

The Local Government Pension Scheme (Northern Ireland)

Guidance effective from 1 April 2009

Lifetime Allowance and Additional Cash Commutation

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1 Introduction

- 1.1 Under Regulation 21 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations (Northern Ireland) 2009 (SR 2009/32) (“the Benefits Regulations”), effective from 1 April 2009, a member may, on a benefit crystallisation event (BCE), elect under paragraph (1) of that Regulation to commute some of their own pension in exchange for a lump sum and/or an increase in their retirement grant.
- 1.2 Regulation 21(2) states that the total retirement grant received should not exceed 25% of the capital value of the member’s accrued rights where this value is, as set out in Regulation 21(4), to be calculated in accordance with guidance issued by the Government Actuary’s Department (GAD). For this purpose, the accrued rights to be valued are restricted in terms of the Finance Act 2004 to those rights which are actually being crystallised at the point of retirement from Local Government employment. The main purpose of this note, prepared by GAD for the Department of the Environment (DOENI) and issued to them for onward transmission to Northern Ireland Local Government Officers’ Superannuation Committee (NILGOSC) and employing authorities, is to provide the guidance required by Regulation 21(4).
- 1.3 This note only covers cases where the value of members’ benefits – including those associated with previous and simultaneous BCEs whether from LGPS or another registered pension scheme - does not exceed the Lifetime Allowance (LTA).
- 1.4 DOENI has confirmed to us that, in determining the value of a member’s benefits for the purpose of this note, any benefits awarded in terms of any Regulations other than the Benefits Regulations, the Local Government Pension Scheme (Administration) Regulations (Northern Ireland) 2009 (SR 2009/33) (“the Administration Regulations”), the Local Government Pension Scheme (Amendment and Transitional Provisions) Regulations (Northern Ireland) 2009 (SR 2009/34) (“the Transitional Regulations”), the Local Government Pension Scheme Regulations (Northern Ireland) 2002 (SR 2002/352) (“the 2002 Regulations”) or the Local Government Pension Scheme Regulations (Northern Ireland) 2000 (SR 2000/177), as amended, should be disregarded.
- 1.5 The note also sets out how, in some cases where the value of the benefits before commutation exceeds the LTA, the member’s pension may be partly commuted in order to bring the value of members’ benefits within the LTA. Other cases where the LTA may be exceeded are covered by the GAD Guidance on Regulation 22 of the Benefits Regulations.

2 Calculations

- 2.1 The calculation of the capital value of the member's accrued rights under Regulation 21 depends upon whether or not members have made money-purchase type Additional Voluntary Contributions (AVCs) under the terms of Regulation 21 of the Administration Regulations. Where they have, the calculation also depends upon the accumulated value of those contributions relative to that of the underlying scheme benefits and on whether they draw some or all of the AVCs at the same time as the main LGPS benefits. The value of the rights may also depend on whether or not any pension is commuted under the terms of Regulation 21 of the Benefits Regulations, and if so how much. Where there are no money purchase AVCs, and no additional lump sum is taken, the capital value of the accrued rights = $20 \times P + RG$, where

P = Annual pension and

RG = Retirement grant (noting that this would have a zero value for members who had accrued benefits exclusively at the sixtieths accrual rate applicable from 1 April 2009).

- 2.2 For the purpose of this guidance, it is necessary to determine the capital value of the accrued rights where the maximum allowed amount of lump sum (MAXLS) is taken.
- 2.3 If the member does not crystallise the whole of his or her accumulated AVCs at the same time as the main LGPS benefits, on subsequent crystallisation of the residual balance of the AVCs, up to 25% of the residual value may be taken as cash and the rest must be taken as pension. The later crystallisation of these AVCs counts as a separate BCE for the purposes of the Finance Act 2004 and the test against the balance of the LTA should be applied at that time.

2.4 Type (I) cases

Where there are no accumulated money purchase AVCs, or, if there are, the amount drawn at the same time as the main LGPS benefits is insufficient to provide the whole of the difference between the MAXLS and the RG, it is assumed that the whole of the amount of accumulated AVCs drawn simultaneously are used to add to the RG, with further lump sum (up to the maximum allowed) being provided by means of commutation of the member's scheme pension. In this case, which corresponds with meeting the condition

$AVCs < (20 \times P - 3 \times RG) / 3$, then

(I) the capital value of the accrued rights after allowing for maximisation of lump sum = $(120 \times P + 10 \times RG + 10 \times AVCs) / 7$,

where AVCs = accumulated value of money purchase AVCs taken on retirement (a term which can be set to zero if necessary)

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2.5 Type (II) cases

Where the accumulated value of the money purchase AVCs drawn at the same time as the main LGPS benefits is sufficient to provide the whole of the difference between the MAXLS and the RG, it is assumed that these AVCs are used for this purpose (with any balance being used to purchase additional pension), so that there is no need to commute any of the member's scheme pension in order to obtain the MAXLS. In this case, which corresponds with meeting the condition

$AVCs \geq (20 \times P - 3 \times RG) / 3$, then

(II) the capital value of the accrued rights after allowing for maximisation of lump sum = $20 \times P + RG + AVCs$

2.6 The MAXLS is 25% of the capital value shown in either (I) or (II) as appropriate.

2.7 Under the terms of Regulation 21 of the Benefits Regulations, the amount of cash obtained by commuting £1 pa of pension is £12. Thus the pension to be commuted to obtain MAXLS, and the resulting reduced pension are calculated as follows:

Pension required to be commuted = $\text{Max} \{0, [(MAXLS - RG - AVCs) / 12]\}$

Reduced pension = $P - \text{Pension required to be commuted}$

2.8 Examples of calculating MAXLS where the value of benefits before commutation falls below the LTA are set out at Annex A.

