



Government Actuary's Department

HSC Pension Scheme

Commutation

Factors and guidance

Version 1.0

Date: 31 March 2015

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1 Introduction

- 1.1 This Note is addressed to HSC as administrator of the Health and Social Care Pension Scheme ('HSCPS') and identifies the various circumstances under which scheme pension may be commuted for a lump sum (or vice versa). It sets out the factors to be used in each case and specifies how they should be applied.
- 1.2 The Regulations which include an option allowing a member to commute part of their pension for a lump sum (or vice versa) are shown in the tables below.

Provision	Statutory Reference	Section
General option to exchange part of pension for lump sum	SR 1995/95 17A (as inserted by SR 2008/163 14) SR 2008/256 58(2)/185(2)	2
Mandatory Lump Sum for 2008 Choice Optants	SR 2008/256 136L(2)/260K(2) (as inserted by SR 2010/22 55/96 respectively)	3
Option for members in serious ill-health to exchange whole pension for lump sum	SR 1995/95 12(7), 13(10), 13A(10) (as amended by SR 2008/163 9/11) SR 2008/256 59/186	4
Commutation of small/trivial pensions	SR 1995/95 94 SR 2008/256 128/252	5
Inverse commutation	SR 1995/95 17(8) (as amended by SR 2006/410 9 & SR 2012/42 5)	6
Deduction of tax: further provisions Cover benefit reductions due to annual allowance or lifetime allowance	SR 1995/95 89A (as inserted by SR 2006/410 16, and amended by SR 2008/163 62) SR 2008/256 131/255	Covered in separate guidance

- 1.3 The scope of cases under each scenario which are covered by this guidance are detailed later in this note. Cases which are not covered by this guidance should be referred to GAD.
- 1.4 The factors provided in this Note have been prepared in light of our advice to the Department of Health, Social Services and Public Safety dated 27 March 2015 and its instructions following that advice. This guidance is intended to supersede any factors or advice previously issued, for the purposes of commutation calculations, carried out from 1 April 2015. No advice or factors issued in the past should be used for cases after this date. No advice or factors issued for the HSCPS 2015 should be used for commutation calculations in respect of HSCPS benefits.
- 1.5 Where members have benefits in both the HSCPS 2015 and the HSCPS benefits in each scheme must be treated separately.



- 1.6 The effective date for this guidance is 1 April 2015. The version number for this guidance is 1.0.
- 1.7 A summary of the assumptions underlying the factors covered in Section 5 and 6 above is listed in Appendix A. The factors are provided in Appendices B and C.

Implementation and review

- 1.8 As agreed the factors and guidance contained in this note should be followed with effect from 1 April 2015.
- 1.9 The remainder of this Note covers the factor tables, guidance on their use and worked examples.
- 1.10 The actuarially determined factors (i.e. excluding those explicitly set in the Regulations) 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.
- 1.11 In line with best practice, GAD should review a number of sample cases to ensure factors are used as intended.



2 Exchange part of retirement pension for lump sum

- 2.1 The scheme regulations give any member who ceases pensionable employment and retires from the scheme after 31 March 2008 the option to commute part of their pension to a lump sum. This right also applies to pension credit members, except those with a disqualifying pension credit¹.
- 2.2 This section refers to benefits payable in accordance with Regulations SR 1995/95 – 17A and SR 2008/256 – 58(2) and 185(2). That is those regulations relating to the lump sum available by commutation at retirement for whatever reason except serious ill health, regardless of the member's age or sex, but subject to the restrictions as set out below.
- 2.3 A factor of 12 is prescribed in the Regulations and should be used to calculate the amount of lump sum by commutation of a member's pension (and the corresponding reduction in pension).

