask the Secretary of State for Work and Pensions

(1) what estimate his Department has made of the number of people affected by ending the payment of guaranteed minimum pension increases; [181793]

(2) what impact assessment his Department has conducted of ending the payment of guaranteed minimum pension increases; [181794]

(3) what estimate he has made of the average loss to persons affected by ending the payment of guaranteed minimum pension increases; [181795]

(4) what estimate his Department has made of the total saving to the public purse as a result of ending the payment of guaranteed minimum pension increases. [181860]

**Steve Webb:** The Department for Work and Pensions does not pay increases on guaranteed minimum pensions (GMPs). GMPs are occupational pension scheme benefits. The Department for Work and Pensions does not pay increases on guaranteed minimum pensions (GMPs). GMPs are occupational pension scheme benefits which were accrued between 1978 and 1997. Pension schemes are liable for any statutory indexation of GMPs, and this liability will not change as a result of the single tier reforms. The Department for Work and Pensions pays state pension benefits and their indexation, including additional state pension (SERPS and S2P) and basic state pension.

Additional state pension and GMPs are linked in that when a person reaches pensionable age, the total amount of GMP is subtracted from the total amount of additional state pension built up between 1978 and 1997, and any net amount is paid. This subtraction of the total GMP amount is called a 'contracted-out deduction', and reflects that reduced national insurance was paid during the period of contracting out in return for meeting

<sup>15</sup> [Pensions Act 2014](#), Sch. 12 para 19



## 9 Guaranteed Minimum Pension (GMP) increases

legislative requirements. This calculation is performed each year that the pension is payable.

There is no statutory obligation on schemes to pay increases on GMPs accrued between 1978 and 1988. However, additional state pension built up during that period is subject to increases. When the contracted-out deduction is subtracted from the additional state pension, the remaining additional state pension includes an increase linked to prices. In this way, an amount broadly equivalent to the GMP, but which is in fact additional state pension, is subject to an increase. Schemes are under an obligation to pay increases on GMPs accrued between 1988 and 1997, subject to a cap of 3%.

With the introduction of single tier, the additional state pension will close, as will the facility to contract-out. For those reaching state pension age from April 2016, we will value their national insurance record to that point. We will compare what state pension the single-tier rules would give them with what they have built up as at April 2016 under the current system. The higher of these two valuations will become the individual's 'foundation amount'.

As set out in the White Paper, the design of the transition will benefit many people with a history of contracting out. In effect, these individuals may be able to offset their contracted-out deduction with further qualifying years until they reach the full amount of single tier. This means that many individuals who have previously been contracted-out may receive more state pension than they would have under the current system.

The Department estimates that over 2 million people will reach state pension age in the five years after the introduction of single tier, of whom around 40% to 45% will have been contracted out of private and public sector defined benefit schemes between 1978 and 1988. From 1988 onwards, the facility to contract out was extended to people in defined contribution schemes. By the mid-2030s over 80% of people reaching state pension age will have had a deduction for being contracted out factored into their transitional calculations and many will be able to benefit from the transition described above, as well as from the indexation arrangements for single tier compared to the current arrangements for additional pension and basic state pension.

The single tier reforms will cost no more than the existing system, and expenditure is projected to be within 1% of current spending until the late 2030s. The impacts of the single tier reforms have been captured in the impact assessment for single tier, which is published online. We estimate that those who hold GMPs are no more likely to have a lower outcome as a result of the reforms overall than the rest of the population.<sup>16</sup>

In March 2016, the National Audit Office (NAO) produced a report on [the impact of state pension reforms on people with Guaranteed Minimum Pensions](#). It concluded that:

17 The uprating of Guaranteed Minimum Pensions is a complicated area. The impact of reforms on individuals will depend on a number of factors including their age, employment history, earnings and future inflation. Some people are likely to

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<sup>16</sup> [HC Deb 6 January 2014 c51W](#)

lose out and they have not been able to find the information they need.

