



Government Actuary's Department

Health and Social Care Pension Scheme 2015

Reduction to benefits due to Scheme Pays Annual Allowance and Lifetime Allowance Tax Charge

Factors and guidance

Version 1.0

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1 Introduction

Purpose

- 1.1 This Note is addressed to the HSC as administrator of the Health and Social Care Pension Scheme 2015 ('HSCPS 2015' or 'Scheme'). It sets out how a benefit reduction should be calculated in certain circumstances such as retirement or transfer, following an individual's election to exercise the 'scheme pays' option in respect of tax charges incurred due to the Annual Allowance ('AA'). It also sets out the calculation of the member's and dependant's pension reduction at retirement for a Lifetime Allowance ('LTA') tax charge.
- 1.2 This document relates to paragraphs 16(16)(b) and 16(3) of Schedule 3 of SR2015/120, under which the adjustment to the member's present or future benefits should be calculated by reference to advice provided by the Scheme Actuary for that purpose.
- 1.3 The factors and guidance provided in this note have been prepared in light of our advice to DHSSPS dated 27 March 2015 and its instructions following that advice. No factors or advice provided for the HSCPS should be used for reductions to HSCPS 2015 benefits.
- 1.4 Where a transitional member has benefits in both the HSCPS and the HSCPS 2015, the Scheme Pays charge should be applied to the Scheme in which the tax liability arises. For the purposes of determining this the Annual Allowance (including any carry forward) should be pro-rated between the Schemes based on the increase in value accrued in each Scheme. Section 3 explains the calculations required. Any cases arising should be referred to GAD until the policy for payment of the charge and reduction of benefits correspondingly has been confirmed.
- 1.5 The effective date of this guidance is 1 April 2015. The version number for this guidance is 1.0.
- 1.6 A summary of the assumptions underlying the factors is listed in Appendix A. The factors are provided in Appendix B, C and D.

Implementation and review

- 1.7 The factors contained in this note should be used with effect from 1 April 2015. The factors applicable for AA deductions are essentially the same as the factors used to determine pension credits on divorce, as detailed in our note 'HSCPS 2015 Pension Sharing Following Divorce: Calculation of Cash Equivalents and Pension credits'.
- 1.8 The factors set out in the Appendices are as follows:

Factors	Table name	Appendix
AA factors for normal health retirement reductions	SP1	B
AA factors for ill-health retirement reductions	SP2	C



	LTA pension reduction factors	SP3	D
1.9	The factors should be reconsidered whenever there is a change in the SCAPE basis, following each actuarial valuation where mortality and other relevant experience is reviewed or if other credible and material information comes to light.		
1.10	The remainder of this note contains the factor tables, guidance on their use and a number of worked examples.		
1.11	In line with best practice, GAD should review a number of sample cases to ensure factors are used as intended.		

Limitations

- 1.12 This guidance note should only be used for calculating the reduction to benefits following an election to utilise the Annual Allowance or Lifetime Allowance Scheme Pays mechanism. It should not be used for any other purpose.
- 1.13 HSC should satisfy themselves that the pension reduction resulting from a Scheme Pays election complies with all legislative requirements including, but not limited to, tax and contracting-out requirements. Any legal advice in this area should be sought from an appropriately qualified person or source.
- 1.14 This guidance note does not cover the method for determining the amount of any Annual Allowance or Lifetime Allowance charge although Section 3 does refer to this calculation. This guidance note also does not cover the method used to calculate the negative DC balance at retirement or other relevant date. This guidance has been provided separately to HSC.

