

**Police Pension Schemes 1987 and 1988
& New Police Pension Schemes 2006**

Commutation and Exchange of Lump Sum

Date: 21 May 2008



Introduction

The attached tables set out the factors for commutation of pension to lump sum in the Police Pension Scheme (PPS). Also attached are factors for calculating the exchange of lump sum for additional annual pension in the New Police Pension Scheme (NPPS) introduced in April 2006.

The factors apply in accordance with the following regulations:

- regulation B7 of The Police Pensions Regulations 1987 (UK SI 1987/257)
- regulation M3 (in England and Wales) or M11 (in Scotland) of The Police Pensions Regulations 1987 (UK SI 1987/257)
- regulations B7 and N2 of The Royal Ulster Constabulary Pensions Regulations 1988 (NI SR 1988/374)
- regulation 37 of The Police Pensions Regulations 2006 (UK SI 2006/3415)
- regulation 37 of The Police Pensions (Scotland) Regulations 2007 (Scottish SI 2007/201)
- regulation 34 of The Police Pensions (Northern Ireland) Regulations 2007 (NI SR 2007/476)

This guidance applies to any pensions commencing on or after 1 October 2007 in the case of PPS and to any pensions commencing on or after 1 July 2008 in the case of NPPS. This guidance supersedes any previous guidance or advice issued by GAD in connection with police pension commutation or exchange of lump sum.

This guidance does not apply to the trivial commutation of pension under regulations B8 and E4(3) of The Police Pensions Regulations 1987 and regulation 38 of The Police Pensions Regulations 2006 (and under the corresponding Scottish and Northern Ireland regulations).

This guidance also does not cover the calculation of the capitalised value of benefits for the purpose of determining death gratuities under regulation E3 of The Police Pensions Regulations 1987 and regulation 45 of The Police Pensions Regulations 2006 (and under the corresponding Scottish and Northern Ireland regulations).

If administrators have any questions about how to use this guidance they should in the first instance consult published information or raise queries on the Police Pensions Administrators' Forum at:

<http://pensions.police.homeoffice.gov.uk/>

If the Forum does not help, administrators may contact the Police Pensions Teams at the Home Office, the Scottish Public Pensions Agency or the Northern Ireland Office, as applicable. The Home Office, the Scottish Public Pensions Agency or the Northern Ireland Office will seek input from the scheme actuary if necessary.

Administration

1. The amount of PPS pension that can be commuted is subject to the limits set out in the PPS regulations. In most cases a quarter of the pension can be commuted. An ordinary pension in respect of at least 25 but less than 30 years of service (but not one that is paid on compulsory retirement on account of age or on retirement on or after what would have been the compulsory retirement age for the officer's rank and force if that age had not been altered on 1 October 2006) can be commuted to give a maximum lump sum of no more than 2¼ times the gross annual pension.
2. Police Pension Scheme regulation B10 describes additional restrictions on the level of pension that can be commuted in certain circumstances.
3. Restrictions on pension commutation are also imposed by the pension taxation regime under Finance Act 2004. Administrators must ensure that the payment of a lump sum in lieu of pension is compliant with the tax rules as well as with the police pension regulations. The main taxation restriction is that for a lump sum to be authorised under the tax rules it must not exceed 25% of the total value of benefits vested.
4. Use of the attached factors will not in most cases cause the 25% HMRC limit to be breached. However, two scenarios where the limit could potentially be breached are as follows:
 - Allocation in accordance with Police Pension Scheme regulation B9
 - Pension commencing before age 55 after a gap since leaving service

These scenarios are discussed in more detail later in this note.

PPS commutation – retiring from active service

5. For an officer retiring on pension directly from police service (and for pension credit members) the lump sum payable can be determined as follows:

pension given up × factor from table 1

Equivalently, the pension given up can be determined as follows:

