# The Local Government Pension Scheme (England and Wales)
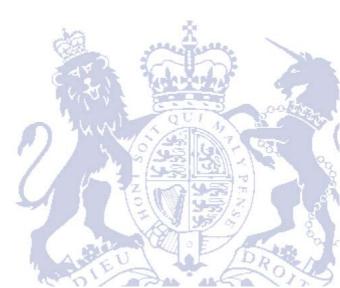
# Guidance effective from 1 April 2008

# 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 2007 (SI 2007/1166) ("the Benefits Regulations"), effective from 1 April 2008, a member may, on a benefit crystallisation event (BCE), elect to increase the retirement grant payable under paragraph (3) of that Regulation by commuting some of their own pension.

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 Communities and Local Government (CLG) and issued to them for onward transmission to administering authorities 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    CLG 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 2008 (SI 2008/239) ("the Administration Regulations") the Local Government Scheme Pension Scheme Regulations 1997 (SI 1997/1612) ("the 1997 Regulations") or the Local Government Pension Scheme Regulations 1995 (SI 1995/1019), 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.

## 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 Regulations 25 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 additional lump sum (over and above the Retirement Grant) is taken, 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 x P + RG, where

P = Annual pension and
RG = Retirement grant.

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 balance of the AVCs, up to 25% of the 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 <u>Type (I) cases</u>

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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 x P – 3 x RG) / 3, then*

(I) the capital value of the accrued rights after allowing for maximisation of lump sum = (120 x P + 10 x RG + 10 x 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 x P – 3 x RG) / 3, then
>
> (II) the capital value of the accrued rights after allowing for maximisation of lump sum = 20 x 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, 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 = Max {0, [(MAXLS – RG – AVCs) / 12]}

Reduced pension = P – 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.

3.3   In Type (I) cases, the capital value of the accrued rights before any commutation of pension is 20 x 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 = Min{0.25 x LTA,  0.25 x [(120 x P + 10 x RG + 10 x AVCs) / 7]}, and

Capital Value = {[P - (MAXLS – RG - AVCs)/12] x 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 x [20 x P + 20/12 x (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:

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

Reduced pension = P – Pension required to be commuted

3.6   If the member exercises an option not covered in paragraphs 2.5 to 3.1, the case should instead be dealt with in terms of the GAD Guidance under Regulation 22.

3.7   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.

**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 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 55 of the 1997 Regulations, from any membership **previously** purchased in terms of the **old** Regulation 66 of the 1997 regulations or additional pension purchased under the terms of regulation 14 of the Benefit Regulations.

- This guidance assumes that AVCs are taken as cash or annuitised outside of the scheme. If a member is considering purchasing membership **at retirement** (ie currently) in terms of Regulation 26 of the Administration Regulations, then the guidance under Regulation 22 should be referred to.

- The amount of any long-term 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.

Local Government Pension Scheme (England and Wales)
Lifetime Allowance and Additional Cash Commutation (effective from 1 April 2008)

5

- 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 Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239) 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**

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**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 x (120 x £5,000 + 10 x £15,000) / 7 = £26,785.71
Member wishes to take the maximum lump sum

Amount of pension to be commuted
= Max (0, (£26,785.71 – £15,000) / 12) = £982.14 pa
Reduced pension = £5,000 – £982.14 = £4,017.86 pa

Check: Capital value = 20 x £4,017.86 + £26,785.71 = £107,142.91
MAXLS = 0.25 x £107,142.91 = £26,785.71 √

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**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 x £8,640 – 3 x £32,760) / 3 = £24,840, so this is a Type (I) case

MAXLS = 0.25 x [(120 x £8,640 + 10 x £32,760 + 10 x £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
= Max (0, ((£51,585.71 – £32,760 – £8,000) / 12)) = £902.14 pa
Reduced pension = £8,640 – £902.14 = £7,737.86 pa

Check Capital value = 20 x £7,737.86 + £51,585.71 = £206,342.91
MAXLS = 0.25 x £206,342.91 = £51,585.71 √

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**Example A3**
P = £6,000 pa
RG = £18,000
Money purchase AVC balance = £25,000

Check that AVCs $\geq$ (20 x £6,000 – 3 x £18,000) / 3 = £22,000, so this is a Type (II) case

MAXLS = 0.25 x [20 x £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 x £6,000 + £40,750 + £2,250 = £163,000
MAXLS = 0.25 x £163,000 = £40,750 $\sqrt{}$

# 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**

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**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 x £67,000 + £201,000 = £1,541,000, ie over LTA

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

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

MINLS (to stay within LTA) = 3/2 x [20 x £67,000 + 20/12 x £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 x 20 + £262,500 = £1,500,000 (= LTA)

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**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 x £67,000 – 3 x £201,000) / 3 so Type (I)

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

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

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

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