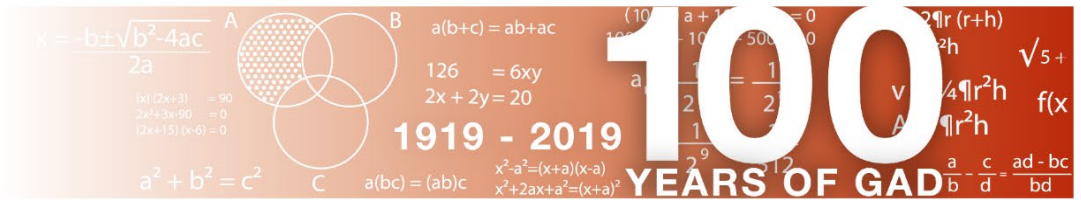




Government
Actuary's
Department



Police pension schemes (Scotland)

2015 Scheme

Maximum commutation limit

Factors and guidance

Date: 13 September 2019





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1 Introduction

- 1.1 This note is provided for the Scottish Public Pensions Agency (SPPA) in our capacity as scheme actuary to the police pension schemes in Scotland. This note relates to the 2015 Scheme only (it does not apply to the 1987 or 2006 schemes) and its purpose is to set out how the maximum limit for commutation should be calculated.
- 1.2 This note contains tables which can be used by the administrators to determine the maximum proportion of 2015 Scheme pension which can be commuted at retirement.
- 1.3 The factors and guidance provided in this note have been prepared in light of our advice to SPPA dated 30 October 2018 and its instructions following that advice.
- 1.4 This guidance is intended to supersede any factors or advice previously issued for the purposes of maximum commutation on retirement calculations, which rely on input from the scheme actuary. In particular, this guidance supersedes:
- “Police pension schemes (Scotland): 2015 Scheme: Maximum commutation limit – Factors and guidance” dated 5 October 2015.
- Factors contained in this note have been updated but the calculation methodology remains unchanged.
- 1.5 Regulation 114 of the Police Pension Scheme (Scotland) Regulations 2015 (SSI 2015/142) (‘Option to commute part of pension’) sets out three different restrictions on the maximum lump sums available at retirement through commutation,
- Lump sums cannot be more than 25% of the cash value of the pension, as advised by the scheme actuary (*Regulation 114(4)*)
 - Lump sums cannot be such that they result in a ‘scheme chargeable payment’ (*Regulation 114(5)*)
 - The post commutation pension cannot be less than the member’s GMP (*Regulation 114(6)*).
- 1.6 As the lump sum cannot breach any of these limits, the maximum lump sum should be determined by the lowest limit applying to a member on retirement.
- 1.7 If you have any questions about how to use this guidance, please contact SPPA, who will seek input from the Scheme Actuary if necessary.
- 1.8 Appendix B sets out some important limitations.
- 1.9 The remainder of this note covers the factor tables, guidance on their use and a worked example.



Implementation and Review

- 1.10 The factors contained in this guidance will apply from 21 January 2019. This guidance will apply from the date issued on the cover.
- 1.11 This guidance has been written for pension administrators and assumes some knowledge of general pension terminology, and some familiarity with retirement calculations for the Police pension schemes (Scotland).
- 1.12 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.

Third party reliance

- 1.13 This guidance has been prepared for the use of SPPA and 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 and the scheme administrator'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 and 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 Calculating maximum 2015 Scheme lump sum

- 2.1 To calculate the maximum lump sum that a member can take at retirement all three of the limits shown above should be considered.

Limit 1: 25% of the cash value of the pension

- 2.2 The 'cash value' of the pension at retirement is based on the cash equivalent value that would be calculated for the purpose of pension sharing on divorce. As such, under regulation 114(4) the commutation lump sum is limited to 25% of the member's cash equivalent pension value when calculated on unisex terms.
- 2.3 The factors set out in Table 2 of this guidance note refer to the factors for determining the cash equivalent pension value current at the date of issuing this guidance note (i.e. those set out in the latest version of the GAD guidance document '*Police pension schemes (Scotland): 2015 Scheme: Transfer values and pension sharing on divorce: Factors and Guidance*').
- 2.4 Please note that the factors contained in cash equivalent transfer value guidance document are subject to review and any changes to the factors will result in changes to the amount that may be commuted under limit 1, and hence the values set out in Table 2. When calculating the maximum 2015 Scheme lump sum, administrators should check that they are using the latest factors in force when using the factors in Table 2.
- 2.5 For a given amount of pension income, the cash equivalent value varies by the member's age and form of retirement. Younger members have a larger cash equivalent value than older members, which results in a higher commutation limit under regulation 114(4) for those who retire at younger ages.

