The NHS Pension Scheme Review Consultation

Technical Document

Moving to a 21st-century pension scheme

A part of the NHS Confederation working on behalf of the NHS

NHS Employers

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Foreword

by John Hutton MP

This consultation is important for all NHS employees in England and Wales. As one of a series of reviews taking place across the public sector pension Schemes, it sets out proposals for changing the current NHS Pension Scheme in ways which will maintain its importance to staff, while making it more relevant to the health service of today. The Government needs your views on the ideas it contains, so that we can decide how best to change the Scheme.

At the outset I decided that this stage of the Review should be led by those most directly affected – NHS staff, represented by the Trade Unions on the National Staff Side, and employers represented through the NHS Confederation. I believe that the process has benefited from this approach, which has ensured that key issues of concern to both have been identified and discussed. I am grateful to the partners for producing a detailed and considered assessment, setting out wide areas of consensus, as well as identifying issues where differences remain.

The approach taken to the Review does mean that the recommendations are those of the partners, rather than Government, and they will need to be assessed against wider Government, as well as NHS, requirements. However, the Government remains as committed as ever to good pension provision for NHS staff. Pensions are a central part of the remuneration package, representing deferred pay and financial security in retirement. They are also an essential tool in the recruitment and retention of high quality and motivated staff, albeit one that has not always had the recognition it deserves. But, both working patterns and longevity have changed immeasurably since the NHS Pension Scheme was launched in 1948. The Scheme must change to reflect the needs of NHS staff and employers alike in the 21st century. The proposals in the consultation document set out ways of doing this, and of taking advantage of wider Government plans to improve such schemes.

Employers and staff representatives have worked hard to develop these ideas. Now we need your opinions on what is proposed before we take final decisions. I look forward to hearing your views.

John Hutton

John Hutton MP
Minister of State for Health

Foreword

by the Review partners

We began the review of the NHS Pension Scheme with a stated aim of ensuring the scheme meets the needs of a modern NHS and its staff, by making benefits more appropriate for today's workforce.

This consultation document is a product of over 12 months of partnership working between management and staff-side representatives.

We have not been able to agree on everything: in particular the Government's proposal to increase the normal pension age to 65 and the financial scope for benefits changes. Where the Review partners are jointly recommending a proposal, this is clearly indicated. In areas where we have different views, these are set out. When we have received responses to the consultation, we will make final recommendations to Department of Health ministers who will make final decisions on the shape of the scheme.

We believe that the changes we are jointly recommending offer improved benefits to the dedicated individuals that make up the NHS workforce. The proposed new scheme will aim to avoid age and gender discrimination and will offer choice and flexibility to scheme members, giving them control over how and when they plan their retirement.

We believe that the joint recommendations would give the NHS a pension scheme that will support ongoing recruitment and retention initiatives and will help make the NHS an employer of choice.

We welcome views on the questions set out in this document and any other views or ideas you might have on the NHS Pension Scheme and encourage you to take part in the consultation.


David Jordison
Review sponsor and chair


Eddie Saville
Staff side chair

1 Why is a review necessary?

1.1 At the end of April 2003 the Minister of Health, John Hutton, asked the NHS Confederation, the representative body for NHS employers, to lead, on behalf of NHS employers and in conjunction with the Department of Health, the NHS Pensions Agency and the National Assembly for Wales, a review of the NHS Pension Scheme. The Review is now being taken forward by NHS Employers (the employers' organisation for the NHS and part of the NHS Confederation) in partnership with the NHS trade unions. Reviews of pension schemes are taking place across the public sector. There are several common factors across all schemes, as well as issues specific to the NHS. Of the drivers for the Review, perhaps the most important are:

- the Inland Revenue proposals on changes to the tax regime for pensions which create new opportunities for making the Scheme more flexible
- the Government proposal of moving the normal pension age to 65 for most public service schemes
- age discrimination legislation to be implemented by 2006
- pressure from within the NHS from both employers and trade unions to make the scheme more appropriate for a 21st-century NHS workforce.

1.2 The current Review follows an earlier review in 1999 that culminated in the publication of *A millennium health check for the NHS pension scheme* by the NHS Pensions Agency in December 2002. The report concluded that it would be difficult to make the changes suggested by employers and members without structural change to the Scheme, and therefore there should be consideration of creating a new pension scheme for the NHS.

1.3 The aims and values of the Review are set out in more detail in section 5. The overall objective of the Review partners was to develop a scheme that was better placed to support the aim of the NHS to be the employer of choice. The Review would develop options for change that would provide secure personal and family benefits and allow NHS staff to extend their working lives in a way that facilitated a gradual transition from work to retirement, or a mixture of both, and to provide the means for members to save more for their retirement if they wished to do so.

1.4 This document sets out the recommendations that have emerged from the Review. In some areas these are proposals agreed by the partners as the best way forward. In others, more than one possible option is set out. The issues we are seeking views on are to be found throughout the text and are collected in the response form in annex J.

The Review partners will consider the responses before making final recommendations to the Minister of Health, including reporting on views received during consultation. The Minister will then decide how to take forward the modernisation of the pension scheme in the light of the Review report and the responses to consultation.

Changes to occupational pensions

The Inland Revenue's simplification measures introduce a new tax regime for pensions effective from 6 April 2006. The new regime will replace the eight existing regimes and is designed to provide greater flexibility for members and reduced administration for schemes. The key changes are:

- introduction of a lifetime allowance on the total accrued value of an individual's pension rights which benefit from tax relief. This will be set initially at £1.5 million
- introduction of an annual allowance on the amount of increase to pension benefits, initially set at £215,000
- 100% of salary limit for tax relief on member contributions
- introduction of tax-free lump sums of up to 25% of the value of benefits taken
- an increase to the minimum pension age from 50 to 55 by 2010 with limited protection for existing members
- increased opportunities for schemes to offer flexible retirement provisions, such as draw down.

Public service pension schemes

The Government's Green Paper on pensions, *Simplicity, security and choice: working and saving for retirement*, made the proposal that the normal pension age for public service pension schemes, the age at which pension benefits are payable in full, should be raised from 60 to 65. This was part of a package of reforms to ensure that people are adequately provided for in retirement, to encourage longer working lives, greater participation of older workers and improved pension information. The Government has since announced its general intention to implement this.

1.5 The Review has been carried out for the NHS in England and Wales and its recommendations only relate to the NHS in those countries. Northern Ireland and Scotland are conducting separate reviews. The review of the NHS Superannuation Scheme in Scotland is being addressed by the Scottish Pensions Review Group (SPensiR), which is a sub-group of the Scottish NHS HR Forum. Pension provision for NHS staff in Scotland has largely mirrored that in place for NHS staff in England and Wales and Northern Ireland. This reflected public sector pensions policy generally, and the fact that the Treasury provided funding for all public sector pension schemes in the UK.

To retain consistency, SPensiR is consulting with NHS staff in Scotland on a similar basis and within the same time frame as the consultation of NHS staff in England and Wales. However, there may be distinctive Scottish issues which arise as a result of the consultation with NHS staff in Scotland, and these will be addressed by SPensiR before a recommendation on the structure of a new pension scheme in Scotland is made to Scottish ministers.

1.6 Pension provision for Health and Personal Social Services (HPSS) staff in Northern Ireland has largely mirrored that in place for NHS staff in England and Wales and Scotland. This reflected public sector pensions policy generally, and the fact that the Treasury provided funding for all public sector pension schemes in the UK. To retain consistency, the Department of Health, Social Services & Public Safety will be consulting with HPSS staff and other interested parties and the timeframe will be as close as possible to that for England and Wales.

2 The process

2.1 This Review marks the first time the NHS Pension Scheme has undergone a fundamental change since its inception in 1948. The current scheme runs to more than 100 pages of legislation, covers around 1.2 million working members, of which around 77% are women (half of whom work part time), 11,500 employers and authorises the payment of around 40,000 new pensions every year. A summary of the current scheme is set out in annex A.

2.2 For this reason, the NHS Confederation believed it was important that the Review was as inclusive and comprehensive as possible, drawing on expertise within and outside the public service and working in partnership with NHS trade unions.

2.3 The formal decision-making body for the Review, the Steering Group, is made up of management-side representatives and representatives drawn from all NHS trade unions. Initial ideas were developed in a larger Reference Group with wider representation from trade unions, employers, other public sector schemes and professionals from the pensions industry. The process has been managed by a small project team from the NHS Confederation.

2.4 A summary of the Review process and those involved in the Review is in Annex B.

The assurances

2.5 In asking the NHS Confederation to take forward the Review, the Government gave a number of assurances:

- **Partnership with all NHS trade unions.** The Review would be taken forward in partnership with all NHS trade unions and they would be represented on the Steering Group, Reference Group and Technical Advisory Group.
- **Retention of a defined benefit scheme.** There are two types of pension: defined benefit and defined contribution. Defined benefit schemes promise a certain level of benefit, based on salary, or service or even a fixed pension. Examples are final salary schemes and career average schemes. Most public service schemes, including the NHS scheme, are defined benefit schemes. The Government has promised that this will continue. Defined contribution schemes cannot guarantee the level of benefits as these depend upon the value of the investment return on the contributions paid into the scheme by the employer and employee and the annuity rates applying when the investment is converted into pension. Examples are money purchase schemes and personal pension schemes.
- **Protection for existing members.** Those NHS staff who intend to retire before 2013 will be able to do so without any loss of existing pension rights. NHS staff who intend to retire after 2013 will have their pension rights built up until 2013 protected under the existing terms. This means that service for existing NHS staff up until 2013 will be payable on retirement after the age of 60 without reduction, calculated on the basis of pensionable pay at the time of retirement. Those with special retirement rights, including those with Mental Health Officer (MHO) status, will have the same protection in relation to their right to retire at 55. In addition, the Review partners have considered whether and to what extent improvements might be made to the current scheme which could encourage NHS staff to extend their working lives should they wish to do so (section 9). The Review partners have also said that they would expect existing NHS staff to be given the opportunity to choose to join any new pension arrangements that may be set up.

3 The wider pensions context

3.1 Pension schemes have become much more newsworthy in recent years. Following the Mirror Group pension issue, the Government responded with the Pensions Act 1995, part of which provided for more communication with scheme members, and also introduced stricter funding requirements. Since then, a downturn in the stock market, through which most pension schemes have funds invested, has put further pressure on pension scheme assets and, in some extreme cases, resulted in there being insufficient funds to pay benefits. Additional changes to working practices and the fact that people are working for fewer years and living longer in retirement have also added to pension scheme costs.

3.2 Companies have responded to these pressures in a number of ways. Some have increased their contribution rates, others have closed schemes or restructured the benefits to reduce the risks to themselves and share the risks with employees. There is a general move away from defined benefit pension schemes towards defined contribution arrangements, where the costs are known but the benefits depend on investment returns.

3.3 The NHS Pension Scheme, like other public sector schemes, is not immune to these changes, although it is not exposed to the vagaries of the stock market as it has no actual fund invested. Benefits are underwritten (guaranteed to be paid) by the Government. Nevertheless, the pressures created by changes in the financial world and changing working patterns have an impact on the cost of the scheme and this needs to be considered when making any changes.

3.4 The Government has promoted a range of 'active ageing' initiatives, aimed to support older people returning to, or continuing in, active employment. More and more now, society is blurring the lines between the traditional stages of education, employment and retirement. Pension schemes need to adapt to recognise this.

3.5 Wider concerns around these issues resulted in the Green Paper on pensions, *Simplicity, security and choice: working and saving for retirement*, and the joint Inland Revenue and Department for Work and Pensions document, *Simplifying the taxation of pensions*. The measures set out in these documents, among other things, will create the ability for pension schemes to adapt to changes by creating flexibility around the levels able to be saved in a pension, and removing barriers to longer pensionable careers.

3.6 More recently, the Pension Commission report, *Pensions: challenges and choices* (primarily aimed at reporting on private pension provision) highlighted that pensions saving and pensions costs were moving apart and that changes would be needed to prevent an increase in pensioner poverty. These changes included the suggestions of increased taxes, savings and retirement ages, probably a combination of all three.

Public sector pension schemes

3.7 The NHS Pension Scheme is a public service scheme and must operate, therefore, within the Government's public service pensions policy. The consent of the Treasury is required before NHS Pension Scheme regulations may be amended. It is important also to consider the possible wider repercussive effects of changes both across other parts of the public service and, outside, in the private sector.

3.8 Many other public service schemes are undergoing reviews for the reasons mentioned earlier. The Steering Group has been in contact with these schemes in order to ensure options for change reflect best practice but also are the best possible fit for the NHS and staff.

The European dimension

3.9 Over the next half century, the United Nations is forecasting that those above retirement age in the European Union will increase from 60 million to 100 million and that the proportion of the population over 80 will virtually treble. The European Commission in March 2002 stated that the effect of an ageing population would materialise over the next 10 years and that member states need to put in place credible and effective strategies and to give clear signals to citizens about what they can expect from their pension systems and what they have to do to achieve an adequate living standard in retirement.

3.10 The EU has also put in place a statutory framework on equality issues that has an impact on all pension arrangements across the EU. The European Directive which aims to ensure equal treatment is generally described as the Employment Directive. The aim is to prevent unacceptable discrimination at work and training on grounds of age, sexual orientation, disability and religion or belief. It sets a framework which will ensure that there are minimum standards for combating discrimination throughout the European Union.

3.11 All member states are required to comply with European Union Directives. This means that the Review had to ensure that any new provisions would not contravene the principles of equal treatment. From 2005, for example, civil partnership registration is being introduced for same-sex partners. This means that partners of the same sex will be able to register their relationship and receive the same rights as married couples. With regard to age discrimination, laws preventing unjustifiable differences on the grounds of age will be in force by October 2006.

[1] *Council Directive 2000/78/EC 'Establishing a general framework for equal treatment in employment and occupation'.*

4 The NHS context

4.1 The NHS is currently in an unparalleled period of expansion. Since 1999 the workforce has expanded at nearly 4% per annum. While the current rate of growth will slow, demand for NHS staff is likely to continue to rise in line with increased demand for healthcare and the needs of an ageing population. There will continue to be pressure points in certain workforce groups. Healthcare is likely to remain labour intensive.

4.2 Continuing growth in the healthcare workforce is likely to be set against a tightening labour market. The NHS will face challenges in securing the workforce it needs. The profile of the UK workforce is ageing. More women are participating in the UK workforce, although this is levelling off. The proportion of older workers relative to younger workers in the UK workforce is growing as the population ages and this is expected to continue.

UK population trends

Over the current decade, the numbers in the UK population in the 45–54 age group is expected to increase by 19% and the over-65 group by 14%. At the same time, the 25–34 group is set to decline by 19% and the under-25 age group by 6%. In the longer term the working age population in the UK is predicted to decline by 12% from 2000 to 2050.

Life expectancy in the UK has been increasing from 69.2 in 1950 to 77.2 in 2000 and is expected to continue to rise. At the same time, average retirement age has been reducing: from 66.2 in 1960 to 62.7 in 1995.

4.3 The ageing of the workforce affects the NHS too. For example, the annual loss from the NHS nursing workforce is projected to rise from around 15,000 in 2004 to 25,000 in 2015 as a result of the age profile of the nursing workforce.

4.4 The available data suggest that the average age at retirement for staff (including those with the right to retire at age 55) reaching pension age in NHS employment has decreased gradually over the last decade from about 62½ to about 62. For this group, the average time that pensions are expected to be in payment has risen from about 21 years a decade ago to about 24 years currently and the assumption adopted in modelling new entrant costs is consistent with a further increase in this measure to about 26 years.

What this means

4.5 The demographic evidence emphasises the need for effective policies to recruit and retain older staff. NHS organisations will need comprehensive workforce strategies to ensure they recruit and retain sufficient staff to meet workforce demand. They will need to promote NHS careers for new entrants throughout the age range, encourage those who leave the NHS to return, conduct overseas recruitment and retain older workers. The challenge for a modernised NHS Pension Scheme is how it can support delivery of strategies for all these groups of workers through:

- **Recruitment.** The staff pensions survey (see section 5) found that for almost 20% of staff, the pension scheme was an important influence on their decision to join the NHS. However, for 60% it was not an important influence. Given the increasing awareness of pensions issues among potential recruits, there is a real opportunity for the pension scheme to play a greater role in aiding recruitment.
- **Return.** A major issue for NHS staff, particularly female staff, is that of broken careers with less career progression and shorter service built up. Current pension legislation and Inland Revenue rules have further constrained the ability of these staff to build their pension. A pension scheme with 77% female membership was designed around a career few achieve; i.e. 40 years at the age of 60. The pension scheme needs to address better the needs of the changing NHS workforce and their diverse career patterns.
- **Retention.** Within England and Wales, there have been initiatives to use the pension scheme to encourage staff to extend their working lives. This work raised awareness of the impact of pension rules on approaches to retirement. It focused on protection for step-down arrangements where staff choose to take a less demanding post, wind-down arrangements where staff choose to work part time and arrangements for returning after retirement. Whilst some people choose to continue working beyond the normal pension age, the current scheme does provide limited incentives to encourage longer working. This work highlighted the inflexibility within the current pension scheme in respect of incentivising retention, particularly with regard to older employees. It is particularly noteworthy that the pension scheme does not allow people to rejoin after retirement.

Raising the normal pension age (NPA) to 65

4.6 The Government's intention to increase the normal pension age to 65 has been contentious. A significant proportion of representations received by the Review set out opposition to the change. The management and staff sides have different views on this issue.

Managementside view on NPA65

4.7 The managementside representatives believe it is important to recognise the demographic trends referred to earlier in this document. The current pension age for the NHS was set when life expectancy was shorter. Pensions have to be paid for by a partnership between employer and employee. As pension costs rise, it is right to look again at the balance between working life and retirement. Furthermore, the NHS has a pressing need to retain its older workforce and to secure longer working lives. The Government's concern that public and private sector pension ages should remain in broad balance is also recognised.

