Pensions Ombudsman Service

Ombudsman's Determination

Applicant	Mr H
Scheme	Local Government Pension Scheme
Respondents	Strathclyde Pension Fund Office

Outcome

1. I do not uphold Mr H's complaint and no further action is required by Strathclyde Pension Fund.

2. My reasons for reaching this decision are explained in more detail below.

Complaint summary

3. Mr H has complained that the Strathclyde Pension Fund have not allowed him to take his entire additional voluntary contributions fund (**AVC fund**) with the Scheme, as a lump sum.

Background information, including submissions from the parties

4. Mr H was employed by South Lanarkshire Council until October 2013, during which time he contributed to the Scheme's AVC fund set up with the Prudential Insurance Company. Mr H wished to begin drawing his pension in May 2015, having passed his normal retirement date on 5 August 2014. He requested that he be able to take his entire AVC fund as a lump sum payment, with the first 25% being tax free in line with the pension's freedoms announced in the April 2014 budget. Mr H's total AVC fund value was £30,561.80.

5. Mr H joined the Scheme when The Local Government Pension Scheme (Scotland) Regulations 1998 (**the 1998 Regulations**), were in force. Under the 1998 Regulations Mr H accrued a retirement grant of £8,681.46 and an annual pension.

6. The 1998 Regulations were subsequently revoked by The Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008 (**the Transitional Provisions**). The Transitional provisions set out the following:

"**3 Membership accrued before 1st April 2009: active members**

(1) This regulation applies to a person who was an active member of the 1998 Scheme and becomes a member of the Scheme by virtue of regulation 3(2) (active members) of the Benefits Regulations.

(2) Notwithstanding the revocations effected by regulation 2, the regulations listed in Schedule 1 continue to have effect so far as is necessary so that -

(a) the member's total membership accrued in the 1998 Scheme in respect of, or calculated by reference to, the member's service before 1st April 2009, and the pension rights accrued at that date, are preserved…"

7. Mr H's pension is now governed by The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 (**the Regulations**). The Regulations set out the following:

15. **Elections to pay AVCs (Regulation 15)**

…

(2) Where a member chooses to take some or all of the benefits referred to in paragraph (1) in the form of a lump sum, that sum forms part of the total amount referred to in regulation 21(2) (election for lump sum in lieu of pension).

….

21. Election for lump sum in lieu of pension (Regulation 21)

(1) A member in respect of whom a benefit crystallisation event within the meaning of Chapter 5 of Part IV of the Finance Act 2004 occurs on or after 1st April 2009 may choose in writing to the appropriate administering authority before any benefits become payable to commute the member's pension, or a part thereof, at a rate of £12 for every £1 of annual pension entitlement surrendered.

(2) But the total amount of the member's commuted sum, including any sum received as benefits provided in the form of a lump sum in accordance with regulation 15 (elections to pay AVCs) shall not exceed 25% of the capital value of the member's accrued rights.

(3) For the purposes of this regulation, a member's accrued rights include rights accrued in respect of any payments made by or for the member in accordance with the 1998 Regulations.

(4)The capital value of a member's accrued rights shall be calculated in accordance with guidance issued by the scheme actuary

8. Strathclyde Pension Fund has said that under Regulation 21, Mr H would not be able to take his entire AVC fund as a lump sum. The capital value of Mr H's pension fund is £134,835.64; therefore he could take up to £33,708.91 (25%) of his benefits as a tax free lump sum. As Mr H was receiving a retirement grant of £8,681.46 under the 1998 Regulations, he could only take £25,027.45 of his AVC fund as a lump sum payment, as this amounted to £33,708.91. The residual amount of £5,534.35 left in Mr H's AVC fund must be taken in the form of an annual pension.

9. Mr H has said that the Strathclyde Pension Fund has interpreted the Scheme Regulations incorrectly. Firstly, he believes Regulation 21 does not apply to him as he did not elect to receive any lump sum in lieu of his pension, as the retirement grant was a compulsory benefit accrued under a previous scheme. Secondly, he believes the Scheme Regulations do allow him to take his entire AVC fund as a lump sum as the residual amount can be taken as taxable income.

10. Further to this Mr H has said that in line with pensions freedoms introduced by the Chancellor he should not be forced to purchase an annuity with his residual AVC fund. He thinks Strathclyde Pension Fund should have used the statutory override, which came in to force in April 2015, to pay him his AVC fund as a lump sum payment, or should provide a satisfactory justification for not doing so.

Adjudicator's Opinion

11. Mr H's complaint was considered by one of our Adjudicators who concluded that no further action was required by Strathclyde Pension Fund. The Adjudicator's findings are summarised briefly below:

    - Regulation 21 of the Regulations applied to Mr H, as is set out under Regulation 15.

    - Strathclyde Pension Fund had interpreted the Regulations correctly, by concluding that Regulation 21(2) allowed Mr H to take a total of 25% of the capital value of his accrued rights under the Scheme, as a lump sum. The figures supplied by Strathclyde Pension Fund show that Mr H had received a lump sum made up of his retirement grant and part of his AVC fund, which was equal to 25% of his accrued rights.

    - Strathclyde Pension Fund can only provide Mr H with benefits in line with the Regulations, and as such Mr H cannot receive a lump sum in excess of 25% of his accrued rights, regardless of whether this is subject to tax.

