Adviser guide

Scheme-specific protection

The information contained in this guide is based on our understanding of current law, practice and taxation, which may be subject to change.

Introduction

Scheme-specific protection is a form of transitional protection – in other words, protecting pension rights that accrued before a major rule change, in this case before pensions simplification (A-Day) on 6 April 2006.

There are two types of scheme-specific protection.

- Protected lump sum rights
- Protected pension age

These are rights that arose in particular schemes before A-Day and are specific to that scheme.

Other forms of transitional protection, by comparison, apply across all of the member's registered pension schemes. Because of this, the types of protection covered in this guide are referred to as scheme-specific protection. Members did not need to notify HMRC of this protection. It was all documented by the scheme administrators of the particular schemes.

Protected lump sum rights

To recap, the maximum pension commencement lump sum (PCLS) a member can take from A-Day is the lower of 25% of the value being crystallised and 25% of the member's available lifetime allowance.

For most members of registered pension schemes, the lump sum rules applying now are at least as favourable as the rules that applied before 6 April 2006. However, there are some members whose lump sum rights at A-Day exceeded 25% of their fund value due to the old methods of valuing tax-free lump sums. For these members, a degree of protection is given for their lump sum rights as they stood at 5 April 2006.

These lump sum rights will have accrued under **occupational schemes** or deferred annuity contracts (section 32 policies). They were not available in personal pension schemes or retirement annuity contracts.

As the rights were held in specific schemes, it was decided that scheme administrators could document the protected amounts themselves based on their A-Day records. There are no certificates for this form of protection.

Conditions

There are three conditions that must be met for scheme-specific protection to apply:

1. the benefits must be paid from the **scheme** in which the rights were held on 5 April 2006 (the original scheme) or a registered pension scheme to which the rights were transferred as part of a block transfer after 5 April 2006;
2. the uncrystallised lump sum rights in the original scheme on 5 April 2006 were more than 25% of the value of the uncrystallised pension rights in the scheme on that date; and
3. the member must become entitled to all of their pension and lump sum rights (that were not in payment on 5 April 2006) under the scheme on the same day.

Protected PCLS in practice

The calculation is in two parts:

1) the monetary amount the member was entitled to at A-Day, revalued with changes in the lifetime allowance since that date ('LS')

   PLUS

2) an additional lump sum amount ('ALSA') which is broadly equivalent to 25% of the fund growth, contributions and transfers-in since A-Day.

The official formula is outlined along with the data that you will require for the calculation below.

LS = [VULSR x (ULA / FSLA)]

ALSA = [(LS + AC) – (VUR x (CSLA / FSLA)] x 25%

Total PCLS = [LS + ALSA]

Scheme-specific info

VULSR = Value of Uncrystallised Lump Sum Rights at A-Day

VUR = Value of Uncrystallised Rights at A-Day

General LTA figures

ULA = Underpinned Lifetime Allowance (will be £1.8 million until CSLA is above £1.8 million)

FSLA = Former Standard Lifetime Allowance (will always be £1.5 million)

CSLA = Current Standard Lifetime Allowance

Calculation

ALSA = Additional Lump Sum Amount

LS = Lump Sum

LS + AC = Whole uncrystallised fund value

Notes

Following the reductions in the standard LTA from 6 April 2012, the LTA figure used in the calculation is the greater of the current standard LTA or the underpinned allowance of £1,800,000.

Having calculated the protected lump sum, you calculate the additional lump sum amount. The two are then added together.

Example

Mr Pike had scheme-specific lump sum rights on 5 April 2006 of £50,000 and uncrystallised pension rights valued at £100,000.

Mr Pike makes contributions to the scheme and then takes all his benefits from the scheme on 16 April 2021. At this point, the benefits are valued at £220,000. The **SLA** is £1,073,100, meaning the underpinned allowance of £1,800,000 is used in the first part of the calculation.