4.8 Older workers have an important and valuable contribution to make to the workforce. Evidence cited to the Review emphasised that the capability of older workers changes but does not decline. While physical and mental capacity generally reduce, social capacity, motivation and experience increase. Continued work can have a positive impact on health, providing that employers recognise the importance of changing work to reflect changing capacity. NHS employers need to have positive age-related employment policies which enable them to offer older workers the opportunity to participate appropriately in the workforce.

4.9 It is clear that staff are prepared to consider working longer for the NHS, if they are physically able to do so, if they enjoy their work, find the work arrangements sufficiently flexible and feel supported and appreciated by their employer and co-workers. The pension survey found that 37% of the sample indicated that they intended to work beyond the age at which they are eligible to retire – 62% are interested in returning to work after retirement, mainly working part time, while 67% are interested in stepping down or winding down. It is also clear that income in retirement is a major issue for many staff in the NHS. Many staff need to work beyond the current normal pension age. Even so, the average pension in payment to former members was about £4,800 a year in 1999, and since then appears to have increased to about £5,400 a year.

4.10 Managementside representatives recognise that the Government's intention to raise the NPA to 65 for public sector staff carries considerable concern for NHS staff. However, the increase in NPA also gives an opportunity for reinvesting savings in the scheme (see section 7) and the Inland Revenue's proposals on tax simplification provide the opportunity for greater flexibility in the pension scheme – for example, by removing the current 15% employee contribution limit. Without the savings achievable by raising the normal pension age to 65, it would not be possible to make the improvements in the scheme that everyone wants to see.

4.11 The Scheme is periodically valued to ensure that contributions are sufficient to meet the cost of paying benefits. A number of assumptions are made for valuations such as life expectancy and retirement patterns. When the Scheme was last valued in 1999, it was assumed (taking into account the scheme experience) that those NHS staff with a pension age of 60 who stay in work to that age continue on average until they are nearly 63. The rise in NPA to 65 will therefore be a smaller increase than for other public sector schemes with a lower average retirement age. It should also enable staff who work to 65 to get increased pension value for each year they work and therefore to retire with larger pensions.

4.12 For those who are unable to work longer, there will still be the protection of ill-health retirement arrangements. In addition, managementside representatives want to make it easier for NHS staff to save more for their retirement if they wish to retire before 65.

4.13 Taken together as a package, the increase of NPA and the changes in the wider legal framework, including the new Inland Revenue flexibilities, provide the opportunity for a new NHS Pension Scheme that better meets the needs of NHS staff and employers. The NHS needs to support its staff to work longer and needs a pension scheme that rewards staff for doing so.

4.14 The NHS HR strategies in England and Wales set out the aspiration to make the NHS the employer of choice. The drivers and changes outlined in sections 1 to 4 provide the NHS with the opportunity to develop a pension scheme that helps make that aspiration a reality. The NHS already has a good pension scheme. It can be even better.

Staffside view on NPA65

4.15 The staffside representatives in the NHS Pension Review Group strongly oppose a compulsory rise in pension age for NHS staff. The reasons for doing so are that:

- the Government has not as yet made the case for reform in a way that convinces public sector workers that the changes can be justified or are fair
- the environment in which many NHS staff work and the types of roles they fulfil are not always compatible with extended working lives
- a voluntary approach may be more effective in achieving the joint aims of Government and trade unions to encourage those NHS staff who wish to continue working beyond their pension age to do so, and that a compulsory rise in pension age may have unintended and counter-productive outcomes.

4.16 The staffside representatives in the NHS Pension Review Group acknowledge the changing population demographics: that the average age of Britons is increasing; that the number of older people relative to the number of younger people is increasing and there are improvements in longevity. However, the Government's own analysis of population ageing is that the impact, in the long term, will not affect the sustainability of public sector finances. A Treasury publication stated that the changing demographic structure of the UK's population, and especially the ageing aspect, is projected to have only a limited impact on public sector spending over the coming decades.

4.17 Although the average life expectancy is increasing there is evidence that this is not associated with a simultaneous increase in the number of years of good health experienced by older people. This is particularly pertinent for NHS staff, many of whom work shifts in order to provide a 24-hour service.

There is considerable research evidence that shows that working shifts for prolonged periods has a serious and negative impact on health and life expectancy.

4.18 The staffside representatives in the NHS Pension Review Group believe that a compulsory, across-the-board increase in pension age is inappropriate for the NHS because the environment in which many NHS staff work and the types of roles they fulfil are not always compatible with extended working lives.

4.19 Historically, the special rights to early retirement without actuarial reduction were introduced in recognition of the physical and emotional demands of many roles in the NHS. These demands have not changed. Work commissioned by the Department of Health (1998) showed that stress levels among NHS staff were higher than for British employees generally (26.6% compared with 18.4%). For nurses the incidence was 40% higher than their comparison group (associate professional and technical occupations) in the general population.

4.20 The NHS needs to retain a pension scheme that supports the recruitment, retention and return of staff, particularly as the healthcare labour market is forecast to become increasingly competitive. Like the population as a whole, the proportion of older NHS employees is increasing and there is not a replacement workforce readily available. Some occupational groups, such as nursing, are running hard to keep still. It is vital that those older workers who wish to work beyond retirement are supported to do so. The staffside representatives support the proposals in this document to allow flexibility in retirement and for work and pensions to be combined. This is a positive move that encourages the voluntary recruitment and retention of older staff. However, the evidence shows that the current retention of older staff could be improved. For example, while there is no constraint on nurses working beyond their retirement age, relatively few choose to do so and growing numbers are choosing early retirement.

4.21 A compulsory rise in pension age fails to address the reasons why many NHS staff either do not choose to or cannot continue working beyond the current normal pension age. The staffside representatives in the NHS Pension Review Group believe that more effective retention of staff will result from the implementation of appropriate support measures, in the form of older worker policies, which research shows are needed.

4.22 The staffside representatives in the NHS Pension Review Group believe a compulsory rise in pension age will have unintended and negative outcomes which undermine the aim of retaining older staff. These include:

- a risk to patient safety – people, whose capability is compromised by age-related challenges but are not eligible for ill-health retirement, may continue to work in vital occupations in order to avoid reducing their pension benefits.

- reduction in staff morale, encouraging many older employees to leave the service before they may have done – either to take early retirement or to work elsewhere. Staff morale will be affected by the fact that a compulsory rise in pension age means that scheme members will need to work longer for the same annual pension. Those that benefit from Agenda for Change (AfC) will perceive that any gains have been removed by the financial losses incurred by increasing the pension age.
- increases in costs to the public purse. The increase in ill-health retirement has already been mentioned. In addition, failure to address flexible work issues for older NHS staff may lead to increased employer costs for temporary staff. Employers' expenditure on bank and agency staff is a considerable burden on public finances. In 2001, the Audit Commission reported that agency and bank expenditure was £810 million in England and Wales.

4.23 The NHS has a good scheme. The staffside Review partners believe that raising the NPA will make it worse.

Shared view

4.24 Both staff and management sides agree that increasing the normal pension age will not by itself result in staff working longer for the NHS. We both agree that, regardless of the issue of NPA, the NHS needs to implement a range of measures to support retention of the older workforce. These include:

- job redesign taking account of patterns of shift working, workload etc
- appropriate occupational health services
- elder care policies
- providing continuing professional development
- tackling age discriminatory attitudes and employment practices
- addressing environmental pressures that undermine employee morale and organisational commitment. For example, the NHS staff pensions survey found that only 43% of NHS respondents to the NHS Pension Review survey (see section 5) agree they can maintain a healthy balance between their work and personal lives, compared with 53% of the wider workforce. Only 36% of respondents believe that employees in the NHS are treated with dignity and respect, including by patients and the public, regardless of their position, age or background. This compares with 63% in the wider workforce.

The Review partners seek views on the issues contained within this section, in particular:

- **the Government's intention to increase the normal pension age to 65 for public sector workers**
- **its appropriateness for the NHS**
- **ways in which the NHS can retain its older workforce and the issues it needs to address in doing so.**

5 What staff said: the NHS pensions survey

5.1 The Review commissioned Mercer Human Resource Consulting to undertake a social survey research project to investigate the views and opinions of NHS employees regarding the NHS Pension Scheme and retirement planning. The survey design and analysis were undertaken by Mercer working in close co-operation with the joint research sub-committee of the NHS Pension Review Group. This section is drawn from the executive summary of the report.

The survey's design

5.2 The research design included four main features.

- The survey was administered to 11,825 employees (outgoing questionnaires).
- Questionnaires were distributed to a sample of GP practices and NHS trusts across England and Wales.
- A total of 3,116 completed questionnaires were returned, which is a response rate of 26%, slightly below expectations, but possibly due to the fieldwork being conducted in the month of August.
- The final sample has been weighted so that it accurately matches the NHS workforce in terms of the following characteristics: age, ethnic group, gender and occupational group.

5.3 There are four major themes in the findings that have emerged from this research.

Pension awareness

5.4 Many employees have a poor understanding of the NHS Pension Scheme and lack confidence in their own retirement planning. A number of specific findings point to the need for greater communication and education efforts to improve pension planning and increase the level of savings for retirement.

5.5 This finding is important because the research also demonstrates that pension communication has a strong influence on satisfaction levels with the pension scheme, which in turn has a significant influence on employee commitment.

Pension savings

5.6 There is a general desire to increase pension savings. Among all occupational groups a majority of employees was interested in the option to increase their main monthly contribution.

- However, the vast majority of employees have not made additional contributions to the scheme, for example through additional voluntary contributions (AVCs) or added years. The number one reason cited was the lack of information to help the employee decide whether or not to invest more. This indicates that with the right information employees may decide to increase their pension savings.
- Increasing pension savings is not an option open to all. For a third of current and former scheme members who are not making additional savings, affordability is an issue

preventing additional savings. While this may be due to limited financial resources, it may also be due to a lack of awareness regarding the true costs and future benefits of increasing pension contributions.

Desire for flexibility

5.7 The research demonstrates a high level of interest in having greater flexibility to assist retirement planning. This is in terms of:

- having the option to increase the main monthly contribution level
- varying the lump sum benefit in order to increase – or for some to decrease – monthly pension income
- having options for flexible retirement, including the option to 'step-down' into retirement – provided that the employee's pension is unaffected, and also the option of returning to work after retirement.

Satisfaction with the NHS Pension Scheme in context

5.8 There is a high level of satisfaction with the NHS Pension Scheme. Only 3% said that they were dissatisfied with the current scheme and 70% said that they were satisfied. Given the relatively low level of knowledge about what the scheme offers, it is clear that this satisfaction is based on trust rather than insight.

- Pension satisfaction is found to be a significant driver of employee commitment and many employees report that the Pension Scheme is one of the reasons that they remain working within the NHS.
- The Pension Scheme is regarded as an important attribute of a job in the NHS with 54% expecting it to be the most important source of income in retirement.
- One of the consequences of employees' satisfaction with the scheme and the importance that they attribute to it is that it has an impact on employee retention. This is most evident among career groups that are not involved in clinical practice and therefore less likely to be motivated by the clinical and vocational challenges provided by a career in the NHS.

5.9 While there are many issues affecting employee commitment and retention this research has established a causal link with the design and delivery of the NHS Pension Scheme. In summary, pension communication leads to greater satisfaction with the Scheme, and this leads to higher levels of employee commitment and a greater willingness to defer retirement.

5.10 The full report is available on the NHS Employers website, www.nhsemployers.org

6 Review aims

Overall review aim

To ensure the NHS Pension Scheme meets the needs of a modern NHS and its staff, by making benefits more appropriate for today's workforce.

6.1 It is important that the pension scheme reflects the values and meets the needs of the NHS. The NHS needs to provide a high-quality statutory pension scheme that supports the aim of making the NHS the employer of choice by helping the NHS to recruit and retain staff and to encourage staff who have left the NHS to return. We need a 21st-century pension scheme that provides staff with an assured income in retirement that recognises their service to the NHS and enables them to save appropriately for retirement.

Key principles

6.2 The Review members agreed a set of principles for developing a modernised pension scheme that need to underpin its design.

Mutuality

6.3 The NHS Pension Scheme should retain the mutuality principle – seeing the scheme as a jointly owned benefit rather than as individual savings. Mutuality means that members and their employers join together to fund the benefits.

Defined benefit

6.4 The Government has promised that defined benefit pensions will continue to be provided in the public sector. A defined benefit pension scheme will be vital in attracting and retaining NHS staff.

Equity

6.5 The NHS Pension Scheme must be seen to be fair to members. The scheme should adopt an equitable approach with transparency of benefits for all NHS staff groups and for male and female staff.

Equality and diversity

6.6 The design of the NHS Pension Scheme should seek to avoid discrimination on the grounds of age, race, sex, sexual orientation, marital status or disability, and must at all times reflect the spirit of all aspects of equality legislation.

Modern career patterns

6.7 The design of the NHS Pension Scheme needs to reflect modern career patterns such as part-time working, career breaks, portfolio careers and the changing job roles of NHS staff.

Supporting recruitment and retention

6.8 Incentives in the Pension Scheme need to be aligned with NHS employers' responsibility to recruit and retain the workforce the NHS needs.

Flexibility

6.9 Retirement should no longer be seen as a once and for all occurrence, a one-off event separating employment and retirement. Rather, the NHS Pension Scheme should encourage, on a voluntary basis, a flexible boundary between employment and retirement. The NHS Pension Scheme should also allow flexibility as to the sum members choose to save towards retirement.

Affordability and value for money

6.10 The NHS Pension Scheme must be affordable both for employers and employees. Proposals need to offer value for money for both employers and employees and minimise risk to the overall financial position of the NHS in the short and longer term.

Communications

6.11 General awareness of pension issues among members needs to be raised. Members and recruits to the NHS need to be well informed about the NHS Pension Scheme, how it might change and how the changes might affect them. Where options are offered, they need to be sufficiently simple that members can make informed decisions.

The NHS Pension Scheme must be a scheme that is easily understood by members, employers and the NHS Pensions Agency.

Choice

6.12 Current NHS Pension Scheme members should be offered choice in relation to scheme options. In addition, scheme members should be offered the choice to purchase improved benefits. Scheme design should encourage members to make informed decisions about retirement and offer continued choice in retirement.

7 Financial considerations

Pension Scheme funding arrangements

7.1 The NHS Pension Scheme is an unfunded scheme. This means that instead of paying for benefits out of scheme investments at each valuation of the Scheme, the Government Actuary's Department (GAD) aims to set a standard contribution rate that ensures benefits are paid for as they build up during active service. The current contribution rate is 20%, made up of a 14% contribution by employers and 6% by employees (5% for manual workers). This was set by the 1994–99 valuation published in 2003. Employees receive tax relief on pension contributions and a national insurance rebate; therefore, the real cost to employees is around 3.5% net. GAD are about to embark on a valuation for 1999–2004, but this was not available for the Review. A summary of the basis for costings is in annex C.

The Review's financial framework

7.2 Recommendations for change are based within the financial framework set by the Government, as outlined below.

- **There is no new money for improving pensions.**
  The Government requires pension schemes to make savings as part of the pension reviews.
- **Employer contribution rates should not be increased.**
  The pension scheme contribution rate is currently determined every five years by the Government Actuary based on a series of financial and other assumptions. Rates can vary depending on the assumptions used and the actual retirement practices of the members. The Review should not introduce changes that cause the contribution rate to increase for employers.
- **Improvements in the schemes have to be funded from changes.**
  Logically, if no new money is available and employer contribution rates remain the same, any improvements in the scheme have to be paid for by changing the structure of the benefits to keep within the overall cost envelope or by increasing the employee contribution rate.

Creating savings for improvements

7.3 The main source of savings is from changing the normal pension age from 60 to 65. This provides savings of 1.3% of pensionable pay. The savings would be greater but the cost of some other benefits increases as the pension age rises. For example, the cost of providing ill-health pensions is greater as the incidence of Ill-health retirement increases with age. Also, the average age at which NHS scheme members choose to retire (about 62) makes savings from changing the NPA smaller. As the savings are linked to a move in pension age, the Government's view is that benefit improvements funded from this should only be made available once members have moved to 65 as a pension age. There are other savings available from restructuring some existing benefits not related to the retirement age, and these could be made available for reinvestment sooner.

Staffside position on financial framework

7.4 The NHS unions do not accept the Government's position that improvements, including legislative changes to the scheme, have to be funded from within existing costs. There are a number of areas of change, created by the Government's proposals, that serve to increase the cost of pension provision. However, these costs are being met by reducing the value of benefits to scheme members, rather than by further funding from HM Treasury or sharing the cost increases between employers and employees.

7.5 If the Government's current position is maintained, the NHS unions believe that the revised pension package will result in detrimental changes to the value of NHS pensions.

7.6 Further staffside views on the financial framework are included in annex D.

Options for existing staff

7.7 The Review partners recognised the need to consider very carefully options that might be made available to existing NHS staff. The preference of the staff side was to see improvements made available to both existing and new NHS staff on an equal basis. However, this approach needed new money to be put into the Review, which, as explained above, was unlikely to be forthcoming

7.8 Despite this constraint, the Review partners felt strongly that there needed to be some benefit improvements for existing staff, if possible before the end of the protection period. Further, the staff side proposed that all of the savings from changing the NPA should be made available for improvements. It was agreed that this proposal should be put to ministers, subject to the outcome of the consultation exercise.

The Review partners would welcome views on the funding issues set out in this section recognising the firmly held view of the staff side that *all* the savings from the proposed changes to the scheme should be made available for improvements and the Government position that savings should be made.

8 A new pension scheme

8.1 This section describes options for a new scheme. The improvements costed, with resource implications, are set out in annex C. It will not be possible to afford all improvements. The Review partners have prioritised the improvements in the tables. As previously indicated, any recommendations will be subject to agreement by the Government.

8.2 If the decision is made to go ahead with an increase in the normal pension age (NPA) to 65, then it is envisaged that a new pension scheme will be set up. The new arrangements will form part of the overall NHS pension scheme. All new entrants would only be eligible for the new scheme. Existing staff would be able to join the scheme subject to certain conditions (see section 9). The new scheme would have a normal pension age of 65 and a minimum pension age of 55. The latest a pension could be taken would be 75. Pension taken before normal pension age would be actuarially reduced. Pension taken after normal pension age would be actuarially increased.