3 Commutation in order to avoid exceeding LTA

3.1 This guidance does not apply for members subject to primary or enhanced protection who are covered separately by the GAD Guidance on Regulation 22 of the Benefits Regulations. In certain other Type I cases where the capital value of the standard pension and retirement grant plus AVCs exceeds the LTA, there will sometimes be scope to reduce the capital value to below the LTA by commuting some pension for cash. This scope is not available for Type (II) cases, and where the capital value in these cases exceeds the LTA, such cases are covered by the GAD Guidance on Regulation 22.

3.2 The Guidance note covers Type (I) cases in which it is possible to eliminate entirely any excess value over the LTA by means of commutation, but is restricted to cases where there is no previous or simultaneous Benefit Crystallisation Event. All other categories of "over the LTA" cases are covered by the GAD Guidance on Regulation 22 of the Benefits Regulations, including those in which the member exercises an option not covered in paragraphs 2.5 to 3.1, such as conversion of accumulated AVCs to pension.

3.3 In Type (I) cases, the capital value of the accrued rights before any commutation of pension is $20 \times P + RG + AVCs$. If this exceeds the LTA, calculate MAXLS and the capital value of the accrued rights if MAXLS is taken as follows:

$$MAXLS = \text{Min}\{0.25 \times LTA, 0.25 \times [(120 \times P + 10 \times RG + 10 \times AVCs) / 7]\}, \text{ and}$$

$$\text{Capital Value} = \{[P - (MAXLS - RG - AVCs)/12] \times 20\} + MAXLS$$

3.4 If the Capital Value so determined exceeds the LTA, then the case is covered by the Guidance on Regulation 22 and not by this Guidance Note. Otherwise, it is possible to reduce the Capital Value of the benefits to fall within the LTA if the member chooses to commute additional pension to increase the lump sum taken at least to a minimum level (MINLS), where

$$MINLS = 3/2 \times [20 \times P + 20/12 \times (RG + AVCs) - LTA]$$

3.5 Under the terms of Regulation 21, the amount of cash obtained by commuting £1 pa of pension is £12. Thus the pension to be commuted to obtain a total lump sum of LS, and the resulting reduced pension are calculated as follows:

$$\text{Pension required to be commuted} = \text{Max}\{0, [(LS - RG - AVCs) / 12]\}$$

$$\text{Reduced pension} = P - \text{Pension required to be commuted}$$

3.6 Examples of the calculations required when exploring the possibility in Type (I) cases of using commutation to bring the value of benefits below the LTA are set out at Annex B.

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Important notes

- The formulae above should not be used for those with benefits (either from LGPS or in aggregation with other sources) whose post-commutation value exceeds the standard LTA even after commuting sufficient pension to take MAXLS, or for those with primary or enhanced protection. Such cases are covered by GAD Guidance on Regulation 22.
- We understand that Regulation 21 of the Benefits Regulations does not apply to Pension Credit members, and that they therefore cannot commute their pensions to increase their lump sums.
- If pension and/or retirement grant are reduced for early payment the reduced amounts should be used to determine the MAXLS and MINLS.
- The MAXLS and MINLS calculated using the above formulae includes the RG, some or all of the accumulated AVCs taken at retirement, if any, plus, in Type (I) cases, the proceeds of commuting some of the member's scheme pension.
- The calculation assumes the amount by which the maximum amount exceeds the RG will be taken by first using any money purchase AVC funds to be crystallised simultaneously with the main LGPS benefits and then by commutation of pension. An alternative calculation, with a lower resultant maximum lump sum, would be required if this was not the case.
- Both P and RG should include any benefits resulting either from added service-type AVCs contracts entered generally under the terms of Regulation 57 of the 2002 Regulations or from additional pension purchased under the terms of regulation 14 of the Benefits Regulations
- This guidance assumes that AVCs are taken as cash or annuitised outside of the scheme. If a member is considering converting accumulated AVCs to pension **at retirement** (ie currently) in terms of Regulation 22 of the Administration Regulations, it should be noted that (with the possible exception of some "over the LTA" cases) it seems unlikely that such conversion could lead to an increase in the MAXLS available. Furthermore, GAD Guidance under that Regulation precludes the possibility of commuting extra pension obtained by means of such a conversion.
- The amount of any dependants' pension is not affected by a member's election to commute their own pension for additional cash.
- Where the objective is to bring the value of benefits within the LTA, this can be achieved by taking a lump sum amount falling between MINLS and MAXLS where the conditions set out are satisfied.