2 Annual Allowance, Lifetime Allowance and Scheme Pays in HSCPS 2015

Introduction

- 2.1 Subject to meeting certain conditions, when a member becomes liable to an AA or LTA charge, he or she can make an election requiring the HSC to pay the charge on their behalf out of their pension benefits (referred to as 'Scheme Pays').
- 2.2 For cumulative AA charges HSC will keep track, via a 'negative DC balance', of the amount paid or due to be paid by the HSC (effectively a debt owed to HSCPS 2015 by the member). When the member takes benefits or transfers benefits out of the Scheme, the negative DC balance is converted into a benefit reduction.
- 2.3 For LTA charges the deduction is applied at the point of retirement.
- 2.4 This Note describes the steps required to calculate the benefit reduction applicable in the circumstances described in paragraphs 2.2 and 2.3.
- 2.5 In the calculations included in this Note, the 'Total DC Pot' represents the negative DC balance in respect of AA charges paid by the Scheme at the effective date of the calculation. The negative DC balance should be calculated by following the guidance and examples provided for that purpose. Note that in the remainder of this document the 'Total DC Pot' for transitional members¹ relates solely to that relevant to the HSCPS 2015. Section 3 sets out how that amount should be determined.

Calculation of the benefit reduction

- 2.6 Calculations related to Scheme Pays AA benefit reductions in different circumstances are set out in the different sections of this Note. The calculations allow for the following features:
 - > Dependants' benefits are unaffected by AA Scheme Pays, i.e. reductions do not apply to dependants' benefits payable on death in service, death in deferment or death in retirement
 - > Pension debits applying in retirement will be subject to annual increases in line with the Pension (Increase) Act 1971
 - > Separate factors are provided for ill-health retirement cases to reflect reduced life-expectancy.
- 2.7 This Note describes the steps necessary to calculate AA benefit reductions in the following circumstances:

¹ Transitional members refers to members with benefits in both the HSCPS and HSCPS 2015 where the HSCPS benefit retains the final salary link (including practitioners retaining the active service level of revaluation in relation to HSCPS benefits).



Circumstance	Section
Age Retirement	4
Early Retirement	5
Late Retirement	6
Ill-health Retirement	7
Transfer Values	8
Divorce Cases	9
Partial Retirement	10
Abatement	11
Redundancy	12

- 2.8 This Note reflects our current interpretation of how Scheme Pays reductions will be treated in practice. Please note, however, that certain aspects of the Scheme Pays mechanism may require clarification from your legal advisors and/or HMRC. The calculation guidance set out in this Note is therefore subject to change.
- 2.9 Section 13 covers the calculation of pension reductions in respect of LTA charges paid by the scheme. In the case of LTA charges both the member's pension and dependant's pension is subject to reduction.

3 Transitional members - Allocation of AA charge in any year to relevant Scheme

- 3.1 For transitional members (those accruing benefits in the HSCPS 2015 but with retained final salary linking on HSCPS benefits, including practitioners who retain the in service revaluation rate on HSCPS benefits) the amount of any annual allowance charge arising in respect of HSCPS 2015 benefits should be determined as below.
- 3.2 The amount subject to any annual allowance charge which arises in respect of HSCPS benefits should be determined separately in accordance with guidance specific to that scheme. This amount is required for the calculation set out below and is referred to here as 'HSCPS AA value'.
- 3.3 The policy on elections for 'Scheme Pays' for a transitional member has yet to be confirmed and such cases should be referred to GAD.
- 3.4 In the remainder of this document 'Total DC Pot' relates only to any charge arising in respect of HSCPS 2015 benefits.
- 3.5 **Determine increase in value of HSCPS 2015 benefits in year [HSCPS 2015 AA value]**

Increase in value of HSCPS 2015 benefits in year

$$= \text{Max} [(\text{PEN}_1 - \text{PEN}_0 \times \text{CPI}) \times 16, 0]$$

Where

PEN_1 = accrued HSCPS 2015 pension (including revaluation) at end of year

PEN_0 = accrued HSCPS 2015 pension (including revaluation) at start of year

CPI = increase in CPI measure of inflation for the year in question (equal to PI increase applied in April following the year end)

Any transfers in received, AP secured or MP AVCs paid in the year should be included in the calculation as normal

- 3.6 **Determine amount of annual allowance applicable to the HSCPS 2015 [HSCPS 2015 AA]**

Annual allowance applicable to HSCPS 2015

$$= \text{Annual allowance for the year (including any carryforward available)} \times$$

$$\text{HSCPS 2015 AA value (from 3.5)} / (\text{HSCPS 2015 AA value} + \text{HSCPS AA value (see 3.2)})$$



3.7 Determine increase in value of HSCPS 2015 benefits in year in excess of AA [HSCPS 2015 AA EXCESS]

= Maximum [(HSCPS 2015 AA value – HSCPS 2015 AA), 0]

The annual allowance charge in relation to the HSCPS 2015 is based on this amount.

