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Dear Colleague

POLICE PENSIONS CIRCULAR No 2008/3 THE POLICE PENSIONS AMENDMENTS (SCOTLAND) REGULATIONS 2006

This circular should be brought to the immediate attention of force personnel officers, Human Resource Managers and the Pension Managers and administrators of the PPS.

POLICE PENSION SCHEME 1987 AND NEW POLICE PENSION SCHEME 2006: NEW FACTORS FOR COMMUTATION AND EXCHANGE OF LUMP SUM

TRIVIAL COMMUTATION AND CAPITALISATION FOR DEATH GRATUITIES

1. Introduction

1.1 This Circular provides guidance on the introduction of new actuarial factors for:

- (a) the commutation of pension for a lump sum in the Police Pension Schemes 1987 and 1988 (PPS);
- (b) the exchange of lump sum for additional annual pension in the New Police Pension Scheme 2006 (NPPS); and
- (c) guidance by Government Actuary's Department (GAD) on 'trivial' commutation and capitalisation for death gratuities in the PPS and the NPPS.

- 1.2 The new factors, which have immediate effect, are set out in the accompanying guidance produced by GAD which can be accessed via the attached link – [commutation and exchange of lump sum - Gad guidance](#) . The GAD guidance must be read in conjunction with this Circular, which provides additional guidance on the effects of backdating and various financial issues.
- 1.3 The new factors apply to the commutation of police officers' personal awards and PPS pension credit members' awards. Forces will already be aware that the commutation factors were introduced in the rest of the UK for PPS members in May 2008 with an identical backdating date of 1 October 2007
- 1.4 The action which pensions administrators must take is set out in section 5 of this Circular.

2. The changes relating to new commutation factors

2.1 In addition to new factors, the new guidance introduces changes to the method of calculating lump sums and additional annual pension. The changes are:

- All the factors are now the same for men and women.
- The new PPS factors are at all ages higher than both the existing male and existing female factors, so the amount of lump sum which may be obtained by commutation in PPS is increased.
- The new NPPS factors are lower than the existing factors, so the additional annual pension which may be obtained by exchanging lump sum in NPPS is reduced.
- The new factors vary with attained months of age rather than age next birthday. This increases the number of steps in the factors and so reduces the size of the steps. This avoids the situation, which could arise under the previous arrangements, whereby a lump sum could be substantially smaller if retirement is delayed by one day.
- Application of the new factors is in terms of completed years and months on the day pension commences. For instance, an officer retiring on her 54th birthday (i.e. whose last day of service is the day before her 54th birthday) will qualify for the factor applicable to the age of 54 years 0 months (18.2) and an officer retiring the day before that birthday (i.e. whose last day of service is two days before her birthday) will qualify for the higher factor relating to the previous whole month of age, i.e. 53 years 11 months (18.22). There is no need to retire at least one day before, say, one's 54th birthday in order to avoid the factor for 54 years 1 month.

3. Backdating of PPS factors

3.1 **The effect of the new PPS factors is backdated to 1 October 2007.** This means that the new factors apply to any officer who retired with an immediate pension on



that date or later (i.e. whose last day of service was 30 September 2007 or later) or whose deferred pension came into payment on 1 October 2007 or later. This will require the payment of interest in some cases.

4. No backdating of NPPS factors

4.1 **The new NPPS factors are not backdated, but come into effect from 9 September 2008.** The new NPPS factors therefore apply to any officer who retires with an immediate pension on or after that date (i.e. whose last day of service was 31 August 2008 or later) or whose deferred pension came into payment on 1 September 2008 or later. Any lump sum converted into more annual pension in the case of an officer who has retired from NPPS before 9 September 2008 is not affected.

4.2 There might be cases of officers who are due to retire on or after 9 September 2008 and who have already given notice that they wish to exchange part of their NPPS lump sum for additional annual pension. Any such officer must be given the opportunity to reconsider his or her position in the light of the new factors, since the decision will have been made on the basis of the old factors.