- 2.4 The relevant calculations are:

For a specified reduction of £x pa of pension, the amount of lump sum available is:

$$\text{Lump sum} = \text{Pension (£x pa)} \times 12$$

To receive a specified lump sum of £y, the reduction in pension required is:

$$\text{Reduction to annual pension} = \text{Additional lump sum (£y)} \div 12$$

- 2.5 For any member retiring early on actuarially reduced benefits², the additional lump sum is available by commutation of the actuarially reduced pension. The same £12 lump sum: £1 pa pension factor as above is applied to the actuarially reduced pension.
- 2.6 Any member who has previously elected for Scheme Pays will have a negative DC balance at retirement. This balance must be converted into a benefit reduction at retirement and the resultant pension debit applied to the pension benefit before any commutation for additional lump sum is made. Please refer to the guidance 'HSCPS - Reduction to benefits due to Scheme Pays Annual Allowance Tax Charge' for more details and the factors required to calculate this benefit reduction.

Restrictions

- 2.7 Commutation is subject to certain restrictions:

- > HMRC limits – The total lump sum, including that payable automatically to the members of the 1995 Section³, must not exceed HMRC limits.

¹ For the purposes of paragraph 2 of Schedule 29 of the Finance Act 2004

² Under Regulation 16 of SR 1995/95 or Regulation 48 or 179 of SR 2008/256.

³ Under Regulation 17 of SR 1995/95.



- > GMP restrictions – Members are only allowed to exchange that part of their pension in excess of any guaranteed minimum pensions (GMPs) for a lump sum.

HMRC limits

- 2.8 This Note does not describe the tests to be carried out to check the maximum amount of tax free lump sum available. HSC should ensure that the proposed lump sum is within the applicable limits. Typically a member is permitted to take a lump sum of up to 25% of the capital value of the benefits to be paid. However, this can be restricted further in certain circumstances (for example, if the member exceeds their standard lifetime allowance⁴).

GMP restriction

- 2.9 Early retirement and commutation may be restricted if the main scheme pension, subject to any reduction for early retirement, will be less than a member's guaranteed minimum pension (GMP) at GMP payment age (currently 65 for males and 60 for females). The following test should be applied to check whether a member is eligible for early retirement and/or commutation.

- 2.10 The GMP test is set out below:

Step 1 – eligibility for early retirement

- Calculate the member's pension excluding any Added Years but including any transferred-in service (and before any commutation option):

$$A = \text{Final Pensionable Pay} \times \text{Reckonable Service} \div 80$$

(Note: For 2008 Section members (incl Choice Optants), an accrual rate of 60ths should be used instead)

- Apply the relevant early retirement factor if any:

$$B = A \times \text{ERF1 or ERF2 or } (\text{ERF3} \div \text{PI} + 1.269)^5 \text{ as relevant}$$

- Take revalued annual GMP at date of retirement and add 2.75% for each complete year to GMP payment age:

$$D = \text{Revalued GMP at retirement date} \times [1 + 2.75\% \times (\text{period to date GMP payable})]$$

- Check if B is greater than D. If yes, the member is eligible to retire on actuarially reduced benefits at the relevant age. Otherwise, voluntary early retirement at the relevant age is not permitted.

⁴ Under regulation 17A(6) of SR 1995/95 and regulations 58(5) and 185(5) of SR 2008/256

⁵ Available in 'HSC Pension Scheme – Voluntary Early and Late retirements in normal health – Factors and Guidance'



Step 2 – scope for commutation

- Apply the commutation factor to the [additional] lump sum required (total lump sum for 2008 section members) and calculate the residual pension:

$$C = \text{Total pension} * (B) - ([\text{additional}] \text{ lump sum} \div 12)$$

**after application of ERF if applicable*

- Check if C is greater than D. If yes, the member is eligible to benefit C, i.e. commutation up to the relevant [additional] lump sum.
- Otherwise the member is only permitted to exchange a smaller proportion of pension for a lump sum of up to $12 \times (B - D)$, with corresponding reduction in pension of $(B - D)$.
- Note both steps 1 and 2 must be satisfied for voluntary early retirement.

2.11 Worked examples are provided in Section 7.



3 Mandatory lump sum payable to a 2008 Section Optant

- 3.1 This section refers to benefits payable in accordance with Regulations SR 2008/256 – 136L(2) and 260K(2). That is those Regulations relating to the 'mandatory lump sum' payable to a 2008 Section Optant. The 'mandatory lump sum' is equal to: $\frac{3}{80}$ multiplied by pensionable pay, multiplied by the number of years of service in the 1995 Section (multiplied by an early retirement factor if applicable).
- 3.2 A 'mandatory lump sum' and a reduced pension, based on service up to 31 March 2008, are payable to 2008 Section Optants at retirement. The same £12 lump sum: £1 pa pension factor is used to calculate the reduction to pension following commutation for the 'mandatory lump sum', i.e. reduction to pension = 'mandatory lump sum' divided by 12.
- 3.3 An example is given in Section 7.