18 We are concerned that the Department has limited information about who is affected by the impact of pension reforms on Guaranteed Minimum Pensions. It is now seeking to improve how it communicates the impact of pension reforms, and will need to help people identify how they are affected and provide them with accurate and more complete information so that they can make informed decisions about their future pension arrangements.<sup>17</sup>

Key findings were:

### **Guaranteed Minimum Pensions under existing pension rules**

7 Pension scheme providers are responsible for paying Guaranteed Minimum Pensions. The Guaranteed Minimum Pensions of people who were in contracted-out defined benefit pension schemes between 1978 and 1997 should be broadly equivalent to the additional state pension that they would otherwise have received. Instead of the additional state pension, these people receive an occupational pension which must meet a statutory minimum rate. Individuals and employers who contracted out of the state pension will have paid lower rates of National Insurance (paragraphs 1.4, 1.5 and 1.19).

8 In effect, the government currently pays for some of the annual inflation increases to Guaranteed Minimum Pensions. Under existing rules, pension scheme providers uprate Guaranteed Minimum Pensions accrued between 1988 and 1997 up to a maximum of 3% per year. The Department then recalculates the state pension payable each year, which makes sure that a person's Guaranteed Minimum Pension entitlement is uprated. While the Department does not make any payments directly towards Guaranteed Minimum Pensions, it bears some of the costs of uprating and so, in effect, pays for a share of inflation increases (paragraphs 1.21 to 1.23).

### **Guaranteed Minimum Pensions after state pension reforms**

9 The new state pension ends contracting out. From April 2016 the government will replace the basic and additional state pensions with a new single state pension. Employers will no longer be able to contract their pension schemes out of the state pension scheme. Working-age people will have their existing state pension entitlement adjusted for previous periods of contracting out and transferred to the new state pension scheme. Occupational pension scheme providers will continue to revalue any Guaranteed Minimum Pensions that people have built up (paragraphs 2.6 to 2.11).

10 For people retiring after 6 April 2016, the government will no longer take account of inflation increases to Guaranteed Minimum Pensions when uprating people's new state pension. Scheme providers will continue to uprate occupational pensions – including part of Guaranteed Minimum Pensions – in accordance with scheme rules and statutory requirements. The changes mean any Guaranteed Minimum Pensions that people have accrued between 1978 and 1988 will not be uprated, and the scheme provider will only uprate Guaranteed Minimum Pensions built up between 1988 and 1997 to a maximum of 3% each year. People

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<sup>17</sup> NAO, [DWP – the impact of state pension reforms in people with Guaranteed Minimum Pensions](#), HC 907, 24 March 2016

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who have already started claiming their state pension will be unaffected (paragraphs 2.19 to 2.21). How people may be affected by reforms

11 The increases in state pension age means that Guaranteed Minimum Pensions could lose more value before people draw their state pension. Since 2010 the state pension age has been increasing but the Guaranteed Minimum Pension age will remain at 60 for women and 65 for men. This means there could be a longer period in which Guaranteed Minimum Pensions are not uprated fully before the individual receives their state pension (paragraphs 3.4 to 3.6).

12 Guaranteed Minimum Pensions will lose value under the new rules but people may be able to build up additional entitlement to new state pension. As people are able to build up higher amounts of new state pension (compared with the existing basic state pension), they may be better off overall, or at least offset some of the loss to the value of their Guaranteed Minimum Pension. The amount by which individuals will be affected will depend on the time they were in a contracted-out scheme, the value of their new state pension, how the government decides to uprate the state pension and future inflation rates (paragraphs 3.8 to 3.12)

13 The impact of new state pension reforms on people with Guaranteed Minimum Pensions will vary widely. The type of person who will do comparatively worse under the reforms is someone who has spent long periods in a contracted-out pension scheme and is close to retirement on 6 April 2016, so has little time to build up additional entitlement to new state pension. The Department estimates that 180,000 people who will reach state pension age in 2016-17 will have Guaranteed Minimum Pensions from before 1988. The amount by which people will be affected depends on their specific employment history. The Department's modelling forecasts that 50,000 of these people will be worse off in 2017-18 as a result of the introduction of new state pension (paragraphs 3.13 to 3.17).<sup>18</sup>

### 3. Public service schemes

There are specific legislative requirements applying to public service pensions – which must be annually increased in line with prices – measured according to the CPI.<sup>19</sup> Previous governments made commitments to ensure the GMPs of public servants were increased:

For example, on 20 May 1975, Mr Alec Jones (Minister for Social Security) gave assurances to the House of Commons that the GMP of public service schemes will receive price increases:

“will nevertheless provide a guaranteed minimum pension which will receive the cost of living increases under the bill.”