5. Action to be taken

Implementation of the new factors going forward

5.1 The GAD guidance and the new factors must be implemented with immediate effect. Note in particular the changes mentioned at the last two bullet points in paragraph 2.1: the use of attained months of age rather than age next birthday and application of the new factors in terms of completed years and months on the day pension commences.

5.2 We would anticipate that every police authority will have implemented the new factors and guidance by 30 September 2008. The new factors for PPS must be applied to any officer who retires or has retired on or after 1 October 2007, so the backdating arrangements described in the paragraphs which follow must take into account any officer who retires between now and the date on which all the practical steps necessary to implement the new factors are brought into effect.

Identification of officers entitled to backdated payments (PPS)

5.3 Administrators must identify any officer who retired on or after 1 October 2007, or whose deferred pension came into payment on or after that date, and who commuted some of his or her annual pension for a lump sum under the Police Pensions Regulations 1987. In all such cases the lump sum to which the officer is entitled must be recalculated using the new factors and guidance, based on the terms of the officer's original notice of commutation.

5.4 As a matter of priority administrators must identify those members who retired from 1 October 2007 onwards in the first instance. Any backdated payments under these arrangements are authorised payments for the purposes of the Finance Act 2004,

provided that they are made within 12 months of the date on which the officer retired. They do not constitute a new benefit crystallisation event.

- 5.5 Hence those qualifying members who are approaching the anniversary of their retirement **must** be dealt with before the twelve month time limit to avoid any potential tax charge.
- 5.6 Such officers will, given the higher new factors, be entitled to an additional payment. Forces must write to the officers concerned to explain the reason for the additional payment. The default position is that the officer is given more lump sum, but he or she will be given an opportunity to return the money and request additional annual pension instead if he or she does so within one month of the date of the notification. This period may be extended at the police authority's discretion in exceptional circumstances. You should, for example, allow a longer period if the officer is away and does not receive the notification directly after it is sent. For those pensioners to be treated as a priority (mentioned in paragraph 5.4) forces may decide on quicker means of communication such as the telephone or e-mail.
- 5.7 Given that the revised factors have already been introduced in England and Wales it is anticipated that those officers who have retired since 1 October 2007 will already be alert to the change and will be anticipating contact from the force regarding backdated arrears.
- 5.8 Model notification letters, depending on the officer's circumstances, are provided in the attached **Annex A**. The letters are designed to meet various scenarios, but may need to be adapted further to meet an officer's individual circumstances.
- 5.9 The additional amounts must be paid to officers as soon as can be arranged, subject to the following considerations:
- interest must be paid on any payment made three months or more after the entitlement arose;
 - officers who retired with less than 30 years service and who commuted to give a maximum lump sum of 2¼ times the annual pension before commutation cannot receive any additional lump sum payment, but must instead receive the extra money to which they are entitled in the form of additional annual pension;
 - some officers who retired with less than 30 years service who did not commute to give a maximum lump sum might nevertheless be taken over the maximum by the additional payment in which case they will receive an additional lump sum payment up to the maximum and the rest as additional annual pension.
- 5.10 Guidance on these complicating factors is given in paragraphs 5.9 and 5.14.

Payment of interest

- 5.11 Interest will be paid on any backdated payment which is not paid within three months of the date to which entitlement has been backdated (i.e. the officer's date of retirement or the date a deferred pension came into payment).

- 5.12 Interest on backdated payments, which is taxable, should be calculated on a daily basis at 1% above the base bank rate (i.e. as specified in SPPA Circular 2003/2 in relation to late payment of lump sums in individual cases, except that the point at which interest becomes payable is three months rather than 30 days). The interest must be applied to each backdated payment, with each additional instalment of pension payment having interest applied separately. The following example illustrates the calculations that are required.

Interest example 1 - backdated lump sum

date pension commences: 22 December 2007

date of back-payment: 1 September 2008

period of backdating = 254 days

backdated lump sum due = £17,500

total backdated payment due = £17,500 x (1 + (6% x 254/365)) = £18,230.68

interest due = £18,230.68 - £17,500 = £730.68

Notes:

1. The rate of interest is based on the base bank rate at 4 September 2008.
2. Use 365 days in the calculation even though 2008 is a leap year

- 5.13 It has been confirmed with HMRC that it is the responsibility of the recipient to declare the interest on his or her self assessment return or to inform their tax office if they do not complete a return. The tax will not be deducted at source.
- 5.14 Interest payments have been taken into account with the additional funding provided for this particular exercise see para 7.