8.3 Staffside partners have accepted that the Review's proposals are structured on a new scheme basis but would wish for an amended scheme approach, where new and existing staff are in the same scheme, to be evaluated if their arguments for a different financial framework were accepted. This issue is set out further in 9.9.

8.4 This section describes the recommendations and options for the new scheme. They include:

- choice over the size of tax-free lump sum that is taken
- changes to the way the pension is built up (accrual)
- survivor benefits for all eligible unmarried partners
- more flexibility around taking the pension
- new ways to save more for retirement
- a review of sickness and ill-health arrangements
- widening access to the pension scheme for healthcare staff.

Building the pension

8.5 The new pension scheme will be a defined benefit scheme in line with the Government assurance at the start of the Review. The Review considered two options for the new scheme:

- one based on final salary where pension is calculated on pensionable pay close to retirement
- one based on career average revalued earnings (CARE) where pension is calculated on an annual basis, depending on earnings in that year and then revalued (increased) each year.

Choice of lump sum

8.6 For both options, we recommend that the current approach of having an accrual rate for the pension of 1/80 (1.25%) of pensionable pay for each year and 3/80 (3.75%) lump sum be replaced with a single accrual rate for benefits taken. This gives members much more flexibility and the opportunity to choose how much lump sum they wish to take. Members would be able to choose the size of tax-free lump sum they wish to take up to 25% of the value of the pension as calculated by the Inland Revenue methodology (see boxes below). Members would receive a tax-free lump sum payment of £12 for every £1 of pension they gave up; this is known as commutation. In such a scheme, the maximum lump sum can be worked out by multiplying the pre-commutation pension by 30/7 (or 4.28).

The new Inland Revenue rules

As part of the new pensions arrangements, the Inland Revenue will be introducing rules for calculating the value of defined benefit (final salary and career average) pensions. The value of the pension will be calculated as 20 times the pension after commutation plus the value of the lump sum. The value of a pension of £4,000 and a lump sum of £12,000 would be £92,000.

Lump sum options – 25% example

Jack has earned a pension of £10,000. If he wishes, he can choose not to take a lump sum at all so that he can maximise his pension. The maximum 25% lump sum he can take is £42,857. This would leave him with a residual pension of £6,429. He has given up £3,571 of pension for which he receives 12 times that as a lump sum. He can take any size of lump sum between those two figures. For instance, if he wished to take a lump sum of £36,000, this would leave him with a pension of £7,000. If he took a lump sum of £24,000, this would leave him with a pension of £8,000.

Improving the accrual rate: final salary option

8.7 In our discussions, there was strong support for improving the accrual rate – the amount of pension members receive for each year of service. The Review looked at two approaches to doing this. The first approach would be to improve the accrual rate to 1/60 while retaining a final salary scheme. Any lump sum would be taken by commuting pension at the rate of £12 for every £1 of pension foregone. This would mean that although pensions were not payable in full until the age of 65, the member would receive additional value for each year they worked of around 6%. An example is shown in the box below.

A $^{1}/_{60}$ scheme

Angela has chosen to retire at 65 with 30 years' service. Her salary is £30,000. Under the current scheme she would be entitled to a pension of $^{30}/_{80}$ of her final salary (£11,250) and a lump sum of three times her pension (£33,750). Under a $^{1}/_{60}$ scheme, her pension would be $^{30}/_{60}$ of her final salary (£15,000) but without a separate lump sum. If she chose to take the same lump sum of £33,750 then her pension would be £12,187. If she chose to take the same pension of £11,250, then her lump sum would be £45,000.

Improving the accrual rate: career average option

8.8 An alternative way of calculating a pension that the Review considered was career average revalued earnings (CARE). In a CARE pension scheme, benefits are built up on an annual basis and revalued (increased) typically in line with either national average earnings (NAE) or the retail price index (RPI).

8.9 GP and dentist pensions are based on a form of career average. Typically, the accrual rate for a CARE pension is different than for a final salary pension: for example, for practitioners (GPs and dentists) the current rate is 1.4% ($^{1}/_{71}$) of salary per year compared with 1.25% ($^{1}/_{80}$) for each year for the current final salary scheme. Some private sector pension schemes have moved from final salary to career average schemes as a way of reducing scheme costs or scheme risks. The Review only considered a CARE scheme at the same cost as a $^{1}/_{60}$ (1.67%) final salary scheme. The Government Actuary's Department (GAD) has advised that at the current scheme costs the accrual rate for a CARE scheme would be around 2.05% ($^{1}/_{49}$) per annum if revalued in line with RPI. If revalued in line with NAE, it would be around 1.8% ($^{1}/_{56}$) per annum. Earnings have historically increased by more than prices so with RPI revaluation the accrual rate is higher with a lower revaluation, and vice versa for NAE .

8.10 How this would work is set out in the box below. GAD will be undertaking a formal actuarial valuation of the NHS Pension Scheme as at 31 March 2004. If the new scheme were to be CARE based, then the accrual rate might be appropriately set with regard to the costs of a $^{1}/_{60}$ scheme after the valuation.

8.11 Of the two CARE options, an approach using NAE revaluation for active members is preferred to provide an incentive for staff to stay with the NHS. The benefits of those who leave as now would be increased by RPI after leaving. All comparisons and examples use NAE revaluation.

8.12 The Review's independent actuarial adviser has produced a theoretical modeller that is available to compare final salary and career average benefits. This will be available on the NHS Employers website at www.nhsemployers.org. Some comparative examples are shown in annex F.

How pension builds up in a CARE pension with a 1.8% accrual rate and revaluation by national average earnings (NAE)

David is a newly qualified nurse. He starts his career in 2006 at age 23 at the bottom of pay band 5 with a salary of £18,114. At the end of that year he has earned 1.8% of his income as pension (£326).

In the second year his salary increases to £18,647. He earns a further £336 of pension. He has now earned £662 of pension at constant earnings.

Each year 1.8% of his salary will be added to his pension. The pension earned will be payable without reduction when David is 65. At 32, David becomes a health visitor (band 6) and works full time until he retires at 65. His salary at retirement is £29,302 and his pension before taking a lump sum is £20,446. With a final salary $^1/_{60}$ scheme his pension would be £20,511.

This example is at constant prices and earnings, and only shows David receiving pay rises through promotion and pay band increments at current rates. In reality earnings would not be constant. Under CARE each years' pension earned would be revalued annually by increases in NAE. Under a final salary scheme, pensionable pay would increase by the level of NHS pay increases each year in addition to the promotional increases. These general earnings increases are not shown in the example so as to provide a better comparison with current earnings levels.

The Review partners would welcome views on the strong recommendation that the proposed new scheme should improve the accrual rate.

Final salary and career average

8.13 To compare final salary and career average, the following assumptions have been made. For a final salary scheme, accrual would be at $^1/_{60}$ (1.67%). For CARE, the equivalent accrual rate is $^1/_{56}$ (1.8%) revalued by NAE. The definition of pensionable pay used for both arrangements is the current one. Lump sum is by commutation in both arrangements.

8.14 In a theoretical comparison of a final salary scheme with a career average scheme, costing the same amount, there would be winners and losers. A final salary pension calculation is based on years worked and final pensionable pay. It does not take account of the pensions contributions made over a career. In a simplified comparison carried out for the Review based on the 1999 valuation pay progression assumptions, the annual pensions of the different staff groups were compared with their average annual contributions over a notional 40 year career.

8.15 In this comparison, there is a variation of approximately 30% in the value different groups of scheme members receive from their contributions. A career average scheme maintains a much closer relationship between pension and contributions than a final salary scheme.

8.16 Using this comparison, men receive around 10% more initial pension from their contributions than women, as a result of higher career progression. Typically, those with significant career pay progression (often higher paid staff) in the NHS get more value from their pension contributions.

Pensionable pay definition

8.17 CARE schemes, if properly designed and funded, benefit those with flat career structures. However, compared with final salary schemes, they do this by taking away benefits from those with better career progression. Agenda for Change will introduce new pay structures, linked to a new Knowledge and Skills Framework, which are aimed at improving career prospects for all staff in the NHS. Staffside colleagues are concerned that the potential benefits of these arrangements may be clawed back through changes to the pension scheme if CARE is adopted.

8.18 A final salary pension scheme provides a pension that is predictable and easily calculated from a member's earnings before retirement. It ensures that the pension scheme benefits for all of a member's service grow in line with their salary.

8.19 In the current final salary pension scheme, not all pay is pensionable. For instance, overtime pay is excluded. There are strong arguments that in a career average scheme more NHS pay should be pensionable. This is the approach now taken for GPs in their CARE pension scheme. This would have costs for both employers and employees. We anticipate that if more pay were pensionable, then depending on the definition used, pensionable pay costs might eventually increase by 5-10%. This cost would build up over time as staff moved into a career average scheme. This would increase pensions for staff who currently have pay that is not pensioned, for instance those who do overtime. The examples used in this document would show larger CARE pensions if this was included.

Active and deferred members

8.20 In a final salary scheme, deferred members (those who have left the NHS but not transferred their pension benefits to another scheme) can subsidise those who stay and whose benefits are revalued by their final salary. In a CARE scheme with RPI revaluation it makes no difference to revaluation of pension whether a member is active or deferred. If revaluation by NAE is used for active members and returners and RPI revaluation for deferred members, then this gives an incentive somewhat similar to a final salary scheme for members to stay in the NHS or rejoin. Given the strong imperative to retain staff, this approach is more likely to be appropriate for the NHS. However, final salary generally gives more benefits to active members compared to deferred members than the CARE arrangement being used for comparison.

Funding issues

8.21 Costs in a final salary scheme are more volatile. If overall pay progression increases and more staff stay in the NHS, then costs and member benefits will rise beyond the increase in the NHS pay bill. Likewise, if pay progression is lower and more people leave the NHS then member benefits will be lower. In a career average scheme, increases in costs as a result of pay progression are largely fixed and tied to increases in the overall pay bill.

Staff attitudes

8.22 Final salary schemes are widely seen as the 'gold standard' for pensions. They are known and trusted, which is particularly important in the current climate of uncertainty surrounding pensions. It is likely that retention of a final salary scheme will be warmly welcomed by existing scheme members.

Complexity and understanding

8.23 It is clear that NHS staff generally have a good if limited understanding of a final salary scheme. CARE is not known or understood other than by practitioners. There is a view that schemes based on career average earnings are generally more complex to understand than final salary ones.

8.24 In an NHS context, if a new pension scheme were to be introduced based on CARE, it would make it significantly more difficult for existing members to decide whether or not it was in their best interests to transfer to the new scheme. There would need to be a major communications exercise if the new scheme was to include CARE, to enable NHS staff to understand the scheme.

Managementside view

8.25 The managementside representatives recognise the arguments for retaining a final salary approach, particularly the support that existing staff undoubtedly have for a final salary pension. However, they have major concerns about equity, equality and value for money.

8.26 The current final salary scheme has distributed benefits on an inequitable basis between members. It can be seen as distributing benefits away from groups with members who are less well paid, with interrupted service and lower career progression towards those groups with higher pay and better career progression. Career average would mean all receiving more or less equal value from their contributions.

8.27 At a time when the NHS is changing its pay systems, retaining a final salary pension scheme could bring increased risks of higher scheme costs leading to an increase in the contribution rate. This could result in funding pressures impacting on NHS services. For example, an increase in the employers' contribution rate for the pension scheme of 2% would add around £500 million per annum to NHS costs. Increases in employers' pension costs reduce resources available for patient care, unless funded additionally by the Government.

8.28 Retaining final salary increases the risk of funding pressures on the scheme and therefore the risk of the NHS needing to increase the contribution rate in the future. There are a number of factors that impact on the costs of the pension scheme. The management side believes that the NHS will benefit from a more stable contribution rate and that a career average scheme is more likely to deliver this.

The staffside view

8.29 The staffside representatives have not been convinced of the case for CARE. They believe that there is not enough information on its operation in practice for it to be properly evaluated and therefore command support. Conversely, a final salary scheme is known and valued by members.

8.30 The staff side acknowledges that scheme members with non-traditional career patterns, for example those who work part time or take career breaks, can face additional barriers in terms of developing their careers in the NHS, which can in turn impact on their pensions. Most NHS trusts have put policies and training in place to break down these barriers, but there is undoubtedly more work to be done to achieve real equality. The staff side believes that the best way to tackle this kind of discrimination is by getting to the root of the problem through the proper HR processes, and not through the pension scheme.

8.31 The trade unions in the NHS have been assured repeatedly that the cost of pay modernisation, in particular Agenda for Change, has been fully funded. The new pay system has been equality proofed and will provide for enhanced career progression. The staffside representatives consider that the costs of this enhanced career progression should not be recovered in the NHS by the adoption of CARE. Additionally, they consider that a final salary pension scheme will be an aid to recruitment of new staff. Therefore, the staff side continues its support for a final salary scheme.

The Review partners seek views on which of the two alternative defined benefit options are favoured, the retention of final salary pensions or the introduction of career average pensions in the new scheme.

The Review partners seek views on the pensionable pay definition to be used should CARE be adopted.

Other accrual issues

New limits to scheme benefits

8.32 Within the current scheme, members are limited to 40 years' membership at the age of 60 and 45 years' membership at the age of 65. The service limits for MHOs and special classes are different. A very low proportion of members are restricted by these rules because they have more than 40 years' service. In addition, for members joining after 1989, maximum pensionable pay is set at £102,000. Under the Inland Revenue's new rules, a single lifetime allowance for the level of tax-privileged pension saving of £1.5 million in 2006, rising to £1.8 million in 2010, is put in place. This limit is a maximum for tax-privileged pension saving. The scheme could choose to set lower limits or other restrictions if it chose to.

8.33 We recommend that the new NHS scheme should not set lower limits than the Inland Revenue maxima on the lifetime tax-privileged pension allowance. We also recommend that there should be no limits to years of membership in the new scheme, in line with Inland Revenue rules. A summary of the Inland Revenue proposals is in annex E.

The Review partners welcome views on the recommendation that there should be no limits on membership or restrictions below the Inland Revenue allowances.

Career breaks

8.34 In discussions, there was some support for the proposal of allowing a 'free' added year to members who took career breaks, provided they returned to work for the NHS for a certain period of time. The idea was to compensate those with broken careers who were often unable to build up sufficient scheme membership to get a reasonable pension and who also may experience lower career progression. It would be a similar arrangement to the 'golden hellos' offered to some returning health professionals.

8.35 It is believed that only a very small minority of private sector schemes offer any measure of pensioning career breaks (other than statutory requirements on maternity and paternity leave).

8.36 It has proved very difficult to cost this option. It was assumed that given the high female membership and large number of career breaks, we might expect at least half the membership to qualify for an added year. In this case, costs could be high. It might be possible to implement a much more restricted scheme. However, it was felt that this would be difficult to achieve, particularly given that there would be no financial incentive on trusts to restrict access. Given the likely high cost, the Review cannot recommend including recognition for career breaks. If this was implemented, there would be no money to improve accrual rates. However, it is recommended that employers should be able to pay additional contributions, perhaps on a matched-funding basis. Such an arrangement would be voluntary for employers targeting key staff they wanted to retain.

The Review partners would welcome views on the issue of pensionable career breaks and in particular the proposal that recognition of career breaks should be available at the employer's discretion.

Survivor benefits

Current scheme benefits

8.37 In the current scheme, survivor benefits of $^{1}/_{160}$ (0.625%) of a member's final annual pensionable pay for each year of service are paid to spouses. In addition, on death in service, spouses receive pension at salary rate for between three and six months if there are dependent children. The employer pays this but costs are reimbursed by the scheme. Lump sum death benefits are set at two times pensionable pay. Dependent children are awarded pensions worth varying amounts depending on their circumstances. These are payable up to the age of 17 unless children are in full-time education, in which case they are paid until they leave full-time education.

New options considered

8.38 The new scheme will have to provide survivor benefits to same-sex partners who have registered their relationship, as a result of legislation. The Review examined whether these benefits should be extended. Two options were considered: extending benefits to partners or extending benefits to any nominee. The option of extending benefits to any nominee was discounted. It was felt that the scheme was not intended to pay survivor benefits as a general right regardless of relationship. Such proposals were both difficult to scope and appeared expensive.

8.39 The proposed pensions for the surviving partners of people who are in relationships but who are not married (including same-sex relationships), assumes that the definition of partner broadly follows that adopted by the Principal Civil Service Pensions Scheme. This is that, to qualify for a partner's pension, the member would need to have nominated their partner and, together, completed a joint declaration of partnership. At the time of the member's death, they would need to have been living together in an exclusive, committed long-term relationship, have been free to marry or have a civil registration, and there would need to have been financial dependence or interdependence.

8.40 There is a clear issue of the pension scheme needing to reflect current social patterns of behaviour and to treat all members and their partners fairly. This change would also mean that the practice of cessation of survivor pension on remarriage would cease. This affects surviving widows/widowers who have to give up their survivor pension if they remarry. We strongly recommend that the new scheme includes survivor benefits for partners.

The Review partners welcome views on the recommendation that the new scheme provide partner pensions including ending cessation of survivor pension on remarriage.

Payment of pension at salary level on death in service

8.41 The Review looked at a proposal to pay pension at salary rate on death in service for six months in every case. Currently, this benefit is paid for three or six months depending on whether a member has dependent children. There is uncertainty as to whether the new Inland Revenue rules will allow schemes to continue to do this. It is recognised that this is a valuable benefit for bereaved partners who would otherwise be dependent on the pension benefits being put in payment. We recommend that this benefit should be paid for six months in all cases. If it is no longer possible for the pension scheme to pay this benefit, and we cannot identify another way of achieving the desired results within the scheme, then we recommend that employers be asked to continue to pay this benefit but without reimbursement from the scheme. It is recognised that this would be an additional burden on employers. However, this would be a relatively small cost to employers compared, for instance, with the cost of sickness absence and is consistent with the NHS acting as a good employer.

