

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
GMP Reconciliations	Classification PUBLIC	Enclosures
	Ward(s) affected	One (Exempt)
Pensions Board 21st March 2018	ALL	AGENDA ITEM NO.

1. INTRODUCTION

- 1.1 This report provides the Pensions Board with an update on the Fund's GMP reconciliation (Guaranteed Minimum Pensions) exercise, which is being undertaken to ensure that scheme member records for periods spent contracted out of the second state pension are properly accounted for. The report provides an update on the progress of Phase 2 of the reconciliation exercise and outlines factors for considering and agreeing an increase in the Phase 2 budget, and consider the proposal for the final phase of the project - Phase 3 – Certification & Rectification.

2. RECOMMENDATIONS

- 2.1 The Pensions Board is recommended to note the report

3. RELATED DECISIONS

- Pensions Committee 21st March 2018 – GMP reconciliation update
- Pensions Committee 29th March 2017 – GMP reconciliation exercise
- Pension Board 20th March 2017 – GMP Reconciliations
- Pension Board 26th January 2016 – GMP Reconciliations – Update and Training
- Pensions Committee 21st September 2015 – Pensions Update

4.1 COMMENTS OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

- 4.1 This report sets out for the Pensions Board the issues faced by the Fund as it tries to reconcile historical data for its scheme members for periods during which they were contracted out of the second state pension.
- 4.2 At this time it is difficult to quantify the full financial impact of the GMP data reconciliation exercise, but the Fund has commenced initial investigative phases, using the Fund's external administrators to match the data held on the pension administration system and that held by HMRC.
- 4.3 Whilst the cost of undertaking a GMP reconciliation exercise is likely to be significant, failure to undertake this work would result in the Fund being made responsible for the payment of any GMP liability that HMRC deems to be associated with it. Indications are that the differences between the Fund's administration data and HMRCs records

are considerable, exposing the Fund to significant risk if no reconciliation exercise is undertaken.

- 4.3 The LGA in a letter to administering authorities provided an indication of the level of costs across LGPS for the GMP reconciliation exercise which suggested that total costs could be somewhere between £30m to £100m.

5. COMMENTS OF THE DIRECTOR, LEGAL

- 5.1 As quasi-trustees of the Pension Fund, the Pensions Committee have a fiduciary duty to ensure that the Fund is well managed. The end of contracting out and consequent requirement for pension funds to undertake GMP reconciliation exercises could have considerable implications for the Fund's liabilities, whilst the costs of carrying out a reconciliation exercise can be substantial. Given the potential impact on the Fund, It is consistent with the responsibilities of the Pension Board to review the approach taken by the Committee in this area.
- 5.2 There are no immediate legal implications arising from this report.

6. GMP RECONCILIATION - BACKGROUND

- 6.1 From 6th April 2016 the government introduced the new State Pension (nSP). This was designed to radically simplify pension provision, removing layers of complexity whilst ensuring security in retirement. Amongst the provisions removed was the Additional State Pension (AP), an earnings-related element of the old system. Members of defined benefit occupational schemes such as the LGPS were able to 'contract out' of this element, permitting both employee and employer to pay lower National Insurance contributions as a result. In exchange, schemes guaranteed to provide members with a pension at least as high as they would have received had they not been contracted out. This guaranteed amount is the GMP; it applies to all those who were contracted out between 6 April 1978 and 5 April 1997.
- 6.2 Currently, HMRC offers a service whereby schemes can check their GMP records against those held by HMRC and resolve any differences. HMRC have announced that this will be scaled back considerably in April 2018. In December 2018, HMRC plans to write to all scheme members for whom its records indicate a GMP liability with details of the amount owing and the scheme responsible for payment. Following this, the Scheme Reconciliation Service (SRS) will be withdrawn altogether, with no further support offered for GMP queries. Where schemes have not undertaken a reconciliation of their contracted out liabilities, HMRC takes the stance that its own calculations are final; schemes will become responsible for any GMP liabilities which HMRC believe they hold.
- 6.3 The reconciliation of GMP values is not a mandatory regulatory requirement; however the Fund faces significant risks if its GMP liabilities are not reconciled before the withdrawal of support for queries by HMRC in December 2018. These include:
- Incorrect calculation of GMPs by HMRC, potentially increasing the fund's overall liabilities
 - Assumed liability for GMPs if HMRC holds records for a fund that are not the fund's responsibility
 - Unexpected increase in liabilities if the Fund does not hold records of all the liabilities it is responsible for

