



# Government Actuary's Department

## **Local Government Pension Scheme**

**(England and Wales)**

**Annual allowance charges: calculation of scheme pays offset**

**Elections before 1 April 2014**

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Author: Michael Scanlon FIA  
James Pepler FIA



## Contents

<b>1</b>	<b>Introduction</b>	<b>1</b>
<b>2</b>	<b>Annual allowance - Scheme pays mechanism</b>	<b>3</b>
<b>3</b>	<b>Examples</b>	<b>8</b>
<b>4</b>	<b>Tables of factors</b>	<b>9</b>
	<b>Appendix A: Limitations</b>	<b>12</b>



## 1 Introduction

### Purpose

- 1.1 Under Regulation 68A of The Local Government Pension Scheme (Administration) Regulations 2012 (SI 2008/239) ('the Miscellaneous Regulations') the Secretary of State is responsible for issuing guidance relating to the reduction of a member's pension rights following an election for an annual allowance charge to be met by the Pension Fund.
- 1.2 This document sets out the general method for assessing a consequential pension offset that is applied to those LGPS members who incur Annual Allowance charges (as defined in Section 227 of the Finance Act 2004) and subsequently elect for the scheme to meet part, or all, of this charge through the 'scheme pays' mechanism.
- 1.3 The remainder of this introduction contains:
  - > details of the implementation and future review of this guidance,
  - > the relevant legislative references, and
  - > statements about third party reliance and liability.
- 1.4 In the remainder of this note:
  - > the second section describes the scheme pays mechanism and sets out the calculation of the offset
  - > the fourth section contains the relevant factors
  - > Appendix A contains the legislative references
  - > Appendix B sets out some important limitations.

### Implementation and Review

- 1.5 The Department for Communities and Local Government (DCLG) has asked GAD to recommend guidance in respect of the regulations detailed above. This document forms GAD's recommendation for the guidance required by these regulations.
- 1.6 This note has effect only when this guidance is issued by the Secretary of, and is subject to the implementation instructions provided at that time.
- 1.7 Administrators should satisfy themselves that the pension offset resulting from a scheme pays election complies with all legislative requirements including, but not limited to, tax requirements. Any legal advice in this area should be sought from an appropriately qualified person or source.
- 1.8 This guidance note does not cover the method for determining the amount of any Annual Allowance charge, Cash Equivalent Transfer Values (CETV), Club transfers involving the Local Government Pension Scheme or the service credits on transfers-in (Club or CETV).



- 1.9 The factors contained in this note are taken from other guidance issued by GAD, which will be reviewed periodically. This will depend on external circumstances, for example when changes in the actuarial assumptions adopted for other scheme factors take place, or following each triennial cycle of future valuations of the LGPS. The calculation methodology is unchanged from the previous guidance and therefore examples in the previous guidance dated 6 September 2012, updated for factors in this guidance can be used for illustrative purposes.
- 1.10 This guidance has been written for pension administrators and assumes some knowledge of general pension terminology, and some familiarity with retirement calculations for the Local Government Pension Scheme. Any questions concerning the application of the guidance should, in the first instance, be referred to DCLG.

#### **Use of this note**

- 1.11 This note has been prepared for DCLG and can be relied upon by them. We are content for this note to be released to third parties, provided that:
- > it is released in full
  - > the advice is not quoted selectively or partially, and
  - > GAD is identified as the source of the note.
- 1.12 Third parties may wish to seek their own actuarial advice where appropriate. GAD has no liability to any person or third party for any act or omission taken, either in whole or in part, on the basis of this note.

#### **Third party reliance**

- 1.13 When issued by the Secretary of State in accordance with paragraph 1.6 above, this note should be used as the actuarial guidance required under the regulations cited. Other than for this purpose, no person or third party is entitled to place any reliance on the contents of this note, except to any extent explicitly stated herein.



## 2 Annual allowance - Scheme pays mechanism

### Introduction

- 2.1 This section sets out the method and instructions for calculating the pension offset applied to a member who incurs an Annual Allowance charge and elects to utilise the scheme pays mechanism to meet this charge. The Scheme Pays mechanism will not be available to all members incurring Annual Allowance charges and administering authorities will need to ensure members' eligibility before applying the approach set out in this guidance note.
- 2.2 It is our understanding from HM Treasury's initial documentation prepared during the development of the revised Annual Allowance regime, that costs incurred by the authorities in relation to operating the scheme pays mechanism may not be recovered from the member concerned.
- 2.3 DCLG have confirmed that the Relevant Date (also known as the Implementation Date) will be the day coincident with the end of the pension input period. The pension input period in the LGPS runs from 1 April to 31 March, so the Relevant Date will be 31 March.