4 Exchange whole pension for lump sum due to serious ill health

- 4.1 This section refers to benefits payable in accordance with Regulations SR 1995/95 – 12(7), 13(10) and 13A(10) and SR 2008/256 – 59 and 186. These Regulations give members in serious ill-health the option to exchange their entire pension for a lump sum.

- 4.2 For members retiring in serious ill-health, the £12 lump sum: £1 pa pension factor should be applied, subject to the modification set out below.

The lump sum payment from commuting the entire pension should be determined as follows:

- 1) Calculate the maximum [additional] amount of lump sum (total lump sum for 2008 section members) the member would be entitled to commute tax free in normal health, which is the limit set by HMRC (see paragraph 2.7).
- 2) Commute this at the rate of £12 lump sum: £1 pension pa to give the residual pension as follows:

Residual pension = Pension to be put into payment ignoring commutation – maximum [additional] lump sum ÷ 12

- 3) The residual pension should then be converted to lump sum using a factor of £5 lump sum: £1 pension pa as follows:

Lump sum from residual pension = Residual pension x 5

- 4) Total lump sum payable = main scheme benefit lump sum (if applicable) + maximum [additional] tax free lump sum allowed by commutation + lump sum from residual pension

- 4.3 Any member who has previously elected for Scheme Pays will have a negative DC balance at retirement. This balance must be converted into a benefit reduction at retirement and then applied to the pension benefit (and lump sum where applicable) before exchange of the whole pension for a lump sum due to serious ill health is made. Please refer to the guidance 'HSCPS - Reduction to benefits due to Scheme Pays Annual Allowance Tax Charge' for more details and the factors required to calculate this benefit reduction.



5 Trivial commutation

- 5.1 Various restrictions on trivial pension commutation are imposed by HMRC. HSC should ensure that the payment of a lump sum in lieu of a small pension is compliant with these as well as with the HSCPS regulations.

- 5.2 The lump sum payable in respect of commutation of a trivial pension (in addition to any other lump sum due) should be determined as follows:

Total annual pension amount x factor (from TRIV1 for 1995 Section members and TRIV2 for 2008 Section members)

- 5.3 The 'Total annual pension amount' is the annual pension that would otherwise be put into payment if trivial commutation were not to proceed. Therefore, this pension is the pension after any reduction due to Scheme Pays⁶ or due to commutation for tax free cash if relevant. Any automatic tax free cash (SR 1995/95 17) taken would be payable in addition to the lump sum calculated above. Total benefits must be considered when assessing whether trivial commutation may be allowed under HMRC limits. Different limits apply depending on whether just HSCPS benefits are considered or whether pensions savings from all sources are taken into consideration.
- 5.4 The 'factor' should be determined from the Tables in Appendix B as applicable for the member's age (age attained in complete years), Section (1995 or 2008) and status at the date of commutation. Status refers to either 'former contributing member' or 'dependant'.
- 5.5 For 'former contributing members' it is assumed that trivial commutation is in lieu of retirement, that is, that the member's pension has not come into payment. By electing for commutation the right to contingent benefit following the member's death lapses.

⁶ Although unlikely in trivial commutation cases, if a member has previously elected for Scheme Pays a benefit reduction is due on retirement.



6 Inverse Commutation

- 6.1 Various restrictions on lump sum payments are imposed by HMRC. Prior to 5 April 2011, lump sum payments to members over age 75 were deemed unauthorised under the Finance Act 2004. From 5 April 2011, HMRC no longer classes such payments as unauthorised.
- 6.2 Regulation 17(8) of SR 1995/95, however, states that members who reached age 75 before 5 April 2011 cannot take their lump sum and must convert it into additional pension. In practice, for those members in NHS employment, a pension and lump sum automatically go into payment at age 75, regardless of whether the member continues in employment. This regulation therefore only applies to deferred members who meet the age criterion and whose benefits have not yet been put into payment. In reality, the number of these types of 'lost' deferred members is likely to be very small.