The Review partners welcome views on the recommendation that the partners of members who die in service should receive a payment at salary level for six months and, if the scheme cannot provide this or equivalent benefits, then employers should be asked to meet the costs of paying this.

Increasing the value of survivor pensions

8.42 Consideration was also given to increasing the value of survivor pensions to $^{1}/_{120}$ of pensionable pay for each year of service. As survivor pensions would be based on uncommuted pension this would mean enhancing the partner pension generally to a greater degree than is represented by moving to a $^{1}/_{60}$ scheme for member benefits. It was felt that, given the costs, this was not achievable without extending the financial envelope.

The Review partners welcome views on whether survivor pensions should be improved in the new Scheme.

Standardising children's pensions

8.43 The current arrangements for children's survivor pensions are complex to administer and are not paid to those over 17 who do not undertake full-time higher education. The Inland Revenue requires that the child must be dependent on the member at the time of death and that pensions should not be paid beyond the age of 23. The Review looked at the cost of providing children's benefits to the age of 23 regardless of educational status. Young adults, whether or not in full-time education, are often dependent on their parents and would therefore suffer the loss of a parent financially.

There was a contrary view expressed that the NHS should not be providing pensions to children of deceased members who were in full-time employment. An alternative approach would be to broaden the criteria for those receiving the pension after the age of 17 to include, for instance, those in part-time education, while still restricting payment of pensions to 23.

The Review partners welcome views on whether the new scheme should pay all children's pensions to 23 or have restrictions after the age of 17 until 23.

Increasing the death in service lump sum

8.44 The Review also looked at the cost of providing an increase in the death in service benefit from two times to three times pensionable pay. Whilst this is clearly a useful benefit, it is unlikely that this would be affordable within the financial envelope currently envisaged by the Government. We did consider an additional multiple of salary for those without a dependant is paid.

8.45 In the course of discussions a number of representations were made to the Review team about the perceived unfairness of only being able to name one beneficiary on the death in service lump sum nomination form. It was pointed out that members might want, for instance, to divide the death in service lump sum among several children. While we recognise that there are some administrative complications with allowing multiple nominees, we agree that this is an unreasonable restriction. We recommend that members be allowed to nominate multiple recipients for their death in service lump sum.

The Review partners would welcome views on

- **increasing death in service lump sum benefit to members**
- **allowing multiple nominees for death in service lump sum**
- **paying an additional year's lump sum payment where no dependant's pension is payable.**

Flexibilities on taking a pension

8.46 We recommend that the new scheme should be designed to remove the cliff edge between retirement and work that exists in the current scheme. The pension scheme needs to encourage staff to join the NHS, return to the NHS if they do leave and work longer for the NHS. A critical issue for NHS staff is income in retirement. Although the available data are incomplete, it is thought that the average level of new awards of pension is currently, very approximately, £6,000 a year and the average membership to achieve that was 18 years. In the NHS staff pensions survey, their NHS pension was by far the most important source of income for staff. However, understanding of the benefits they will receive is limited. Only half those surveyed thought they knew what proportion of final salary they would receive as a pension. Of those, over half expected their pension to be more than half their final salary. The pension scheme needs to support work in NHS trusts to recruit and retain NHS staff and provide opportunities for staff to extend their working lives.

8.47 In a new scheme, the normal pension age of 65 should become simply the date around which benefits are calculated rather than the date when people are expected to retire. The NHS needs a scheme that enables members to plan effectively for their retirement and to build up sufficient pension savings to enable them to retire at the age after 55 that they decide. It needs to offer members a range of options for balancing work and leisure particularly for staff approaching retirement. In the pension survey, 67% of people said they would be interested in working reduced hours before retirement if pension was unaffected, and 63% expressed an interest in returning to work after retirement, the vast majority on a part-time basis.

Draw down, pensionable re-employment and late retirement factors

8.48 We recommend that, in the new scheme, members be allowed to access a range of flexibilities on taking their pension permitted by the new Inland Revenue rules. These would include the following:

- the opportunity to take the pension (including exercising the above flexibilities) at any age between 55 and 75. If this were before 65, then benefits would be subject to an actuarial reduction, if after 65 then benefits would be actuarially increased. Using the illustrative rates included in the background technical papers, this might mean that a pension taken at age 60 would be reduced by around 27% because it would be in payment for five years longer than if taken at 65, while a pension taken at 70 might be increased by around 35% because it would be in payment for five years less
- the ability to draw down a part-pension while continuing to work and build up further pension
- the opportunity to take full pension benefits and continue to work without a break in service, thus building up further pension benefits
- the opportunity to retire, take full pension benefits and then rejoin the scheme after a break.

Supporting wind down

8.49 Wind down means that members can choose to reduce their hours of work. This is available within the current scheme. Protection is provided as their pensionable pay is calculated on the full-time equivalent salary. Years in the scheme accumulate at the proportion of full-time equivalent worked. The Review recommends that this facility should continue.

Changing the reference period for calculating scheme benefits

8.50 The Review has also examined alternative ways of calculating final salary benefits. Currently, pensions are calculated on the best of the last three years' pensionable pay. This means that there is a strong incentive to maintain salary at its highest level until just before retirement. This particularly discourages stepdown options, by which people choose to take a less onerous role with a lower salary. Protected step down is currently only available in a limited form. The NHS Pensions Agency will preserve pension benefits at the final salary when the staff member stepped down to a lower paid post. This protection only applies to rights earned up to that point. As it is a preserved right, the pensionable pay for the calculation is only revalued at RPI. This means that the salary after step down will often be greater than the preserved salary. Step down is little used.

8.51 Costings have been produced for a range of options designed to allow final salary calculations to be made on earnings up to 13 years before retirement.

8.52 The Review also looked at revaluation by NAE but costs were outside the possible range of options for the Review. RPI revaluation is currently used to calculate the pensions of deferred members. This means that the pensionable pay figure used for final salary only increases in line with prices, rather than with NHS pay. There are affordability issues relating to RPI revaluation. However, without RPI revaluation there would be far less of an incentive to step down as the value of salary in earlier years is considerably eroded. The effect of these alternatives would be that all service, including that after step down, would be used for calculating pensionable pay. There would still be the issue of earnings growth outstripping RPI.

Further step down options

8.53 Two further options for encouraging step down were considered by the Review:

- paying contributions at the previous higher salary level
- extending the current protection arrangements.

Paying contributions at a higher level

8.54 An alternative approach to the one set out above is to extend the current step down provisions. The Teachers' Pension Scheme allows for the member, with employer agreement, to elect to continue to pay contributions at the salary rate before step down from minimum pension age. This notional salary is revalued annually. The employer can elect to pay the additional employer's contributions as a retention support. Otherwise the member of staff has to meet the additional employer's contributions as well as his or her own. Such an approach would be broadly cost neutral to the scheme as the level of contributions would be maintained.

Extending the protection arrangements

8.55 Under the current arrangements, protected step down is only permitted when employees lose pay through no fault of their own (through organisational change, for example). Service until the point of step down is protected. In effect, the person who steps down is treated as a returner and previous service as preserved. The Review partners can see a strong case for making this protection available for employees who wish to step down. This is of only limited value as the value of the protection may be quickly eroded by pay increases.

8.56 The Review partners would recommend that step down should be supported in the new scheme: either through an increased reference period for a final salary scheme or, if that is not affordable, by allowing higher contributions to be paid alongside a widening of the provisions for protection.

The Review partners would welcome views on the recommendation that there should be flexibilities of step down, draw down, pensionable reemployment and enhanced pensions for late retirement in the new scheme. Views are also sought on the preferred approach to supporting step down in the new scheme.

Abatement

8.57 Members are currently only able to retire, bring benefits into payment and return to NHS employment on a non-pensionable basis (unless retirement was on ill-health grounds and they are under 50 in which case they can rejoin the scheme). If they do return to work their pension is abated (reduced) if their total income from NHS employment and pension is greater than their pensionable pay on retirement. Abatement ceases at age 60 so in practice applies to re-employed pensioners who retired early on ill-health, redundancy or employer agreed voluntary early retirement grounds or re-employed members of the special classes who retired before age 60. Abatement does not apply to those who retire before age 60 with actuarially-reduced benefits.

8.58 In the new scheme it is proposed that members will be able to take advantage of a range of flexibilities. All of these flexibilities will be actuarially neutral around a normal pension age of 65. There are particular issues about staff with protection that are discussed in section 9. However, for staff with service wholly in the new scheme, it is clearly inappropriate to abate pensions when members exercise the flexibilities.

8.59 There remains an issue about whether to abate pensions when staff have been given an enhancement in respect of ill-health or redundancy. The Review looked at the issue of whether abatement should be totally removed. Whilst this would encourage staff to return to work, it could also be perceived as unfair as staff had been given an enhancement to their pension. There is a cost to this option.

8.60 The Review also looked at options for abatement that applied solely to the enhanced element of the pension in payment. The enhanced element is defined as the difference between the member's actual pension and the pension that they would have received if they took voluntary early retirement. Two methods were explored: one which abated in respect of the whole enhancement and a second which reduced the abatement to recognise loss of office.

The Review partners seek views on how abatement should be addressed.

Increasing saving for retirement

8.61 It is clear that most members should increase saving for retirement. Within the current scheme, if members wish to increase their saving for retirement, they have the option of buying added years or taking out additional voluntary contributions (AVCs). Added years contracts are typically taken out over a long period of time and are paid until retirement. Within the current scheme, there are 70,000 members currently buying added years (less than 6% of active scheme members). Proportionately more senior staff take up the option of buying added years. The rates may be less to reflect their take up by those with high career pay progression. This means that they are less financially attractive for some staff with lower pay progression. There are even fewer members using money purchase additional voluntary contributions (MPAVC) arrangements (43,000). The Review partners believe that the key test of any arrangements is whether they encourage a substantial proportion of NHS staff to save more for their retirement.

8.62 Perhaps the biggest disadvantage for staff is the requirement to make a long-term commitment to paying additional contributions from salary to improve their pension. Many feel unable to make that commitment. In our survey, 42% of those not making additional pensions contributions said that it was because of lack of information and 35% said that they could not afford it. However, 69% said that they would like the opportunity to pay a higher contribution rate to build up their pension more quickly. While added years are valued by some staff, it is clear that there is a gulf between the desire of people to pay more to build up their pension and take-up of the current scheme.

Additional voluntary contributions (AVCs)

8.63 The changes that the Inland Revenue is making to the tax regime provide the opportunity to look again at how members can make additional contributions in the new scheme. From 2006, rules will allow NHS staff to make contributions of up to 100% of their salary tax-free into their pension. This will be subject only to an annual allowance of increasing the value of their pension pot by £215,000 and to a lifetime allowance of £1.5 million before incurring additional tax liabilities. For members in a defined benefit scheme such as the NHS, this means that the annual amount of their pension before commutation can be up to £87,500 before tax is payable.

8.64 The Inland Revenue rules are permissive and the NHS scheme does not have to allow members to build benefits up to this level or allow this level of contributions. However, the Review believes members should be offered encouragement to save for their retirement within the scheme.

8.65 The Review has looked at whether to end or amend added years arrangements in the new scheme. In addition, the Review looked at a new pension purchase arrangement.

A new pension purchase arrangement

8.66 This would mean that members would be able to set up an arrangement with their employer and the NHS Pensions Agency to pay additional contributions set by the member at a level that suits their circumstances. At the end of the pension year (31 March), the additional contributions made by the member over the preceding year would be used to purchase additional pension. The cost of pension purchased would be subject to the age of the member and would be set out in tables produced by the Government Actuary.

8.67 The pension purchased would be revalued annually using either NAE or RPI. Pension benefits thus earned would be treated exactly the same as benefits earned in the main scheme. They would be payable in full at the age of 65 but subject to the same flexibilities as main scheme benefits. Members would be able to decide annually how much they wish their additional contribution to be. This would mean that a member could pay higher contributions when their outgoings were lower and reduce additional contributions when things were tighter.

Limits on in-scheme savings

8.68 The Review was made aware of a strong view on the part of Government that there should be limits on the amount of additional savings members are able to make within the scheme. This would provide guaranteed benefits underwritten by the Government and in setting those limits the Government is likely to want to strike a balance between encouraging staff to save more for their retirement and taking on additional liabilities. Members are of course free to put money into other pension plans outside the scheme in the new scheme. This will be the subject of discussions with the Treasury who have the authority to approve such a scheme.

8.69 Another issue is what the limit should be on pension contributions in any one year. The Inland Revenue would allow this to be up to 100% of salary, rather than the current 15%. The scheme could use the IR maximum limits or introduce its own limits.

8.70 The managementside representatives believe that a pension purchase arrangement would be more appropriate for the majority of NHS staff and should replace added years arrangements. Staffside representatives believe that pension purchase and more flexible added years arrangements should both be offered.

The Review partners welcome views on the proposed additional pension purchase arrangement including the issue of contribution limits and limits on the overall amount of pension purchased.

Views are also sought on the issue of removing or amending added years arrangements in the new scheme.

Money purchase additional voluntary contributions (MPAVCs)

8.71 In the current scheme members have the opportunity to contribute additional voluntary contributions through the payroll to schemes run by three partner providers. The current level of take up of MPAVCs in the NHS is very low. Confidence in MPAVCs was affected by the difficulties experienced by the previous sole provider.

8.72 We consider that there are three options for an externally provided AVC scheme in the future:

- not offer an MPAVC scheme linked to the main scheme
- offer an MPAVC scheme with a choice of providers
- offer an MPAVC scheme with a single provider.

8.73 The Review has received input from the current MPAVC providers. They are of the view that members would benefit most from an MPAVC option with a single provider. They believe that the system of regulation that has been put in place will provide safeguards against a repeat of previous problems with a single provider. Their submission to the Review is available on the NHS Employers website.

8.74 We can see the value of offering members an MPAVC option that is simple, quality assured by scheme managers and which they can contribute to through payroll. We feel many members are more likely to increase retirement savings if the logistics involved are relatively simple.

8.75 On the other hand, there is a risk in the NHS Pension Scheme being seen to endorse private sector providers over whose performance the scheme has no control. Members are free to set up their own pension top-up arrangements.

8.76 If we were to continue with an MPAVC arrangement there are benefits to the single and multiple provider routes. Using multiple providers gives members more of a choice. However, it is possible that members would receive a better service from a single provider who might invest more in providing a better quality product. Availability of independent financial advice is a critical issue.

The Review partners welcome views on which of the three approaches should be taken:

- **to not offer an MPAVC scheme linked to the main scheme**
- **to offer an MPAVC scheme with a choice of providers**
- **to offer an MPAVC scheme with a single provider.**

Practitioner pensions (GPs and dentists)

8.77 General practitioners and dentists have different pension arrangements from NHS staff. As they are self employed, a final salary method for calculating pension benefits would not be appropriate. This is because the earnings pattern is typically different from salaried staff, with peak earnings often occurring in mid career. In addition, self-employed members have greater control over their earnings in any one year and may be able to influence the level of final salary in a way not open to salaried staff.

8.78 Practitioner pensions are therefore calculated using the CARE method. The CARE accrual rate calculated to deliver a pension equivalent to 50% of final salary with 40 years' service is 1.4% ($^1/_{71}$) per year of service rather than 1.25% ($^1/_{80}$) in the final salary scheme. Pension is dynamised using a bespoke formula based on the increase in practitioner profits for GPs and NHS earnings for dentists. Following implementation of the new General Medical Services (GMS) contract, all of GPs' NHS profits are pensionable. Otherwise, practitioners receive broadly the same pension benefits as other staff.

8.79 The Review partners recommend that the Practitioner Pension Scheme should continue on a CARE basis for new practitioners. If the main scheme was to become a CARE scheme, then logically arrangements for practitioners should move onto the same basis. If the main scheme moves to a final salary $^1/_{60}$ based scheme, then it is recommended that the practitioner scheme also moves to a single accrual rate with commutation of pension for the lump sum. The comparable accrual rate for practitioners to maintain parity with the improvement in the main scheme accrual rate would be 1.87%. Staffside Review members favour maintenance of the current approach to dynamisation.

8.80 Other than accrual, the Review partners recommend that new entrant practitioners after 2006 should receive the same benefits package as other new entrants would receive as outlined in this section.

The Review partners seek views on their recommendation that practitioner pensions should continue to be on a CARE basis and that the accrual rate for the practitioner scheme should be set to maintain the current relationship with the main scheme.

Employee contribution rate

8.81 Currently, most employees pay a contribution rate of 6%. Manual staff currently have a contribution rate of 5%. This was originally given in recognition that manual staff had less opportunity for career progression and received a lower level of benefits from the scheme.

8.82 The Review partners recognise that a different contribution rate solely for manual workers is inappropriate after implementation of Agenda for Change (AfC). The 5% rate currently paid by manual staff should be extended to all staff with pay equal or below the top of Agenda for Change pay band 2 (para 9.14 and table).

8.83 With regard to new staff three options were examined:

- moving all staff to a 6% contribution rate
- giving all staff with pay below or equal to the top of pay band 2 a 5% contribution rate
- restructuring contribution rates so that all of every member's pay up to the top of pay band 2 attracts a lower contribution rate but a higher rate is paid on all pensionable pay above that level. It has been calculated that for every 1% that the lower rate is below 6%, the higher rate would need to be 1.5%–1.75% above 6%. So, if the lower rate was to be 5%, then the higher rate would be 7.5%–7.75%.

8.84 There is a strong argument for lower paid staff having a lower contribution rate within a final salary scheme as they are likely to experience lower career progression than other scheme members. On the other hand, AfC is expected to address the issue of career progression. Increasing the contribution rate for higher pay levels while reducing it for lower pay levels would be cost neutral. However, this is likely to be seen as a pay reduction by higher paid staff. It is important to note that there is an affordability issue if staff with pay equal or below the top of AfC pay band 2 are given a 5% contribution rate.

The Review partners would welcome views on the options set out above.