### Calculation of the initial pension offset

- 2.4 This guidance applies where the election was before 1 April 2014. Therefore, it is expected that the initial amount of the debit will have been calculated using previous versions of the guidance. The material relating to that calculation is retained for reference purposes only and the factor tables that would have been required are now omitted.
- 2.5 The calculation of the Pension Offset for different categories of member is set out in the following sections. We note that:
- > Unlike in the calculation of pension debits following a pension sharing order the pension offset is initially calculated using a normal retirement age of 65. The offset will later be adjusted to reflect the date their pension comes into payment
  - > Pension debits resulting from pension sharing orders have a consequential impact on the benefits payable to a surviving spouse or civil partner upon the member's death. This will not be the case for scheme pays pension offset
  - > The scheme pays pension offset will initially be based on the pension relating to post 1 April 2008 service (ie on the current tranche of benefits). Where the post-2008 pension is insufficient to cover the pension offset, then these cases need to be referred to DCLG for onward transmission to GAD.



### **Pension offset for an active member**

- 2.6 The principle is that the pension offset acts like a negative deferred pension (note that the calculation is different if the member has retired). The offset should be expressed as a deduction to the member's pension which is to be recovered from age 65. The calculation will be carried out at the Relevant Date for the particular member. The calculation of the pension offset is:

#### **Pension offset = AATAX / AAFAC**

*Where:*

*AATAX = the Annual Allowance tax charge that the member has notified the scheme that they wish to meet via the scheme pays mechanism.*

*AAFAC = the Annual Allowance scheme pays factor from Table A1 based on the member's gender and age at the Relevant Date – table omitted (see paragraph 2.4)*

- 2.7 The member's age at the Relevant Date required to select the appropriate factors from Table A1.
- 2.8 The pension payable to the member at retirement will be reduced by an amount equal to the member's pension offset.
- 2.9 Pension offsets do not affect GMPs.
- 2.10 Administrators should store the offset calculated above with the Relevant Date on the member's record. Where a member has multiple allowance debits, they should be recorded separately.
- 2.11 The pension offset should be increased in accordance with the Pensions (Increase) Act 1971 (currently this reflects changes in CPI) during the period between the Relevant Date and the member's eventual retirement.
- 2.12 If the pension is drawn before age 65 either as a result of the member having their retirement age protected by virtue of Schedule 2 of the Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (SI 2008/238), early retirement or on grounds of ill health then the pension offset should be reduced. This is because the offset is expected to be applied over a longer period than was assumed when calculating the original offset, so a lower amount should be deducted.
- 2.13 In the case of ill health retirement, the early retirement factor can be found in Table B1 of Section 4. In all other cases of retirement or exit before age 65, an early retirement factor from Table B2 should be applied.
- 2.14 Where a member retires after age 65 then the pension offset should be increased in accordance with the latest GAD guidance note on late retirement. However, where the Relevant Date is after age 65, the late retirement uplift should be applied from the Relevant Date to the date benefits come into payment.



### **Contingent survivor benefits**

- 2.15 The benefits payable to a spouse, civil partner or other partner who is eligible to a pension on the member's death will not be reduced as a result of the scheme pays mechanism. This will apply regardless of whether the member dies during active service, in deferment or after retirement.

### **Other benefits**

- 2.16 No debit will be applied to children's pensions.
- 2.17 No debit will be made to the lump sum death grant payable to an active member who dies in service.
- 2.18 No debit will be made from the death in deferment lump sum award that is payable to deferred members who incurred an Annual Allowance charge prior to exit, and elected for the scheme pays mechanism. However the lump sum will be based on the pension after any scheme pays offset has been applied.
- 2.19 No debit is made to any lump sum paid on death after retirement that is payable to pensioner members who incurred an Annual Allowance charge prior to exit, and elected for the scheme pays mechanism. However the lump sum will be based on the pension after any scheme pays offset has been applied.