- 6.3 The annual pension amount payable in respect of conversion of a lump sum (in addition to any other pension in payment) should be determined as follows:

$$\text{Pension} = \text{Lump sum amount} / \text{Factor}$$

- 6.4 The 'Lump sum amount' is the amount that would otherwise be payable to the member if Regulation 17(8) did not apply.
- 6.5 The 'Factor' should be taken from the table in Appendix C as applicable for the member's age (last birthday).
- 6.6 The factors are based on a single life pension (with no guarantee period). This means there will be no adjustment required to any dependants' benefits payable following the member's death.



7 Examples

- 7.1 This Section sets out a number of worked examples to help illustrate the types of commutation covered in sections 2 – 6.
- 7.2 Except as regards the commutation of trivial pensions, commutation does not affect the amount of the survivor's pension. That is, only the member's pension is commuted. (When a member's trivial pension is commuted the survivor's pension is also extinguished.)

Examples for Section 2 – General commutation option

- 7.3 These examples show how the standard £12: £1 pa factors should be applied on retirement.

A. Normal retirement

Section	= 1995 Section
Age at retirement	= 60
NPA	= 60
Accrued pension at retirement	= £10,000 pa
Accrued retirement lump sum	= £30,000
Accrued survivor's pension	= £5,000 pa
Additional lump sum required	= £12,000
Residual pension	= £10,000 - (£12,000 ÷ 12) = £9,000 pa
Total lump sum	= £30,000 + £12,000 = £42,000
Survivor's pension	= £5,000 pa

B. Early retirement

Section	= 1995 Section
Age at retirement	= 56 years
NPA	= 60
Accrued pension at retirement	= £22,000 pa
Accrued retirement lump sum	= £66,000
Accrued survivor's pension	= £11,000 pa
Early retirement reduction factors at 56	Pension = 0.827 Lump sum = 0.883
Reduced pension at retirement	= £22,000 x 0.827 = £18,194 pa
Reduced retirement lump sum	= £66,000 x 0.883 = £58,278
Survivor's pension	= £11,000 pa
Additional lump sum required	= £24,000
Residual pension	= £18,194 - (£24,000 ÷ 12) = £16,194 pa



Total lump sum	= £58,278 + £24,000 = £82,278
Survivor's pension	= £11,000 pa

C. Early retirement with GMP test

Age at retirement	= 55 years
NPA	= 60
Sex	= female

Total accrued pension at retirement (before reduction)= £5,063

Total pension after application of early retirement reduction factor at 55	= £4,000
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Revalued GMP at date of retirement	= £1,800
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Early retirement pension reduction factor at 55:	= 0.790
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Additional lump sum required	= £6,000
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Step 1 – eligibility for early retirement:

Amount A = £5,063

- Apply the relevant reduction factor (ERF1 or ERF2 or $(ERF3 \div PI + 1.269)$) to the pension figure calculated in Step 1 to give amount B.

Amount B = £5,063 x 0.790 = £4,000

- Take revalued annual GMP at date of retirement and add 2.75% for each complete year and days (pro-rata) to GMP payment age (currently 60 for female)

Amount D = £1,800 x (1 + 2.75% x 5 years) = £1,800 x 1.1375 = £2,047

B is greater than D; therefore the member is eligible for early retirement aged 55.

Step 2 – scope for commutation

- Apply the commutation factor to the additional lump sum required and calculate the residual pension:

Amount C = £4,000 - (£6,000 ÷ 12) = £3,500

C is greater than D therefore commutation is allowed.



C1. Example C with different total pension

Total pension after application of early retirement reduction factor at 55 = £2,300

- *Step 1 – as above (early retirement allowed)*
- *Step 2 – scope for commutation*

Amount C = £2,300 - (£6,000 ÷ 12) = £1,800

C is less than D so commutation is restricted.

