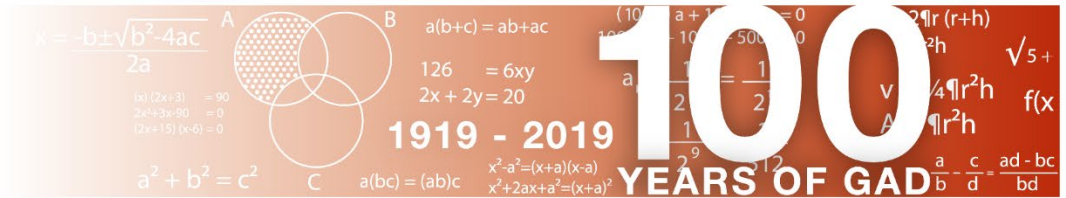




Government  
Actuary's  
Department



## NHS Pension Scheme (Scotland) 2015

### Commutation

### Factors and guidance

Date: 25 October 2019





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## 1 Introduction

- 1.1 This Note is addressed to the Scottish Public Pensions Agency ('SPPA') as administrator of the NHS Pension Scheme (Scotland) 2015 ('NHSPSS 2015') and identifies the various circumstances under which scheme pension may be commuted for a lump sum (or vice versa). It sets out the factors to be used in each case and specifies how they should be applied.
- 1.2 The Regulations which include an option allowing a member to commute part of their pension for a lump sum (or vice versa) are shown in the tables below.

| Provision   | Statutory Reference                | Section                      |
|---|------------------------------------|------------------------------|
| General option to exchange part of pension for lump sum   | SSI 2015/94 (76)                   | 2                            |
| Option for members in serious ill-health to exchange whole pension for lump sum                                 | SSI 2015/94 (108)                  | 3                            |
| Commutation of small pensions   | SSI 2015/94 Schedule 3 Part 2 (6)  | 4                            |
| Deduction of tax: further provisions<br>Covers benefit reductions due to annual allowance or lifetime allowance | SSI 2015/94 Schedule 3 Part 7 (16) | Covered in separate guidance |

- 1.3 The scope of cases under each scenario which are covered by this guidance are detailed later in this note. Cases which are not covered by this guidance should be referred to GAD.
- 1.4 The factors provided in this Note have been prepared in light of our advice to the SPPA dated 30 October 2018 and its instructions following that advice.

The factors contained in this guidance apply from 29 October 2018. This implementation date has been determined by SPPA.

### Implementation and review

- 1.5 This guidance is intended to supersede any factors or advice previously issued, for the purposes of commutation calculations. In particular, this guidance supersedes the following guidance note:
- "NHS Pension Scheme (Scotland) 2015: Commutation. Factors and guidance"* dated 27 March 2015.
- 1.6 No advice or factors issued in the past for the National Health Service Pension Scheme Scotland ('NHSPSS') should be used for commutation calculations in respect of NHSPSS 2015 benefits.



- 1.7 Where members have benefits in both the NHSPSS 2015 and the NHSPSS benefits in each scheme must be treated separately.
- 1.8 This guidance has been written for pension administrators and assumes some knowledge of general pension terminology, and some familiarity with retirement calculations for the NHS Pension Scheme (Scotland) 2015. Any questions concerning the application of the guidance should, in the first instance, be referred to SPPA.
- 1.9 In line with best practice and in order to make sure that factors are being used as intended and the instructions are fit for purpose, we suggest that some example calculations are sent to GAD for review.
- 1.10 The factors contained in this guidance will be subject to review periodically. This will depend on external circumstances, for example whenever there is a change in the SCAPE basis; when changes in the actuarial assumptions adopted for other scheme factors take place; or following each future actuarial valuation where mortality and other relevant experience is reviewed or if other credible and material information comes to light.
- 1.11 The remainder of this Note covers the factor tables, guidance on their use and worked examples.
- 1.12 A summary of the assumptions underlying the factors covered in Section 4 above is listed in Appendix A. The factors are provided in Appendix B.