### **Adjusting benefit offsets on leaving**

- 2.20 If the member leaves the scheme prior to receipt of their pension then the pension offset should be treated in the same way as a pension debit following divorce (except the Scheme Pays offset applies to member benefits only). In particular if the member leaves with a club transfer the Scheme Pays offset will be preserved in the receiving scheme as described in paragraph 7.16 of the Club Memorandum. This approach has been agreed with the Club Secretariat.

### **Adjusting benefit offsets at retirement**

- 2.21 This section sets out the method and instructions for calculating the pension offset to be applied at the point of retirement. In many cases this could be several years after the pension offset was initially calculated.
- 2.22 When the member retires, the total pension is initially calculated ignoring the pension offset. The pension is then reduced to allow for the pension offset. The offset should be revalued from the Relevant Date up to the April immediately before the date of retirement in line with the Pensions Increase Act (currently reflecting changes in CPI). If the pension is not drawn at age 65 then the pension offset will need to be adjusted.
- 2.23 Administrators should take care to ensure that the most recent Early Retirement Factors and Late Retirement Factors are applied. It is the responsibility of administrators to ensure that they are using the most recent factors.



2.24 The pension offset to be applied if member retires at age 65 is as follows:

$$\text{Pension offset at retirement at age 65} = \text{Pension offset} \times \text{PI}$$

Where:

*Pension Offset = as calculated in paragraph 2.5*

*PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.*

2.25 The pension offset to be applied if member retires before age 65 is as follows:

$$\text{Pension offset at retirement before age 65} = \text{Pension offset} \times \text{PI} \times (1 - \text{ERF})$$

Where:

*Pension Offset = as calculated in paragraph 2.5*

*PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.*

*ERF = where the member retires on ill health the relevant factor should be used from Table B1, for all other cases Table B2 should be used.*

2.26 The pension offset to be applied if the member retires after age 65 is as follows:

$$\text{Pension offset at retirement after age 65} = \text{Pension offset} \times \text{PI} \times (1 + \text{LRF})$$

Where:

*Pension Offset = as calculated in paragraph 2.5*

*PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.*

*LRF = late retirement factor from the latest GAD guidance.*

2.27 The pension offset to be applied if the scheme pays election occurs just before retirement is as follows:

$$\text{Pension offset at retirement} = \text{AATAX} / \text{AAFAC}$$

Where:

*AATAX = the Annual Allowance tax charge that the member has notified the scheme that they wish to meet via the scheme pays mechanism*

*AAFAC = if the member is retiring on age grounds then the Annual Allowance scheme pays factor shown in Table D1 based on the member's gender and age at the Relevant Date. If the member is retiring on ill health grounds then consider the factor from Table E1 – tables omitted (see paragraph 2.4)*

2.28 In some circumstances a member retiring on ill health grounds will be exempt from incurring an Annual Allowance charge in the year preceding retirement. However this will not apply to all ill health retirements. Members who are exempt in their final year of service may also have incurred Annual Allowance charges, and opted for Annual Allowance scheme pays, earlier in their careers. In these cases benefit offsets will be applied at retirement but different adjustment factors (shown in table B1) will be applied than those used for other retirements (which can be found in table B2). The debit will only be applied to members who retire on ill-health if they have a permanent (ie tier 1 or tier 2) ill-health pension.





- 2.29 Any cases involving tier 3 ill health retirements should be referred to DCLG, for onward transmission to GAD.

**Additional guidance for certain specific circumstances**

2.30 **Interaction between Annual Allowance and Scheme Pays Lifetime Allowance ('LTA') charges**

We understand that when calculating LTA charges the pension tested should be that which would come into payment after allowing for the impact of any Annual Allowance Scheme Pays offsets. The calculations set out in this document should therefore be carried out prior to any LTA test being applied to these members.

2.31 **Multiple Annual Allowance and Scheme Pays offsets**

Some members may breach the Annual Allowance on more than one occasion during their careers. Since there is no limit on the number of times a member may opt to utilise scheme pays (subject to usual eligibility), a member may also have multiple Annual Allowance Scheme Pays offsets. In this circumstance each offset can be considered separately and treated in accordance with the guidance set out above.