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- The amount of pension commuted must not reduce the remaining pension to below the level, if any, of the member's Guaranteed Minimum Pension, as defined in Schedule 1 of the Administration Regulations nor must it be such as to affect any requirement to pay equivalent pension benefits under the terms of the National Insurance Acts 1965 to 1973.



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ANNEX A

Examples of commutation cases where the value of pre-commutation benefits (including those associated with any previous or simultaneous Benefit Crystallisation Events) does not exceed the LTA

Example A1

P = £5,000 pa

RG = £15,000

No Money Purchase AVCs

No AVCs, so this is a Type (I) case

$MAXLS = 0.25 \times (120 \times £5,000 + 10 \times £15,000) / 7 = £26,785.71$

Member wishes to take the maximum lump sum

Amount of pension to be commuted

= $\text{Max}(0, (£26,785.71 - £15,000) / 12) = £982.14 \text{ pa}$

Reduced pension = $£5,000 - £982.14 = £4,017.86 \text{ pa}$

Check: Capital value = $20 \times £4,017.86 + £26,785.71 = £107,142.91$

$MAXLS = 0.25 \times £107,142.91 = £26,785.71 \checkmark$

Example A2

Early retirement

P = £8,640 pa (after reduction factor applied)

RG = £32,760 (after reduction factor applied)

Money purchase AVCs = £8,000

Check that AVCs < $(20 \times £8,640 - 3 \times £32,760) / 3 = £24,840$, so this is a Type (I) case

$MAXLS = 0.25 \times [(120 \times £8,640 + 10 \times £32,760 + 10 \times £8,000) / 7] = £51,585.71$

Member wishes to take the maximum lump sum

The AVCs are used entirely to provide extra lump sum, but as the total lump sum then still falls short of MAXLS, some of the member's pension also needs to be commuted to obtain the MAXLS

The amount of pension to be commuted

= $\text{Max}(0, ((£51,585.71 - £32,760 - £8,000) / 12)) = £902.14 \text{ pa}$

Reduced pension = $£8,640 - £902.14 = £7,737.86 \text{ pa}$

Check Capital value = $20 \times £7,737.86 + £51,585.71 = £206,342.91$

$MAXLS = 0.25 \times £206,342.91 = £51,585.71 \checkmark$

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Example A3

P = £6,000 pa

RG = £18,000

Money purchase AVC balance = £25,000

Check that AVCs $\geq (20 \times £6,000 - 3 \times £18,000) / 3 = £22,000$, so this is a Type (II) caseMAXLS = $0.25 \times [20 \times £6,000 + £18,000 + £25,000] = £40,750.00$

Member wishes to take the maximum lump sum

The AVC balance at £25,000 is more than sufficient to increase the RG at £18,000 to the MAXLS level of £40,750. Thus £22,750 of AVCs will be used to increase the RG to £40,750, and the residual AVC fund of £2,250 will be used to purchase additional pension. No commutation of pension is necessary to obtain the MAXLS.

Check Capital value = $20 \times £6,000 + £40,750 + £2,250 = £163,000$ MAXLS = $0.25 \times £163,000 = £40,750 \checkmark$

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ANNEX B

Examples of calculations needed to explore the possibility of using commutation to bring the total value of benefits in a Type (I) case from above to below the LTA

Example B1

Retirement in 2006/07

P = £67,000 pa

RG = £201,000

No Money Purchase AVCs, so Type (I)

LTA = £1,500,000

Capital value before additional commutation = $20 \times £67,000 + £201,000 = £1,541,000$, ie over LTA

MAXLS = $\text{Min}\{£375,000, 0.25 \times [(120 \times £67,000 + 10 \times £201,000) / 7]\} = £358,928.57$

Capital value = $\{[£67,000 - (£358,928.57 - £201,000)/12] \times 20\} + £358,928.57 = £1,435,714.29$ (less than LTA)

MINLS (to stay within LTA) = $3/2 \times [20 \times £67,000 + 20/12 \times £201,000 - £1,500,000] = £262,500$

Check on MINLS option

Residual pension = $£67,000 - (£262,500 - £201,000)/12 = £61,875$ pa

Capital value = $£61,875 \times 20 + £262,500 = £1,500,000$ (= LTA)

Example B2

Retirement in 2006/07

P = £67,000 pa

RG = £201,000

Money purchase AVCs = £60,000

LTA = £1,500,000

Check $£60,000 < (20 \times £67,000 - 3 \times £201,000) / 3$ so Type (I)

Capital value before additional commutation = $20 \times £67,000 + £201,000 + £60,000 = £1,601,000$, ie over LTA

MAXLS = $\text{Min}\{£375,000, 0.25 \times [(120 \times £67,000 + 10 \times £201,000 + 10 \times £60,000) / 7]\} = £375,000$

Capital value = $\{[£67,000 - (£375,000 - £201,000 - £60,000)/12] \times 20\} + £375,000 = £1,525,000$ (still over LTA – refer to Guidance on Regulation 22)