

Re: Changes to the NHS Pension Scheme

On the 21st September 2007 a number of important changes to the NHS Pension Scheme were agreed between NHS employers and the NHS Trade Unions. These changes are wide ranging and will mean that existing members will be faced with a number of choices, some of which will need to be made **before** the 31st March 2008 and some thereafter. I summarize below some of the most important changes as well as some of the decisions that will need to be made.

Firstly however, it is important to note that the scheme will continue to be a “Final Salary Scheme” which means that members pensions will continue to be based on Career Average Re-Valued Earnings (CARE) (for GPs) or the highest salary in the last three years before retirement (for Consultants/Officers). This is an extremely valuable benefit, especially at a time when many private sector companies are closing their Final Salary Schemes to new (and in some cases existing) members, to reduce the potential cost of providing these guaranteed benefits.

Major Changes

1. Retirement Age

- Existing NHS Pension Scheme

The current NHS Pension Scheme has a Normal Retirement Age (NRA) of 60 and members who do not move their benefits to the new scheme will continue to be able to retire at 60 without penalty. Early retirement will continue to be available from age 50 although benefits will be actuarially reduced.

- New NHS Pension Scheme

The NRA of the new scheme will be 65. Members will be able to retire early from 55 onwards, although the pension will be actuarially reduced.

Members will be able to move from the existing scheme to the new scheme for a limited period. It is currently planned that this period will run from the 1st July 2009 to the 30th June 2010.

The details of how benefits will be converted are not yet available however, we will write and update you once the information has been published and we have had time to analyse the terms.

The new scheme allows the build up of pension benefits more quickly, however, for those members relatively close to retirement and wishing to retire at age 60, it is likely that remaining in the existing Scheme will be the most appropriate

strategy. For those members wishing to retire at age 65 or later, moving to the new scheme is likely to provide a greater tax free lump sum and/or income.

Members wishing to retire between 50 and 55 should stay in the existing scheme.

2. Costs

- Existing NHS Pension Scheme

Currently members contribute 6% of pay (superannuable pay for GPs) for basic scheme benefits. Since the introduction of the new contract, GPs have also been responsible for paying the 14% employer contribution although, in theory, the 14% should have been included in the GP Practice's global sum. In addition, members may be buying additional benefits via Added Years or Additional Voluntary Contributions (AVCs).

- New NHS Pension Scheme

Under the new scheme contributions will continue to be based on annual pensionable pay, but the contribution rate will be higher for all but the lowest paid members. For members earning above £100,000 (or full time equivalent), the contribution rate will increase from the current level of 6% to 8.5%.

The cost of Added Years will not change.

It should be noted that from the 1st April 2008 the contribution rates of both the new scheme and the existing scheme will be the same even though the accrual rate of the schemes will be different.

Members of the existing scheme are expected to have one year from the 1st July 2009 to the 30th June 2010, to decide whether to join the new Scheme.

3. Pension Accrual

- Existing NHS Pension Scheme

GPs will continue to accrue pension rights at the rate of 1.4% of CARE with an automatic lump sum of 3 x the pension. Employed scheme members will continue to receive 1/80th of final salary for each year's service, along with a lump sum of 3 x the pension.

- New Scheme

GPs will continue with CARE but with an increased accrual rate of 1.87%. However there will be no automatic lump sum. Part of the pension can be given up at the rate of £1 of pension for every £12 of lump sum subject to a maximum lump sum of 25% of the pension value.

For employed members the accrual rate will change to 1/60th of final salary for every one year's service. Again there is no automatic lump sum however, the pension can be reduced to enable the lump sum to be taken, again on a £1 for £12 basis.

To provide some comparison between the two schemes:

A GP starting service now in the existing scheme, who accrued CARE of £2,500,000 during their working life, would receive pension at retirement of £35,000 and the lump sum of £105,000.

The same GP in the new scheme will receive a pension of £38,000 and a lump sum of £105,000.

The figures show that, for a GP just starting out, the new accrual rate produces a pension of £3,000 per annum more for the same contribution. However, this is only an example as there is considerable flexibility on how benefits are taken. The figures are similar for employed members.

It will be important to review the objectives of individual members and the conversion terms for existing scheme membership to new scheme membership before making a decision on whether to move to the new scheme. This will be particularly important where there is a possibility that a member may wish to retire before age 65. This is because the actuarial reduction rate is as yet unknown and is likely to have a significant bearing on any decision.