On 14 December 1978, Mr Eric Deakins, (Minister in the Department for Health and Social Security) spoke of the Social Security Pensions Act 1975:

“the intention in 1975, at the time of the passage of the Pensions Act, was in no way to depart from the principle that all official pensions are to be fully price-protected

“section 59(5) was intended to take account of the fact that increases on the notional additional component will be paid by my department as part of the ‘new State pension scheme’, and that those increases will normally be sufficient to cover inflation proofing of the GMP...<sup>20</sup>

#### 3.1 The old State Pension

The arrangements in place before 6 April 2016 ensured that public servants received indexation on their GMP while preventing duplication. HM Treasury guidance explained:

25. For GMPs earned up to and including 5 April 1988, the occupational scheme is not required to uprate GMPs in payment as the increase is paid by DWP. However, occupational schemes are required to increase any GMPs earned from 6 April 1988 until 5 April 1997 (when GMPs ceased to accrue) by the lower of inflation or 3 per cent, on 6 April each year. Only the balance of inflation above 3 per cent will be paid by DWP [...]

26. To prevent double pensions increase on the GMP element, section 59(5) of the 1975 Act limited public service pensions increase to the part of the public service scheme pension which exceeds the GMP (which is uprated by DWP). Where the additional pension paid by DWP equals or exceeds the GMP element in payment in a public service pension, the GMP entitlement is deducted from the public service pension before any pensions increases are applied at the next review. Similar principles apply to widow/ers pensions although the precise details are different.<sup>21</sup>

In cases where this system did not deliver full indexation (for example, if the pensioner was resident in an overseas country where the UK State

<sup>19</sup> *Pensions Increase Act 1971* and sections 59 and 59A of the *Social Security Pensions Act 1975* as amended

<sup>20</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), November 2016

<sup>21</sup> [A note on the operation of pensions increase legislation for public service pension schemes, May 2001](#)

Pension was not updated), their full public service pension was increased, including the GMP.<sup>22</sup>

### 3.2 The new State Pension

As explained in [section 2](#) above, the mechanism in the old State Pension for providing full indexation of GMPs, is not part of the new State Pension (nSP). HM Treasury has explained:

The introduction of the nSP and abolition of the AP removed the mechanism described above that provided public servants with fully indexed and equalised benefits overall. This impacts members of a public service pension scheme with a GMP earned in a public service pension scheme in two ways:

- they will no longer receive, in effect, indexation of their GMP through the indexation received on the AP
- the previous mechanism designed to avoid unequal payments on account of gender will no longer apply<sup>23</sup>

In June 2015, the Government said it was still considering how to approach the indexation of GMPs for public servants in future.<sup>24</sup> In March 2016, it announced that those reaching State Pension age between 6 April 2016 and 6 December 2018 would receive a fully-indexed public service pension for life:

In response to the introduction of the new State Pension in April 2016, the government will continue to price protect the Guaranteed Minimum Pension of public sector workers.

This means that those who reach State Pension Age on or after the 6th April 2016 and before the 6th December 2018 – when the State Pension Age equalises – will receive a fully indexed public service pension for their whole life.

This will ensure public service pension payments to these individuals continue to be equal between men and women.<sup>25</sup>

Updated Treasury guidance was published in April 2016.<sup>26</sup>

### Consultation on longer-term arrangements

In November 2016, HM Treasury launched a consultation on how to address this issue in the longer term. It explained:

Under the arrangements that previously applied the public service pension and the [additional State Pension] system worked in tandem, providing a mechanism that fully indexed and equalised pension payments (state pension and occupational pension) of public servants, in line with commitments made to these members by previous governments. However, with the removal of the AP, this mechanism no longer works. An estimated 2 million members

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<sup>22</sup> Ibid; HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), November 2016, para 2.3

<sup>23</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), 28 November 2016, para 2.4

<sup>24</sup> Cabinet Office, [FOI response, 18 June 2015](#)

<sup>25</sup> HM Treasury, [Government one step closer to introducing new State Pension this year](#), 1 March 2016

<sup>26</sup> HM Treasury, [Guidance on the operation of pensions increase legislation for public service pension schemes](#), April 2016

of the public service schemes with GMPs who reach their SPa up until 2040 may be affected.

