J05 Pension Income Options 2020/2021
Part 10: Transitional Protection

Following on from Lifetime Allowance this part will deal with Transitional Protection. This enables members to have a higher LTA than the current standard £1,073,100.

The milestones are:

- To know the different methods of transitional protection
- To be able to apply these in a calculation.

As part of its A Day (April 6 2006) reforms, the Government introduced Primary and Enhanced Protection It then introduced more types when the LTA started to be reduced in 2012, every reduction has resulted in a further type of protection. Whether to apply for one of these was a decision for the member. However, it is possible to have what is called scheme specific protection which potentially covers all members of the scheme. This will be looked at later.

The different types of protection available to individual members can be summarised as follows:

Name	**Latest date to apply**
Primary Protection	April 5 2009
Enhanced Protection	April 5 2009
Fixed Protection (2012)	April 5 2012
Fixed Protection (2014)	April 5 2014
Individual Protection (2014)	April 5 2017
Fixed Protection (2016)	No final date
Individual Protection (2016)	No final date

Primary Protection

Prior to A-Day the concept of LTA did not exist and certain individuals, usually high earning executives, had pension funds or rights more than the initial LTA of £1.5m. If the value of their benefits were higher than £1.5m on April 5 2006 they were able to apply for Primary Protection and had until April 5 2009 to do so.

Primary Protection gave the member a **Lifetime Allowance Enhancement Factor** or **LAEF**. This was calculated by deducting £1.5m from the fund value on April 5 2006 and dividing the result by £1.5m. The enhancement factor should always be calculated to two decimal places and always rounded up so 0.32 becomes 0.33

The LAEF will probably be given to you but this is how it was calculated

Carol had a fund of £2,250,000 on 5/4/06.

$$\frac{£2,250,000 - £1,500,000}{£1,500,000} = 0.5$$

Conrad's fund on 5/4/06 was £3m.

$$\frac{£3,000,000 - £1,500,000}{£1,500,000} = 1$$

The original plan was that members would multiply the standard LTA in the year of crystallisation by their enhancement factor and then add back the standard LTA to give them their own personal allowance.

Fiona's enhancement factor was 0.5 and had a BCE in 2009/10 when the LTA was £1,750,000 Her personal LTA would be £1,750,000 x 0.5 which is £875,000 plus £1,750,000 to give £2,625,000.

This system worked until 2012/13 when the LTA was reduced to £1.5m followed by a further reduction to £1.25m in 2014/15 and £1m in 2016/17. To avoid penalising those with Primary Protection the Government introduced the concept of an **underpin of £1.8m** which meant that in calculating an individual's LTA we apply the enhancement factor to £1.8m and then add back in £1.8m.

John has Primary protection with an enhancement factor of 2.2 and is having his first BCE on July 1 2019. His LTA is £1.8m x 2.2 which is £3,960,000 plus £1,800,000 to give £5,760,000.

This means the individual's LTA with Primary Protection will be a fixed amount until and if ever the standard lifetime allowance exceeds £1.8m. Therefore, when there is a BCE since April 6 2012 we don't need to worry about calculating the percentage that was used up, simply deduct the amount that is being crystallised from the individual's enhanced LTA.

A quick sidebar on enhancement factors. Some notes and training guides show them in different ways so 0.5 becomes 50% or 1.5. The way described here is how HMRC do it and you should expect to see any enhancement factor in an exam question to be presented in this way.

Primary Protection and Cash Protection

As the fund must have been more than £1.5m to qualify for Primary Protection it follows that the member would normally have had a PCLS entitlement of more than £375,000 which was 25% of £1.5m. This could also be protected by certifying the maximum PCLS as a specific figure, say £500,000. The intention was that this would also increase with the standard LTA so in 09/10 when the LTA was £1,750,000 it would be increased by £1,750,000 over £1,500,000 to give £583,333.

Not everyone who has Primary Protection will have lump sum cash protection. If they don't we would expect any PCLS to be restricted to 25% of the standard LTA but as a concession following the reductions in LTA the maximum PCLS will be 25% of £1.5m

Any cash protection is increased by a factor of £1.8m over £1.5m which is a 20% increase so a £500,000 protected cash sum becomes £600,000. The value of the fund is totally irrelevant.

The impact of this is that the amount of cash protection under Primary Protection is a fixed amount and will remain so until or if the standard LTA is more than £1.8m. Therefore if there is one you just deduct the amount of cash taken from the member's cash protection provided no cash was taken before April 6 2012.

There is though, a complication that occurs when there was a previous BCE that occurred between April 6 2006 and April 5 2012. This is because during those years the standard LTA was below £1.8m so the individual's enhancement factor would be applied to a lower figure than the current underpin. This means that in percentage terms the percentage remaining would be less than if applied to the underpin of £1.8m.

