Transfer Club and Annual Allowance – February 2015

An HMRC Order entitled "The Finance Act 2004 (Registered Pension Schemes and Annual Allowance Charge) (Amendment) Order 2015" came into effect on **28th January 2015**. The Order can be found at http://www.legislation.gov.uk/uksi/2015/80/contents/made.

Following the Order coming into effect, pension inputs arising from salary increases when a member moves between final salary schemes within the Club must take into account the value of increase in the annual pension payable due to the salary increase.

This document sets out a suggested method (which is not prescriptive) to ensure the appropriate increase in value is calculated. This approach has been agreed with HMRC, based on the information in these examples. The examples are fairly simplistic and it is likely that transfers will be more complicated in practice, as the examples seek to set out the general process and principles rather than covering all scenarios. In particular, schemes should decide on procedures for dealing with transfers where the transfer is made after service in the new scheme has commenced. In these cases the transfer may be in a different pension input period, or the member may have already received a promotion

It should be noted that the amounts shown in the examples represent the amount transferred, and are therefore after any adjustments made prior to the transfer - for example, part-year revaluation could be applied by the exporting scheme to cover the period between the previous revaluation date and when the member transfers.

Scheme managers should ensure their pension administrators are given this information, and may also wish to send it to the scheme actuary.

Final Salary schemes

When an individual takes a Club Transfer their years of service may be actuarially adjusted to reflect differences between schemes. This adjustment is not an enhancement and hence the policy intent is that this should not produce a pension input.

Separate to any actuarial adjustment, members will benefit from any salary increase between their employments. This increases the value of their pension, and the policy intent is that the value of this increase should result in a pension input, as it would do for individuals experiencing an increase in final pensionable salary without changing schemes.

The most straightforward way to deliver this outcome is for the scheme from which the member is leaving to record the closing value of the pension input period in the normal manner. The receiving scheme should enter the opening value as nil and make a deduction from the closing value (the usual process). The deduction should use the number of qualifying years at transfer (after adjustment, if relevant) and then calculate the value of the pension using the final pensionable earnings from the exporting scheme.

Please note that all the actuarial adjustments used in the worked examples below are fictitious and solely for purposes of illustration.

Worked example 1 - Simple move between final salary schemes

Alan is a member of the Principal Civil Service Scheme *classic* section (an 80ths final salary scheme with NRA of 60 and automatic lump sum of 3 times annual pension). He has final pensionable earnings of £30,000 and 10 qualifying years of service.

Alan moves to the LGPS (80ths final salary scheme with NRA of 60 and automatic lump sum of 3 times annual pension), to a post with final pensionable earnings of £40,000. No adjustment is made to his years of service.

The closing value of the *classic* pension is (10/80) * £30,000=£3,750 multiplied by the Annual Allowance factor of 16 to give £60,000 and adding on the lump sum (3*£3,750) to give a total closing value of £71,250.

The opening value of the LGPS pension is nil, regardless of the date within the pension input period when the transfer takes place.

The closing value (assuming 1 additional qualifying year and no change in final pensionable salary) is (11/80) * £40,000=£5,500 multiplied by the Annual Allowance factor of 16 to give £88,000 and adding on the lump sum (3*£5,500) to give a total closing value of £104,500.

From the closing value is deducted (10/80) * £30,000=£3,750 multiplied by the Annual Allowance factor of 16 to give £60,000 and adding on the lump sum (3*£3,750) to give a total of £71,250.

Thus the change in the value of the pension is closing value (£104,500) less deduction (£71,250) less opening value adjusted for price growth (£0) for a total input of £33,250.

Worked example 2 – move between final salary schemes with adjustment for different NRA

Charlie is a member of the Principal Civil Service Scheme *premium* section (a 60ths final salary scheme with NRA of 60 and no automatic lump sum). He has final pensionable earnings of £30,000 and 10 qualifying years of service.

Charlie moves to the LGPS (a 60ths final salary scheme with NRA of 65 and no automatic lump sum), to a post with final pensionable earnings of £40,000. His service is enhanced by 30% (on an actuarially neutral basis) to reflect differences between the schemes, including a higher Normal Retirement Age in the LGPS.

The closing value of the *premium* pension is (10/60) * £30,000=£5,000 multiplied by the Annual Allowance factor of 16 to give £80,000 which is the closing value as there is no lump sum.

The opening value of the LGPS pension is nil.

The closing value (assuming 1 additional qualifying year and no change in final pensionable salary) is (14/60) * £40,000=£9,333.33 multiplied by the Annual Allowance factor of 16 to give £149,333.31. The 14 qualifying years are composed of 10 years transferred in with a 3 year actuarial increase and a further qualifying year.