Amount of additional lump sum allowed is $12 \times (2,300 - 2,047) = £3,036$

Residual pension = £2,047 pa

HMRC limits and GMP restrictions should be tested in all cases.

Example for Section 3 – Choice Optants

D. Choice Optant with Mandatory Lump Sum

Section	= 2008 Section
Age at retirement	= 65
NPA	= 65
Total service	= 10 years
Service to 31 March 2008	= 3 years
Reckonable pay at retirement	= £50,000
Accrued pension at retirement	= £8,333 pa
Mandatory Lump sum	= (3 x service to 31 March 2008 x reckonable pay) / 80 = £5,625
Residual pension	= £8,333 - (£5,625 ÷ 12) = £7,864 pa

Examples for Section 4 – Retirement due to ill health

E. Serious ill health (not life limiting)

Member in the 2008 Section	
Age at retirement	= 55 years and 0 months
NPA	= 65
Ill-health pension at retirement	= £11,000 pa
Accrued survivor's pension	= £4,125 pa
Lump sum required	= £12,000
Residual pension	= £11,000 - (£12,000 ÷ 12) = £10,000
Lump sum	= £12,000
Survivor's pension	= £4,125 pa



F. Serious ill health (life limiting)

Member in the 1995 Section

Ill-health pension at retirement	= £25,000 pa
Ill-health lump sum	= £75,000
Survivor's pension	= £12,500 pa
Maximum additional tax-free lump sum	= £58,920
Residual pension	= £25,000 - (£58,920 ÷ 12) = £20,090 pa
Cash value of residual pension	= £20,090 x 5 = £100,450
Pension payable	= Nil
Total lump sum	= £75,000 + £58,920 + £100,450 = £234,370*
Survivor's pension	= £12,500 pa

(* of which £133,920 is tax free and £100,450 is taxable)

Examples for section 5 – Trivial commutation

G. Former contributing member

Member in the 1995 section

Date of birth:	1 September 1947
Retirement date:	1 September 2015
Total pension payable:	£500 pa
Age (complete years) on commutation date:	68
Lump sum payable:	£500 x 17.081 = £8,540.50

H. Widow (dependant)

Date of birth:	8 September 1936
Effective commutation date:	9 September 2015
Age (complete years) on commutation date:	79
Lump sum payable:	£500 x 11.111 = £5,555.50

Example for Section 6 – Inverse commutation

I. Member aged over 75

Date of birth:	8 September 1936
Effective commutation date:	9 September 2015
Total lump sum payable:	£5,000 pa
Age (complete years) on commutation date:	79
Additional pension payable:	£5,000 / 11.111 = £450.00



Appendix A: Assumptions underlying actuarially set factors

Financial assumptions

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

Mortality assumptions

Base mortality tables	S1NMA and S1NFA
Base table adjustment	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.)
Future mortality improvement	Based on ONS principal UK population projections 2012

Other assumptions

Proportion of male members for the purpose of unisexing factors	33.3% (reducing to zero for factors used to commute trivial dependant pensions)
Age difference between member and partner	Males assumed to be 3 years older than females
Proportions partnered	As assumed for the 2012 valuation
	Sample rates:

Age	Males	Females
50	0.76	0.54
60	0.76	0.54
70	0.74	0.46
80	0.61	0.23
90	0.34	0.07

Allowance for short-term spouses pensions (where relevant)	A 1.5% loading is applied to joint-life factors to allow for short-term spouses' pensions
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Appendix B: Trivial Commutation Factors