4 AA charge: age retirement

- 4.1 The calculations below are appropriate for members subject to benefit reduction due to AA charges retiring at their normal pension age from either active or deferred status.

Factors

- 4.2 The factors used for the calculations are included as Table SP1 in Appendix B.
- 4.3 The appropriate factor will depend on the member's age (last birthday) at their date of retirement.

Normal age retirement calculations

- 4.4 The steps necessary to calculate a benefit reduction for members retiring in normal health at their normal pension age are described below.
- 4.5 The debits calculated below should be applied to main scheme benefits before any member options are exercised, e.g. commutation.

Amounts at retirement	Notation
Total DC pot	DC
Main Scheme Pension	P
Dependant's Pension	DP
Member's Pension Debit	PD
Net Main Scheme Pension	NP
Net Dependant's Pension	NDP

Step	Item	Calculation
1	PD	$= DC \div (\text{Relevant Factor SP1})$
Net benefits payable on age retirement:		
2		
a)	NP	$= P - PD$
b)	NDP	$= DP$

5 AA charge: Early retirement

- 5.1 The calculations below are appropriate for members subject to benefit reduction due to AA charges retiring before their normal pension age from either active or deferred status, other than those retiring on grounds of ill-health.

Factors

- 5.2 The factors used for the calculations are included as Table SP1 in Appendix B.
- 5.3 The appropriate factor will depend on the member's age (last birthday) at their date of (early) retirement.

Early retirement calculations

- 5.4 The steps necessary to calculate a benefit reduction for members retiring in normal health before their normal pension age are described below.
- 5.5 The pension and lump sum debits should be applied to the main scheme benefits after they have been reduced to allow for early retirement². However, the debits should be applied to the main scheme benefits before any member options have been exercised, e.g. commutation.

Amounts at early retirement	Notation
Total DC Pot	DC
Early Retirement Main Scheme Pension	ERP
Dependant's Pension	DP
Member's Pension Debit	PD
Net Early Retirement Main Scheme Pension	NERP
Net Dependant's Pension	NDP

Step	Item	Calculation
1	PD	$= DC \div (\text{Relevant Factor SP1})$
Net Benefits Payable on early retirement:		
2		
a)	NERP	$= ERP - PD$
b)	NDP	$= DP$

² Refer to 'HSCPS 2015 Voluntary Early and Late retirements in normal health: Factors and Guidance'

6 AA charge: late retirement

- 6.1 The calculations below are appropriate for members subject to benefit reduction due to AA charges retiring after their normal pension age from either active or deferred status.

Factors

- 6.2 The factors used for the calculations are included as Table SP1 in Appendix B.
- 6.3 The appropriate factor will depend on the member's age (last birthday) at their date of (late) retirement.

Late retirement calculations

- 6.4 The steps necessary to calculate a benefit reduction for members retiring after their normal pension age are described below.
- 6.5 The pension debits should be applied to the main scheme benefits after they have been adjusted to allow for late retirement³. However, the debits should be applied to the main scheme benefits before any member options are exercised, e.g. commutation.

Amounts at late retirement	Notation
Total DC Pot	DC
Late Retirement Main Scheme Pension	LRP
Dependant's Pension	DP
Member Pension Debit	PD
Net Late Retirement Main Scheme Pension	NLRP
Net Dependant's Pension	NDP

Step	Item	Calculation
1	PD	= DC ÷ (Relevant Factor SP1)
Net Benefits Payable on early retirement:		
2		
a)	NLRP	= LRP – PD
b)	NDP	= DP

³ Refer to 'HSCPS 2015 Voluntary Early and Late retirements in normal health: Factors and Guidance'



7 AA charge: ill-health retirement

- 7.1 The calculations below are appropriate for members subject to benefit reduction due to AA charges retiring on grounds of ill-health.