From the closing value is deducted (13/60) * £30,000=£6,500 multiplied by the Annual Allowance factor of 16 to give £104,000.

Thus the change in the value of the pension is closing value (£149,333.31) less deduction (£104,000) less opening value adjusted for price growth (£0) for a total input of £45,333.31.

Career Average Schemes (LGPS 2014 scheme and other post 2015 schemes)

The Club CARE transferred-in pension is essentially the deferred pension from the sending scheme, adjusted as necessary to reflect any differences in the basic benefit structure between the two schemes (e.g. if the spouse/partner's pension proportion is different in the receiving scheme, this will affect the transferred-in pension).

For members taking a Club Transfer of career average benefits, the annual value of the benefit transferred (after any adjustment) will be ring-fenced within the receiving scheme and receive revaluation equal to what would have been received in the previous scheme for as long as the member remains active (but in all other regards the pension is under the rules of the new scheme, not the previous scheme).

A member's annual pension may be actuarially adjusted to reflect differences between schemes. This adjustment is not an enhancement and hence the policy intent is that this should not produce a pension input.

Unlike with final salary schemes, members will not benefit from any salary increase between their employments. Similar to the treatment for final salary schemes, the opening value for Career Average scheme transfers will be nil, and the deduction from the closing value is the value of the pension transferred in.

However, where there is a gap between employments, members may benefit from enhanced revaluation being applied on re-employment to cover the period of the break in employment. This type of increase should be recorded as a pension input.

Worked example 3 – move between CARE schemes with no break in service

Dave is a member of the 2015 NHS *scheme* (a CARE scheme, with revaluation of CPI+1.5% for active members). He has an NHS career average annual pension of £5,000.

Dave moves to the Civil Service alpha scheme. The annual pension is enhanced by 3% to reflect differences between the schemes, on an actuarially neutral basis.

The closing value of the NHS pension is £5,000 multiplied by the Annual Allowance factor of 16, giving a total closing value of £80,000

The annual pension is enhanced by 3%, so becomes £5,150.

The opening value of the Civil Service pension is nil.

Dave accrues a further £500 of annual pension during the pension input period.

The closing value is £5,650 multiplied by the Annual Allowance factor of 16, giving a closing value of £90,400. Note that this assumes no revaluation has been applied before the pension input closes – if revaluation has been applied during the pension input period this would be counted within the closing value.

From the closing value is deducted £5,150 (no inflation or revaluation adjustment is included) multiplied by the Annual Allowance factor of 16, giving a deduction of £82,400

Thus the change in the value of the pension is closing value (£90,400) less deduction (£82,400) less opening value adjusted for price growth (£0) for a total input of £8,000.

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Worked example 4 – move between CARE schemes with break in service

Ed is a member of the 2015 NHS *scheme* (a CARE scheme, with revaluation of CPI + 1.5% for active members). He has an NHS career average annual pension of £5,000 when he leaves NHS employment.

Ed moves to the Civil Service alpha scheme after a break in employment of 3 years. The sending Club member applies revaluation to the date of transfer. Assume inflation is 2%. The closing value of the NHS pension is £5,000 * 3.5% * 3.5% * 3.5% = £5,543.59 multiplied by the Annual Allowance factor of 16, giving a total closing value of £88,697.43. Note that the pension input arising from the application of the active-member revaluation over the three year break in service will be applied only to the final input period in the NHS scheme, it is not spread across the 3 years of the gap in employment[1].

The opening value of the Civil Service pension is nil.

Ed accrues a further £500 of annual pension during the pension input period. Immediately prior to the end of the pension input period revaluation is applied. The transferred-in NHS service is revalued by 3.5%, so that becomes £5737.62 and the £500 of newly accrued pension is increased by 2% and becomes £510.

The closing value is (£5,737.62 + £510) = £6,247.62 multiplied by the Annual Allowance factor of 16, giving a closing value of £99,961.85.

From the closing value is deducted £5,543.59 (without any revaluation or price adjustment) multiplied by the Annual Allowance factor of 16, giving a deduction of £88,697.44.

Thus the change in the value of the pension is closing value (£99,961.85) less deduction (£88,697.44) less opening value adjusted for price growth (£0) for a total input of £11,264.41.

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[1] Before the member re-joined, their pension would increase by CPI during the break in service. When the member re-joins, the revaluation covering the break in service changes from CPI (deferred members) to CPI + 1.5% (active members). The final pension input period should have a starting pension value based on CPI revaluation applied to deferred members for the break of service (and for the avoidance of doubt, the normal adjustment for inflation applied under the HMRC pension input calculation methodology applies), and a closing value reflecting CPI + 1.5% should be applied for the break in service.