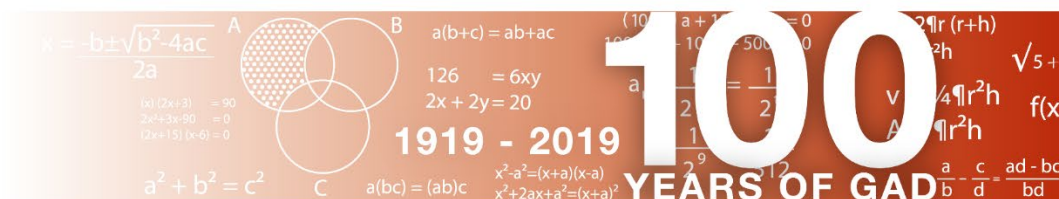




Government
Actuary's
Department



Armed Forces Pension Arrangements

Inverse Commutation

Factor guidance

Version 1.1

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Contents

| | | |
|----------|---|----------|
| 1 | Introduction | 3 |
| 2 | Inverse Commutation at retirement | 4 |
| 3 | Application to Ill-health review cases | 6 |
| 4 | Exclusions and limitations | 7 |
| | Appendix A: Assumptions underlying actuarial factors | 8 |
| | Appendix B: Factor table | 9 |



1 Introduction

- 1.1 This note is provided for the Ministry of Defence (MoD) as scheme manager of the Armed Forces pension arrangements and sets out our guidance on the use of inverse commutation factors where there is an option for members in AFPS 05 and RFPS only to give up all or part of their retirement lump sum in exchange for additional pension.
- 1.2 This note covers inverse commutation factors for eligible members of the AFPS 05 and RFPS.
- 1.3 This guidance supersedes any guidance previously issued for the purposes of inverse commutation calculations. Most sections are the same as the previous inverse commutation guidance note of 2 May 2019, but this version includes an extended factor table and a new section regarding the application of inverse commutation factors to ill-health review cases.
- 1.4 The factors provided in this note have been prepared in light of our advice to MoD dated 28 February 2018 and 30 October 2018 and its instructions following that advice.
- 1.5 The spreadsheet sent to MoD on 4 December 2018 contains the relevant factors for use in inverse commutation calculations. An extended factor table was provided on 16 July 2019. The table for use in inverse commutation cases is table 701. The factors provided in Appendix B of this note are unchanged from the factors provided on 4 December 2018 and 16 July 2019.
- 1.6 These factors are “GAD-Controlled” factors and so these factors came into force with effect from 4 December 2018.
- 1.7 Appendix A in this guidance sets out the assumptions used in the determination of factors.

Implementation and Review

- 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 Armed Forces Pension Scheme. Any questions concerning the application of the guidance should, in the first instance, be referred to MoD.
- 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.



2 Inverse Commutation at retirement

Background

- 2.1 Inverse commutation refers to the option for AFPS05 and RFPS members to give up all or part of their retirement lump sum in exchange for additional pension. Actuarial factors are needed to determine the additional pension payable.

AFPS 05 regulations

- 2.2 The Armed Forces Pension Scheme Order 2005 (as amended) states in Rule D.10 that:
- (1) A member may opt to exchange the whole or any part of the lump sum to which he would otherwise be entitled under this Part for an increase*
 - a. In the amount of pension payable to himself under these Rules, or*
 - b. In the amount of pension payable to himself and to any other person under these Rules as a result of his membership of the Scheme*
 - (2) Where a member so opts, the pension in respect of which he exercises the option is to be increased as from the date it is otherwise payable by so much as in the opinion of the Scheme Actuary is equivalent in value to the amount of the whole or, as the case may be, the relevant part of the lump sum in question.*
- 2.3 The RFPS reference is similar (also Rule D10).

Factor tables

- 2.4 The factors in Appendix B are unisex factors. For inverse commutation at retirement, the factors for age 55 and above should be used.
- 2.5 The factors in the tables represent the annual amount of additional pension in exchange for giving up a lump sum of £100. The factors are provided in a similar format to the previous factors.
- 2.6 Examples of how the factors are used are given below:
- 2.7 A member leaves AFPS 05 at age 60 with a retirement lump sum of £6,000. He elects to give up all of his lump sum in exchange for additional pension payable to himself and his partner (i.e. he opts for member and spouse/partner's pension). The additional pension payable to him by inverse commutation at age 60 is then:

Inverse commutation additional pension

$$= (£6,000 / £100) \times £4.62 = £277.20 \text{ pa}$$



- 2.8 If he dies before his spouse/partner then the spouse/partner will receive a spouse/partner's pension in respect of the inverse commutation additional pension. As usual, this is calculated as 62.5% of the member pension.
- 2.9 A member leaves AFPS 05 at age 56 with a retirement lump sum of £4,000. She elects to give up all of her lump sum in exchange for additional pension. No spouse/partner benefits are opted for. The additional pension payable to her by inverse commutation at age 56 is then:

Inverse commutation additional pension

$$= (£4,000 / £100) \times £4.74 = £189.60 \text{ pa}$$



3 Application to Ill-health review cases

- 3.1 At MoD's request, GAD extended the inverse commutation table down to age 30, so that the administrators could use the inverse commutation factors for ill-health cases as described below. The extended factor table is included in Appendix B.
- 3.2 The only circumstances in which the section of the table from age 30 to age 54 should be used are as follows:
- 3.3 The member has retired on tier 2 ill-health but subsequent to the member's retirement, the benefits have been uplifted to tier 3 ill-health benefits. The additional ill-health pension is put into payment and the additional lump sum needs to be inversely commuted so that it can be paid with the additional pension.
- 3.4 For example, a 40 year old member with an additional lump sum of £8,000 which needs to be inversely commuted into additional member only pension.