Ill-health retirement

8.85 Currently, the NHS provides a single level of ill-health retirement. This involves enhancement of service on retirement for those permanently incapable of carrying out their employment. For members with over twenty years' service, the maximum enhancement is 6½ years, between ten and 20 years the maximum is ten years and below ten years the maximum is five years. There has been a significant decrease in the rates of ill-health retirement experienced in recent years, and GAD has undertaken a preliminary calculation suggesting that a reduction of one-half in the rates of ill-health retirement experienced in the older age-ranges might lead to a reduction in scheme costs of around 0.5% of pay.

8.86 Ill-health retirement formed a major part of the discussions at the NHS Confederation member seminars on risk benefits. A number of points emerged.

- There were felt to be significant problems with the way that ill-health, including ill-health retirement, was dealt with in the NHS both from management and staff side attendees.
- Currently, the processes for dealing with sickness and ill-health retirement were not very well integrated: the former being the responsibility of employers and the latter of the pension scheme.
- There were a group of NHS staff currently left in limbo: deemed too ill to work by their employer but not given ill-health retirement by the NHSPA.
- Occupational health services were often reactive rather than proactive, only becoming involved when sickness was entrenched.
- Redeployment was an important part of dealing with NHS staff who were unable to continue in their current post. However, many trusts found this difficult to cope with in terms of finding suitable alternative employment. This was a particular issue for ambulance trusts, where it was felt that frontline duties were currently difficult to sustain until normal pension age but where there were very few alternatives.
- The Public Sector Review of Ill-health Retirement in 2000 recommended a two-tier approach to ill-health retirement. In a two-tier scheme, typically there would be two levels of benefit depending on the degree of incapacity. Other public service schemes have introduced or are proposing to introduce such two-tier ill-health pensions. There were different views as to whether there could be an advantage in moving to this type of arrangement.
- The issue of ill-health retirement would become even more important if NPA rose to 65. There was a risk that ill-health retirements could rise rapidly.

8.87 It was felt that in the interests of both NHS staff and employers there needed to be an integrated approach to ill-health retirement between employees and the pension scheme. An integrated approach might include the following considerations.

- As a good employer wanting to improve working lives, the NHS should seek to minimise work-related sickness absence through proactive line management. This would include earlier access to occupational health services before sickness becomes a major problem.
- Where ill-health absence occurs for work or non-work-related reasons, the NHS needs to actively manage sickness absence and enable the employee to return to their job.
- Where an employee is unable to return to their post, redeployment should be offered to a post that suits their skills and abilities. Often this will involve stepping down to a less demanding and lower paid job. This might include some protection of salary and pension rights. Redeployment may be to another trust in the health economy. Trusts need to work together and with other partners, for instance higher education, to redeploy staff.
- Where an employee is unable to return to work when sick pay runs out, there might be an additional period of sick pay at ill-health pension rate.
- Where there was a strong possibility that a person may recover sufficiently to come back to work, ill-health pensions could be granted with a review after five years.
- Ill-health retirement would still be available for those deemed to be permanently incapable of returning to work in their current post or any suitable alternative post in the NHS.

8.88 The pension scheme cannot deal with ill-health in isolation. It is important that any changes to the pension scheme are part of an integrated approach to managing ill-health absence.

8.89 It is, however, difficult to develop an effective method of integrating terms and conditions of employment within pension scheme regulations. It is recognised that ill-health is firstly an employment issue, and the pension provisions are only part of the picture. The Review partners recommend that a partnership review of sickness and ill-health arrangements should be carried out by NHS Employers which will help the Pension Review determine this aspect of pension scheme design.

The Review partners welcome views on this approach to reviewing sickness and ill-health retirement arrangements.

Extending scheme coverage

8.90 The Review has received a number of representations from NHS managers, staff representatives and The Business Services Association about the current rules governing those who are able to belong to the NHS pension scheme. Government policy is that staff of private sector employers should not be admitted to unfunded public sector pension schemes. This is because of the risk to an unfunded scheme of incurring liabilities generated as a result of private sector employment policies and transferring the risk of factors such as increased longevity from private sector employers and schemes to the taxpayer. A different approach is taken with regard to the funded Local Government Pension Scheme (LGPS), in which private sector employers carrying out best value contracts can be given 'admitted body status' to the LGPS.

8.91 NHS employees transferring to private sector partners are guaranteed broadly comparable private sector pensions. This broad comparability, a benefits test at the time of transfer, is certificated by the Government Actuary. However, direction body status is only permitted to voluntary sector organisations such as hospices.

8.92 It is clear that pensions are seen as a major issue where staff are transferred away from NHS employers. NHS employers regarded ensuring a broadly comparable pension scheme as a significant administrative complication in advancing private finance initiative (PFI) schemes. This particularly concerns the issue of certification of proposed comparable schemes and how pension costs feed into contract costs.

8.93 Some private sector employers have argued that it is considerably more expensive for them to provide a scheme with comparable benefits than it is for the NHS. This means that those costs are potentially fed into a higher contract cost for the NHS. Representations were made that if the Government is moving to a definition of NHS services as those paid for by the NHS, not necessarily provided by the NHS, then the pension scheme also ought to reflect that definition. It was argued that as a matter of fairness for staff, they should be able to keep their NHS pension. A number of examples were cited of NHS staff losing out, despite broad comparability.

8.94 The Review's independent actuarial adviser has produced a paper discussing options on scheme coverage. This is available within the background papers for the Review on the NHS Employers website. This paper argues that it would be possible for separate schemes within the NHS scheme to be set up for the workforce relating for instance to a PFI contract. The costs for those staff could be assessed separately and employers' contributions could be set according to the liabilities relating to that group of staff. This would protect against the risk of, for instance, employers raising salaries close to retirement to increase pension. The employer would also pay a bond protecting against the impact of insolvency or market exit.

8.95 The Review partners consider that there is a distinction between increased liabilities incurred as a result of private sector employer action (that employers should pay) and those incurred as a result of external factors such as an increase in longevity. The demand for staff providing NHS services (whether NHS- or private sector-employed) is set to continue to increase. There is a relatively low risk of staff numbers reducing or the need for widespread redundancies. In this environment, it could be seen as reasonable that liabilities related, for instance to longevity should be borne by employers at the time those liabilities are assessed. Enabling all staff to access the same pension scheme would provide a more level playing field for contractors and would certainly be welcomed by staff and trade union representatives. If provision of NHS services is opened up by the Choice policy, this is likely to become an issue for the NHS's professional staff as well as support staff in PFI schemes. There is a strong argument that broadening scheme access, with appropriate safeguards, would promote Government policy on plurality of provision.

8.96 It is noteworthy that there is a strong consensus on this issue across NHS and private sector employers and staff representatives that scheme access should be broadened. Review partners understand that issues of the coverage of public sector schemes overall may be subject to wider debate.

The Review partners would welcome views on the consensus across NHS and private sector employers and staff representatives that scheme coverage should be extended for both the new and existing schemes. Views may also inform the wider debate on public service scheme coverage.

Summary

8.97 This section has described options for a new scheme and has identified options for improvement and change. The improvements costed, with resource implications, are set out in annex C. The detailed papers considering these options and those in section 9 are available on the NHS Employers website and are listed in annex H. It will not be possible to afford all improvements. The Review partners have prioritised the improvements in the tables. As previously indicated, any recommendations will be subject to agreement by the Government. Some of these options may be applicable to existing staff who choose to remain in the old scheme. Further detail for existing members is in the next section.

The Review partners seek views on the recommendation that the highest priorities are improving the accrual rate, providing end career flexibilities and partner pensions.

9 Existing members

Protection arrangements

9.1 Under the Government's plans, pension benefits earned after 2013 by existing members will only be payable in full at 65. However, in 2003, the Government promised that for existing NHS scheme members all service earned up to 2013 would be protected in full and pension benefits earned up until 2013 would be payable in full at the age of 60. Full protection is also extended to all added years contracts payable at 55 or 60 that members have taken out. How protection works is set out in the box below. Under the recommendations set out below, these arrangements would operate for those members who chose not to transfer to the new scheme.

9.2 No existing scheme member will have to work until 65 in order to achieve the same pension as they would have had at 60. The amount of protection would vary according to age. A ready reckoner will be available on the NHS Employers website, www.nhsemployers.org, that will enable individual members to model how protection will affect them.

Protection arrangements

Ravi will be 57 in 2013 and expects to have 30 years' service. He intends to fully retire at 60 in 2016 and is able to take the 30 years of benefits he has built up before 2013 in full. This means that they will be worked out on his pensionable pay in 2016 not 2013. The benefits relating to the three years after 2013 will be reduced by around 27%, using the published early retirement factors to reflect the fact that they have been taken before the new normal pension age of 65. Ravi would need to work less than one extra year after the age of 60 to make up the shortfall to the benefits he would previously have received at 60. If he chose to work an extra year, he would also have the benefit of a further year's earnings growth in his pensionable pay, which would provide a higher pensionable pay figure on which to calculate his benefits.

Deborah will be 45 in 2013 and expects to have 15 years' service by then. If she continued working full time, she would build up a further 15 years' service by the time she is 60 in 2028. If she chooses to fully retire at 60, she will be able to take the benefits she built up to 2013 in full but the fifteen years' service after 2013 will be reduced by around 27%. Deborah would have to work two years longer to achieve the same pension that she would have received at 60 under the old arrangements. If she chose to work an extra two years, she would also have the benefit of two further year's earnings growth in her pensionable pay.

9.3 In the course of Review discussions, staff-side members emphasised their concerns about the Government's proposal for public sector pensions to move to NPA65. Their case for a voluntary approach to extending working lives is set out in section 4. If the Government did decide to press ahead with its plans, they felt that an extension of protection might make this move more palatable to staff. Extending protection to existing NHS staff, in the context of a package such as that set out in annex G, with an NPA of 60 would be broadly cost-neutral as this would also delay the receipt of benefit improvements funded by increasing the normal pension age. However, this may not achieve the Government's objective of more staff working longer.

9.4 The Review partners agree that an extension of protection by three to five years would be recognised by NHS staff as a significant concession. It is recognised however, that protection arrangements are an issue that spans all public sector pension schemes and that any decisions will be made in the light of issues across the public sector.

The Review partners seek views on the possible extension of protection by three to five years.

Members with special retirement rights

9.5 There is a group of NHS staff who have special retirement rights and a normal pension age of 55 rather than 60. In addition, staff with Mental Health Officer (MHO) status have the right to retire at 55 and their pension rights after 20 years' membership are subject to double the accrual rate. Staffside representatives in the Review argued that an explicit agreement was reached in 1995 guaranteeing that special retirement rights would be maintained. It is also important to consider that if these groups of staff have an increase in their NPA to 65 this would be double the increase that other NHS staff groups face.

9.6 Managementside representatives recognise that what is decided for these groups will need to be set in the context of other special status groups outside the NHS and establish a position that is defensible for other staff doing the same or similar jobs. The Special Class groups are closed groups and are shrinking. Maintaining protection in the NHS would be broadly cost neutral, as special class groups would receive no further scheme improvements when protection ends for other NHS staff, although they would access some improvements made available in 2006 (see 9.12, below).

Given the finite nature of this group and the strength of views expressed in relation to the 1995 agreement, the Review partners recommend that NHS staff with special retirement rights have indefinite protection maintained and are allowed to keep their rights as they currently stand.

The Review partners recommend that protection for special class groups be maintained.

Moving to the new Pension Scheme

9.7 When the Review was set up, the commitment was made that existing members would be offered the choice of moving to the new arrangements. It is recognised that a significant proportion of NHS staff expect or are prepared to work beyond the current normal pension age of 60, particularly if NHS employers develop more flexible employment options. For these staff, the new scheme with a higher accrual rate but a later normal pension age may give them an opportunity to earn a bigger pension.

9.8 The Review partners recommend that all existing NHS staff should be given the opportunity to move to the new scheme, transferring over existing service. Existing service would be given a transfer value assessed by those implementing the new scheme in consultation with the Government Actuary's Department. Depending on what benefits are in the new scheme, it is expected that the transfer value for years of service earned in the old scheme would be at or close to one year in the new scheme for one year in the old. A year for year transfer would mean that existing NHS staff who chose to move to the new scheme would be treated on exactly the same basis as new members. All their service would be eligible for all benefits, but they would only be payable in full at 65. Members would be voluntarily giving up their protection in return for the benefits in the new scheme. If members were intending to retire at or close to their 65th birthday, then this option would be likely to bring about improved benefits. If the new scheme were to be a CARE scheme, then it would be considerably more challenging to provide members with meaningful comparisons of benefits in the old and new schemes. Staff side partners also proposed the option of moving to the new Scheme for future service only.

9.9 Staff side Review partners consider that as an alternative to a new scheme approach, it would be possible to retain a single scheme for all employees but with differing benefits for staff whilst they retained current pension ages and for staff who had increased pension ages. This approach would in practice require that existing staff be conceded a greater range of benefit changes than the Government's financial framework permits. Staff side partners have accepted that the review proposals are structured on a new scheme basis but would wish for an amended scheme approach to be evaluated if their arguments for a different financial framework were accepted.

Staff side partners believe an amended scheme approach would avoid many of the difficulties associated with transition to a higher pension age for existing staff.

The Review partners would welcome views on the options set out for existing members who choose to transfer to the new scheme.

Arrangements for those who choose not to transfer

Scheme improvements before the pension age is changed

9.10 Under the protection arrangements, if members do not wish to transfer into the new scheme then they will remain in the old scheme, building up pension that can be taken unreduced at their current normal pension age until 2013. The old scheme will need to be amended to give survivor benefits to same-sex civil registered partners from 2005, backdated to 1988. It will also need to be made compliant with age discrimination legislation from October 2006.

9.11 The financial framework (see 7.2) precludes making scheme improvements available to existing members before savings are made in the scheme costs relating to their pensions. The largest part of potential savings available relates to NPA65, which means that improvements funded from that source would only be available after 2013. However, there is a range of improvements that should be affordable before 2013 and could be made available to existing members after 2006.

9.12 The Review partners have discussed a potential package that is broadly cost-neutral using the costing assumptions adopted for the review and should not increase the contribution rate. It is set out in annex G. This package would be aimed at supporting increased retention of existing NHS staff, while providing some other improvements.

9.13 It is proposed that staff be given a new option to take on increased lump sum, greater than the $^{3}/_{80}$ lump sum automatically provided, by converting a part of their $^{1}/_{80}$ pension on the basis of receiving £12 of lump sum for each £1 of pension given up. The maximum total lump sum which the Inland Revenue will allow a member to take can be calculated by multiplying the standard $^{1}/_{80}$ pension by 5.36 and the potential extra lump sum is the difference between this figure and the standard $^{3}/_{80}$ lump sum provided.

9.14 The main retention measure would be the provision of late retirement factors. These would mean that staff in the open groups who chose to work beyond the average age at which people retire in those groups would have their pension increased and perhaps some others depending on the option adopted. The Review looked at two options. The first involved offering late retirement factors to everyone who worked beyond the current normal pension age of 60. The second would offer higher factors but only to staff who worked beyond the current average retirement age for open groups of nearly 63.

9.15 We are also proposing that the current service limits that restrict members to 40 years service at age 60 should be removed. This will remove a disincentive for long serving staff to work longer. For MHOs, this would only apply when they reached 40 years of actual service.

9.16 Currently manual staff pay a contribution rate of 5%. The Review partners recognise that a different contribution rate solely for manual workers is inappropriate after implementation of Agenda for Change (AfC). In relation to existing staff, it is proposed that this is addressed by giving all staff in AfC pay bands 1 and 2 a 5 % contribution rate.

9.17 Other measures in the potential package include a number of improvements proposed for the new scheme that are discussed in section eight. These include:

- Survivor pensions for civil partners including retrospection to 1988 (8.38)
- Removal of cessation of survivor pensions on remarriage (8.40)
- Standardising payment of survivor pensions after death in service at salary rate for six months (8.41)
- Changing children's pension arrangements (8.43)
- Allowing multiple nominees for death in service lump sum (8.45)
- Protected step down (8.53)

9.18 It is anticipated that any changes in arrangements for ill health retirement and for extending scheme coverage, as discussed in section eight, would also apply to existing staff as well as to staff in a new scheme. The proposed pension purchase arrangements could also apply to existing staff. However, issues concerning the interface with current added years arrangements will need to be considered.

9.19 Other measures considered by the Review but not included in the package are also in annex G. The Review partners would recommend such a package as having a positive impact on retention of existing NHS staff.

The Review partners would welcome views on the package of improvements set out above and in annex G.

Transition after protection ends: potential improvements for existing NHS staff after the pension age increases

9.20 For those existing NHS staff who choose to retain protection and stay in the old scheme until protection ends, two possible options were considered:

- to close the old scheme to new contributions when protection ends and move members into the new scheme for future service. It would be possible to offer the choice of transferring their past service into the new scheme (see 9.8)
- to leave existing members who choose not to transfer in a revised version of the old scheme, with an NPA of 65 for future service from when protection ends.

Closing the old scheme

9.21 Closing the old scheme from the end of protection has administrative advantages. However, it also creates problems in mixing old and new scheme benefits. There is a considerable cost involved in NHS staff with normal pension ages of 60 and 55 being able to exercise end-career flexibilities such as those set out in section 8. This is because scheme costs currently take account of the actual retirement ages for those staff. The likely costs in respect of existing staff would be around 3% of pensionable pay across both NPA60 and NPA55 staff.

9.22 It would not be possible to provide end-career flexibilities such as pensionable re-employment and partial draw down for service in the old scheme within the financial framework set out in section 7. Under this option, there would probably need to be rules that restricted members with service in both schemes from exercising flexibilities in respect of old scheme service. This might, for instance, include a special abatement rule for those with mixed service under the old and new terms, reducing pension payments if pension and salary together exceed salary at the time of drawing pension. The maximum a member would be able to earn in salary and pension would be their salary on retirement increased annually by inflation. This would be likely to encourage step down and wind down. A key issue to consider is whether, even with abatement, there would be a tendency for staff to take benefits earlier, thus increasing scheme costs and reducing their total work contribution.

