Guidance to police authorities on preparation for the New Police Pension Scheme and on preparation for A-Day in relation to the Police Pension Scheme

Police Human Resources Unit
Home Office
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1. Introduction

1.1 "A-Day", 6 April 2006, will introduce the new "simplified" tax treatment of pensions. From that date, pension schemes will not be "approved" but "registered". (Existing schemes such as the Police Pension Scheme will be deemed to have registered automatically). HM Revenue and Customs (HMRC) are issuing guidance on the impact of tax simplification in the form of a Registered Pension Schemes Manual which is available only on their website at http://www.hmrc.gov.uk/manuals/rpsmmanual/index.htm. As at October 2005 some parts of this manual are still under development. An extract from part of the Administrator Pages, which is relevant to pensions administrators, is reproduced in Annex 2 to this leaflet. There are also Member Pages, which are targeted at individual pension scheme members. Whilst these are quite complex it is possible that individual police officers might refer to them and ask questions about them.

1.2 For police authorities an additional issue is the introduction, on the same day, of the New Police Pension Scheme.

1.3 This note aims to explain briefly the main implications to police authorities for preparation for the two changes. It covers both the New Police Pension Scheme (NPPS) and the implications for the current Police Pension Scheme. A summary of suggested action points is given in Section 6.

1.4 A separate note will be issued on the "Police Pension Scheme – impact of A-Day on high earners" which will give more detail of the tax protection arrangements.

2. The New Police Pension Scheme (NPPS)

2.1 The New Police Pension Scheme comes into effect from 6 April 2006 for all newly-appointed officers. Existing officers who are members of the Police Pension Scheme will also have an opportunity to transfer their benefits to the new scheme if they wish. In common with practice in other public service schemes, officers will be given a single opportunity to make the change – in the form of a service-wide "options exercise". The advantage of this approach is that it ensures as far as is possible that those who really want to join the new scheme will do so as early as possible, since it prevents officers from putting off the decision to the eventual detriment of either themselves or their surviving dependants.

2.2 Whilst few serving officers are likely to decide to transfer to the new scheme, it is important that sufficient information is available for all to allow them to make an informed choice. It is likely that the number of enquiries about the new scheme will rise as its introduction approaches. Forces will need to plan for the extra volume of calls that their pensions administrators could receive. After discussion with forces it is considered preferable for each force to handle calls in such a way as to record and follow them up as necessary. The key message will be for the officer to wait for his or her individual option pack to arrive (in Autumn 2006) before coming to a decision.

2.3 All staff handling calls about the new scheme should be provide with the briefing pack from the Home Office in the form of the draft Members' Guide to NPPS, Frequently Asked Questions, an "At a glance" guide to the NPPS and a summary of the differences between the two schemes. This briefing pack is being issued to police authorities in October 2005. Questions which cannot be answered by reference to the pack should be referred to the force pensions administrator in the first instance, who will where necessary check with the Home Office for further advice.

2.4 The options exercise is unlikely to take place before the autumn of 2006. The Home Office, after consultation with the PNB, will issue the model for a standardised options pack to be issued to all members of the Police Pension Scheme, consisting of at least the following:

- A summary of the benefits provided by the two schemes, so that they can be compared;
- A decision-making guide, which provides an opportunity for officers to identify what they most want from their pension and helps them to identify the option they should consider further;
- A statement for each officer of their personal entitlement to benefits under the current scheme and what they would receive if they transferred the whole of their benefits to the new scheme – again, set out in a national standard format;
- An options declaration signed by the officer recording his or her decision on whether or not to join the new scheme. Officers will be given three months in which to make their decision.

2.5 At a suitable time before the options exercise – probably about three months before – each force will need to ask each officer to check (and sign in confirmation) the details on which the statement of his or her personal entitlements is to be based. Such a data cleansing exercise is beneficial in itself and will have to be undertaken at some stage in any event.

2.6 Draft versions of the Members' Guide, "At a glance" guide, summary of differences and FAQs are being made available to police authorities in October 2005 with this guidance. Some detailed aspects of the new scheme and of the new Police Pensions Regulations are still to be settled, although the main aspects of the new scheme have been agreed. The drafts are being issued early to help pensions administrators prepare for the introduction of the new scheme and to see what information will be available for members. The drafts should be regarded as provisional and should not be issued to officers at this stage. It is planned that a final version of the Members' Guide should be ready for issue in December 2005.