The impact of no longer receiving a fully indexed GMP will vary significantly across the affected public service employees. In extreme cases the cumulative losses could have an estimated value of £18,000. However, for the majority of those who lose, the government expects the impact to be lower. Many individuals are likely to benefit from transitioning to the new State Pension; analysis from the Department for Work and Pensions estimates that by 2030 almost 80% of UK pension scheme members with GMPs accrued between 9 April 1978 and 5 April 1988 who transition to the new State Pension will receive higher State pension payments than under the old system over their lifetime.

On 1 March 2016, the government announced that public service pensioners reaching SPa after 5 April 2016 and before 6 December 2018, would have the GMPs earned in public service fully indexed by the public service pension scheme. This eased the transition to the new State Pension for a group who would have been likely to lose, and ensured that men and women reaching SPa in that period continued to receive equal pension payments.<sup>27</sup>

The consultation aimed to consider two issues:

- How best to avoid the introduction of unequal payments to men and women in the public service schemes that will result from the abolition of AP. There are legal requirements to pay men and women equal pensions in respect of pensionable service after 16 May 1990, and the old arrangements were designed to deliver equalisation by way of increases to AP
- Whether, following the introduction of the new State Pension, the public service pension schemes should pay full indexation on GMP earned while a member of a public service pension scheme, for someone who reaches SPa after 5 December 2018.<sup>28</sup>

These two problems were “complex and closely linked”. The aim was to address them in a single policy solution. However, the Government was considering whether it was in the public interest to provide indexation payments on the GMP element to all, or only to those who did not gain in the transition to the nSP and would suffer some financial loss over their lifetime:

The government, with its overall responsibility for public service pensions policy and provision, intends to bring forward a policy change and any necessary legislation needed in order to prevent an inequality being introduced for public service pension payments to men and women.

The government is considering how to meet the past commitments of previous governments to fully price protect public service pension payments including the GMP of all affected members of public service pension schemes. In particular, given a significant proportion of the affected group will receive higher payments under the nSP system than under the old (analysis from the Department for Work and Pensions estimates that by 2030

<sup>27</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), November 2016

<sup>28</sup> Ibid

## 15 Guaranteed Minimum Pension (GMP) increases

almost 80% of UK pension scheme members with GMPs accrued between 9 April 1978 and 5 April 1988 who transition to the nSP will receive higher State pension payments than under the old system over their lifetime), the government is considering whether it is in the public interest to provide indexation payments on the GMP element of scheme pension to all, or only to those individuals who do not gain in the transition to the nSP and would suffer some financial loss over their lifetime.<sup>29</sup>

It asked for views on three options:

### **Case-by-case**

This method compares the total income received by the pensioner from public and state pension provision under the old and new system. Where the member has lost financially, the member would be compensated up to the value of the loss of indexation only. This method does not provide full indexation to all members.

To equalise the benefit, this method would then repeat the same calculation for an equivalent, theoretical member of the opposite sex. The scheme would then pay the higher of the male or female benefit to the affected individual. The Government Actuary's Department (GAD) estimate this would increase liabilities for the public service pension schemes by around £1.5 billion. This is equivalent to increasing schemes' total liabilities by 0.15%. It is however very administratively complex, would continue for decades and would require significant investment in administrative systems for all public service pension schemes.

### **Full indexation**

The second method, full indexation for those attaining SPa after 5 December 2018, is a continuation of the current policy announced on 1 March 2016 (see the paragraph before section 1.2), which requires the public service pension schemes to directly meet the cost of indexing the GMP. This also prevents inequalities being introduced between men and women by the abolition of the AP. By fully indexing the GMP it ensures that no individual is worse off as a result of no longer in effect receiving indexation on their GMP through the AP. However, because this policy applies to all individuals it would mean that a large number of individuals would be compensated when they were already better off as a result of the transition to the new State Pension. GAD estimate this policy would increase liabilities for public service pension schemes by around £5 billion. This is equivalent to increasing schemes' total liabilities by around 0.5%. Full indexation is administratively much less complex than case-by-case as it is a continuation of current government policy.