Inverse commutation additional pension

$$= (£8,000 / £100) \times £3.60 = £288.00 \text{ pa}$$

- 3.5 As the factors for ages below age 55 have only been prepared in respect of ill-health pensions, we have allowed for pension increases below age 55 in our calculations. **These factors are therefore not applicable to other circumstances.** Any cases requiring inverse commutation below age 55 which are not covered by the circumstances in paragraph 3.3 should be referred to GAD.



4 Exclusions and limitations

- 4.1 This guidance should not be used for any purpose other than those set out in this guidance.
- 4.2 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.
- 4.3 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.
- 4.4 This guidance only covers the actuarial principles around the calculation and application of inverse commutation factors. Any legal advice in this area should be sought from an appropriately qualified person or source.
- 4.5 Scheme managers and administrators should satisfy themselves that inverse commutation calculations and benefit awards comply with all legislative requirements including, but not limited to, tax and contracting-out requirements.
- 4.6 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 MoD and GAD. Under no circumstances should this guidance take precedence over the Regulations. Administrators should ensure that they comply with all relevant Regulations.

Third party reliance

- 4.7 This guidance has been prepared for the use of MoD 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 MoD 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.
- 4.8 Other than MoD 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.



Appendix A: Assumptions underlying actuarial factors

Financial assumptions

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

Mortality assumptions

| | |
|------------------------------|---|
| Base mortality tables | S2PMA and S2PFA |
| Base table adjustment | 110% of Standard Tables |
| 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 | 90% |
| Age difference between member and partner | Male members assumed to be 3 years older than partner. Female members assumed to be 3 years younger than partner. |
| Proportions married/partnered at retirement | 100% of members who opt for member and spouse benefits |



Appendix B: Factor table

Table 701: Inverse commutation factors

| Amount of additional pension per £100 of lump sum | | | | |
|---|------------------|--------|-------------------------------|--------|
| Age last birthday at retirement | Member's Pension | | Member's and Spouse's Pension | |
| | Male | Female | Male | Female |
| | £ | £ | £ | £ |
| 30 | 3.23 | 3.23 | 3.08 | 3.08 |
| 31 | 3.26 | 3.26 | 3.10 | 3.10 |
| 32 | 3.29 | 3.29 | 3.13 | 3.13 |
| 33 | 3.33 | 3.33 | 3.16 | 3.16 |
| 34 | 3.36 | 3.36 | 3.18 | 3.18 |
| 35 | 3.40 | 3.40 | 3.21 | 3.21 |
| 36 | 3.43 | 3.43 | 3.24 | 3.24 |
| 37 | 3.47 | 3.47 | 3.27 | 3.27 |
| 38 | 3.52 | 3.52 | 3.30 | 3.30 |
| 39 | 3.56 | 3.56 | 3.34 | 3.34 |
| 40 | 3.60 | 3.60 | 3.37 | 3.37 |
| 41 | 3.65 | 3.65 | 3.41 | 3.41 |
| 42 | 3.70 | 3.70 | 3.45 | 3.45 |
| 43 | 3.75 | 3.75 | 3.49 | 3.49 |
| 44 | 3.80 | 3.80 | 3.53 | 3.53 |
| 45 | 3.86 | 3.86 | 3.58 | 3.58 |
| 46 | 3.92 | 3.92 | 3.62 | 3.62 |
| 47 | 3.98 | 3.98 | 3.67 | 3.67 |
| 48 | 4.05 | 4.05 | 3.72 | 3.72 |
| 49 | 4.12 | 4.12 | 3.78 | 3.78 |
| 50 | 4.19 | 4.19 | 3.83 | 3.83 |
| 51 | 4.27 | 4.27 | 3.89 | 3.89 |
| 52 | 4.35 | 4.35 | 3.96 | 3.96 |
| 53 | 4.44 | 4.44 | 4.03 | 4.03 |
| 54 | 4.54 | 4.54 | 4.10 | 4.10 |
| 55 | 4.63 | 4.63 | 4.17 | 4.17 |
| 56 | 4.74 | 4.74 | 4.25 | 4.25 |
| 57 | 4.85 | 4.85 | 4.33 | 4.33 |
| 58 | 4.97 | 4.97 | 4.42 | 4.42 |
| 59 | 5.10 | 5.10 | 4.52 | 4.52 |
| 60 | 5.23 | 5.23 | 4.62 | 4.62 |
| 61 | 5.38 | 5.38 | 4.72 | 4.72 |
| 62 | 5.53 | 5.53 | 4.84 | 4.84 |
| 63 | 5.70 | 5.70 | 4.96 | 4.96 |
| 64 | 5.88 | 5.88 | 5.09 | 5.09 |
| 65 | 6.07 | 6.07 | 5.23 | 5.23 |
| 66 | 6.28 | 6.28 | 5.38 | 5.38 |
| 67 | 6.51 | 6.51 | 5.55 | 5.55 |
| 68 | 6.75 | 6.75 | 5.72 | 5.72 |
| 69 | 7.02 | 7.02 | 5.91 | 5.91 |
| 70 | 7.31 | 7.31 | 6.12 | 6.12 |