2.7 New or modified computer software will need to be introduced to administer the new scheme and to provide information for the production of the individual option packs for issue to officers. It is not essential for this to be implemented by April 2006, as initial take-up is likely to be slow, but it will need to be operational before the end of 2006/07.

2.8 A new feature of the new scheme is pensions for unmarried partners. A pension cannot be paid to such a partner unless all of the appropriate documentation has been completed, including the initial declaration of partnership form. A supply of declaration forms must be available by A-Day for issue to any NPPS members – it would be sensible to include one in the joiner pack. The Home Office is producing a model form which all police forces should use. It is the officer's responsibility to keep any declaration up-to-date but a system of periodic (perhaps annual) reminders would be advisable.

2.9 The introduction of two-tier ill-health pensions brings will require adjustments to the current ill-health retirement procedures and full guidance will be made available as soon as possible after April 2006.

2.10 The final position on provision for an AVC arrangement in the new scheme is yet to be agreed. Such an arrangement is no longer obligatory for registered pension schemes and the desirability of AVC arrangements within new public sector schemes is under review. Police authorities should note that they do not need to plan for new AVC arrangements for the time being. Members of the current scheme who transfer to the new scheme will be able to keep their AVC arrangements.

2.11 The regulations for the new scheme will not be made before January 2006 and some changes will be made from drafts which have been released for consultation. It follows that any guidance provided prior to finalisation of the regulations can only be provisional and must be emphasised as such.

2.11 There will be separate regulations to cover transitional arrangements (including arrangements for transferring from the current Police Pension Scheme to NPPS) and it is planned to make these regulations, with associated Home Office guidance, in February 2006. There will also be regulations making a number of changes to the current scheme. Injury awards will be separate from both the current and new pension schemes and will have their own regulations by April 2006

3. Changes to the taxation system

3.1 The principal changes to the taxation system for occupational pensions are:

- the removal of the limit on maximum pensionable pay (currently applying to post-May 1989 joiners) [this is £105,600 in 2005/06]
- the introduction of a lifetime limit on tax-privileged pension saving [of £1.5m for 2006/07]
- the removal of the present 15% limit on employee contributions – tax-free pension contributions can now be made up to the total taxable earnings of an

individual in a tax year, subject to limitations deriving from an annual allowance
- the introduction of an annual allowance for tax-privileged pension saving [£215,000 in 2006/07] which includes the increase in value of "final salary" pensions and contributions to money purchase pension schemes.

3.2 This new tax regime will apply to both the Police Pension Scheme and the New Police Pension Scheme, but the changes are unlikely to affect many officers in the Police Pension Scheme.

3.3 The removal of the limit on pensionable pay should not have much effect on the Police Pension Scheme since there are as yet few very high-earning officers who joined the Police Pension Scheme after May 1989. Regulation G1(1A) of the Police Pensions Regulations 1987 limits pensionable pay to the permitted maximum under the Income and Corporation Taxes Act 1988, but it is planned to amend the regulations to remove this limit prior to A-Day. In consequence, the entire pay of senior officers will remain pensionable and their pension benefits will be based on the whole of their pay. Pension contributions will also continue to be payable on the whole of the pensionable pay.

3.4 It is likely that only very senior officers will have accrued pension benefits in the Police Pension Scheme above the lifetime limit on A-Day, and these should be easy for police authorities to identify. For active members, the lifetime limit is calculated by multiplying the value of the pension at A-Day by 20, and few officers will have accrued pension benefits of £75,000 p.a. For the majority of forces it will only be the Chief Constable who is likely to be affected. It is of course possible for officers to hold pension rights outside the police scheme (which will also count towards the lifetime allowance) and police authorities will not be aware of these. Police authorities should therefore take positive steps to identify officers whose police pension benefits at 5 April 2006 will be above the standard lifetime allowance of £1.5m, inform them of the total accrued value and that they have three years from A-Day to take any action to protect their pre A-Day rights.