### **Third party reliance**

- 1.13 This guidance has been prepared for the use of SPPA as the scheme administrators for the purposes of demonstrating the application of the factors covered by this guidance only. This guidance may be published on SPPA's website but must not otherwise be reproduced, distributed or communicated in whole or in part to any other person without GAD's prior written permission.
- 1.14 Other than SPPA as the scheme administrators, no person or third party is entitled to place any reliance on the contents of this guidance, except to any extent explicitly stated herein. GAD has no liability to any person or third party for any action taken or for any failure to act, either in whole or in part, on the basis of this guidance, whether or not GAD has agreed to the disclosure of its advice to the third party.



## 2 Exchange part of retirement pension for lump sum

- 2.1 The scheme regulations give any member who ceases pensionable employment and retires from the scheme the option to commute part of their pension to lump sum. This right also applies to pension credit members, except those with a disqualifying pension credit<sup>1</sup>.
- 2.2 This section refers to benefits payable in accordance with Regulations 76 of SSI 2015/94. That is those Regulations relating to the lump sum available by commutation at retirement for whatever reason except serious ill health, regardless of the member's age or sex, but subject to the restrictions as set out below.
- 2.3 A factor of 12 is prescribed in the Regulations and should be used to calculate the amount of lump sum by commutation of a member's pension (and the corresponding reduction in pension).

- 2.4 The relevant calculations are:

For a specified reduction of £x pa of pension, the amount of lump sum available is:

$$\text{Lump sum} = \text{Pension (£x pa)} \times 12$$

To receive a specified lump sum of £y, the reduction in pension required is:

$$\text{Reduction to annual pension} = \text{Lump sum (£y)} \div 12$$

- 2.5 For any member retiring early on actuarially reduced benefits (under regulation 78 of SSI 2015/94), the lump sum is available by commutation of the actuarially reduced pension. The same £12 lump sum: £1 pa pension factor as above is applied to the actuarially reduced pension.
- 2.6 Any member who has previously elected for Scheme Pays will have a reduction applied to their benefits at retirement. The reduction must be applied to the pension benefit before any commutation for additional lump sum is made.

### Restrictions

- 2.7 Commutation is subject to certain restrictions. The total lump sum must not exceed HMRC limits.
- 2.8 This Note does not describe the tests to be carried out to check the maximum amount of lump sum available. SPPA should ensure that the proposed lump sum is within the applicable limits. Typically a member is permitted to take a lump sum of up to 25% of the capital value of the benefits to be paid. However, this can be restricted further in certain circumstances (for example, if the member exceeds their standard lifetime allowance).

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<sup>1</sup> For the purposes of paragraph 2 of Schedule 29 of the Finance Act 2004



- 2.9 No tests are required at retirement if the member has a GMP as a result of a transfer of previously contracted out benefits.



### 3 Exchange whole pension for lump sum due to serious ill health

3.1 This section refers to benefits payable in accordance with Regulation 108 of SSI 2015/94. These Regulations give members in serious ill-health the option to exchange their entire pension for a lump sum.

3.2 For members retiring in serious ill-health, the £12 lump sum: £1 pa pension factor should be applied, subject to the modification set out below.

The lump sum payment from commuting the entire pension should be determined as follows:

- 1) Calculate the maximum amount of lump sum the member would be entitled to commute tax free, which is the limit set by HMRC (see paragraph 2.7).
- 2) Commute this at the rate of £12 lump sum: £1 pension pa to give the residual pension as follows:

Residual pension = Pension to be put into payment ignoring commutation – maximum lump sum ÷ 12

- 3) The residual pension should then be converted to lump sum using a factor of £5 lump sum: £1 pension pa as follows:

Lump sum from residual pension = Residual pension x 5

- 4) Total lump sum payable = Tax free lump sum allowed by commutation + lump sum from residual pension

3.3 Any member who has previously elected for Scheme Pays will have a reduction applied to their benefits at retirement. The reduction must be applied to the pension benefit before exchange of the whole pension for a lump sum due to serious ill health is made.