Mr Pike's lump sum is calculated as follows:

£50,000 x (£1,800,000 ÷ £1,500,000) = £60,000

And his additional lump sum amount is calculated like this:

(£220,000 – (£100,000 x £1,073,100 ÷ £1,500,000)) x 25% = £37,116.67

Mr Pike's total PCLS is therefore:

£60,000 + £37,115 = £97,116.67

Interaction with fixed and individual protection

A member with a scheme-specific protected lump sum may have subsequently applied for one of the types of fixed or individual protection. There is a slight quirk in the calculation for these members.

The A-Day lump sum is calculated in the same manner as outlined above. However, the additional lump sum amount calculation uses the protected lifetime allowance rather than the SLA where the protected amount is higher. This can result in the member receiving a lower PCLS than they would have done without the additional protection, as can be seen in the following example.

Mr Pike had scheme-specific lump sum rights on 5 April 2006 of £50,000 and uncrystallised pension rights valued at £100,000.

Mr Pike makes contributions to the scheme and then applies for Fixed Protection (2014). He then takes all his benefits from the scheme on 16 April 2021. At this point, the benefits are valued at £220,000. The **SLA** is £1,073,100.

Mr Pike's protected lump sum is valued at **£60,000**.

£50,000 x (£1,800,000 ÷ £1,500,000) = £60,000

The additional lump sum amount payable, however, is now valued at **£30,000**.

(£220,000 – (£100,000 x £1,500,000 ÷ £1,500,000)) x 25% = £30,000.
This means a total PCLS of **£90,000** can be paid to Mr Pike rather than the £97,116.67 he could have received if he hadn't applied for Fixed Protection 2016

£60,000 + £30,000 = £90,000.

Protected pension age

The 'normal minimum pension age' (NMPA) is the earliest age at which a member can take benefits. For most members, this is age 55. Prior to 5 April 2010, it was age 50. It is due to increase to age 57 in 2028 at the time of writing.

However, members of certain occupations in certain schemes had the right before A-Day to take benefits before age 50. The list of occupations included footballers, cyclists, models, wrestlers, dancers and even trapeze artists. The typical minimum pension age for these members is age 35 to 42.

Although specific retirement rules exist for those in the armed forces, fire service and police service, anyone new to the occupations that benefited from lower retirement ages before A-Day will have to wait until age 55 before they can take benefits.

Members with protected pension ages could continue to make contributions and/or transfer benefits from other schemes without protection into their protected scheme to benefit from the lower retirement age.

However, when a client with a protected pension age wants to use that right to take their pension and/or lump sum benefits before **normal minimum pension age**, they must become entitled to all of their pension and lump sum rights under the **scheme** on the same day. This means they cannot do a partial crystallisation.

Reduction in the lifetime allowance

A member with a protected pension age of less than 50 (i.e. the normal minimum pension age at A-Day) who takes a pension or lump sum before they reach age 50 will have their **lifetime allowance** reduced by 2.5% for each complete year between the date of the BCE and the date on which the member will reach the current normal minimum pension age (currently 55).

Mr Heckham crystallised his benefits the week after his 35th birthday. There were 19 complete years between his 35th birthday and age 55, meaning his personal LTA was reduced by 47.5%.

19 x 2.5% = 47.5%

The BCE date was 10 May 2016, at which point the standard LTA was £1,000,000. This meant his available lifetime allowance at the BCE was £525,000:

£1,000,000 x 47.5% = £475,000 reduction
£1,000,000 – £475,0000 = £525,000

The reduced LTA alters the member's available LTA both for the purposes of calculating whether any **LTA tax charge** is due and for the purposes of calculating the maximum **PCLS** payable.

(Remember, the maximum PCLS payable is the lower of 25% of the value being crystallised or the member's available LTA calculated on the basis that the member is entitled only to the SLA.)

If a member had a right to take benefits before age 50, but chose to take them between age 50 and 55, then there would be no such reduction in their lifetime allowance.

Block transfers

Some pension members will have 'scheme-specific' protection relating to pension rights built up before A-Day. This may entitle them to take more than 25% of their pension fund as a tax-free PCLS, or to access their pension at an earlier age.