3.5 Whilst only a very few officers are likely to be affected by the lifetime limit, it is possible that others will want to check their position and police authorities will need to be able to provide information, on request, to allow them to do this. Authorities may be asked to provide:

- a valuation of pension benefits already in payment ["crystallised rights"] on 5 April 2006
- a valuation of pension benefits accrued, but not in payment ["uncrystallised rights"] on 5 April 2006

3.6 Any officer who does request this information should be reminded that if he or she has other pension rights outside the police scheme then he or she needs to add the value of these to that of his or her police pension when comparing against the lifetime allowance.

3.7 There are two methods of protecting pension rights at A-Day for which individuals can register with HMRC. “Primary protection” protects the value of pre A-Day pension rights and benefits in excess of £1.5m. “Enhanced protection” exempts benefit payments made after A-Day from a tax charge but is, in broad terms, only appropriate to individuals who cease to build up further pension benefits after A-Day.

3.8 Whatever arrangements are to be made specifically for high earners, there are no plans to require officers to opt out of the Police Pension Scheme before they breach the life-time limit. Forces should therefore prepare for the need to comply with HMRC requirements as to the payment of the recovery charge etc.

3.9 Police authorities should **not** attempt to advise police officers whether or not it is their interests to register for either form of protection but they should make them aware of the changes and make it clear to them that they are responsible for seeking advice and for taking any necessary action themselves. The Home Office will provide, in Autumn 2005, a model letter for forces to use which should be issued to all ACPO-rank officers. The model letter will include guidance for scheme members on how to calculate whether they may need to register. The Home Office plans to supplement this guidance by providing a spreadsheet to police authorities which may be used to calculate the value of an individual officer’s police pension rights at 5 April 2005.

3.10 It is also possible to protect pension credit rights (arising from divorce proceedings) at 5 April 2006. This is unlikely to be of benefit to many officers as it is only of value if the officer’s pension rights are below the standard lifetime allowance at A-Day but he or she expects them to have increased to more than the standard lifetime allowance when he or she retires.

3.11 At present, the Police Pensions (Additional Voluntary Contributions) Regulations 1991, reg 8(4) and the Police Pensions (Purchase of Increased Benefits) Regulations 1987, reg 5(5), limit an officer’s total pension contributions to 15% of his or her pay. Whilst the tax simplification legislation offers the opportunity to increase or remove these limits, there are no plans to do this. From A-Day, individual officers will be free to make other pension arrangements outside the NPPS, but this is not a matter for the police authority to become involved in or to advise about.

3.12 For police pensions, the annual allowance should only impact in very few cases. The annual allowance is measured against 10 times the increase in the officer’s pension entitlement in the year. It is possible that an officer’s pension entitlement might increase by more than £21,500 in a year if he or she obtains a major promotion or if there were to be a very large police pay award (e.g. if his or her salary was to increase by £32,250 and he or she had accrued 40 years’ pensionable service, his or her annual pension rights would increase by £32,250 x 40/60 = £21,500). The allowance does not apply in the year that benefits are paid, so there is no problem about enhancing pension benefits for ill-health retirement. A tax charge could arise if an officer plans to make a large pension contribution to a money purchase scheme in the same year that his or her police pension rights have a large increase in value, if the money purchase contribution plus the increase in value amounts to more than the annual allowance for the year.

3.13 One consequence of the tax simplification measures is that it will no longer be possible for police authorities to decide unileterally to pay very small pensions as a lump sum. Pension payments must be made at least annually. The pensioner will have the right to request commutation of small pensions (subject to conditions).

3.14 From A-Day it will be possible (subject to an amendment to the Police Pensions Regulations at an appropriate time) for a lump sum to be taken from AVC funds, of up to 25% of the fund value. There has been some further suggestion in the pensions press that as the Revenue is to apply the 25% lump sum test to the whole of a pension scheme's benefits, it might become possible to take the whole of an AVC fund as a lump sum and the whole of a defined benefit pension as a pension; however, indications from the Treasury are that this increased latitude is unlikely to be made available to public sector pension schemes.

3.15 Police authorities should be aware that there will be a need to devise some new procedures for administering pensions post A-Day, for example:

- applying a tax charge to any pension benefits paid over the lifetime allowance for any reason (this is likely to result in a reduction to the pension payments to the member, and will require an amendment to the Police Pensions regulations)
- calculating "relevant benefit accrual" for individual members
- complying with the HMRC provision of information requirements (see Section 5 below).