To compensate for this, the amount crystallised between April 2006 and April 2012 is reduced using the formula:

Amount crystallised x <u>Current</u> LTA/LTA at date of <u>previous</u> crystallisation. (PTM092300)

Martin has an enhancement factor of 0.2

In 08/09 when the LTA was £1,650,000 his enhanced LTA was £1,980,000. He crystallised £1,188,000 using up 60% of this.

In 18/19 using the underpin of £1.8m his enhanced LTA was £2,160,000 so with 40% remaining a new BCE above £864,000 would seem to result in a charge.

However, the previous amount crystallised can be reduced as follows:

£1,188,000 x £1,073,100/£1.65m = £772,632

Martin has £2,160,000 less £772,632 = £1,387,368 of his LTA left.

A similar process is followed with cash protection. The amount of cash protection is a fixed amount, Protected Cash at A day + 20%. Each time PCLS is taken this is reduced until it is exhausted. Again we have to revalue any PCLS taken between April 2006 and April 2012 but this time the amount taken is increased using the formula:

Amount of PCLS x £1.8m/LTA when previous PCLS was taken.

Dan had registered amount of £400,000 of PCLS which with the 20% increase is now £500,000

In 08/09 he took £200,000 as PCLS.

This must be revalued as follows:

£200,000 x £1.8m/£1.65m = £218,182.

Remaining cash is £500,000 less £218,182 =£281,818.

The likely scenario for any question will be as follows:

- The subject has Primary Protection with cash protection.
- They have had a previous BCE prior to April 6 2012
- They are having a BCE in 2018/19 and you are asked to calculate the remaining LTA or calculate the lifetime charge.

As with any calculation the secret is to follow a process breaking it down into a series of steps.

1. Calculate the individual's cash protection by increasing the protected cash at A Day by 20%
2. Revalue the cash taken before April 2012 then deduct this from the protected cash in step 2. This gives you the remaining amount of available cash.
3. Deduct the PCLS being taken now, this will usually be 25% of the amount being crystallised. If this is more than the remaining protected cash only the remaining amount can be taken.
4. Calculate the individual's LTA by applying the LAEF to the Underpin of £1.8m
5. Revalue the amount that was crystallised before April 2012 and deduct this from the amount in step 4. This gives you the amount of the remaining LTA
6. Deduct the total amount being crystallised now to give the remaining LTA.
7. If the LTA has been exhausted then the excess will be subject to an LTA charge

Note that revaluation of both BCE and cash is not required if the previous event takes place after April 6 2012.

A few final points on Primary Protection. The member can still contribute although whether this is worthwhile is debateable as the underpin of £1.8m will only increase if the standard LTA ever goes becomes higher than this.

A member can never renounce Primary Protection and can only be reduced if a pension sharing order is attached.

When that happens, the administrator must recalculate the enhancement factor by deducting the pension credit from the fund value at A-Day.

Fred had a pension fund of £3m at A-Day and is LAEF was 1.0. Following a pension sharing order his wife was awarded £1m. This reduces the A-Day fund to £2m so the LAEF is recalculated as 0.34.

This will not affect any protected tax free cash but if the sharing order reduces the A-Day fund below £1.5m both Primary Protection and any protected cash will be lost.

Enhanced Protection

The other way individuals had to protect their pre-2006 benefits was Enhanced Protection. This was open to anyone but the main appeal was to those just under the then LTA of £1.5m. Having Enhanced Protection means the member will never be subject to a Lifetime Allowance charge but is not allowed to have any pension input. If there is an input, Enhanced Protection is lost and can never be reclaimed.

Cash could also be protected but it was the percentage of cash to the fund at A-Day that was registered, not a lump sum as is done with Primary Protection.

Peter applied for enhanced protection with cash protection. At A Day his fund was £1.6m and he had a cash entitlement of £640,000 so she gets cash protection of 40%.

It was possible to register for both Primary and Enhanced assuming you met the criteria for Primary. Enhanced takes priority and the member is not allowed any pension input. Having both can lead to an interesting situation when cash is taken.

Raviva has registered for both Primary and Enhanced Protection and has cash protection with both. At A Day her fund was £2m and she had protected cash of £800,000 under Primary and 40% under enhanced.

In August 2018 the fund has a value of £2.6m so if she uses Enhanced her maximum PCLS is 40% of this which is £1,040,000. Using Primary the maximum PCLS is £800,000 revalued by 20% which is £960,000 so she would use Enhanced.

On the other hand if the fund had fallen to £1.8m she could still take £960,000 under Primary as it is not linked to the fund value but under enhanced only 40% could be taken which is £720,000

Fixed Protection

The other individual protections were brought in whenever the LTA was reduced. Generally one year's notice was given and individuals could register to keep their LTA at the higher level. These are referred to as Fixed Protections.