Rights that benefit from scheme-specific protection are – as the name suggests – specific to the pension scheme where the rights were accrued, and are usually lost on transfer. However, if a 'block transfer' (sometimes also known as a 'buddy transfer') is made, then the rights can be carried across to the new scheme.

There are three conditions for a transfer to be a block transfer. All three must be satisfied for the protection to be retained.

1. **There must be two or more members. All members involved in the block transfer must be transferring from the same transferring scheme to the same receiving scheme.**

   However, there is no requirement for both members to have scheme-specific protection – so one member with protection could 'buddy up' with someone who has no protection.

2. **All of the sums and assets relating to those members must be transferred as a single transfer**

   The instruction to transfer for both/all members must come through as one request. It does not mean that all assets must be transferred on the same day, as this may not be practical – especially when transferring in specie. Partial transfers cannot satisfy the block transfer conditions.

3. **None of the members can have been a member of the receiving scheme for more than 12 months prior to the (completion of the) transfer.**

   Setting up a new arrangement within a scheme the individual has already been a member of for more than 12 months would not get round this issue. It must be a completely separate scheme (with a different pension scheme tax reference (PSTR) from HMRC).

If any of the conditions are not satisfied, the transfer cannot be a block transfer. It could still be a recognised transfer, so there are no unauthorised payment issues. However, the member would lose their right to the protected benefit entitlement on the funds that were transferred to the new scheme. If any funds remained in the transferring scheme, these would still retain the protection.

There aren't any restrictions on the type of scheme that can accept a block transfer. However, it's not possible to do a block transfer from a retirement annuity contract or a deferred annuity contract (Section 32 policy), as these schemes only have one member, so a transfer could never meet the block transfer criteria. If someone has a protected PCLS under a one-member scheme, then the statutory permissive override may be useful to allow them to take the protected amount and still access flexi-access drawdown rather than having to purchase an annuity. See the section below for more information.

If an individual has scheme-specific protection in relation to more than one pension scheme, it is not possible to consolidate these into one scheme and keep all the protected amounts, even if the block transfer conditions are met. The protection is only retained in respect of the first transfer.

When it comes to accessing the pension, the fund must be fully crystallised in order to use the protection (whether it is protected PCLS or a protected retirement age); it is not possible to partially crystallise. This includes any other funds that have been transferred in, or contributions made, that didn't originate from the scheme where the protection was acquired.

However, if someone fully crystallised but just took their protected PCLS, they can continue making contributions, or transfer other funds in, and take these at a later date. The crucial point is that they must crystallise everything that is in the pension fund at the time of the benefit crystallisation event.

If a member has a protected retirement age which they use to crystallise benefits early, they would not need to do a block transfer if they wanted to continue benefitting from their protected retirement age. In other words, the right to a protected pension age is 'used' or 'locked in' at the moment a member takes benefits. This was not always the case; before 6 April 2015, a member had to continue doing block transfers in order to continue withdrawing income before the normal minimum pension age. However, if they subsequently make other transfers in, or make further contributions, they will need to wait until age 55 to access these additional benefits.

Statutory permissive override

When pension freedoms were introduced in 2015, there were many changes that needed to be made in a short space of time. To help with this, legislation was put in place that meant any money purchase arrangement could offer the new types of pension payments without having to update their scheme rules. This statutory permissive override can be found in the Finance Act 2004 s273B and allows payments of drawdown pension for members, dependants, nominees and successors, along with other pension freedom payments.

This means any money purchase pension scheme can designate funds to drawdown for the member or, on their death, for their beneficiary, regardless of what is written in their scheme rules. If the original scheme does not have the functionality to physically make the payments, then they only need to make the designation and then make a like-for-like drawdown transfer to a scheme that can facilitate the payments.

The receiving scheme will need confirmation:

- that the funds are designated into flexi-access drawdown in the member's name;
- of the date of designation;
- of the amount designated; and
- whether the MPAA has been triggered.

In practice, the MPAA will never be triggered if the ceding scheme does not have the ability to pay income, but the ceding scheme needs to include this in its written confirmation to the new scheme.