## 4 Trivial commutation

4.1 Various restrictions on trivial pension commutation are imposed by HMRC. SPPA should ensure that the payment of a lump sum in lieu of a small pension is compliant with these as well as with the NHSPSS 2015 regulations (SSI 2015/94 Schedule 3 Part 2 (6)).

4.2 The lump sum payable in respect of commutation of a trivial pension (in addition to any other lump sum due) should be determined as follows:

Total annual pension amount x factor

4.3 The 'Total annual pension amount' is the annual pension that would otherwise be put into payment if trivial commutation were not to proceed. Therefore, this pension is the pension after any reduction due to Scheme Pays<sup>2</sup> or due to commutation for tax-free cash if relevant. Total benefits must be considered when assessing whether trivial commutation may be allowed under HMRC limits. Different limits apply depending on whether just NHSPSS 2015 benefits are considered or whether pensions savings from all sources are taken into consideration.

4.4 The 'factor' should be determined from the Tables in Appendix B as applicable for the member's age (age attained in complete years) and status at the date of commutation. Status refers to either 'former contributing member' or 'dependant'.

4.5 For 'former contributing members' it is assumed that trivial commutation is in lieu of retirement, that is, that the member's pension has not come into payment. By electing for commutation the right to contingent benefit following the member's death lapses.

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<sup>2</sup> Although unlikely in trivial commutation cases, if a member has previously elected for Scheme Pays a benefit reduction is due on retirement.





## 5 Examples

- 5.1 This Section sets out a number of worked examples to help illustrate the types of commutation covered in sections 2 – 4.
- 5.2 Except as regard the commutation of trivial/small pensions, commutation does not affect the amount of the survivor's pension. That is, only the member's pension is commuted. (When a member's trivial pension is commuted the survivor's pension is also extinguished.)

### Examples for Section 2 – General commutation option

- 5.3 These examples show how the standard £12: £1 pa factors should be applied on retirement.

#### A. Normal retirement

|                               |  |
|-------------------------------|--|
| Age at retirement             | = 67                                   |
| NPA                           | = 67                                   |
| Accrued pension at retirement | = £10,000 pa                           |
| Accrued survivor's pension    | = £3,375 pa                            |
| Lump sum required             | = £12,000                              |
| Residual pension              | = £10,000 - (£12,000 ÷ 12) = £9,000 pa |
| Lump sum                      | = £12,000                              |
| Survivor's pension            | = £3,375 pa                            |

#### B. Early retirement

|   |  |
|---|--|
| Age at retirement                       | = 60 years                                 |
| NPA                                     | = 68                                       |
| Accrued pension at retirement           | = £22,000 pa                               |
| Accrued survivor's pension              | = £7,425 pa                                |
| Early retirement reduction factor at 60 | = 0.660                                    |
| Reduced pension at retirement           | = £22,000 x 0.660 = £14,520 pa             |
| Survivor's pension                      | = £7,425 pa                                |
| Lump sum required                       | = £24,000                                  |
| Residual pension                        | = £14,520 - (£24,000 ÷ 12)<br>= £12,520 pa |
| Lump sum                                | = £24,000                                  |
| Survivor's pension                      | = £7,425 pa                                |

**HMRC limits should be tested in all cases.**



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### Examples for Section 3 – Retirement due to ill health

#### C. Ill health (not life limiting)

|                                  |   |
|----------------------------------|---|
| Age at retirement                | = 55 years and 0 months                 |
| NPA                              | = 67                                    |
| Ill-health pension at retirement | = £11,000 pa                            |
| Accrued survivor's pension       | = £3,713 pa                             |
| Lump sum required                | = £12,000                               |
| Residual pension                 | = £11,000 - (£12,000 ÷ 12) = £10,000 pa |
| Lump sum                         | = £12,000                               |
| Survivor's pension               | = £3,713 pa                             |