Officers who received or would receive the maximum lump sum

- 5.15 Under regulation B7 of the Police Pensions Regulations 1987, the maximum commutation lump sum payable to an officer who retired with an ordinary pension based on less than 30 years pensionable service before his or her pre-October 2006 compulsory retirement age is 2¼ times the annual pension before commutation. This requirement is not changed by the new factors, so an officer who received this maximum cannot receive any additional payment by way of a lump sum. The extra amount to which an officer is entitled as a result of the new factors must, to the extent that it would cause the 2¼ maximum to be exceeded, be paid as additional annual pension instead. If the original commutation fell short of the maximum, an additional payment of lump sum could be made to the extent that the maximum is not exceeded.
- 5.16 Where an officer or former officer has already received the maximum lump sum, you should recalculate the amount of annual pension which the officer has to give up in order to receive the maximum, using the new factors. This will be less than the amount he or she previously had to give up using the old factors, so the balance is paid as additional annual pension. A similar approach is adopted where the officer or former officer receives part lump sum and part additional annual pension.

- 5.17 Interest must be paid on additional annual pension on the same basis as on lump sums. The following example illustrates the calculations that are required.

Interest example 2 - backdated pension

date of first pension payment: 1 May 2008
date of back-payment: 25 September 2008
backdated pension due = £50 per month

Interest on backdated pension payments is calculated in the same way as interest on lump sums but account is taken of each backdated pension payment that is more than 3 months late. At 25 September 2008 the backdated pension payments in respect of pension instalments on 1 May and 1 June will be more than 3 months late, and so attract interest.

period from 1 May 2008 to 25 September 2008 = 148 days
period from 1 June 2008 to 25 September 2008 = 117 days

total backdated payment due for May = $£50 \times (1 + (6\% \times 148/365)) = £51.22$
total backdated payment due for June = $£50 \times (1 + (6\% \times 117/365)) = £50.96$
total interest due = $£51.22 + £50.96 - £100 = £2.18$

Note: The rate of interest is based on the base bank rate at 4 September 2008.

Officers who have died since 1 October 2007

- 5.18 There may be cases where a former officer has died after having retired or after having had a deferred pension come into payment on or after 1 October 2007. In such cases, the additional lump sum payment and interest should be calculated in the same way as in any other case, but the payment should be made to the former officer's legal personal representative (i.e. his or her estate).
- 5.19 The instructions at paragraphs 5.9 - 5.10, in relation to the maximum lump sum, apply equally to payments in respect of former officers who have died. Payments in respect of former officers who have died will take the form of additional pension only where and to the extent that the maximum lump sum would otherwise be exceeded. Payment of additional pension in respect of officers who have died will take the form of a one-off payment to the former officer's legal personal representative (i.e. his or her estate).
- 5.20 Any additional payments under these arrangements in respect of former officers who have died have no effect on the level of any adult or child survivor's pension.

6. Software

- 6.1 We have been in touch with Heywoods who are the main police pensions software providers for Scotland about the new format for the factors. Software should be ready to accommodate the new factors by 4 September.

7. Funding arrangements

- 7.1 Police Grant will be increased to allow for these extra payments.