lump sum payable ÷ factor from table 1

6. Example 1 on page 6 illustrates this calculation.

PPS commutation – break between leaving service and pension commencing

7. The commutation lump sum should be calculated as in paragraph 5 above in the following cases:
- If the pension commences at or above age 55; or
 - If the pension commences on grounds of ill health before age 55 and attracts full pension increases; or
 - If the pension commences on an actuarially reduced basis under regulation 14 of The Police Service of Northern Ireland Reserve (Full-time) Severance Regulations 2006.
8. In other cases where the pension commences before age 55 a special calculation is needed. The two scenarios where this arises are as follows:
- Officer left service before age 50 with at least 25 but less than 30 years of police service. The PPS pension comes into payment at age 50 but pension increases are not payable until 55.
 - Officer left service at any age with a deferred pension entitlement. They are later awarded early payment of the pension on ill-health grounds but do not meet the stricter criterion to enjoy full pension increases under the Pension Increase Act. The PPS pension comes into payment immediately but pension increases are not payable until 55.
9. In these cases, the lump sum payable should be determined as follows:
- $$\text{pension given up} \times (\text{factor from table 1} + (\text{PI percentage} \times \text{factor from table 2}))$$
- Equivalently, the pension given up can be determined as follows:
- $$\text{lump sum payable} \div (\text{factor from table 1} + (\text{PI percentage} \times \text{factor from table 2}))$$
- The PI percentage is the percentage increase in the pension that is attributable to pension increases announced during the period between leaving service and the pension commencing.
10. Examples 2 and 3 on pages 6 and 7 respectively illustrate this calculation.
11. For the officer drawing an ordinary pension from age 50 (ie not on ill health grounds) after a gap since leaving service the appropriate factor from table 2 will always be 15.
12. The amount of pension that can be commuted in these cases is subject to the normal limits under the PPS regulations. For example, for the officer drawing the ordinary pension at age 50 the lump sum is limited to “an amount equal to 2¼ times the annual amount of his pension...” (regulation B7(4)(b)). GAD’s view is that this should be interpreted as meaning that the lump sum is limited to 2¼ times the basic pension, ie without any pension increase applied for the period between retirement and reaching age 50. However, this is not a legal view and different interpretations may be possible.

13. No additional lump sums are payable at age 55 or at any other time. The full value of the pension being given up on commutation has been allowed for in setting the commutation factors. The pension payable from age 55 is the level of pension after commutation multiplied by the PI percentage from date of leaving service up to age 55.

Factors that could breach the HMRC limit

14. As mentioned in paragraph 4, there are two scenarios that may breach the HMRC limit of authorised lump sums being no more than 25% of the total benefit value. The first is allocation – when a member chooses to give up part of their own pension in favour of additional dependant's pension after their death.
15. The second scenario that may breach the limit is on pension commencing before age 55 after a gap since leaving service and where pension increases will not be paid until age 55 (ie as per paragraph 8). Example 4 on page 8 illustrates how this can result in the commuted lump sum exceeding 25% of the total value of benefits.
16. Lump sums above the 25% HMRC limit are taxed at 55% in the hands of the member with the possibility of additional scheme sanction charges on the administrator. Administrators should alert members who are in danger of breaching the HMRC limit to the tax consequences of opting to commute to the maximum extent.

NPPS exchange of lump sum

17. All or part of an NPPS lump sum may be exchanged for increased annual pension. This option applies to an ordinary pension or a deferred pension but not to an ill-health pension or to a deferred pension paid early on grounds of ill-health.
18. The additional pension payable should be determined as follows:

lump sum given up ÷ factor from table 3

19. Example 5 on page 9 illustrates this calculation.

Example Calculations

This section provides examples of the calculations described in this note.

Example 1 – PPS: retiring from active service

date of birth: 22 December 1952
date pension commences: 22 December 2007
total pension payable: £20,000 pa

age on day pension commences: 55 years

maximum pension that can be commuted: £5,000 pa

lump sum payable: = pension given up × factor from table 1
 = 5,000 × 18
 = **£90,000**

Example 2 – PPS: pension commencing at age 50 after a gap since leaving service

date of birth: 1 January 1958
pension at leaving service: £15,000 pa
date pension commences: 1 January 2008
accrued PI when pension commences: 10%

age on day pension commences: 50 years

maximum lump sum payable = $2\frac{1}{4}$ × pension = £33,750

pension to be commuted to lump sum:

 = lump sum payable ÷ (factor from table 1 + (PI percentage × factor from table 2))
 = 33,750 ÷ (19 + (10% × 15))
 = **£1,646.34 pa**

pension payable at age 50 = 15,000 – 1,646.34
 = **£13,353.66 pa**

Example 3 – PPS: pension commencing on ill health grounds without PI after a gap since leaving service

date of birth: 30 June 1965

pension at leaving service: £8,000 pa

date pension commences: 15 October 2010

accrued PI when pension commences: 5%

age on day pension commences: 45 years 3 months

maximum pension that can be commuted: £2,000 pa

lump sum payable:

= pension given up \times (factor from table 1 + (PI percentage \times factor from table 2))

= 2,000 \times (19 + (5% \times 12.6))

= **£39,260**

Example 4 – PPS: HMRC limit breached on pension commencing on ill health grounds without PI after a gap since leaving service

date of birth: 10 June 1965
 pension at leaving service: £8,000 pa
 date pension commences: 15 October 2010
 accrued PI when pension commences: 30%

age on day pension commences: 45 years 4 months

maximum pension that can be commuted under PPS regs: £2,000 pa

lump sum payable:
 = pension given up × (factor from table 1 + (PI percentage × factor from table 2))
 = 2,000 × (19 + (30% × 12.6))
 = £45,560

total HMRC value of benefits = £6,000 * 20 + £45,560
 = £165,560

lump sum proportion: = £45,560 / £165,560
 = **27.5% of total value**

maximum pension that can be commuted within 25% HMRC limit = £1,811.18 pa

lump sum payable:
 = pension given up × (factor from table 1 + (PI percentage × factor from table 2))
 = 1,811.18 × (19 + (30% × 12.6))
 = £41,258.68

total HMRC value of benefits = (8,000 – 1,811.18) * 20 + 41,258.68
 = £165,035.08

lump sum proportion: = £41,258.68 / £165,035.08
 = **25% of total value**

Example 5 – NPPS: exchange of lump sum

date of birth: 22 October 1952

date pension commences: 12 December 2007

lump sum payable: £40,000 pa

age on day pension commences: 55 years 1 month

additional pension payable: = lump sum given up ÷ factor from table 3
= 40,000 ÷ 18.58
= £2,152.85 pa