#### D. Serious ill health (life limiting)

|                                  |  |
|----------------------------------|--|
| Ill-health pension at retirement | = £33,333 pa                             |
| Survivor's pension               | = £11,250 pa                             |
| Maximum tax-free lump sum        | = £142,855                               |
| Residual pension                 | = £33,333 - (£142,855 ÷ 12) = £21,428 pa |
| Cash value of residual pension   | = £21,428 x 5 = £107,140                 |
| Pension payable                  | = Nil                                    |
| Total lump sum                   | = £142,855 + £107,140 = £249,995         |
| Survivor's pension               | = £11,250 pa                             |

**HMRC limits apply**



## Examples for Section 4 – Trivial commutation

### E. Former contributing member

|   |                               |
|---|-------------------------------|
| Date of birth:                            | 1 September 1952              |
| Retirement date:                          | 1 September 2020              |
| Total pension payable:                    | £500 pa                       |
| Age (complete years) on commutation date: | 68                            |
| Lump sum payable:                         | $£500 \times 16.678 = £8,339$ |

### F. Widow (dependant)

|   |                              |
|---|------------------------------|
| Date of birth:                            | 8 September 1941             |
| Effective commutation date:               | 9 September 2020             |
| Age (complete years) on commutation date: | 79                           |
| Lump sum payable:                         | $£500 \times 9.478 = £4,739$ |



## Appendix A: Assumptions underlying factors

### Financial assumptions

|                                       |        |
|---------------------------------------|--------|
| Nominal discount rate                 | 4.448% |
| Real discount rate (in excess of CPI) | 2.40%  |

### Mortality assumptions

|                              |  |
|------------------------------|--|
| Base mortality tables        | S2NMA and S12NFA   |
| Base table adjustment        | 95.5% of S2NMA (Males) and 97.5% of S2NFA (Females) (As per 2016 valuation.) |
| Future mortality improvement | Based on ONS principal UK population projections 2016                        |
| Year of Use                  | 2020   |

### Other assumptions

|   |   |
|---|---|
| Proportion of male members for the purpose of unisexing factors | 33.3% (reducing to zero for factors used to commute trivial dependant pensions)                     |
| Age difference between member and partner                       | Males assumed to be 3 years older than partner. Females assumed to be 3 years younger than partner. |
| Proportions partnered   | As assumed for the 2016 valuation<br>Sample rates:  |

| Age | Males | Females |
|-----|-------|---------|
| 50  | 0.76  | 0.54    |
| 60  | 0.76  | 0.54    |
| 70  | 0.74  | 0.46    |
| 80  | 0.61  | 0.23    |
| 90  | 0.34  | 0.07    |

|  |   |
|--|---|
| Allowance for short term spouses pensions (where relevant) | A 1.5% loading is applied to member factors to allow for short-term spouses' pensions |
|--|---|