4. General

4.1 With all of the recent media interest in pension reform, it is possible, despite all our efforts, that some officers will mistakenly assume that major changes are about to be imposed on the current Police Pension Scheme. This is not the case and police authorities might wish to consider giving reassurances at an appropriate time (e.g. when the Pensions Commission issues its second report, which is due for release by 30 November 2005). In particular, the right of members of the Police Pension Scheme to retire with an ordinary pension after 25 years, as they can do now, is not affected. Changes which are envisaged to the current scheme are:

- the introduction of "widows'" pensions and pension sharing for registered civil partners, following the introduction of the Civil Partnership Act [providing for the official registration of same-sex partnerships] in December 2005

- the need to review current compulsory retirement ages set out in regulation A18 of the Police Pensions Regulations, since they will need to be objectively justified under new age discrimination legislation due to come into force in October 2006.
- after A-Day, any short service or ill-health gratuity will be limited to the officer's aggregate pension contributions (as a "short service refund lump sum" under Finance Act 2004 s166)
- from April 2006 officers re-joining the force under the 30+ scheme will need to be aged 50 or above since those taking advantage of a protected pension age cannot continue working for the same employer while still under 50 after starting to draw benefits. (From 2010 the same will apply for officers under age 55)
- from April 2006 officers taking advantage of a protected pension age will have to take any AVC benefits on the same day as the main police pension benefits are taken
- a change to the deferred pension age from 60 to 65 at some point in the future (for accruals from then on) is still subject to the outcome of the wider issue of introducing 65 as a new public service pension age.

Note- as part of the changes to accommodate civil partnerships in the current Police Pensions Regulations the Home Office will propose to make widows' and children's pensions payable after two years' qualifying service (rather than 3 years' pensionable service)

4.2 Officers who are concerned about breaching the new lifetime limit may consider opting out of the scheme (and possibly rejoining later). It would be good practice for police authorities to inform officers who have asked to opt out how their pension benefits will be affected, if this has not already been done.

5. Administrative issues

5.1 The introduction of the new tax regime brings with it significant changes in reporting requirements to the Revenue. All registered pension schemes must have a "scheme administrator" who has responsibility for all tax charges, interest and penalties and for filing reports. All registered pension schemes will be required to file pension tax forms and information online as well as to make payments electronically.

5.2 For a central scheme which is administered locally (e.g. both the Police Pension Scheme and the NPPS) it is not yet confirmed who should be the scheme administrator. The original policy intention was that it would be the Treasurer to the Police Authority, but it is possible that police authorities themselves, as corporate bodies, will become scheme administrators. Some of the duties of scheme administrators may be delegated to "practitioners"

5.3 The sections of the Registered Pension Schemes Manual which deal with administration are (as at October 2005) still under development. Draft regulations (The Registered Pension Schemes (Provision of Information) Regulations 2005) are available on the HMRC website. These list, among other things, reportable events and information to be provided to members. Reportable events include:

- payments exceeding 50% of the standard lifetime allowance
- suspension of an ill-health pension
- benefit crystallisation events (i.e. payments of pension benefits) which exceed the standard lifetime allowance where the member has registered for primary or enhanced protection
- pension commencement lump sums exceeding 7.5% of the standard lifetime allowance (e.g. exceeding £112,500 in 2006/07)
- transfers to qualifying recognised overseas pension schemes
- changes in the number of scheme members (only between four very wide bands)

5.4 Scheme members who are entitled to an enhanced lifetime allowance (e.g. due to primary protection or to pension credit rights [arising from divorce proceedings] held at 5 April 2006) or to enhanced protection must inform their scheme administrator. The scheme administrator must provide to each retiring member within three months of retirement, and to each pensioner annually, a statement showing the value of any benefit crystallisation events in the year [i.e. the value of any new pension benefits paid] and the previously used amount of the lifetime allowance.