TRIV1_HSCPS_1995 Section

Age	Former contributing member	Dependant	Age	Former contributing member	Dependant
20	N/A	29.712	60	20.598	19.710
21	N/A	29.576	61	20.196	19.306
22	N/A	29.435	62	19.784	18.892
23	N/A	29.290	63	19.359	18.470
24	N/A	29.140	64	18.926	18.040
25	N/A	28.986	65	18.481	17.599
26	N/A	28.827	66	18.023	17.148
27	N/A	28.663	67	17.556	16.687
28	N/A	28.494	68	17.081	16.216
29	N/A	28.320	69	16.574	15.735
30	N/A	28.142	70	16.062	15.717
31	N/A	27.957	71	15.574	15.227
32	N/A	27.768	72	15.084	14.728
33	N/A	27.573	73	14.589	14.224
34	N/A	27.372	74	14.037	13.714
35	N/A	27.167	75	13.477	13.203
36	N/A	26.955	76	12.959	12.691
37	N/A	26.738	77	12.436	12.181
38	N/A	26.515	78	11.913	11.673
39	N/A	26.286	79	11.330	11.111
40	N/A	26.050	80	10.759	10.566
41	N/A	25.808	81	10.268	10.074
42	N/A	25.558	82	9.796	9.599
43	N/A	25.301	83	9.346	9.077
44	N/A	25.037	84	8.860	8.558
45	N/A	24.765	85	8.400	8.092
46	N/A	24.484	86	8.027	7.597
47	N/A	24.195	87	7.680	7.121
48	N/A	23.898	88	7.359	6.666
49	N/A	23.593	89	7.008	6.238
50	N/A	23.280	90	6.684	5.834
51	N/A	22.960	91	6.440	5.457
52	N/A	22.631	92	6.217	5.101
53	N/A	22.295	93	6.015	4.766
54	N/A	21.951	94	5.833	4.449
55	22.448	21.599	95	5.313	4.145
56	22.096	21.239	96	4.874	3.851
57	21.735	20.870	97	4.864	3.580
58	21.366	20.492	98	4.855	3.327
59	20.987	20.105	99	4.846	3.093
			100	4.838	2.875



TRIV2_HSCPS_2008 Section

Age	Former contributing member	Dependant	Age	Former contributing member	Dependant
20	N/A	29.712	60	20.405	19.710
21	N/A	29.576	61	20.001	19.306
22	N/A	29.435	62	19.586	18.892
23	N/A	29.290	63	19.159	18.470
24	N/A	29.140	64	18.723	18.040
25	N/A	28.986	65	18.275	17.599
26	N/A	28.827	66	17.815	17.148
27	N/A	28.663	67	17.346	16.687
28	N/A	28.494	68	16.869	16.216
29	N/A	28.320	69	16.367	15.735
30	N/A	28.142	70	15.861	15.717
31	N/A	27.957	71	15.372	15.227
32	N/A	27.768	72	14.881	14.728
33	N/A	27.573	73	14.385	14.224
34	N/A	27.372	74	13.845	13.714
35	N/A	27.167	75	13.297	13.203
36	N/A	26.955	76	12.780	12.691
37	N/A	26.738	77	12.258	12.181
38	N/A	26.515	78	11.737	11.673
39	N/A	26.286	79	11.172	11.111
40	N/A	26.050	80	10.619	10.566
41	N/A	25.808	81	10.130	10.074
42	N/A	25.558	82	9.660	9.599
43	N/A	25.301	83	9.213	9.077
44	N/A	25.037	84	8.744	8.558
45	N/A	24.765	85	8.303	8.092
46	N/A	24.484	86	7.933	7.597
47	N/A	24.195	87	7.589	7.121
48	N/A	23.898	88	7.271	6.666
49	N/A	23.593	89	6.938	6.238
50	N/A	23.280	90	6.630	5.834
51	N/A	22.960	91	6.388	5.457
52	N/A	22.631	92	6.168	5.101
53	N/A	22.295	93	5.969	4.766
54	N/A	21.951	94	5.789	4.449
55	22.271	21.599	95	5.271	4.145
56	21.915	21.239	96	4.835	3.851
57	21.551	20.870	97	4.846	3.580
58	21.179	20.492	98	4.839	3.327
59	20.798	20.105	99	4.814	3.093
			100	4.822	2.875



Appendix C: Inverse Commutation Factors

INVCOMM1_HSCPS

Age	Factor
75	13.203
76	12.691
77	12.181
78	11.673
79	11.111
80	10.566
81	10.074
82	9.599
83	9.077
84	8.558
85	8.092
86	7.597
87	7.121
88	6.666
89	6.238
90	5.834
91	5.457
92	5.101
93	4.766
94	4.449
95	4.145
96	3.851
97	3.580
98	3.327
99	3.093
100	2.875