Fixed Protection 2012 (FP12) meant that the member's LTA was £1.8m.
Fixed Protection 2014 (FP 14 meant that the member's LTA was £1.5m.
Fixed Protection 2016 (FP16) that will give a member an LTA of £1.25m

In all cases the protection will be permanently lost if the member has any pension input.

In 2018/19 it is too late to apply for either FP12 or FP14. There is no cut-off date for applying for FP16 but there must have been no input on or after 6 April 2016. There is no minimum fund value for FP16. This could be useful if someone believes that with reasonable investment growth the fund might be greater than £1m when benefits are taken. The only other proviso is that the applicant must not have either Primary, Enhanced or any previous Fixed Protection

Under all versions of the Fixed Protection if there have been no previous BCE then you simply deduct the amount that is being crystallised from whatever is the fixed protection figure.

Tova has FP14. In November 2017 she crystallises £800,000.

She has £700,000 of LTA remaining

The administrator must still issue a certificate (in this case for 53.33%). This is because Tova may renounce FP14 or switch to one of the Individual Protections when the remaining percentage will be applied to a different figure.

Individual Protection

There are two versions, **Individual Protection 2014 (IP14)** and **Individual Protection 2016 (IP16)** The last date to apply for IP14 was April 5 2017. There is no cut-off date for IP16 and the individual can elect for this when they have a BCE.

The basis of protection for both is the same in that the member's lifetime allowance will be the total of all their pension rights at either 5 April 2014 or 5 April 2016 but capped at either £1.5m or £1.25m respectively. Unlike Fixed Protection the member can have further input. This can be useful as in this situation.

Tom had a SIPP with a fund value of £1.4m at 5 April 2014. If he applied for Fixed Protection (2014) he would be prohibited from making any further contributions.

If the fund falls in value that gives him a dilemma. He can hope the fund will recover but if he renounces IP14 to allow further input, his LTA will be the standard one for that year so in 19/20 that would be £1,055,000.

If he had taken IP 14 the protection would have been £1.4m rather than £1.5m but he can have further input should his fund fall in value.

It is possible to apply for both Fixed and Individual Protection but only for the same year, that is FP14 and IP14 but not FP14 and IP16. Where both are taken FP takes priority and no input is allowed unless it is renounced.

Those who already have an earlier version of Fixed protection can also renounce it and take up Individual Protection.

It is also possible for those with enhanced protection to apply for IP 14 & 16 by revoking EP. This means further input is possible and they will benefit from a higher lifetime allowance than the current £1m. Anyone who has already revoked EP can also apply for IP 2014 and 2016

Scheme Specific Lump Sum Protection

This is taken out by the scheme administrator rather than the member. The most common type occurs when a member of a money purchase occupational scheme had a higher cash entitlement than 25% of the fund at A-Day. This was because prior to A-Day the method of calculating the PCLS from an occupational scheme was based on a formula rather than just a straight 25% of the fund value which often resulted in a higher PCLS.

The maximum amount of cash at A-Day was registered by the administrator and increased in line with the rise in Lifetime Allowance. As with Primary Protection this is now increased by 20% as it assumes the Lifetime Allowance is still £1.8m.

It is only the pre A-Day cash that is protected, the fund built up after that date is subject to the normal maximum of 25%. However, the fund at A Day is adjusted proportionally to take account of changes in the LTA.

For 2020/21 the A-Day fund is reduced by £1,073,100/£1.5m

Brian had a fund of £100,000 fund at A day with protected cash of £50,000. In 2020/21 the fund value was £130,000.

The pre day cash is increased by 20% to £60,000

The fund at A Day is revalued £100,000 x £1,073,100/£1,500,000 = £71,540

The growth is £130,000 less £71,540 which is £58,460 The usual 25% can be taken as cash which gives us £14,615 so the total of the two elements is £74,615.

If the client has Fixed Protection (2012) the A day fund is **increased** by the factor 1.8/1.5
If the client has Fixed Protection (2014) the A day fund remains the same. To be strictly accurate the factor applied is 1.5/1.5. Fixed 2016 would be revalued by 1.25/1.5

Cash protection will be lost if the member transfers the fund unless this is as a result of a bulk transfer. This can also be a "buddy" transfer where at least one other member transfers. The issue of transfer is significant because the member's scheme may only allow benefits to be secured by a lifetime annuity which means that if they want to use FAD they will lose their higher protected cash. Again this shows the importance of checking what options are open under the member's existing scheme.

That concludes this chapter so you should now:

- know the different methods of transitional protection
- be able to apply these in a calculation.