Retaining the old scheme and introducing a new scheme

9.23 Continuing with the old scheme from 2013 would increase administrative complexity. However, it could avoid the complications arising from mixing service in two schemes. If a decision were made to introduce career average in the new scheme, it would enable existing members to choose to remain wholly in a final salary scheme; not just until 2013.

9.24 Under this option, some further improvements would be made to the existing Scheme in 2013 to compensate for the increase to NPA65. This might include partner pensions in respect of future service and an improvement in the accrual rate for future service.

Staff side view

9.25 Staff side partners consider that there are problems with both of these transition options, arising from the separation of the new Scheme and of protected benefits in the old Scheme. These are driven by the financial framework. The proposed choice exercise at the centre of the transition process will be difficult for members to understand and will generate enormous administrative difficulties. A policy of amending the existing Scheme as set out in paragraph 9.9 would avoid many of these difficulties. It would also permit the extension of full flexibilities on drawing a pension to all staff in a way which would benefit all and encourage many to extend their careers. This would need a less restrictive financial framework.

Practitioner issues

9.26 The same issues with regard to transition apply to practitioners as to main scheme members and the same considerations as discussed in this section would apply.

The Review partners welcome views on transition including the two options set out for moving to a new scheme.

Rejoiners

9.27 Under the current arrangements, scheme members who return to the scheme are counted as new members if they return after a break of more than 12 months. Those with special retirement rights can maintain those rights if they return within five years.

9.28 The management-side view is that the current arrangements should be maintained. Staff who return after a break of more than twelve months would return with a normal pension age of 65.

9.29 The staff-side view is that scheme members who return to the scheme during the protection period should have a right to return to the old scheme until protection ends.

9.30 The Review partners agree that returners should be given the choice of joining the new scheme.

The Review partners welcome views on the options for rejoiners.

New issues

Retrospection

9.31 The Review partners also obtained costings for giving existing members improvements to benefits in respect of existing service. The case was made to the Review that benefits that relate to equal treatment such as those relating to pre-1988 widowers' pensions and partner pensions should be provided retrospectively for all staff as all NHS staff paid the same contribution rate.

9.32 Review members, while understanding the strength of feeling on this issue, also recognised the long-standing Government policy that the additional costs of any retrospective improvements in scheme benefits should not fall to the tax payer. There was also a view that providing retrospection for a proportion of scheme members was not a good use of any available resources, given the financial framework. Members have already had the opportunity to purchase pre-1988 widowers' retrospection. It would be appropriate to offer a similar opportunity, should partner benefits be granted to existing members. This would be costly for individuals. Illustrative figures produced for the Review by GAD suggest that each year of service for which retrospection was being purchased might be reduced to 0.84 for men and 0.925 for women. Under the recommendations for a new scheme, existing members would also be able to achieve retrospection for all scheme improvements through transferring to the new scheme.

The Review partners would welcome views on the retrospection issues.

10 Understanding your pension

10.1 Throughout the Review process, feedback consistently highlighted the lack of understanding about the scheme on the part of the employers and employees. Many did not appear to understand what the scheme provided. There was little understanding of the value of the pension package which offered pension and risk benefits (family and ill-health benefits) at a standard employee contribution rate of 5 or 6%, (around 3.5% net with tax relief and national insurance rebate). With a combined contribution of 20%, the NHS Pension Scheme offers excellent value for money. However, there was concern that coverage of NHS employees was not as high as it might be, particularly among low-income groups. Also, very few employers actively referred to the scheme within their recruitment literature or during exit/return interviews.

10.2 Pensions accreditation as part of the Department of Health's Improving Working Lives initiative did go some way to ensuring pensions was given proper consideration as part of the HR agenda. However, the Review partners understood that, due to the scale of NHS membership, direct contact with all 1.2 million members and 11,500 employers would be patchy at best. Feedback on the effectiveness of current communications about the scheme echoed the Government's Green Paper on pensions, which emphasised the need for employers to make pension

information available in the workplace in order for staff to make informed decisions about their pension rights and eventual income in retirement.

10.3 The round of Reference Group and NHS Confederation member seminars impressed upon the Review partners the need to ensure that NHS staff understood what was available to them, its value and its part in the overall remuneration package. Communication was a vital component in ensuring that staff knew what the current arrangements offered, how these compared to the new arrangements and how staff might best maximise their eventual income in retirement if this was an important part of their financial plans.

The tools

10.4 A final salary scheme has been a part of the NHS for well over 50 years, but the scheme as a whole is still widely misunderstood by scheme members and employers. Whether the final conclusion is that a defined benefit arrangement should be in the form of a final salary scheme or a career average scheme (as explained in section 8), communications should aim to be simple to understand and offer a greater degree of clarity, to help NHS staff make informed decisions about their income in retirement.

10.5 Employers and members felt that more support was needed to aid understanding, for example, web-based ready reckoners, question and answers, presentation materials and scheme literature that broke through the perception that pensions were confusing and complex. The diversity of the NHS meant that the traditional methods of communicating might not be appropriate. English may not be the first language of many NHS staff, current terminology can seem alien and irrelevant to those who simply wish to know how much they might secure as a pension when they retire. An important part of this process will be the development of annual benefit statements (ABS) by the NHS Pensions Agency, which will allow staff to see the value of their benefits year on year and information on how they might achieve their target income in retirement. See section 11: Administrative issues, for more information about ABS.

Ready reckoners

10.6 The NHS Employers website, www.nhspemployers.org contains a $^{1}/_{80}$ pension calculator, which can be used by members and non-members alike. The pension calculator provides basic information on potential scheme benefits based on years of membership and pay. The NHS Employers website also has calculators that provide basic information on:

- how protection works within the current $^{1}/_{80}$ scheme
- value of benefits within a $^{1}/_{60}$ scheme
- value of benefits within a CARE scheme.

NHS Pensions Online

10.7 NHS Pensions Online is a free service for all NHS employers and provides practical support in workforce planning. For absolute security, the system is available through NHS Net and each employer has access to a database of employees (in respect of that particular employer only) who are members of the scheme.

10.8 NHS Pensions Online can provide, in a matter of minutes, the value of current pension benefits and their value if employees left early, stayed on or bought extra membership. The system can also provide the cost to employers on redundancy or voluntary early retirement. In partnership with the pension/payroll experts, employers have almost instant access to information, which could help local managers discuss changes in working patterns, and how this could affect their pension rights if, for example, they chose to reduce their hours or step down.

10.9 The records of some scheme members with more complex membership patterns are not yet accessible via Pensions Online, for example, part-time Mental Health Officers, male members of the special classes (those who retain the right to retire from age 55), and medical and dental practitioners. The NHS Pensions Agency is developing a new system that will encompass the more complex cases currently excluded from the Pensions Online system.

The Agency is also developing options that would allow employers who do not have access to NHS Net to be able to use the system securely.

10.10 The Agency's longer-term aim is to allow individual members to access the system beyond the workplace. Consideration will include access via the internet, but security will remain the main objective during its development.

The Review partners welcome views on how changes might be better communicated both locally and centrally

11 Administrative issues

11.1 Modernisation of the pension scheme has considerable implications for employers and also for the NHS Pensions Agency. This section examines these issues.

NHS Pensions Agency issues

11.2 A number of key areas are highlighted below which will need to be developed to meet the requirements of the new scheme and ensure the effective transition from the current scheme. These include:

- IT system development
- training and education
- pension scheme literature
- data integrity.

11.3 The prime responsibility for IT system development will rest with the NHS Pensions Agency. However, in terms of the design of the new system it is proposed that a user group be established jointly between the stakeholders, the NHS Pensions Agency and the system suppliers.

11.4 It is essential that there is effective training and development of all staff involved in the introduction and ongoing administration of the Pension Scheme. This has not been the case in the past with the current scheme; in particular the level of employer understanding of the scheme has been mixed. It is also vital that the operation of the scheme is underpinned by publications that are easily understood by members. This latter role has traditionally been undertaken by the NHS Pensions Agency and some of the documentation has been praised in terms of its presentation. However, there has generally been little user involvement in the design of material for the scheme. A key component in this area will be the design, content and ease of use of the Agency's website to assist stakeholders in their understanding and access to the scheme.

The Review partners would welcome suggestions on the approach to training and development and the drawing up of literature in support of the scheme.

11.5 A key requirement to ensure the efficient operation of the NHS Pension Scheme is the accuracy and integrity of the data supplied by employers regarding employees. Looking to the future this will be significantly enhanced by the electronic staff record, which is planned to interface directly with the Pension Scheme. This will ensure that staff records not only cover employment issues but also pension issues.

11.6 The Pensions Agency has recently embarked on a major exercise to cleanse the data held on their systems. This involves looking at about 1.4 million data items where there are errors, anomalies or omissions. Discussions are also ongoing with those employers whose records are not up to date.

11.7 Historically, the accuracy of the data and the updating of records has been patchy. Some employers are extremely good but problems have arisen when non-standard systems are used, employers receive their services from third-party payroll providers and manual systems are still in operation. GP practices are an area where work is required to improve the records issue.

Given the number of employers (11,500), of which the majority are GP practices, the Review Partners would welcome ideas on ways to improve the data accuracy and updating of records

11.8 Underpinning the administrative issues will be a need for significant investment in each of the four areas highlighted above. The planning for this will need to start immediately as there will be a long lead time prior to implementation of the new scheme, particularly around system development and data integrity. Improvements in the data are also key to the needs of the electronic staff record and annual benefit statements. The financial requirements will need to be built into the allocations timetable for the NHS.

The Review partners would welcome views on how best the NHS Pensions Agency can support the various stakeholders (particularly employers, staff and trade unions) in implementing the changes in pension arrangements

Employer issues

11.9 NHS employers are currently dealing with a demanding HR agenda. Within this, perhaps the major challenge is the implementation of Agenda for Change. The changes set out in this document will present a major challenge. Employers, however, have a critical role in:

- consulting with staff on changes
- providing staff with information on the proposed changes
- working with the NHS Pensions Agency to support data cleansing
- working with the NHS Pensions Agency to carry out the proposed choice exercise
- ensuring that the pension scheme is used effectively as a recruitment and retention tool.

11.10 This will have significant resource implications that NHS trusts will need to recognise and plan for. The change is complex, and payroll, pensions and HR staff will need to work together to plan to introduce these arrangements.

11.11 In the initial phase after publication of the consultation document, employers will have access to a pack of materials to support them in consulting with staff. The events being held around the country will also provide support and information. The Review partners consider that trusts and Primary Care Trusts (PCTs) will need to hold events to help staff understand both the current scheme and the proposed changes. PCTs will need to support GP practices in communicating with their staff.

The Review partners recognise that NHS employers will continue to need support as decisions are made and changes are implemented.

11.12 As implementation is taken forward it will be important for HR managers in trusts to be supported by the NHS Pensions Agency. It will be important that pensions staff in NHS trusts and PCTs are trained correctly, and receive the basic pension knowledge. Organisational change has meant that the knowledge base on pensions issues among HR staff is thinner. This will be an important role for the NHS Pensions Agency. There will need to be a programme of development and support. It has been suggested that regional pension manager networks could be set up. Staff representatives will also need support and training to help them give support and information to members.

11.13 HR managers involved in the Review recognise the opportunity presented by the Review to use the pension scheme more effectively as a recruitment and retention tool. They have stressed the importance of having excellent communications materials centrally produced by the NHS Pensions Agency to support trusts and obviate the need for activities to be duplicated. They also emphasised the importance of changes being communicated in a clear and timely manner.

The Review partners would welcome views on the implications of the changes in the pension scheme for NHS employers.

Workforce planning issues

11.14 The data held by the NHSP Pensions Agency are the most comprehensive available about staff leaving and joining the NHS. This is crucial workforce information and should inform local and national workforce planning. The NHS needs better information about flows in and out of the workforce in order to improve its identification of training needs. This information would also be vital for gauging the success of recruitment and retention campaigns. However, the employment groups used for valuation are in the main not comparable with the NHS census staff categories and are therefore little used. It is, for instance, difficult to derive the average retirement age for nurses from the valuation data. In addition, data is difficult to access for workforce planning purposes.

11.15 This situation should improve with the implementation of the NHS electronic staff record. However, it does need to be grouped comparably to other NHS workforce information. The Review partners recommend that the Scheme moves to using comparable staff groups to the main NHS census for valuation purposes.

The Review partners would welcome views on the recommendation that the NHS Pension Scheme should change the description of the employment groups to reflect widely used NHS staff categories.

12 Next steps

12.1 The NHS Pension Scheme Review partners want to hear views on the proposals contained in this document and there are a number of ways that you can feed your opinions in to the Review process.

12.2 On pages 104 to 116 of this document there is a response form with a series of specific questions on which we would like your views. You can do this by completing the form and returning by post to the NHS Pension Scheme Review, NHS Employers, 29 Bressenden Place, London, SW1E 5DD or by completing the online response form at www.nhsemployers.org. Alternatively you can e-mail your formal submission to nhspensionconsultation@ nhsemployers.org.

12.3 Employers will be able to help with any queries and explain how staff can get involved in the consultation process or whom you should speak to for further information. Queries can also be directed to nhspensionreview@nhsemployers.org. Trade union representatives will be able to advise on how members can respond to the Review either collectively or individually.

How you can get involved

12.4 All NHS employers have a legal requirement to consult with their staff on any changes that may affect future pension rights and benefits. For this reason the Review partners encourage employers to hold internal consultation sessions to allow staff give their thoughts and opinions. The Review partners have provided employers with tools such as a concise version of this consultation document, powerpoint presentation, questions and answers, case studies, pensions calculator and glossary to enable them to answer questions that colleagues and staff may have. All material is available on the NHS Employers website, www.nhsemployers.org.

12.5 The Review partners are also holding a series of events throughout England and Wales in January 2005. These events should be attended by board level NHS individuals, trade union representatives and pension and payroll officers. Feedback received by the Review partners at these events will not constitute part of the formal consultation but the events will give delegates the opportunity to hear first hand the Review Partners' proposals and discuss their impact. Further details and booking forms can be obtained from the NHS Employers website, www.nhsemployers.org.

12.6 All NHS staff in England and Wales, and those individuals who are part of the NHS Pension Scheme in 'direction bodies' will be contacted by the joint chairs of the Review early in 2005 with details of the proposals and information on who they should contact for more assistance on any queries they may have.

Timescales

12.7 All responses to the consultation must be received by the Review partners by 11 April 2005.

12.8 Responses will then be collated by the Review partners and a submission made to the Minister of Health. A summary of responses will be made available on the NHS Employers website in spring 2005.

12.9 Queries specific to current pension entitlements or questions about the current pension scheme should be directed to NHS Pensions Agency at Hesketh House, 200-220 Broadway, Fleetwood, FY7 8LG.

Annexes

Annex A

Current scheme benefits

Benefits	Options
1 Normal retirement age (NRA)	60, but members can continue in pensionable employment until age 70 Certain members employed prior to 6.4.95 retain a right to retire at 55.
2 Pensionable earnings	Basic pay plus allowances deemed to be pensionable up to full-time, overtime is not pensionable unless part-time
3 Pay for calculation	GPs and dentist: career average of pensionable earnings. All other members: best of the last 3 years' pensionable pay.
4 Relation to State Earnings Related Pension Scheme (SERPS)	Contracted out of SERPS – reduced NI contributions
5 Member's contributions	5% of pensionable pay for manual staff 6% of pensionable pay for non-manual staff Tax relief – contribution deducted prior to taxation real costs near 3.5% for a standard tax payer
6 Entitlement to benefits	Completion of at least 2 years' membership (or over age 60) $^{1}/_{80}$ of pensionable pay for each year of membership or for practitioners earnings uprated to current value times 1.4%
7 Pension	Membership: a. $^{Z}/_{80}$ x Pensionable pay = annual pension b. 3 x $^{Z}/_{80}$ Pensionable Pay = tax free lump sum where Z is years of service GPs and dentists: a. 1.4% of all career uprated earnings = annual pension b. 4.2% of all career uprated earnings = tax free lump sum
8 Benefits for early leavers	Ill-health – from any age with minimum of 2 years' membership Redundancy – from age 50 with minimum of 5 years' membership (excluding practitioners)

Current scheme benefits continued

Benefits	**Options**
9 Voluntary early retirement	• From age 50 • Accrued pension reduced to meet cost of early payment, or • Accrued pension unreduced (employer can choose to meet the cost) - option not available to GPs and Dentists
10 Ill-Health enhancement Accrued Membership a. 2 to 5 years b. 5 to 10 years c. More than 10 years	Increased to compensate for involuntary early retirement a. No enhancement b. Membership doubled [1] c. Greater of: • service enhanced to 20 years [1] • extra 6 $^2/_3$ years' membership [2]
11 Redundancy enhancement	Increased to compensate for early retirement • option not available to GPs and dentists • employer meets cost of enhancement and early payment
12 Accrued membership a. less than 10 years b. 10 years or more	a. Membership doubled [1] b. 10 years maximum
13 Death in Service a. lump sum b. spouse's pension c. child allowance	a. 2 x annual pensionable pay – tax free b. 50% of member's pension based on enhanced pension [4] c. 25% of members pension based on enhanced pension for each child up to a maximum of 50% [5]
14 Death in retirement a. lump sum b. spouse's pension c. child allowance	a. 5 years' pension less pension and lump sum already paid b. 50% of member's pension [4] c. 25% of member's pension based on enhanced pension for each child up to a maximum of 50% [5]
15 Allocation: giving up part of a pension	Members can choose to allocate up to $^1/_3$ of their pension for a dependant, but is irrevocable [6]

[1] Subject to a maximum enhancement of the potential membership to 65
[2] Subject to a maximum enhancement of the potential membership to 60
[4] Only membership from April 1988 accrues for widower's benefits. Additional contributions may be paid to improve these contingent spouse's pensions. Certain short-term (up to 6 months) spouse's pensions may be paid in addition.
[5] Allowance may increase if there is no surviving parent or alter if there are children to more than one partner.
[6] Subject to a medical to prove good health. Cost depend on age difference between scheme members and recipient.