Table 1: PPS factors for commutation of pension to lump sum
Males and Females

Years	Age in years and completed months on day pension commences											
	0	1	2	3	4	5	6	7	8	9	10	11
49 and below	19	19	19	19	19	19	19	19	19	19	19	19
50	19	18.98	18.97	18.95	18.93	18.92	18.9	18.88	18.87	18.85	18.83	18.82
51	18.8	18.78	18.77	18.75	18.73	18.72	18.7	18.68	18.67	18.65	18.63	18.62
52	18.6	18.58	18.57	18.55	18.53	18.52	18.5	18.48	18.47	18.45	18.43	18.42
53	18.4	18.38	18.37	18.35	18.33	18.32	18.3	18.28	18.27	18.25	18.23	18.22
54	18.2	18.18	18.17	18.15	18.13	18.12	18.1	18.08	18.07	18.05	18.03	18.02
55	18	17.97	17.93	17.9	17.87	17.83	17.8	17.77	17.73	17.7	17.67	17.63
56	17.6	17.57	17.53	17.5	17.47	17.43	17.4	17.37	17.33	17.3	17.27	17.23
57	17.2	17.17	17.13	17.1	17.07	17.03	17	16.97	16.93	16.9	16.87	16.83
58	16.8	16.77	16.73	16.7	16.67	16.63	16.6	16.57	16.53	16.5	16.47	16.43
59	16.4	16.37	16.33	16.3	16.27	16.23	16.2	16.17	16.13	16.1	16.07	16.03
60	16	15.97	15.93	15.9	15.87	15.83	15.8	15.77	15.73	15.7	15.67	15.63
61	15.6	15.57	15.53	15.5	15.47	15.43	15.4	15.37	15.33	15.3	15.27	15.23
62	15.2	15.17	15.13	15.1	15.07	15.03	15	14.97	14.93	14.9	14.87	14.83
63	14.8	14.77	14.73	14.7	14.67	14.63	14.6	14.57	14.53	14.5	14.47	14.43
64	14.4	14.37	14.33	14.3	14.27	14.23	14.2	14.17	14.13	14.1	14.07	14.03
65	14											

Table 2: PPS additional factors in respect of accrued pension increases for use in commutation before age 55 after a gap since leaving service

Males and Females

Age in completed years on day pension commences	Factor
21	5.5
22	5.7
23	5.9
24	6.1
25	6.3
26	6.5
27	6.8
28	7
29	7.3
30	7.5
31	7.8
32	8.1
33	8.3
34	8.6
35	8.9
36	9.2
37	9.6
38	9.9
39	10.3
40	10.6
41	11
42	11.4
43	11.8
44	12.2
45	12.6
46	13.1
47	13.5
48	14
49	14.5
50	15
51	15.5
52	16
53	16.6
54	17.2

**Table 3: NPPS factors for exchange of lump sum for additional annual pension
Males and Females**

Years	Age in years and completed months on day pension commences											
	0	1	2	3	4	5	6	7	8	9	10	11
55	18.6	18.58	18.57	18.55	18.53	18.52	18.5	18.48	18.47	18.45	18.43	18.42
56	18.4	18.38	18.37	18.35	18.33	18.32	18.3	18.28	18.27	18.25	18.23	18.22
57	18.2	18.18	18.17	18.15	18.13	18.12	18.1	18.08	18.07	18.05	18.03	18.02
58	18	17.97	17.93	17.9	17.87	17.83	17.8	17.77	17.73	17.7	17.67	17.63
59	17.6	17.57	17.53	17.5	17.47	17.43	17.4	17.37	17.33	17.3	17.27	17.23
60	17.2	17.17	17.13	17.1	17.07	17.03	17	16.97	16.93	16.9	16.87	16.83
61	16.8	16.77	16.73	16.7	16.67	16.63	16.6	16.57	16.53	16.5	16.47	16.43
62	16.4	16.37	16.33	16.3	16.27	16.23	16.2	16.17	16.13	16.1	16.07	16.03
63	16	15.97	15.93	15.9	15.87	15.83	15.8	15.77	15.73	15.7	15.67	15.63
64	15.6	15.57	15.53	15.5	15.47	15.43	15.4	15.37	15.33	15.3	15.27	15.23
65	15.2											