Limit 2: Avoid triggering a scheme chargeable payment

- 2.6 A scheme chargeable payment, under the Finance Act 2004, occurs when an unauthorised payment is made. A retirement commutation lump sum will be considered as an unauthorised payment if it exceeds the lower of,
- a) 25% of the member's available lifetime allowance, and
 - b) 25% of HMRC's assessment of the value of the member's crystallised benefits at retirement.
- 2.7 The limit shown under 2.6(a) will depend on the member's available lifetime allowance at retirement and should take into consideration any valid primary, fixed individual or enhanced protection that the member is entitled to. Guidance on how this is calculated can be found in Part 1, Schedule 29 of the Finance Act 2004.
- 2.8 Any retirement lump sums or pensions received from other registered pension schemes (including the 1987 and 2006 police pension schemes), need to be taken into account when assessing the member's available lifetime allowance.



- 2.9 Administrators should consult HMRC's Pensions Tax Manual¹ in order to determine the maximum 2015 Scheme lump sum that applies under this limit for members with benefits in both the 2015 Scheme and a pre-2015 scheme, or any other registered pension scheme.
- 2.10 The limit under 2.6(b) prevents the lump sum from being more than 25% of the value of crystallised benefits at retirement, assessed using the HMRC factor of £20 for every £1 of pension. The maximum lump sum available under this limit can be expressed using the following formula, with 'Y' being the proportion commuted and 'P' being the pre-commutation pension at retirement:

$$\text{Lump Sum} = 25\% \times (\text{Lump Sum} + \text{HMRC value of post-commutation pension})$$

This can be written as

$$12 \times Y \times P = 25\% \times (12 \times Y \times P + 20 \times (1 - Y) \times P)$$

Which can be rearranged to give

$$Y = 5 / 14 = 35.7\%$$

Therefore, under limit 2(b) the member is allowed to commute up to 35.7% of their 2015 Scheme retirement pension.

- 2.11 Please note that this is based on our understanding of pension tax rules. It is the administrator's responsibility to ensure that they comply with all relevant taxation legislation and HMRC guidance. If there is any doubt, queries should be directed to HMRC.

Limit 3: GMP underpin

- 2.12 Under regulation 114(6) a retiree is not allowed to commute pension to such an extent that their post-commutation pension is lower than their GMP in the 2015 Scheme.²
- 2.13 Administrators should compare the member's planned post-commutation pension against their GMP. If the accrued GMP is larger than 75% of the post commutation pension, please refer the case to SPPA, who can advise on the appropriate commutation limit for this member.

¹ <http://www.hmrc.gov.uk/manuals/ptmanual/>

² GMP in the 2015 Scheme means any GMP rights transferred into the 2015 Scheme. Administrators should ignore any GMP attributable to accrual in one of the pre-2015 police pension schemes, unless those rights were subsequently transferred into the 2015 Scheme.



3 Maximum proportion of commuted pension for a typical 2015 Scheme member

- 3.1 A typical 2015 Scheme member will have a maximum commutation proportion based on their age last birthday as shown in Table 2 of Appendix A. In this table, we have combined the limits 1 (under paragraphs 2.2 to 2.5) and 2.6(b).
- 3.2 In Table 2, the HMRC limit of 35.7% applies for members below the age of 64. At and above age 64, the maximum commutation amount is related to the pensioner cash equivalent factors which decrease as the member's age increases.
- 3.3 The amount of available lifetime allowance (limit under 2.6(a)) will vary according to each retiree, and as such there is no generic maximum amount that will apply in all cases for this limit. As Tables 1 and 2 make no allowance for the lifetime allowance limit, administrators should compare the provisional maximum commutation amount, calculated using the Table 1 or 2 (as appropriate) to the amount allowed under limit 2.5(a) for that member.
- 3.4 In general, we would not expect a member to have sufficient GMP rights within the 2015 Scheme to be captured by limit 3. As set out in paragraph 2.13, administrators should check whether the member's accrued GMP at retirement is greater than 75% of the post-commutation pension. If not, the commutation amount can be paid, if it is the case should be referred to SPPA.
- 3.5 Please note that for members with benefits in a pre-2015 police pension scheme (1987 or 2006 scheme) or any other pension scheme, the maximum proportion may be lower than that calculated using Tables 1 and 2 (as appropriate) as any pension scheme benefits crystallised prior to retirement from the 2015 Scheme will reduce the member's available lifetime allowance. Where applicable, administrators should consult with HMRC guidance in order to determine the maximum 2015 Scheme lump sum that applies under this limit for members who have benefits crystallised in a pre-2015 scheme or any other registered pension scheme.