2.32 **Interaction between Annual Allowance, Scheme Pays offsets and Pension debits**

It is possible for members to have both AA Scheme Pays offsets and pension debits resulting from Pension Sharing on Divorce ('PSOD'). In this case each instance of the Annual Allowance Scheme Pays offset or the PSOD pension debits is treated in accordance with the relevant set of guidance.

2.33 **Members exercising options at the point of retirement**

Some members are able to exercise options at the point of retirement such as commuting pension for lump sum. This guidance note does not attempt to illustrate the interaction between Annual Allowance scheme pays offsets and any of these member options.

2.34 **Interaction between Scheme Pays offsets and Flexible Retirement**

Where a member opts to draw-down their membership, the debit relating to that part of the membership which is being drawn-down should be applied at the point of flexible retirement (and having regard to paragraphs 2.24 to 2.26 where relevant). Where the member elects to only draw-down a proportion of the membership, the debit should be pro-rated (in proportion to the membership being drawn-down) and applied to the relevant benefit being drawn-down, with allowance for early / late retirement factors as appropriate. The remaining debit should be applied when the member eventually retires.



### 3 Examples

- 3.1 The calculation methodology is unchanged from the previous guidance and therefore examples in the previous guidance, updated for factors in this guidance, can be used for illustrative purposes.



## 4 Tables of factors

Table B1 – Reduction to pension offset on ill health retirement

<i>Years until age 65 at date of retirement</i>	<i>Pension Offset Reduction (%)</i>	
	<i>Males</i>	<i>Females</i>
0	0.0	0.0
1	6.5	5.8
2	12.2	11.1
3	17.4	15.9
4	22.2	20.5
5	26.6	24.6
6	30.7	28.5
7	34.4	32.1
8	37.9	35.5
9	41.1	38.6
10	44.1	41.6
11	46.9	44.3
12	49.4	46.9
13	51.8	49.3
14	54.1	51.5
15	56.2	53.6
16	58.2	55.6
17	60.0	57.5
18	61.8	59.3
19	63.4	61.0
20	65.0	62.6
21	66.5	64.1
22	67.9	65.5
23	69.3	66.9
24	70.5	68.2
25	71.7	69.4
26	72.9	70.6



<i>Years until age 65 at date of retirement</i>	<i>Pension Offset Reduction (%)</i>	
	<i>Males</i>	<i>Females</i>
27	73.9	71.7
28	75.0	72.8
29	75.9	73.8
30	76.8	74.7
31	77.7	75.6
32	78.5	76.5
33	79.3	77.4
34	80.1	78.2
35	80.8	78.9
36	81.5	79.7
37	82.1	80.4
38	82.8	81.0
39	83.4	81.7
40	83.9	82.3
41	84.5	82.9
42	85.0	83.4
43	85.5	84.0
44	86.0	84.5
45	86.5	85.0

**Notes:**

- (1) Where the age at retirement is not an integer number, the reduction factors from the table should be interpolated for part years.



**Table B2 – Reduction to pension offset on retirement before age 65**

<i>Years until age 65 at date of retirement</i>	<i>Pension offset Reduction (%)</i>	
	<i>Males</i>	<i>Females</i>
0	0.0	0.0
1	5.6	5.2
2	10.8	10.1
3	15.5	14.6
4	20.0	18.8
5	24.0	22.7
6	27.8	26.4
7	31.4	29.8
8	34.7	33.0
9	37.7	36.1
10	40.6	38.9

**Notes:**

- (1) Where the age at retirement is not an integer number, the reduction factors from the table should be interpolated for part years.



## Appendix A: Limitations

- A.1 This note should not be used for any purpose other than to determine the offset to apply to a member's benefits following a scheme pays election in accordance with the regulations cited above.
- A.2 The factors contained in this note are subject to regular review. Administrators need to ensure that they are using the latest factors, as relevant, when processing cases.
- A.3 This note should be considered in its entirety as individual sections, if considered in isolation, may be misleading, and conclusions reached by a review of some sections on their own may be incorrect.
- A.4 This note only covers the actuarial principles around the calculation and application of an offset in relation to scheme pays elections. Any legal advice in this area should be sought from an appropriately qualified person or source.
- A.5 Administrators should satisfy themselves that the offset and scheme pays arrangements comply with all legislative requirements including, but not limited to, tax requirements.
- A.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 DCLG. In no circumstances should this guidance take precedence over the Regulations. Administrators should ensure that they comply with all relevant Regulations.