## Appendix B: Trivial Commutation Factors

### Factor consolidation spreadsheet table number 503

| Age | Former contributing member | Dependant | Age | Former contributing member | Dependant |
|-----|----------------------------|-----------|-----|----------------------------|-----------|
| 20  | N/A                        | 33.964    | 60  | 20.899                     | 20.109    |
| 21  | N/A                        | 33.749    | 61  | 20.402                     | 19.603    |
| 22  | N/A                        | 33.528    | 62  | 19.896                     | 19.089    |
| 23  | N/A                        | 33.301    | 63  | 19.382                     | 18.568    |
| 24  | N/A                        | 33.069    | 64  | 18.860                     | 18.040    |
| 25  | N/A                        | 32.832    | 65  | 18.329                     | 17.506    |
| 26  | N/A                        | 32.588    | 66  | 17.791                     | 16.966    |
| 27  | N/A                        | 32.338    | 67  | 17.247                     | 16.421    |
| 28  | N/A                        | 32.083    | 68  | 16.678                     | 15.851    |
| 29  | N/A                        | 31.821    | 69  | 16.068                     | 15.258    |
| 30  | N/A                        | 31.553    | 70  | 15.455                     | 14.663    |
| 31  | N/A                        | 31.279    | 71  | 14.860                     | 14.069    |
| 32  | N/A                        | 30.999    | 72  | 14.266                     | 13.480    |
| 33  | N/A                        | 30.711    | 73  | 13.677                     | 12.898    |
| 34  | N/A                        | 30.418    | 74  | 13.059                     | 12.319    |
| 35  | N/A                        | 30.117    | 75  | 12.441                     | 11.741    |
| 36  | N/A                        | 29.810    | 76  | 11.856                     | 11.168    |
| 37  | N/A                        | 29.497    | 77  | 11.273                     | 10.599    |
| 38  | N/A                        | 29.176    | 78  | 10.695                     | 10.036    |
| 39  | N/A                        | 28.849    | 79  | 10.086                     | 9.478     |
| 40  | N/A                        | 28.514    | 80  | 9.484                      | 8.929     |
| 41  | N/A                        | 28.172    | 81  | 8.924                      | 8.387     |
| 42  | N/A                        | 27.823    | 82  | 8.375                      | 7.857     |
| 43  | N/A                        | 27.465    | 83  | 7.836                      | 7.339     |
| 44  | N/A                        | 27.100    | 84  | 7.281                      | 6.835     |
| 45  | N/A                        | 26.726    | 85  | 6.746                      | 6.350     |
| 46  | N/A                        | 26.345    | 86  | 6.264                      | 5.888     |
| 47  | N/A                        | 25.954    | 87  | 5.807                      | 5.451     |
| 48  | N/A                        | 25.555    | 88  | 5.379                      | 5.043     |
| 49  | N/A                        | 25.147    | 89  | 4.952                      | 4.662     |
| 50  | N/A                        | 24.731    | 90  | 4.553                      | 4.308     |
| 51  | N/A                        | 24.306    | 91  | 4.206                      | 3.977     |
| 52  | N/A                        | 23.872    | 92  | 3.883                      | 3.671     |
| 53  | N/A                        | 23.430    | 93  | 3.583                      | 3.389     |
| 54  | N/A                        | 22.979    | 94  | 3.308                      | 3.132     |
| 55  | 23.246                     | 22.521    | 95  | 3.060                      | 2.902     |
| 56  | 22.794                     | 22.054    | 96  | 2.839                      | 2.697     |
| 57  | 22.333                     | 21.579    | 97  | 2.645                      | 2.518     |
| 58  | 21.864                     | 21.097    | 98  | 2.478                      | 2.364     |
| 59  | 21.386                     | 20.608    | 99  | 2.330                      | 2.229     |
|     |                            |           | 100 | 2.197                      | 2.108     |



## Appendix C: Limitations

- C.1 This guidance should not be used for any purpose other than those set out in this guidance.
- C.2 The factors contained in this guidance are subject to regular review. Scheme managers and administrators need to ensure that they are using the latest factors, as relevant, when processing cases.
- C.3 Advice provided by GAD must be taken in context and is intended to be considered in its entirety. Individual sections, if considered in isolation, may be misleading, and conclusions reached by a review of some sections on their own may be incorrect. GAD does not accept responsibility for advice that is altered or used selectively. Clarification should be sought if there is any doubt about the intention or scope of advice provided by GAD.
- C.4 This guidance only covers the actuarial principles around the calculation and application of commutation factors. Any legal advice in this area should be sought from an appropriately qualified person or source.
- C.5 Scheme managers and administrators should satisfy themselves that commutation calculations and benefit awards comply with all legislative requirements including, but not limited to, tax and contracting-out requirements.
- C.6 This guidance is based on the Regulations in force at the time of writing. It is possible that future changes to the Regulations might create inconsistencies between this guidance and the Regulations. If users of this guidance believe there to be any such inconsistencies, they should bring this to the attention of SPPA and GAD. Under no circumstances should this guidance take precedence over the Regulations. Administrators should ensure that they comply with all relevant Regulations.