Steps to follow when calculating maximum proportion

- 3.6 Please use the following steps in order to determine the maximum proportion for a 2015 Scheme member.
1. Determine an indicative maximum commutation lump sum according to the maximum proportions set out in Tables 1 and 2 in Appendix A.
 2. Assess the indicative maximum commutation lump sum against the available lifetime allowance for lump sums. The 2015 Scheme lump sum is not allowed to breach this limit, so the maximum lump sum may have to be reduced from that determined in step one.
 3. Compare the implied post-commutation pension against the member's accrued GMP at retirement. Where the accrued GMP is larger than 75% of the post commutation pension, please refer the case to GAD for appropriate advice.



4 Example calculation

Example

Gender	Male
Age last birthday at retirement date	60
Total annual pension at retirement	£15,000 pa
Pre 88 GMP amount	nil
Post 88 GMP amount	£100 pa
Available Lifetime Allowance	£1,055,000

Step 1: Determine indicative maximum commutation lump sum using Table 1 or 2.

From Table 2 in Appendix A, the indicative maximum commutation proportion for a member retiring at age last birthday 60 is 35.7%. The resulting provisional commutation amount is calculated below.

Member's provisional commutation amount after commuting 35.7% of pension

$$\begin{aligned} &= 0.357 \times £15,000.00 \times 12 \\ &= £64,260.00 \end{aligned}$$

Step 2: Assess lump sum against lifetime allowance.

This member has not used up any of his lifetime allowance of £1,055,000. His maximum commutation amount under limit 2a is:

$$\begin{aligned} &= 0.25 \times £1,055,000.00 \\ &= £263,750.00 \end{aligned}$$

This amount is more than the amount calculated in Step 1 above, and therefore the provisional commutation amount does not breach limit 2a.

Step 3: Compare post commutation pension against accrued GMP

Post commutation pension:

$$\begin{aligned} &= £15,000.00 - (0.357 \times £15,000.00) \\ &= £9,645.00 \text{ pa} \end{aligned}$$

The member's GMP of £100 pa is less than 75% of the post-commutation pension (£7,233.75 pa), so no further action needs to be taken.

Therefore, this member's maximum commutation proportion is **35.7%**, and his maximum commutation lump sum is £64,260.00.



Appendix A: Maximum commutation proportion tables

Table 1: Provisional maximum proportion of pension for those retiring on grounds of ill-health (Table 508 in consolidated factors spreadsheet)

Age	Male and Female Retirees
All ages	35.7%

Table 2³: Provisional maximum proportion of pension for those retiring on grounds other than ill-health (Table 509 in consolidated factors spreadsheet)

Age last birthday	Male and Female Retirees
55	35.7%
56	35.7%
57	35.7%
58	35.7%
59	35.7%
60	35.7%
61	35.7%
62	35.7%
63	35.7%
64	35.7%
65	35.1%
66	33.9%
67	32.7%
68	31.6%
69	30.3%
70	29.1%
71	27.9%
72	26.7%
73	25.4%
74	24.1%
75	22.8%

³ These proportions are related to the factors for determining the cash equivalent pension value current at the date of issuing this guidance note (i.e. those issued to SPPA on 21 January 2019). Administrators should check that the factors in the latest guidance note issued by GAD have not been superseded when using these factors. If the latest guidance has been superseded and no replacement of this guidance note is available, please contact SPPA.



Appendix B: Limitations

- B.1 This guidance should not be used for any purpose other than those set out in this guidance.
- B.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.
- B.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.
- B.4 This guidance only covers the actuarial principles around the calculation and application of maximum commutation limit on retirement factors. Any legal advice in this area should be sought from an appropriately qualified person or source.
- B.5 Scheme managers and administrators should satisfy themselves that maximum commutation limit on retirement calculations and benefit awards comply with all legislative requirements including, but not limited to, tax and contracting-out requirements.
- B.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.