- Breach of The Pensions Regulator's (TPR) code of practice regarding record keeping
- Over and underpayment of pension benefits to individual scheme members
- Queries following HMRC notifications to scheme members in 2018
- Reputational issues

6.4 Officers have been working with the pension administrators, Equiniti and the Fund's benefits consultant, AON on a phased reconciliation project. The project is being undertaken by a specialist team within Equiniti's discontinuance department, and is separate from the main administration service provided to the Fund. It is run on a phased basis, with the scope and estimate costings being agreed for each phase prior to approval.

7. GMP RECONCILIATION PROJECT - UPDATE

7.1 As reported in March 2017, Phase 1 of the project was completed which involved requesting and receiving data from both HMRC and the Fund's administrator, a bulk analysis to identify sets of defined queries e.g. records that appear on Compendia, the administration system but not on HMRC's NICO database and vice versa. This also included any records for which the NICO data is insufficient, incorrect or missing and all initial queries submitted in bulk to HMRC for analysis. Phase 1 of the project was completed within the agreed budget of £28,000.

7.2 The project proposal and budget of £208,096 for Phase 2, was presented to Pensions Committee in March 2017. The scope of the work and budget were agreed and work commenced, and still continues, on:

- Finalising the '*in scope membership*' for the project by resolving queries over disputed membership (i.e. those records which appear on one database but not the other)
- Agreeing GMP amounts and State Scheme Premiums for records already matched (i.e. members definitively in scope as records appear) on both databases
- Identifying corrections to data anomalies or populating missing data items in either data set

7.3 In Q1 of 2017/18, Equiniti conducted an analysis on the 'Gap' members (i.e. members whose status changed between the date of the initial data run of April 2016 and April 2017), to assess the additional members to be brought into the scope of Phases 2 & 3 of the project. This analysis identified a further 353 pensioners and 1,049 deferred members to be brought into scope. In addition, it was agreed to analyse the Funds active membership of 7,531 (as at April 2017) to assess the number of active records that needed to be brought into the project, and this analysis was completed at an agreed cost of £2,325, increasing the Phase 2 budget to £210,421.

7.4 Further analysis undertaken on the additional records against HMRC's NICO system, during Q2 & Q3 of 2017/18, has identified a significant increase in the number of records that need to be included in the scope of the project. These include not only the 8,933 additional records (see 7.3) but also those records that appear on NICO but not on the administration record (Not on Admin) and also those that appear on the administration record but not on the NICO extract (Not on NICO), as this makes up the overall '*in scope*' numbers. Indications are there are 10,834 records to bring

into scope, taking the total to 27,600 from the initial number of 16,706. A breakdown of the additional 'in scope' records is as follows:

5,963	Records corresponded and appeared on both the Admin and on NICO records
421	Records on the NICO file but did not appear on the Admin records
4,450	Records appeared on the Admin records but did not appear on the NICO records
10,834	Is the total number of "in scope actives" that need addressing

- 7.5 The result of including the 'actives' in the project, has not only increased the records requiring investigation, and possible rectification, but has severely impacted on the Phase 2. A breakdown of the cost so far is provided below:

Period (2017/18)	Costs/reported spend (£)
Q4 (2016/17) – March (start of Phase 2)	12,750
Q1 – April to June	91,729
Q2 – July to September	102,659
Q3 – October	2,743
Total spend	209,881