Current scheme benefits continued

Benefits	Options
16 Refund and preservation	Refund • Less than 2 years membership, member's contributions refunded. Deductions include 20% 'tax charge' and an amount to buy employee back into the state scheme. Overall refunds generally amount to the net contributions paid into the Scheme [7] Preservation • 2 years or more membership, benefits are preserved in the Scheme and increase in line with Retail Price Index (RPI), payable from age 60
17 Increasing benefits	Overall contributions cannot exceed • 15% of pensionable pay in any one year • pension benefits must not exceed ⅔ of gross pensionable pay at retirement Different methods available: a. purchase of additional membership b. money purchase added voluntary contributions (AVCs) c. Stakeholder pensions d. free standing added voluntary contributions (FSAVCs)
18 Purchasing added years	Purchase by: a. single lump sum payment [8] b. additional contributions [9]
19 Money Purchase AVC	The NHS Scheme offers a choice of providers • Additional Contributions are invested in a fund which is used to buy an annuity at retirement
20 Stakeholder pension	The NHS Scheme offers a choice of stakeholder providers a. no employer contribution b. charge of 1% or less on person's fund c. maximum annual contribution of £3,600 d. 25% of fund may be taken as a lump sum
21 Free Standing AVC	Independently arranged outside scheme

[7] Less than 2 year and over 60 entitlement to benefits
[8] Subject to purchase within the first year of scheme membership and an overall maximum of 40 years membership
[9] Subject to an overall maximum scheme membership of 40 years and a contract of 2 years minimum

Current scheme benefits continued

Benefits	Options
22 Transfering pension benefits into the NHS Pension Scheme	Application within 12 months of joining the NHS Scheme and before age 60 Acceptable from: a. occupational pension scheme b. personal pension [10] c. annuity contract [10]
23 Transfering pension benefits outside the NHS Pension Scheme	Application after leaving the Scheme and under age 60 Acceptable to: a. occupational pension scheme b. personal pension [10] c. annuity contract [10]
24 Non-NHS employments – application for 'direction' status	Non-NHS employers may be allowed to operate the NHS Pension Scheme in respect of ex-NHS employees Criteria • status is approved under Section 7(1) or 7(2) of the Superannuation (Miscellaneous) Act 1967 • charitable or voluntary bodies providing health care • employees who have contributed to the NHS pension scheme during the previous 12 months • application to retain membership should be made within the first 3 months Early retirements are not included in the provisions but employers have the option to make equivalent payments [11] Direction employees typically include: • hospices • Voluntary Service Overseas • Care in the Community

[10] Approval under Section 620 (formally 226) of the income and Corporation Taxes Act 1988 are not acceptable
[11] Funded employer retirement include Redundancy and employer agreed Voluntary Early Retirements

Annex B

The review process

Initial ideas were developed in a Reference Group with a wide range of staff and management representation, including representatives from other public service pension schemes to provide a wider perspective. Reference Group discussions covered: aims and values, survivor benefits, building a pension, taking a pension and transition issues. A special session was held to discuss issues around raising the normal pension age (NPA) to 65.

The ideas emerging from the Reference Group were turned into options for assessment and approved by the Steering Group. The options were scoped by a Technical Advisory Group (TAG). To carry out the analytical work for the Review, the project team engaged the services of the Government Actuary's Department (GAD). In addition, an independent actuarial adviser was appointed by competition from First Actuarial, who supported and advised the joint Technical Advisory Group on a range of issues, including best practice in the public and private sectors, detailed impact analysis of the options and the costs. As well as the options papers, the project team commissioned further work that explored the policy and administrative implications of the options for change.

In addition views were gathered from a wider group of stakeholders:

- nine NHS Confederation member seminars were held, which followed a similar theme to the joint Reference Group seminars. Attendees included staff-side representatives as well as managers from NHS trusts
- presentations were also provided for a number of local SHRINE (human resource) networks, national conferences and to other analogous pension schemes
- six NHS Confederation Briefings have been produced and widely distributed. In response to these and a briefing note distributed with pay statements, over 1,000 e-mails and letters have been received. The main issues raised in these responses were concerns about raising the normal pension age to 65 and the position of mental health officers (MHOs).
- a staff survey was conducted (details in section 5).

Decisions on the options thus developed were made by the Steering Group and are reflected in this document. The chart below sets out the process.

The process

Joint Reference Group
Provide advice/feedback

↓

Project Team
Support the review process
Develop proposals

↓

Joint Technical Advisory Group
Commission and appraise analytical work
Advise on technical issues and costs

↓

Joint Steering Group
Decision making body
On options for change

A summary of the feedback from the joint Reference Groups and NHS Confederation member seminars is available on the NHS Employers website, www.nhsemployers.org. The work produced by the Technical Advisory Group is also available on the website. This forms the analytical underpinning to the Review.

NHS Pension Scheme review

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Reference Group

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Judith Taylor Calderdale and Huddersfield NHS Trust

Denis Linfoot Canterbury and Coastal PCT

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Liz Nicholson Avon and Wiltshire Mental Health NHS Trust

Anne-Marie Walker Tees, East and North Yorkshire Ambulance Service

Warwick Heale Torbay PCT

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Liz Flatt National Blood Service

Graham Urwin South Birmingham PCT

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Annex C

Costings of current package and possible changes for new members

Basis for Costings

Benefit costings in this consultation document have been produced by the Government Actuary's Department based on the most recent valuation of the NHS Pension Scheme as at 31 March 1999, albeit with different assumptions being adopted where appropriate. The costings have been scrutinised by the Technical Advisory Group (TAG) to the review and by an independent actuary. Further detail on the figures and the assumptions adopted are available in a series of TAG papers which can be accessed from www.nhsemployers.org.

The Review undertook two sets of costings. The first is for new NHS staff from 2006 who under the Government's proposals will have a normal pension age (NPA) of 65. The second is for existing NHS staff, who under the Government's proposals will have protection under their current terms until 2013. Baseline costings were established for both groups. Then the costs of various benefit improvements for each group were assessed. The results are set out below. Table IA shows a package of improvements for new entrants which might fall within the cost envelope, and Table IB shows improvements for new entrants which might not fall wthin the envelope. The costings for existing members are set out in annex G.

Costings of potential benefit changes are expressed as a percentage of pensionable pay. They have been calculated separately for new staff and for existing staff and have been calculated on the basis of a normal pension age (NPA) of both 65 and 60. The baseline costs of the current scheme benefits for new and existing members are set out in the table below. The costs for both existing staff and new entrants have been based on the 1999 valuation assumptions, except that new entrants costs include allowance for some further projected improvements in longevity meaning that their pensions are expected to be be in payment for longer(and except where the benefit to be costed is such that new assumptions are required).

There is a general right to retire at 60 without reduction of benefits but also included are the costs of those NHS staff in special class groups with the right to retire at 55 without reduction of benefits and those with Mental Health Officer (MHO) status. This right was removed for new staff in 1995. The new entrant costs are shown with a normal pension age of both 60 and 65.

It can be seen that the difference in costs between a scheme for new entrants with an NPA of 65 and an NPA of 60 is calculated at 1.3% of pensionable pay. This represents the savings from moving to a NPA of 65. The costs at NPA60 are based on current scheme costs. These (and the new entrant NPA60 costings) are based on the actual average retirement age for those with the right to retire at 60 of slightly below 63.

Table: Costs of current benefit package

Benefit Category	New Members NPA 65	New Members NPA60	Existing Members
Member's normal retirement and withdrawal benefits	11.0%	13.6%	13.5%
Member's Benefits on ill health retirement	4.6%	3.4%	4.5%
Spouse's Benefits	1.0%	0.9%	1.3%
Lump Sum Death benefits	0.3%	0.3%	0.3%
Total	**16.9%**	**18.2%**	**19.6%**

Ill health costs are the total cost of pension benefits for those that retire on ill health pensions and not just the increased costs attributable to ill health retirement.

The actual contribution rate paid of 20% is 0.4% higher than the assessed baseline rate of 19.6%

The costs for existing NHS staff are a mix of those with the right to retire at 60 and 55.

Existing staff have a different demographic profile from new entrants, and the new entrant costings also reflect more projected future longevity mprovements than those for existing members.

IA. Table of package of proposed changes which might fall within the cost envelope for new entrants from 2006

Description	Cost	Comments
Baseline cost	16.90%	See TAG02 – NPA65, reflects no upper limits on service, no short-term pensions on death but covers same sex registered partners
Provide lifelong survivor pensions to eligible unmarried & unregistered partners and remove cessation on remarriage of widow(er)s	0.25%	See TAG01
Increase accrual rate to 1/60 with commutation at 12 for 1	0.80%	See TAG03. The maximum cash lump sum is that set out under the Inland Revenue simplification regime

Description	Cost	Comments
Provide end career flexibility of pensionable reemployment, partial draw down and actuarial enhancement after NPA	0.05%	This is principally the deadweight cost of those assumed to retire after age 65 in any event
Standardise end date for children's survivor pensions to 23	De minimis	Currently the end date varies according to time spent in higher education. NB this is affordable but not a joint recommendation
Provide an additional one times salary life cover for members without eligible partners	De minimis	See TAG06 (but based on partner assumptions set out in TAG01).
Increase the period for short term spouses pensions payable on death in service to six months in all cases	De minimis	Currently only spouses with dependent children receive six months pension at the level of pensionable pay. For technical reasons, this benefit was not included in the baseline. If it had been, the cost would have been de minimis as in the case of existing members.
Allow multiple nominees for death benefits	Nil	Administrative issues for Trusts/ NHS Pensions Agency
Protected Step Down.	Nil if paid for by either the employee alone or with the employer, de minimis if met from the scheme	This includes extension of the current protection arrangements so that staff can choose to step down and have their pension up to the point of stepping down calculated on pensionable pay at that point. If met by employers and/or employees, contributions would continue to be paid at the higher protected salary. The employer would have discretion to pay the additional employers contribution as a retention incentive. Otherwise the staff member would have to pick up the full employer and employee contributions. If met by the scheme, costs would arise to the extent that staff who would otherwise have left stay on in a lower paying post, so leading to an increase in the average age of the scheme. The extent of any such behavioural change is unknown, but the review team has indicated that they expect it to be low. If the proportion of payroll attributable to those over age 50 rose by 5% as a result, the cost would be de minimis.

Description	Cost	Comments
Changed Abatement Formula	To be De minimis	The review intends to devise an abatement formula based around only abating enhancements which leads to a minimal cost increase to the scheme.
Packaging costs, rounding effects and summation of de minimis items	De minimis	Few material interacting changes
Total cost	18.00%	

IB. Table of possible individual changes unlikely to fall within the cost envelope for new entrants from 2006

Description	Cost	Comments
Improve accrual rate for survivors' pensions to $^1/_{120}$	0.40%	Covers spouses, same sex registered partners and unmarried unregistered eligible partners – see TAG03
Provide an additional one times salary life cover for all members	0.15%	See TAG06
Extend reference period for final salary calculation to best of last ten years	0.10%-0.20%	See TAG08 - including some allowance for pay patterns not following those of sample analysed
End Abatement	0.1%	
5% contribution rate for all staff in Agenda for Change Bands 1&2	0.05%	Net of the saving achieved by ceasing to recruit into the manual category.
Provide a year's free accrual to those on approved career break (50% take up assumed)	1.00%	Assumes 50% take-up – see TAG07

Technical Advisory Group (TAG papers) are available on the NHS Employers website, www.nhsemployers.org.

Annex D

Staffside view on financial framework

The NHS Pension Scheme represents a key benefit for NHS career staff and embodies a promise of a level of pension benefits. The staffside partners believe it is a betrayal of trust for this promise to be reduced on account of an imposed cash limit on its cost and that employer contributions above the level of 14% of salary are justifiable relative to the cost of similar final salary pension schemes provided by private sector companies.

While it is accepted that the cost of the Scheme's benefits are rising due to employees living longer, they do not accept that this unfunded scheme faces the same degree of problems that funded private sector schemes do in respect of poor investment returns and financial deficits.

Staffside partners therefore do not accept the Government approach that any benefit improvements resulting from the Review can only be financed out of savings resulting from an increase in the normal pension age. They also do not accept the longer-standing policy, which this extends, of insisting that any benefit improvements should be paid for entirely by higher employee contributions.

The current Scheme incorporates elements of discrimination in its benefit provision which are morally objectionable, most notably the denial of dependants' pensions to unmarried partners and the limitation of dependants' pensions for widowers to pension rights earned after 1988. They believe the costs of remedying these injustices should be paid through higher employer contributions. They should not be paid by Scheme members, whether collectively out of pension age savings or individually by affected individuals having to sacrifice part of their own pension or pay extra contributions.

Staff-side partners believe that all savings arising out of any increase in normal pension age should be reinvested in improving other benefits of the Scheme. If this is not the case then the Review will amount to a pay cut for NHS staff and important opportunities will be lost to remedy deficiencies in the Scheme and to make changes that will provide real encouragement in the form of better pension to those who extend their careers in the NHS.

The financial framework insisted upon by the Government has the effect of denying access for existing members to flexibilities in respect of drawing pension benefits that are crucial to encouraging employees to extend their NHS careers or to return to NHS employment after retirement. These flexibilities will only be accessible to staff who give up rights to maintain the current normal pension age. This is an unfortunate and perverse result, as clearly the Government's priority should be to extend encouragement and flexibility to older existing employees if it wishes to maximise the retention of the older workforce.

The staffside Review partners believe that the way in which the savings deriving from a higher pension age are calculated is unfair and that this results in the compensatory benefit changes suggested being inadequate. At the present time large numbers of staff opt voluntarily to continue working after their normal pension age and this reduces substantially the cost of providing the pension benefits they have earned. The Government approach insists on taking advantage of this saving by saying that the saving from a higher normal pension age is the difference between what the Scheme actually costs now and what it would cost at the higher pension age.

This approach denies all NHS staff the opportunity of fair recompense for the reduction in the value of their individual benefit rights, due to their option of retiring with a full pension at their current normal pension age being replaced by an option to retire at a higher pension age in future. If savings were calculated by reference to the reduction in the value of members' rights then the savings associated with an increase in normal pension age would be 50% higher than the figure on which the Review's consultation proposals are based.

A further problem with the way in which savings are calculated is that they are reduced substantially by additional costs which the Scheme incurs in providing ill-health pensions and death in service benefits that result directly from the imposition of a higher pension age. This has an even larger effect in terms of reducing the savings from an increase in a normal pension age, but the money here at least recycles into providing benefits to the minority of members of the Scheme affected by these contingencies. What it does bring into question is the wider case for raising the normal pension age as a means of reducing the cost of the Scheme and it suggests that for a significant proportion of NHS staff a higher pension age would be associated with adverse health problems.

Annex E

CARE comparisons

Brief commentary for NHS Pension Scheme Review on final salary versus career average benefit design

Benefits Structure

Final salary schemes promise a level of benefits based on salary at retirement or leaving.

Career Average Revalued Earnings (CARE) schemes promise a level of benefit based on average salary over a career. Earnings from years before retirement or leaving are revalued so they keep their real value. The suggested CARE scheme for the NHS will revalue prior year earnings in line with salary inflation as measured by National Average Earnings (NAE) increases.

Accrual Rates

CARE benefits, being based on an average salary over a career will tend to be based on a lower pensionable salary, so a CARE scheme can have a higher accrual rate than a final salary scheme and still cost the same amount of money to provide.

For comparison purposes, the figures below assume a final salary accrual rate of $^1/_{60}$ (or 1.67%).

The proposal is that a CARE scheme for the NHS, equivalent in cost (on the current costing basis) to a $^1/_{60}$ final salary accrual, would have an accrual rate of 1.8% which is midway between a $^1/_{55}$ and a $^1/_{56}$ accrual rate.

In both cases, there is no automatic accrual of lump sum although members may commute, or give up, pension in exchange for a lump sum at the rate of £12 cash for every £1 per annum of pension given up.

Pensionable earnings

In final salary schemes (including the NHSPS), elements of pay such as overtime tend to be excluded from pensionable pay. As such earnings tend to reduce as employees approach retirement, including them as pensionable would mean that employees would pay contributions on overtime earnings but not receive benefits on them. It is usual under a CARE scheme for all earnings to be pensionable including elements such as overtime. As benefits are based on average revalued earnings over a career, overtime earnings do contribute to the total pension benefit.

Example benefits

The tables below shows example benefits for two different careers. The careers are short to make the numbers manageable but the principles apply over longer periods. All the numbers are expressed in today's prices (in other words assuming price inflation is zero) but assume that National Average Earnings increases will be at 1.5% per annum. It is this general earnings growth which sets the revaluation factors and not the rate at which the employee's earnings grow.

Employee with flat earnings

Year	Earnings	Revaluation Factor	Revalued Earnings
1	£15,000	1.08	£16,200
2	£15,500	1.06	£16,430
3	£15,750	1.045	£16,459
4	£16,100	1.03	£16,583
5	£16,500	1.015	£16,747
6	£17,000	1	£17,000
Average Revalued Earnings			£16,570
Final Salary Pension	= $^{1}/_{60}$ x 6 x £17,000 **= £1,700**		
CARE Pension	= 1.8% x 6 x £16,570 **= £1,790**		

Employee with rising earnings

Year	Earnings	Revaluation Factor	Revalued Earnings
1	£15,000	1.08	£16,200
2	£15,500	1.06	£16,430
3	£17,000	1.045	£17,765
4	£18,000	1.03	£18,540
5	£20,000	1.015	£20,300
6	£25,000	1	£25,000
Average Revalued Earnings			£19,039
Final Salary Pension	= $^{1}/_{60}$ x 6 x £25,000 **= £2,500**		
CARE Pension	= 1.8% x 6 x £19,039 **= £2,056**		

In these particular examples, CARE benefits tend to be better then final salary for those with flat salaries. Conversely, final salary benefits are better for those who have more steeply rising salaries.