5.4 Some draft forms are also currently available on the HMRC website – the four main ones (which must all be submitted online) for scheme administrators are:

- Registration of a Pension Scheme [it remains to be determined whether every police authority will need to complete a form for the New Police Pension Scheme}
- Event Report [the onus is on the scheme to initiate a report, which is made after the end of the year in which the event occurs]
- Accounting for Tax Return [to be returned quarterly within 45 days of the end of each quarter]
- Registered Pension Scheme Return [annual return, due by 31 January after the end of the tax year; HMRC have suggested that not every scheme will be asked to make a return each year]

5.5 Reference should be made to the HMRC website for additional and updated information.

5.6 New arrangements will be put in place for the financing of the new police pension scheme. This is outside the scope of this paper.

6. Summary of actions

6.1 The **Home Office** will:

- In October 2005 issue draft NPPS Members' Guide, FAQs, "At a glance guide" and summary of differences between the two schemes available to Police Authorities.

- As soon as possible follow this up with final versions of the above (dependant upon final agreement of draft NPPS Regulations in December 2005)

- By November 2005 issue guidance, model letter and spreadsheet calculator on high earners to Police Authorities.

- By November 2005 issue draft guidance and forms for partner pensions, with final versions available as soon as possible thereafter

- In early 2006 issue guidance to police authorities on how to conduct the options exercise

- In early 2006 issue further guidance or FAQs, as necessary, to police authorities

- By February 2006 issue guidance on transitional Regulations to police authorities

- By March 2006 issue guidance on ill-health retirement under NPPS

- By April 2006 issue full commentary on NPPS Regulations by April 2006

6.2 **Forces and pensions administrators** should (timings are in some cases dependant upon Home Office guidance and are to be agreed):

- From October 2005 make available draft NPPS Members' Guide, FAQs, "At a glance guide" and summary of differences between the two schemes to administrative staff who may be required to answer queries from officers about the new scheme.

- Provide reassurance where necessary to current Police Pension Scheme members that their scheme will remain largely unaffected.

- Provide information on the implications of opting out of the pension scheme to any officer who requests it.

- Implement new computer software to administer NPPS, before the end of 2006.

- Identify any officers who joined the pension scheme after 1989 and whose pensionable earnings exceed £105,600 – following amendment to the regulations to remove the earnings cap, their Police Pension Scheme benefits will now improve but their contributions will increase.

- Advise all Superintendents and above about the ability to register for primary and enhanced protection.

- Introduce new medical procedures for the determination of medical questions in NPPS with FMAs/SMPs, before April 2006.

- Identify officers whose benefits in the Police Pension Scheme are above the new lifetime limit at A-Day, and contact them stating this and saying that they have a period of three years in which to decide to take any action to protect their benefits.

- Put system in place to calculate the value of accrued pension rights ("uncrystallised benefits") at 5 April 2006 for individual officers.

- Put system in place to identify officers whose police pension benefits increase by more than £21,500 pa (other than in the year of their retirement).

- Ensure that small pensions are paid at least annually after 6 April 2006 unless the pensioner requests commutation to a lump sum.

- Produce statements of pension data (e.g. date of joining, period of membership, total pensionable service, current pensionable pay, and possibly current marital status if this information is maintained) for all active members of the Police Pension Scheme so that they may be checked and, if necessary, amended by July 2006 (timing to be agreed).

- Starting in October 2006 (to be agreed) carry out options exercise for all officers who are members of current scheme, giving them the opportunity to express wish to join the new scheme. [This will involve providing statements of comparative benefits under current and new pension schemes for all existing members of the Police Pension Scheme and collecting their signed option forms].

- Review HMRC draft provision of information requirements and draft forms, and set up procedures to provide the information required.

7. Feedback

7.1 The Home Office would welcome any further feedback from police authorities on this guidance. In particular, if police authorities feel that there are important issues which are omitted from this paper on which they feel that central guidance would be of value, details should be given to the Home Office who will then aim to cover the gaps through issuing future guidance where possible.

7.2 Feedback (by email please) should be sent to Ian Moir in the Police Pensions Section, Police Human Resources Unit, email iancharles.moir@homeoffice.gsi.gov.uk.