- 7.6 During Q3 the Phase 2 budget was exhausted, but due to the time constraints on the project, Equiniti have continued to work 'at risk' during the remainder of October and into early December 2017, and as such have accumulated further costs which the Fund is yet to be invoiced for. In order not to accumulate any additional '*unauthorised*' cost, the project has been paused and but it is now '*at risk*' of not being completed on time or not at all, if the increase in budget is not approved.
- 7.7 Costs for completing Phase 2 are shown at Appendix 1 to this report. Whilst the additional cost is significant and is mainly due to the inclusion of the active membership, failure to undertake this work would leave the Fund exposed to the risks described in section 6.3 of this report. As the increase in budget is significant, officers of the Fund have requested further information on the active members in scope, as it is understood that the current estimates relate to all active members, rather than those with pre-1997 service only.
- 7.8 If, by the date of the Committee, members and officers are satisfied that the cost estimates presented are reasonable, the Committee will be asked to consider formal approval for the increase in budget for completing Phase 2, so that work can immediately commence to get the project back on track and completed within the deadline. Officers will receive a monthly report from Equiniti detailing progress made and costs incurred; summaries of these reports can be provided to the Committee as required. Additionally, Equiniti will provide a budget tracker as set out in Appendix 1.
- 7.8 Phase 3 of the project is the Certification and Rectification of the Fund's administration data and benefits:

- Certification – ‘all in scope’ records; records on the administration system to have indicator that data is fully reconciled and whether or not any changes have been made & what those changes are
- Rectification – ‘some in scope’ records; the physical change to the data and and/or any payments made/changes in benefits.

7.9 The detailed proposal set out in Appendix 2, breaks this phase into several ‘sub-phases’ to gather information and develop scheme specific calculations in order to assist the Fund in making informed decisions as the work progresses. Each phase will have its own associated costs that will need to be monitored.

- Phase 3a – Initiation
Comparison of pension & GMP values, provides high level view of cases that can be rectified using an agreed automated method, or are more complex and need to be rectified manually
- Phase 3b – Certification
Indicator added to member records confirming a reconciliation has been undertaken – several cycles of this will need to be done as records are agreed/matched/cleared
- Phase 3c – Pilot Phase
Enhanced comparison of complex data from Phase 3a – to reduce number of cases needing manual rectification
- Phase 3d – Rectification casework
Physical amendments to the admin system and necessary corrections to benefits in payment

7.10 Equiniti have indicated that once ‘sub-phases’ 3a and 3c have been actioned, it will give the Fund a more realistic timescale and budget estimate for the future rectification work in 3d. They have also set out a recommend approach (as detailed in Appendix 2, page 14) in the form of ‘data cycles’. A series of ‘notification caps’ set at each data cycle, will assist the Fund in monitoring the on-going costs for Phase 3.

7.10 Therefore, Pensions Committee will be asked to consider formal approval for Equiniti to commence sub-phase 3a. The ‘notification cap’ of this first data cycle is estimated at £4,960, this is for the preparation a first version of the Certification and Rectification approach, including project management.

7.11 The Fund will need to formulate its own ‘Rectification Policy’; by considering rectification tolerance levels, identify any priority cases, dealing with cases of under and/or over payment of pensions, any budget constraints to rectify benefits already in payment and any member communications. As Phase 3 progresses, and decisions and policies are required, officers will bring the reports and recommendations to Committee as necessary.

7.12 The provision of accurate cost information for the project as a whole is a particular challenge associated with GMP reconciliation. The work is time intensive, and as the project progresses the costs will increase as we filter the data and approach the rectification of member benefits. Until the details of the extent of the discrepancies are known, the Fund is reliant on estimated costings.

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EXEMPT - Appendix 1 – rationale for increase in budget for completing Phases 2

EXEMPT - Appendix 2 – proposal for Phase 3 & estimated costs