Trivial Commutation and Capitalisation for Death Gratuities

- 8.1 Attached is guidance by GAD in “trivial” commutation and capitalisation for death gratuities in PPS and NPPS.
- 8.2 The new factors, like the recently announced new lump sum commutation factors for PPS, are backdated to 1 October 2007. Any commutation of a small pension for a lump sum which has been carried out on or after that date must be recalculated and any additional amount paid to the recipient. This is subject to the proviso that the lump sum should be adjusted only in cases where the new factors result in a higher lump sum. In any case where the new factors would result in a lower figure, the original calculation should stand. There are unlikely to be many such cases (trivial commutation is itself comparatively rare), but there have until now been no published tables of factors and trivial commutation has been dealt with on a case by case basis. GAD are aware of some recent cases which used factors that were slightly higher than those in the new tables.
- 8.3 Note the following specific points:
- The factors are gender specific after age 65. This is because it is harder to defend gender-neutral factors at ages over 65.
 - Unlike the new lump sum commutation factors, the trivial commutation factors change in yearly rather than monthly steps. The annual step sizes are in any case smaller at ages over 60 and the sums at stake will generally not be so large, so the transition from one year to the next should not be so marked as for the main commutation factors.
 - Child capitalisation factors are excluded. These will continue to be dealt with on a case by case basis.
- 8.4 Note also the taxation restrictions set out in paragraph 1.3 of the GAD guidance, in particular the requirement that the former officer must confirm that his or her total pension rights held in registered pension schemes do not exceed 1% of the standard

lifetime allowance on the nomination date. As the guidance says, this is likely to change to allow commutation of pension rights of a total value of £2,000 or less, irrespective of other pension rights held in other schemes. We shall issue further advice when this change is made, later this year.

View attachments here:

[Police pensions trivial commutation and capitalisation GAD guidance 23.06.08.](#)

Yours sincerely

Jim Preston
Policy Manager

Annex: model letters to police officers

Letter 1: former officer entitled to an additional lump sum payment, retired on or after 1 October 2007

I am writing to let you know about an increase in the amount of your police pension lump sum.

You chose to commute part of your annual pension for a lump sum payment and the amount of your lump sum was calculated according to factors prepared by Government Actuary's Department (GAD). These factors have been reviewed by GAD and new factors have been introduced with backdated effect to 1 October 2007. We have therefore recalculated the amount of your lump sum using the new factors and you are entitled to an additional lump sum payment of £ , plus interest of £. This will be included in your next payment.

If you would prefer to receive additional annual pension instead of the additional lump sum, you may choose to do so provided you tell us and return the lump sum to us within one month of the date of this letter.

Please get in touch with us if you have any questions about this change.

Letter 2: former officer entitled to an additional lump sum payment but has already received the maximum 2¼ times annual pension

I am writing to let you know about an increase in the amount of your police pension.

You chose to commute part of your annual pension for a lump sum payment and the amount of your lump sum was calculated according to factors prepared by Government Actuary's Department (GAD). These factors have been reviewed by GAD and new factors have been introduced with backdated effect to 1 October 2007.

Since you chose to commute to the maximum lump sum of 2¼ times annual pension allowed by the Police Pensions Regulations 1987, the additional amount can only be paid in the form of additional annual pension.

We have therefore recalculated the amount the amount of annual pension which you would have to give up in order to receive the maximum lump sum using the new factors. The amount of additional annual pension to which you are entitled is £ , which will be included in your next payment onwards. You are also entitled to interest of £ . This will be included in your next payment.

Please get in touch with us if you have any questions about this change.

Letter 3: former officer entitled to an additional lump sum payment but it would take him or her over the maximum 2¼ times annual pension

I am writing to let you know about an increase in the amount of your police pension lump sum and annual pension.

You chose to commute part of your annual pension for a lump sum payment and the

amount of your lump sum was calculated according to factors prepared by Government Actuary's Department (GAD). These factors have been reviewed by GAD and new factors have been introduced with backdated effect to 1 October 2007. We have therefore recalculated the amount of your lump sum using the new factors and you are entitled to an additional lump sum of £ , plus interest of £ . However, if this amount were to be paid to you in full your total lump sum would exceed the maximum of 2¼ times annual pension allowed by the Police Pensions Regulations 1987. You will therefore receive an additional lump sum payment of £ and the rest will be paid in the form of additional annual pension. The amount of additional annual pension to which you are entitled is £ .

The additional lump sum and interest will be included in your next payment and your annual pension will be increased from that payment onwards.

If you would prefer to receive all the extra amount to which you are entitled in the form of additional annual pension, you may choose to do so provided you tell us and return the lump sum to us within one month of the date of this letter.

Please get in touch with us if you have any questions about this change.