Factors

- 7.2 The factors used for the calculations are included as Table SP2 in Appendix C.
- 7.3 The appropriate factor will depend on the member's age (last birthday) at their date of retirement.

Ill-health retirement calculations

- 7.4 The steps necessary to calculate a benefit reduction for members retiring in ill-health are described below.
- 7.5 The pension debits should be applied to the (enhanced) main scheme benefits. The debits should be applied to benefits before member options are exercised, e.g. commutation.

Amounts at retirement	Notation
Total DC Pot	DC
Main Scheme Ill-health Pension	IHP
Dependant's Pension	DP
Member Pension Debit	PD
Net Main Scheme Ill-health Pension	NIHP
Net Dependant's Pension	NDP

Step	Item	Calculation
1	PD	$= DC \div (\text{Relevant Factor SP2})$
Net Benefits Payable on ill-health retirement:		
2		
a)	NIHRP	$= IHRP - PD$
b)	NDP	$= DP$

8 AA charge: transfer values

Statutory cash equivalent transfer values (CETV)

- 8.1 This section covers the calculations appropriate for members subject to benefit reduction due to AA charges and where a CETV is to be paid. A gross CETV should be calculated in the usual way at the relevant date, ignoring the negative DC pot. The notional negative DC pot should then be revalued up to the date at which CETV is calculated. The CETV payable would then be as follows:

$$\text{Net CETV} = \text{Gross CETV} - \text{revalued Negative DC pot}$$

- 8.2 If the transfer-out option forms are received within the guarantee period there is no requirement to amend the total negative DC balance. If the forms are received outside the guarantee period, the total negative DC balance should be revalued only where a revised CETV is calculated.
- 8.3 The calculation of a CETV is subject to an underpin if the member has received a transfer-in of benefits from another scheme. If the underpin bites, the value of the underpin is usually paid. It is extremely unlikely that there would be case where an underpin bites where a member has exercised Scheme Pays, which would have the result that the Annual Allowance charge paid by the HSCPS 2015 could not be recouped. However, should such a case arise, this should be referred to GAD.

Club transfers out of HSCPS 2015

- 8.4 As for CETVs, a gross transfer value should be calculated in the usual way at the relevant date ignoring the negative DC pot. The notional negative DC pot should also be revalued up to the date at which Club transfer is calculated. The Club transfer payable would then be as follows:

$$\text{Net transfer} = \text{Gross Club Transfer Value} - \text{revalued Negative DC pot}$$

- 8.5 HSC will also need to provide the Club scheme with a second transfer statement. This should cover the value of the gross transfer value (i.e. before deduction of the negative DC balance) in order for the Club scheme to calculate the membership credit. It will also mean that the Club scheme can determine the negative DC balance used in the transfer calculation which can then be converted into a Scheme Pays debit (or other method of recovery).

Non-Club transfers into HSCPS 2015

- 8.6 Where the member had elected to utilise Scheme Pays with their previous scheme, HSC should receive a transfer-in payment allowing for this (i.e. with any Scheme Pays pension debit or notional negative balance already having been deducted). The earnings credit can then be calculated on this net CETV payment.



Club transfers into HSCPS 2015

- 8.7 Where a member with a previous Scheme Pays election receives a transfer-in from a Club scheme, the transfer value payment will be net of any deduction due to the Scheme Pays election. In addition, HSC will receive a calculation of the gross Club Transfer calculation (i.e. excluding the reduction for Scheme Pays) in order to calculate the membership credit.
- 8.8 An earnings credit in the HSCPS 2015 should be calculated in the usual way based on the gross transfer amount quoted at the relevant date.
- 8.9 The difference in the gross transfer value quoted and the transfer payment actually received should be taken to be the negative DC pot in the HSCPS 2015 as at the date of transfer. Interest will then apply to the negative DC pot from 1 January (following receipt of the transfer payment) until benefits become payable or transferred.