    - The pensions freedoms introduced in April 2015 were permissive and not mandatory. Therefore, Strathclyde Pension Fund was not obliged to adopt these flexibilities or provide justification for not doing so.

12. Mr H did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. In his response Mr H said even if Regulation 21 applied to him; he did not think his retirement grant received under the 1998 Regulations could be factored in to calculating whether he had received up to 25% of his accrued rights under Regulation 21(2). He believes just the AVC fund and any commuted sum received under Regulation 21(1) should be considered.

13. Mr H's comments were passed to Strathclyde Pension Fund. In its response it confirmed that Regulation 21(4) stated that the capital value of a member's accrued rights shall be calculated in accordance with the Scheme actuary's guidance. It provided the Government Actuary's Department's (**GAD**) guidance note entitled "*LGPS (Scotland) Lifetime Allowance and Additional Cash Commutation*". This guidance sets out that the retirement grant is considered part of the lump sum, when calculating whether a member has received the maximum of 25% of their accrued rights.

14. The guidance note contains the following information:

> "1.1 Under Regulation 21… a member may, on a benefit crystallisation event (BCE), elect to increase the retirement grant payable under paragraph (3) of that Regulation by commuting some of their own pension
>
> ….
>
> 2.3 …The capital value of the member's accrued rights is therefore:
>
> CV = LS + (20 x P)
> Where:
> LS = Retirement grant + additional lump sum by commutation
> P = pension after commutation
>
> …
>
> 2.5 Under Regulation 23 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, a member may use the accumulated value of his AVCs to provide additional benefits under the Scheme…
>
> 2.6 If additional benefits are provided through the scheme, then these can be in the form of a lump sum, a pension, or a combination of the two. In this case, LS is the sum of the member's retirement grant, additional lump sum by commutation and lump sum taken from the AVC fund…"

15. The example calculations contained in the guidance notes, also detail the retirement grant being factored in to the lump sum calculations under Regulation 21.

16. Strathclyde Pension Fund agreed that Regulation 21(2) could be clearer, and it was thought the word commuted was used in Regulation 21(2) as under the Regulations there was no longer an automatic retirement grant. However, it believed the GAD guidance note provided the distinction that allowed the Scheme to be administered in a way that complied with the Finance Act 2004.

Ombudsman’s decision

17. I agree with the Adjudicator’s Opinion, summarised above, and I will therefore only respond to the key points made by Mr H, and the new information provided, for completeness.

18. Mr H has argued that due to the use of the word ‘commuted’ in Regulation 21(2), the retirement grant he received under the 1998 Regulations (which is not commuted but an automatic benefit) should not be considered under Regulation 21(2).

19. Regulation 21 is intended to mirror the provisions in the Finance Act 2004 (**the Act**), which sets out that up to 25% of the capital value of pension benefits can be received as a lump sum and considered an authorised payment. Whilst payments can be made in excess of this amount, the Act imposes high tax charges as a clear deterrent to both Schemes and their members. So the intention of Regulation 21 is undeniably to ensure any lump sum paid is considered to be an authorised payment under the Act.

20. Regulation 21(3) sets out that when calculating the capital value of the accrued rights, any payment made under the 1998 Regulations should be included, which is in line with the Act. The intention of Regulation 21(2) logically is then to limit all lump sum payments to a total of 25%, to also be in line with the Act. Even if this was in any doubt, the GAD guidance confirms that it is intended that the retirement grant be considered a lump sum under Regulation 21(2) and factored in to calculating whether a member has received 25%.

21. When the Regulations came in to force, the accrual rate for an annual pension was increased, however the lump sum was no longer an automatic benefit and instead members could commute part of their annual pension in to a lump sum. The change in benefits was designed to be actuarially equivalent, but to offer more flexibility for those not wishing to take a lump sum. The use of the word commuted in Regulation 21(2) is an oversight; however it is intended to be a description of all lump sums paid by the Scheme. The retirement grant is the equivalent lump sum benefit of the commuted sum under the 1998 Regulations, and so it is reasonable that the phrase “commuted sum” in Regulation 21(2) be interpreted to also include the retirement grant.

22. I agree with Strathclyde Pension Fund that the Regulation could be clearer and set out explicitly that the retirement grant is to be included in the 25% calculations, and I would strongly recommend that an appropriate amendment is considered in a future review of the Regulations.

23. However, I cannot make decision based on the language in isolation and disregard the intended application of the Regulations. Regulation 21(2) is intended to allow members to take a lump sum that amounts to up to 25% of the capital value of their accrued rights, which can be through receiving a retirement grant, payments from their AVC fund or commuting part of their pension. To reach a conclusion that gave

rise to members being entitled to take lump sum payments from the Scheme that were in excess of 25% and did not comply with the Act, would be unreasonable given the clear evidence of the Regulation’s purpose.

24. It is worth noting that Mr H is not financially disadvantaged by this interpretation as he is receiving actuarially equivalent benefits, just in the form of an annuity rather than a lump sum. In fact if Mr H had been allowed to take the remainder as lump sum, he would have suffered a loss of around 55% due to tax charges.

25. Therefore, I do not uphold Mr H’s complaint.

Anthony Arter

Pensions Ombudsman
8 June 2016