4. Increasing Benefit

- Existing NHS Pension Scheme

Members are able to purchase Added Years and/or make contributions to investment-linked Additional Voluntary Contribution (AVC) Schemes

- New NHS Pension Scheme

Added Years will no longer be available however, members will be able to purchase an additional annual pension of up to £5,000 per year. Members will also be able to contribute to investment-based AVCs.

Existing Added Years Contracts will be honoured but no new contracts will be available.

It is important that members wishing to purchase Added Years do so without delay. Applications to purchase Added Years must be received by the NHS Pensions Agency by the 31st March 2008 at the latest and the contributions must start before the 31st March 2009. This is because Added Years Contracts commence on a member's birthday and therefore although applications must be in by 31st March 2008, the actual contributions will not start until the member's actual birthday.

Our analysis has shown that in many cases the purchase of Added Years is attractive. Often, to match the guaranteed benefits from the Added Years contract, an investment-linked AVC would require very optimistic and challenging rates of return. However, each individual case will need to be considered on its own merit.

Members of the existing Scheme will be able to purchase an additional pension of up to £5,000 per annum in addition to Added Years should they wish.

5. Pensionable Pay

With effect from the 1st April 2008, the current earnings cap (£112,800) for pension contributions (for GPs who joined the scheme after the 1st June 1989), will be removed. Therefore total pensionable pay will be taken into account when determining contributions and benefits.

There have been many headlines about the increased costs that will arise as a result of the increased contribution rate and the removal of the earnings cap, however, for many members this is unlikely to be an issue as they would have joined the scheme before the cap was introduced, therefore the removal of the cap will have no effect on pensionable earnings. These members will however see an increase in their personal contribution of 2.5%.

For younger members the removal of the cap will have an effect for those earning more than £112,800 per year. These members will see an increase in their overall pensionable pay as well as an increase in their contribution rate.

It should be noted that the increase in contribution and the removal of the cap, whilst increasing the member's personal contribution to the scheme, does also increase the member's benefits. It is also important to remember that all contributions will qualify for tax relief at the member's highest marginal rate. For members paying the top tier rate of 8.5% this means that contributions will benefit from 40% tax relief.

With effect from 1st April 2008, GPs earnings will be dynamised (revalued) at a fixed rate linked to the Retail Prices Index (RPI) plus 1.5%.

6. Dependants Benefits

- Existing NHS Pension Scheme

Currently the existing Scheme provides benefits for legally married members or those with Registered Civil Partnerships from 2005. In addition, widows/widowers benefits currently cease in the event of re-marriage. Common Law Relationships are not recognized at all by the scheme.

- New NHS Pension Scheme

With the introduction of the new scheme all qualifying partners are eligible for dependant's pensions for all service back-dated to 1988. This will include married couples, Civil Partnerships and financially dependant/independent relationships of at least two years.

Members will have to nominate a qualifying partner (i.e. someone with whom they have been in an exclusive and long term committed relationship for at least two years), to the scheme administrators.

In addition, widows/widowers or other qualifying partners will keep the survivors pension even when they re-marry or co-habit.

Conclusion

Clearly there will be many decisions for members to make with regard to their NHS Pension benefits but these decisions need to be made in light of member's own circumstances. There is no question that the new scheme does provide significantly more flexibility than the existing scheme and may allow members over the age of 55, a number of different work/retirement options. However it is important to ensure that the decision is made once **all** the information is available and has been evaluated to ensure that the most appropriate course of action is chosen.

The NHS Pension Scheme still provides significant benefits for its members and is the envy of many pension arrangements in the private sector. Given the generous tax relief's available along with the security of a government-backed pension scheme, the NHS Pension should still be looked upon as a significant benefit rather than an unwelcome cost by its members.

Our firm has spent over 16 years advising members of the medical profession on their financial affairs and the number one concern still seems to be "will I have sufficient resources to be able to maintain my desired standard of living when I stop working". The benefits provided by the NHS Pension Scheme go a long way to providing that security.

I hope you find the above information useful and I hope it helps to clarify some of the important issues facing NHS Pension Scheme members at this time.

Kevin Quinn
Certified Financial Planner

Ramsay Brown Financial Services Limited
Tel: 020 8370 7716 or e-mail: kevin@ramsaybrown.co.uk