9 AA charge: divorce cases

Scheme pays election applies after divorce pension share

- 9.1 Benefit reduction due to a Scheme Pays election applies in tandem with a pension debit due to a pension sharing order. The Scheme Pays benefit reduction should be carried out consistently with those described in the relevant section of this guidance (Age Retirement, Early Retirement, Late Retirement or Ill-health Retirement).

Divorce cash equivalent calculation following a scheme pays election

- 9.2 Calculations for divorce purposes are covered in the guidance 'HSCPS 2015 Pension Sharing Following Divorce: Calculation of Cash Equivalents and Pension Credits'.
- 9.3 If a calculation of a cash equivalent of a member's benefits for divorce purposes is requested for contributing members or deferred pensioners not entitled to an immediate pension without actuarial reduction, this guidance states that the cash equivalent transfer value should normally be quoted. This should be calculated using the same approach as would apply to a normal non-Club transfer value, even if the member is not normally entitled to a transfer value.
- 9.4 The same principle applies when the member has previously elected to utilise Scheme Pays. As described in Section 8, the gross CETV should be calculated in the usual way at the relevant date ignoring the negative DC pot. The negative DC pot should also then be determined at the relevant date. The transfer value to be quoted for divorce purposes would then be equal to the gross CETV less the negative DC pot. It may be useful to provide additional disclosures to the courts covering both the gross transfer value and negative DC balance.
- 9.5 For pensioner members, the benefit reduction due to Scheme Pays should already have been applied (at the point of retirement) and so the calculation of a cash equivalent of the member's benefits for divorce purposes can be carried out in the usual way.



10 AA charge: partial retirement

- 10.1 Where a member opts to draw down their accrued pension, the negative DC pot relating to their membership to date should be applied at the point of flexible retirement.
- 10.2 Where the member elects to draw down only a proportion of their accrued pension, the pension debit should be calculated based on a pro-rated negative DC pot (based on the proportion of the accrued pension being drawn down). The benefit reduction calculations should be carried out consistently with those described in the relevant section of this guidance (Age Retirement, Early Retirement or Late Retirement).
- 10.3 The remaining negative DC pot will continue to attract interest to retirement, where it will then be converted into a benefit reduction.

11 AA charge: abatement

- 11.1 Under the HSCPS 2015 Regulations, if certain pensioner members return to pensionable employment in the NHS, then their pension may be reduced, or abated. Full details around abatement and calculating the level of abatement required is given in the guidance 'HSCPS 2015 Abatement of a member's pension on return to work: Factors and guidance'.
- 11.2 Generally, abatement applies where earnings from re-employment plus the unearned element of pension exceeds earnings before retirement. The unearned pension is the difference between the member's annual pension and 'earned pension'. Earned pension is generally the equivalent actuarially-reduced pension i.e. the pension in payment but as if it had been calculated under the regulations relating to early retirement with actuarial reduction.
- 11.3 In comparing the pension in payment with the equivalent actuarially-reduced pension as calculated under the early retirement with actuarial reduction regulations, it is the pension gross of any benefit reductions due to Scheme Pays that must be compared.



12 AA charge: redundancy

- 12.1 Under the HSCPS 2015 Regulations, in the event of compulsory early retirement some members may be able to retire without an early retirement reduction (or with a reduced early retirement reduction). The costs of this are calculated so that they may be covered by either the employer or the employee. Full details around redundancy and calculating the costs of redundancy are given in the guidance 'HSCPS 2015: Compulsory Early Retirement'.
- 12.2 In calculating the costs of redundancy, the unreduced pension gross of any benefit reductions due to Scheme Pays should be used.



13 LTA charge

- 13.1 The process below is appropriate for members at retirement and subject to benefit reduction due to an LTA charge. The HM Treasury note 'How to pass on the lifetime charge' dated 23 December 2004 remains relevant except that a factor of 20 is no longer applied to convert an LTA charge into a pension reduction. Note the factor of 20 is still applied to determine the amount of any LTA charge.
- 13.2 The determination of LTA charges is outside the scope of this note but such charges should be determined after the member has decided the form of benefits to be taken (ie after commutation decisions).
- 13.3 Members subject to an LTA charge are subject to a reduction in member's pension and dependant's pension. The dependant's pension entitlement should be reduced by 33.75% of the member's reduction.