### **Conversion**

The final option, conversion, converts the GMP into a scheme benefit, equating £1 of GMP to £1 of scheme benefit. This method has a similar outcome to full indexation, but public service schemes would no longer need to abide by existing GMP legislation for these members. It has a similar cost to full indexation and is likely to involve some administrative complexity

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<sup>29</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), November 2016



to complete the conversion but should be significantly simpler in the longer term for schemes.<sup>30</sup>

In its response to consultation on 22 January 2018, it said it had decided to extend the interim solution for a further two years, while investigating the possibility of an alternative long-term methodology known as “conversion”:

The government has been implementing an “interim solution” between 6 April 2016 and 5 December 2018. The outcome of this consultation is that this solution will be extended for a further two years and four months. This will cover those members of public service schemes with a GMP who reach state Pension Age on or after 6 December 2018 and before 6 April 2021. During this period, the government will investigate the possibility of an alternative long-term methodology, known as “conversion”.<sup>31</sup>

An example (Box 3.B) illustrates how this would work.

The Government said that extending the interim solution would result in an increase in public service pension scheme liabilities, which would have to be met by scheme employers and would, other things being equal, lead to an increase in the employer contribution rates paid. Administratively, it was one of the least complex options under consideration. In the longer term, the Government expects most members to gain from the transition to the new system, with almost 80% of those reaching State Pension age by 2020, with GMPs accrued between 1978 and 1987 gaining from the transition to the new State Pension, compared to if the old system had continued.<sup>32</sup>

The trade union Prospect welcomed the announcement:

This is welcome news for public sector pension scheme members. The proposed removal of inflation increases for GMPs would have had an insidious effect on their incomes in retirement. The members covered by the extension of current policy should benefit to the tune of thousands of pounds over the course of their retirement. Prospect will continue to push for the protection of these payments for all members.<sup>33</sup>

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<sup>30</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), 28 November 2016

<sup>31</sup> HM Treasury, [Consultation outcome. Indexation and equalisation of GMP in public service pension schemes](#), 22 January 2018

<sup>32</sup> HM Treasury, [Consultation on indexation and equalisation of GMP in public service pension schemes](#), 22 January 2018

<sup>33</sup> [Public sector pension scheme members to get full inflation protection, Prospect, 22 January 2018](#)



## 4. Debate on GMP Increase Orders

The Secretary of State is required to review the general level of prices in Great Britain annually and lay a draft Order before Parliament specifying the percentage by which GMPs are to be increased. This must be in line with the general level of prices, capped at three per cent.<sup>34</sup> Annual increases in the State Pension are provided for in the *Social Security Benefits (Up-rating) Order*.<sup>35</sup>

The GMP Increase Order and Social Security Benefits Up-rating Order are generally debated together. As Ministers have said in successive years, the Benefits Up-rating Order is generally the focus of discussions, the GMP increase order being an “entirely technical matter.” In 2018, for example, Work and Pensions Minister, Kit Malthouse, said:

The draft Guaranteed Minimum Pensions Increase Order 2018 is an entirely technical matter that we attend to each year in this House and I do not imagine that we will need to spend much time on it today. The statutory instrument provides for contracted-out defined benefit occupational pension schemes to increase members’ guaranteed minimum pensions that accrued between 1988 and 1997 by 3%.<sup>36</sup>

In 2019, Baroness Drake used the debate on the GMP increase order to ask whether the Government intended to legislate on GMP equalisation, following a High Court decision.<sup>37</sup> This issue is discussed in more detail in Library Briefing Paper CBP 8427 [Guaranteed Minimum Pension equalisation](#).

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<sup>34</sup> [Pension Schemes Act 1993, section 109](#)

<sup>35</sup> See Library Standard Note [SN 5649 State Pension Up-rating – 2010 onwards](#)

<sup>36</sup> [HC Deb 9 February 2015 c569 \[Steve Webb\]](#); [HC Deb 5 February 2018 c1257 \[Kit Malthouse\]](#)

<sup>37</sup> [HL Deb 14 Feb 2019 c1956](#)

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