Annex 1

Summary of key dates

June 2005	*Close of consultation period on pension finance reform*
July 2005	
Aug 2005	
Sept 2005	Production of example of final layout of draft Members' Guide
Oct 2005	Closure of consultation period on draft pensions regulations Blueprint of transitional issues made available Issue of draft NPPS Members' Guide, "At a glance guide" and FAQs to police authorities Issue of Home Office draft guidance on preparation for A-Day and the impact on high earners Issue of PNB guidance to FMAs/SMPs on two-tier ill-health retirement
Nov 2005	
Dec 2005	
Jan 2006	New Police Pension Scheme regulations laid before Parliament
Feb 2006	New Police Pension Scheme transitional regulations laid before Parliament
March 2006	
April 2006	Implementation of New Police Pension Scheme Issue of Commentary to police authorities on New Police Pension Scheme *Implementation of new pension financing arrangements*
May 2006	
June 2006	
July 2006	
Aug 2006	
Sept 2006	
Oct 2006	Commencement of options exercise

Annex 2

Extracts from HMRC Registered Pension Schemes Manual information

This is for information only. The up-to-date text of the manual is available online at the HMRC website and reference must be made to this before acting on any of the guidance in the manual

Protecting pension rights from tax charges - The scheme's role

An individual may want to protect their existing pension and lump sum rights as they stood on 5 April 2006 from the **lifetime allowance charge**. If they do the responsibility for notifying HMRC rests with the member of the scheme. The member may approach the scheme for information to help them establish whether tax charges may affect them.

The member may need

- a valuation of his or her **uncrystallised pension** rights in the scheme as at 5 April 2006
- the value of his or her lump sum rights as at 5 April 2006
- the annual income from any pension in payment under the scheme on 5 April 2006
- [the maximum income that could be drawn from a drawdown arrangement in the year 2005-2006]
- the annual income of any annuity purchased from an approved pension scheme in the year 2005-2006.

What pension rights can be protected?

An individual can protect certain pension rights which they had before the tax system for pension schemes changed on 6 April 2006. These pension rights are the total of

- **crystallised** pension rights from **relevant existing pensions** and
- **uncrystallised** pension and lump sum rights from **relevant pension arrangements**

taken at their values on 5 April 2006.

Crystallised pension rights do not include lump sums taken before 6 April 2006.

Relevant existing pension … does not include a pension in payment that became payable on the death of another individual.

Uncrystallised pension rights include a right to a separately calculated tax-free lump sum. A separately calculated lump sum usually occurs in public sector schemes.

How are rights valued?
Have benefits crystallised?

Where a member has received a lump sum or has a pension in payment, benefits have already **crystallised**. Benefits are **uncrystallised** where the individual has a right to benefits, but they are not yet in payment. But note that where pension is to be paid in arrears, for example annually, benefits have crystallised at the start of the arrears period even if the first payment has not yet been made.

Valuing crystallised rights at 5 April 2006

The value of a member's crystallised pension rights is the total of the values of all **relevant existing pensions** in payment at 5 April 2006.

The value of each pension is 25 times the annual rate of the relevant existing pension in payment at 5 April 2006.

This factor of 25 takes into account that a tax-free lump sum was probably paid when the pension originally came into payment. So no further figure needs to be included in respect of any tax-free lump sum actually paid. The tax-free lump sum element is deemed to be 25% of the value of the pension rights.

Example

Pension in payment at 5 April 2006	£10,000 a year
25 x £10,000 =	£250,000
£250,000 x 25% =	£62,500

Pre-6 April 2006 tax-free lump sums for future **pension commencement lump sums** taken to be £62,500 irrespective of the amount of lump sum actually paid before 6 April 2006.

Valuing uncrystallised rights - defined benefit arrangements

The value of the pension rights is 20 times the annual pension (before commutation) which the member would have been entitled to receive had they acquired the right to payment on 5 April 2006.

Where an individual has the right to a separate lump sum (typically in a public sector scheme) then the value of the individual’s pension rights will be the total of two figures

- the annual rate of pension multiplied by 20, and
- the tax-free lump sum due without commutation

The valuation should be carried out assuming that

- the individual has reached the age on 5 April 2006 where no actuarial reduction on account of the immediate early payment would be applied as set out in the terms of the arrangement as they stood on 10 December 2003. If no age was specified in the terms of the arrangement as they stood on 10 December 2003 and an actuarial reduction would be applied because of the individual's present age the individual will be assumed to have reached aged 60 on 5 April 2006.
- the individual is deemed to be in good physical and mental health on 5 April 2006.