Factors

- 13.4 The factors to be used to determine the member's pension reduction to cover an LTA charge are included as Table SP3 in Appendix D.
- 13.5 The appropriate factor will depend on the member's age (last birthday) at their date of retirement.

Pension reduction calculation

- 13.6 The reduction in member's pension should be determined as follows:

Pension within LTA = (LTA - tax-free cash taken) / 20 = A

Pension above LTA = Pension after commutation chosen - A = B

Tax charge payable on pension = 25% x 20 x B = C

Reduction in member's pension = C / SP3 = D

Tax charge on any excess lump sum is paid by deduction from the lump sum payable to the member.

Pension payable to the member from retirement = A + B - D = E

Dependant's pension payable following member's death

= Total dependant's pension – 33.75% x D

- 13.7 The appropriate reduction applicable in other circumstance (eg on retirement at ages below MPA) is outside the scope of this note and such calculations should be referred to GAD.



Appendix A: Assumptions underlying factors

Financial assumptions

Nominal discount rate	5.06%
Real discount rate (in excess of CPI)	3.00%

Mortality assumptions

Base mortality tables (normal health)	S1NMA and S1NFA
Base table adjustment (normal health)	Adjustments applied so that 20% fewer deaths at each age are assumed for male members and 15% fewer deaths at each age are assumed for female members than implied by the standard tables. (As per 2012 valuation.)
Base table adjustment (ill health)	Nil
Future mortality improvement	Based on ONS principal UK population projections 2012
Year of Use	2016

Other assumptions

Proportion of male members for the purpose of unisexing factors	33.3%
Allowance for commutation	Nil



Appendix B: AA Reduction factors – normal health

Table SP1

Factors to calculate reduction to pension for AA charges – retirement not on grounds of ill health

Age Last Birthday	Factor
55	21.60
56	21.24
57	20.87
58	20.49
59	20.11
60	19.71
61	19.31
62	18.89
63	18.47
64	18.04
65	17.60
66	17.15
67	16.69
68	16.22
69	15.73
70	15.25
71	14.75
72	14.24
73	13.73
74	13.22
75	12.71



Appendix C: AA Reduction factors – retirement on ill-health

Table SP2

Factors to calculate reduction to pension for AA charges - retirement on grounds of ill-health

Age Last Birthday	Factor
20	27.05
21	26.89
22	26.72
23	26.55
24	26.38
25	26.21
26	26.03
27	25.85
28	25.68
29	25.50
30	25.32
31	25.15
32	24.97
33	24.79
34	24.61
35	24.43
36	24.24
37	24.06
38	23.88
39	23.69
40	23.49
41	23.29
42	23.08
43	22.86
44	22.62
45	22.38
46	22.12
47	21.85
48	21.56
49	21.27
50	20.97
51	20.66
52	20.35
53	20.02
54	19.70
55	19.36
56	19.02
57	18.66
58	18.30
59	17.93
60	17.56
61	17.17
62	16.78
63	16.38



Age Last Birthday	Factor
64	15.98
65	15.56
66	15.13
67	14.69



Appendix D: LTA Reduction factors

Table SP3

Factors to calculate reduction to pension for LTA charges

Age Last Birthday	Factor
20	30.28
21	30.14
22	30.01
23	29.86
24	29.72
25	29.56
26	29.41
27	29.24
28	29.08
29	28.91
30	28.73
31	28.55
32	28.36
33	28.17
34	27.97
35	27.76
36	27.55
37	27.34
38	27.11
39	26.89
40	26.65
41	26.41
42	26.16
43	25.90
44	25.64
45	25.37
46	25.09
47	24.80
48	24.50
49	24.20
50	23.89
51	23.57
52	23.24
53	22.91
54	22.57
55	22.22
56	21.86
57	21.50
58	21.12
59	20.74
60	20.35
61	19.94
62	19.53
63	19.10
64	18.66
65	18.21



66	17.75
67	17.28
68	16.81
69	16.31
70	15.80
71	15.31
72	14.82
73	14.32
74	13.79
75	13.24