Within the Agenda for Change pay structure, CARE would tend to be better for:

1 Those who remain in the same pay band throughout their career (especially for those who join at a young age)

2 Those who stay to retirement, receiving one promotion to a higher pay band very early in their career but then are on the same earnings level for the rest of their career

Those who have significant overtime earnings if these were pensionable under CARE

Conversely, final salary tends to be better for:

1 Those with promotional pay increases over the course of their career – including those who move over three or more pay bands

2 Those who are promoted late in their career.

For members who do not fall within either of these groups, the comparison is less predictable with final salary being better sometimes and CARE other times depending on the timing of the career progression.

Risks

A CARE scheme can significantly reduce the risks in the scheme, meaning the risk of the cost of the scheme escalating. This is because the possibility of an employee's salary increasing near retirement and so substantially affecting past service liabilities is removed. Once an individual has earned salary in one year, those benefits are fixed in real terms – that is they may revalue each year but they will not be affected by that employee's particular career path.

Examples

The next sheets show some example careers and compares the pension they would receive under:

a) a final salary scheme where the pension accrues at 1.67% (or 1/60) per annum, and

b) a CARE scheme where the pension accrues at 1.8% (or approx 1/56) per annum.

The pensions shown are payable at age 65. Figures are expressed in today's earnings terms.

The examples show the benefits over an NHS career up to retirement. In practice, many scheme members leave before reaching retirement.

The examples assume no difference in the pensionable pay definitions under the final salary and CARE options. If pay which is currently non-pensionable under the final salary scheme were to become pensionable in a CARE arrangement, this could make the CARE option more attractive for those with high non-pensionable earnings early in their careers.

The examples show various career paths within the NHS based on Agenda for Change or current doctor pay scales. There are no examples for GPs or Dentists who are already pensioned by the CARE method as it is proposed that a CARE basis is retained for these groups.

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Example career paths and benefits earned

Career – Grade and Earnings History	Part Time Hours	Final Pensionable Salary	Final Salary Benefits at 65	CARE Benefits at 65
Band 4 to 8b Member Full Time Age 21: Band 4, £15,504 Age 28: Band 5, £19,180 Age 31: Band 7, £26,106 Age 38: Band 8a, £33,298 Age 42: Band 8b, £38,786	Full Time Throughout	Top of Band 8b: £47,949	£35,200	£28,800
Band 5 to 8c Member Full Time Age 21: Band 5, £18,114 Age 30: Band 6, £24,401 Age 36: Band 7, £30,155 Age 40: Band 8b, £38,786 Age 42: Band 8c, £46,471	Full Time Throughout	Top of Band 8c: £57,539	£42,200	£33,100
Band 5 to 6 Member Full Time Age 21: Band 5, £18,114 Age 26: Band 6, £24,401	Full Time Throughout	Top of Band 6: £29,302	£21,500	£21,600
Band 5 to 6 Member Full Time Age 21: Band 5, £18,114 Age 30: Band 6, £24,401	Full Time Throughout	Top of Band 6: £29,302	£21,500	£21,500
Band 5 to 6 Member Full Time Age 21: Band 5, £18,114 Age 46: Band 6, £24,401	Full Time Throughout	Top of Band 6: £29,302	£21,500	£19,800
Band 5 to 6 Member Full Time Age 25: Band 5 £18,114 Age 55: Band 6 £24,401	Full Time Throughout	Top of Band 6: £29,302	£19,500	£17,200

Example career paths and benefits earned continued

Career – Grade and Earnings History	Part Time Hours	Final Pensionable Salary	Final Salary Benefits at 65	CARE Benefits at 65
Band 5 to 6 Member Full Time Age 30: Band 5 £18,114 Age 60: Band 6 £24,401	Full Time Throughout	Near to top of Band 6: £27,917	£16,300	£14,500
Band 5 to 6 Member Part Time with Breaks Age 18: Band 5, £18,114 Age 40: Band 6, £24,401	Age 18: Full Time Age 28: Career Break Age 33: 50% Hours Age 37: Full Time	Top of Band 6: £29,302	£19,500	£18,800
Band 5 to 6 Member Part Time with Breaks Age 23: Band 5, £18,114 Age 27: Band 6, £24,401	Age 23: Full Time Age 30: Career Break Age 32: 50% Hours Age 34: Career Break Age 36: 50% Hours Age 46: Full Time	Top of Band 6: £29,302	£15,600	£15,600
Band 5-7 Member, Part Time with Breaks Age 23: Band 5, £18,114 Age 27: Band 6, £21,630 Age 40: Band 7, £30,155	Age 23: Full Time Age 30: Career Break Age 32: 50% Hours Age 34: Career Break Age 36: 50% Hours Age 46: Full Time	Top of Band 7: £34,417	£18,400	£17,500
Band 5 Member Full Time Age 21: Band 5 £18,114	Full time throughout	Top of Band 5: £23,442	£17,200	£18,100
Band 2/3 Member, Part Time with Break Age 23: Band 2, £11,508 Age 36: Band 3, £14,598	Age 23: Full Time Age 30: Career Break Age 33: 50% Hours Age 43: Full Time	Top of Band 3: £15,877	£9,000	£9,200

Example career paths and benefits earned continued

Career – Grade and Earnings History	Part Time Hours	Final Pensionable Salary	Final Salary Benefits at 65	CARE Benefits at 65
Band 5-7 Member, Full Time Age 21: Band 5, £18,114 Age 27: Band 6, £21,630 Age 36: Band 7, £30,155	Full Time Throughout	Top of Band 7: £34,417	£25,200	£24,000
Band 3-4 Member Full Time Age 34: Band 3, £13,266 Age 41: Band 4, £16,463	Full Time Throughout	Top of Band 4: £18,647	£9,600	£9,800
Band 4 Member Full Time Age 45 Band 4 £15,504	Full time throughout	Top of Band 4: £18,647	£6,200	£6,500
Band 3 Member Full Time Age 55 Band 3 £13,266	Full time throughout	Top of Band 3: £15,877	£2,600	£2,700
Full time Consultant Age 24: PRHO: £19,703 Age 25: SHO: £24,587 Age 28: Specialist Registrar: £28,875 Age 33: Consultant; £69,243	Full time throughout	Point 8 with 12 CEAss: £126,441	£86,400	£63,000
Part time Consultant Age 24: PRHO: £19,703 Age 25: SHO: £24,587 Age 28: Specialist Registrar: £28,875 Age 40: Consultant (no on call): £67,133 Age 45: Consultant: £81,004	Age 24: Full time Age 30: Career break Age 33: 50% hours Age 40: 75% hours Age 45: Full time	Point 8 with 10 CEAs: £121,037	£67,100	£46,000
Associate Specialist Age 26: SHO: £24,587 Age 35: staff Grade: £34,734 Age 44: Associate Specialist: £47,510	Full time throughout	Associate Specialist: £66,180	£43,000	£34,700

Annex F

Inland Revenue Tax Simplification Proposals

The tax simplification proposals, which are due to come into operation in April 2006, introduce a greatly simplified tax regime for pension arrangements and more flexibility in the form that benefits can be taken. The Finance Act 2004 that introduces the changes represents the most thorough overhaul of the tax treatment of UK schemes since 1921. The changes introduce one set of rules covering occupational pension and personal pensions. Benefits and contribution limits generally are to be replaced with allowances, in particular the individual lifetime allowance and an annual allowance.

There is no restriction on what can be saved for retirement within registered pension schemes but tax charges will be levied where contributions or benefits exceed the permissible allowance. Members will be able to contribute to any number of registered pension arrangements at the same time. Annual tax relief on personal contributions will be given on the higher of £3,600 and 100% of UK earnings. Personal contributions in excess of that limit will not attract tax relief. There will be no limit on employers contributions.

Schemes will no longer need to seek formal approval from the Inland Revenue. A new registration process will require new schemes to submit a form with core registration information. Existing approved schemes will automatically be registered under the new regime.

Lifetime Allowance (LTA)

There will be a maximum amount for all forms of registered pension saving, known as the lifetime allowance. The limit is the total capital value of a member's pension and lump sum benefits from all registered pension schemes. The limit is £1.5 million for the tax year 2006/07. Funds will be tested against the LTA at each benefit vesting event.

The LTA will be increased in stages to £1.8 million in 2010/11. The basis for its indexation beyond that date will be reviewed, maybe on the basis of RPI or earnings.

The current earnings cap (£102,000) and existing limits on benefits will no longer apply.

At each vesting event, part of the individual's LTA is used up. Pension Benefits must be valued according to the rules outlines below in order to determine the amount of LTA available after each vesting.

- Where lifetime annuities are purchased, the value of the fund will be used. This covers money purchase arrangements including cash balance.
- For scheme pensions, a standard factor of 20 will be used to value the annual pension and any lump sum benefit (whether accrued separately or via a commutation). Therefore the capital value will be the starting annual amount of the pension times 20, plus the amount of any lump sum. This applies to accrued rights not yet in payment.
- For scheme pensions in payment at A Day (6 April 2006), the standard factor will be 25 to allow for lump sums assumed to have been taken at retirement. Therefore, the capital value for a pension in payment will be the annual rate of pension times 25.
- Each amount previously claimed must be adjusted in line with the increase in the standard lifetime allowance over the period between the previous and current benefit claims.

Example

For a member with a pensionable salary of £120,000 with 40 years membership in the current NHS scheme, the capital value is:

Pension	£60,000 x 20	=	£1,200,000
Lump Sum		=	£180,000
Pension Pot			£1,380,000

Transitional Protection

Transitional protection has been provided for those people who have accrued rights under the existing tax regimes that are greater or are likely to be greater, than those that will be tax exempt under the new regime.

There are two forms of transitional protection for pension rights which have been built up before A Day (6 April 2006):

Primary protection can only be used if the individual member's benefits from all registered schemes are greater than £1.5m at A Day. Benefits are also subject to a test against the current (pre-A Day) revenue limits. The value of those pre-A Day benefits becomes the individual's lifetime allowance which increases in line with increases in the standard lifetime allowances. Further benefits can be accrue under primary protection, but will be subject to the lifetime allowance charge.

Enhanced Protection is available to any individual with benefits accrued at A Day. It will allow the value of pre-A Day rights to be linked to movements in earnings (for defined benefit schemes), the greater of 5% or the RPI (for cash balance schemes) or investment growth (for money purchase schemes). Enhanced protection removes the lifetime allowance charge.

However, this is subject to several important conditions.

Benefits at A Day are also subject to a test against the current pre A day Revenue limits.

No further benefits can accrue, nor can contributions be paid into any registered pension scheme after 6 April 2006.

There are restrictions on final pensionable salary. For members who were subject to the post 1989 earnings cap regime, pensionable salary must not be more than either the best 12 months' earnings in the three years before first taking scheme benefits, or 7.5% of the LTA, if this is lower.

For members who were not subject to the post 1989 earnings cap regime , pensionable salary must not be more than:

- The best 12 months' earnings in the three years before first taking benefits, if this is less than 7.5% of the LTA

  or

- Their average salary over the three years prior to first taking benefits, if this is more than 7.5% of the LTA

Slightly different arrangements will apply to Public Service Schemes like the NHS; in particular the 7.5% limit will not apply. However, the precise details have yet to be confirmed.

Individuals will normally have until 5 April 2009 to make their decisions and register their pre 6 April 2006 accrued benefits. However, if they wish to register for enhanced protection then benefits accrual must stop by 6 April 2006.

There will be an option to go back to primary protection provided the individual has registered for it but this must be exercised by 6 April 2009.

Individuals can register for both forms of protection, if appropriate.

Annual Allowance (AA)

In addition to the lifetime allowance, there will also be an annual limit on the increase in the value of registered pension saving, known as the annual allowance. The annual allowance will not apply in the tax year during which the member becomes entitled to all their benefits, or in the year of their death.

The annual allowance will at first be set at £215,000 and will rise to £255,000 by 2010/11. The basis for indexation beyond that date will be reviewed, maybe on the basis of RPI or earnings.

The annual allowance will apply to:

- Contributions made by the member to money purchase arrangements (including money AVCs) and by the employer.
- Increases in the capital value of defined benefit pensions (including added year AVCs) and lump sum for active members, whether due to pensionable pay increases, normal accrual or augmentation
- For cash balance schemes, increases in the capital value of cash balance benefits above the greater of 5% or the RPI.

The following will not count towards the AA:

- Contributions for death in service benefits (unless part of the "ordinary" contribution to a money purchase arrangement)
- Any member contributions not qualifying for tax relief

The total pension amount in each year is tested against the AA.

For money purchase arrangements, (other than cash balance arrangements), the pension input amount is the value of contributions paid during the year (subject to the exemptions)

For other arrangements, the pension input amount is the difference between the benefit accrued at the end of the year and the benefit accrued at the start. To determine the value of the difference, pension benefits must be valued according to the following rules.

- The annual increase in defined benefit arrangements, including any "added years" AVCs, is valued using a standard factor of 10.
- Cash balance arrangements are valued as the difference between the value at the beginning of the year, uprated by the greater of 5% or RPI, and the value at the end of the year.

Example of an Annual Allowance test for a Defined Benefit Scheme ($^1/_{60}$ accrual)

Service and Pensionable salary at 5/4/06	35 years	£90,000
Service and Pensionable salary at 5/4/07	36 years	£120,000
Accrued Pension at 5/4/06		£52,500
Accrued Pension at 5/4/07		£72,000
Increase in Pension		£19,500
Deemed value of Increase = £19,500 x 10 =		£195,000

This is below the annual allowance of £215,000 for 2006/07 so no tax liability arises in this relatively extreme example.

Pension Age

The minimum Pension Age at which benefits can be taken, other than in the event of ill health is currently 50 but this will rise to age 55 from 6 April 2010.

Those in registered pension schemes who at 5 April 2006 have an actual or prospective right under the pension scheme to draw a pension before 55, which was documented before 10 December 2003, may keep that right. However, they must draw their pension fully and leave employment.

Drawdown (Flexible Retirement)

It will be possible to claim benefits (whether wholly or partially) while remaining in the same employment and continuing to accrue future benefits in the same scheme, before or beyond normal pension age.

Lump Sum

Lump sums of up to 25% of the Revenue's definition of the capital value of the pension up to the lifetime allowance can be paid tax free from registered schemes. This means (ignoring transitional protection) the maximum tax free lump sum available will be £375,000 at 6 April 2006. Entitlement to lump sums in excess of £375,000 at 5 April 2006 can be protected but no further lump sum entitlement can accrue in respect of service after that date.

Trivial Commutation

If the member's total funds from all registered schemes are less than 1% of the lifetime allowance, all benefits may be commuted. The member may choose to commute only between age 60 and 75, all benefits must be removed from all schemes and commutations must be completed within a 12 month period.

25% of the trivial commutation sum will be tax-free and remainder will be taxed as income.

Divorce

For pension sharing orders that are implemented after A Day, pension credits will count towards the recipients lifetime allowance. Both debits and credits are ignored for the purposes of the annual allowance.

For pension sharing orders that were implemented before A Day, the value of any pension shared will be ignored for the purposes of both parties' lifetime allowances.

Taxation

Recovery Charge - Excess over the Lifetime allowance if taken as a pension, will be subject to a lifetime allowance charge of 25% at the time benefits are vested. The individual will then pay income tax on their pension, giving an effective tax rate, for a higher rate taxpayer, of 55%. If the benefit is taken entirely as a lump sum, the lifetime allowance charge is 55%.

Excess over the annual allowance is charged to the individual at a rate of 40% and dealt with via self assessment. There is no charge if the member dies before the end of the tax year or becomes entitled to all their scheme benefits.

Lump sums paid on death before benefits are taken are free of up to the lifetime allowance. Any part of the non vested pension pot paid as dependant's pension escapes being tested against the lifetime allowance.

Lump sum death benefits after pension payments begin are taxed at 35%.

Lump sum payments of up to the lower of 25% of the pension pot or the lifetime allowance are tax free. Higher sums accrued to A Day may be protected.

Refund to scheme members known as short service refunds will be taxed at 20% up to £10,800 and 40% of the excess.

Annex G

Costing of possible changes for existing members

IIA Table of package of proposed changes which might fall within the cost envelope for existing members in 2006 who decide to remain in a closed scheme

Description	**Cost (saving)**	**Comments**
First: changes with effect from April 2006		
Increase lump sum available to the 25% maximum permitted under IR rules: commutation rate £12 for every £1 of pension forgone to obtain additional lump sum	(0.40%) past service plus (0.10%) in respect of period from 2006 to 2013	On the assumption that the average lump sum taken is as under the central commutation assumption in TAG04, this would generate a saving. Includes both closed and open groups. The saving relates to past service and the 7 years of future service from 2006 to 2013.
Late retirement factors for staff who work beyond current average retirement age (or at an equivalent cost) on an increasing sliding scale from age 60.	0.35%	One option would be to offer nearly actuarially neutral late retirement factors around the current actual average retirement age of nearly 63 for the open groups. Another would be to offer lower factors to those working beyond the current normal retirement age. Any factor would have to balance the deadweight costs of the current experience of those working beyond average retirement age with the gain from the expected number who would work longer to increase their pension. Costed for open groups only (but costs expressed in terms of total pay). Costs include past service to 2006 and future service from 2006 to 2013. Actual factors to be determined give nil net cost of 2006 changes shown below.

Description	Cost (saving)	Comments
Protected step down.	Nil if paid for by either the employee alone or with the employer, de minimis if met from the scheme	This includes extension of the current protection arrangements so that staff can choose to step down and have their pension up to the point of stepping down calculated on pensionable pay at that point. If met by employers and/or employees, contributions would continue to be paid at the higher protected salary. The employer would have discretion to pay the additional employers contribution as a retention incentive. Otherwise the staff member would have to pick up the full employer and employee contributions.
Removing limits to years in the scheme for all except MHOs	De minimis	Currently around very few members reach the limits of 40 years at 60 or 45 years at 65 (55 and 57.5/60 for MHOs and those with the right to retire at 55).This proposal would allow this group of staff to continue to increase their service for pension purposes.
5% manual contribution extended to all staff in Agenda for Change bands 1 and 2.	0.05% of total pay (future service only)	This would be a way of addressing the anomaly between manual and non-manual staff highlighted by Agenda for Change.
Allow multiple nominees for death benefits	Nil	Administrative issues for trusts/NHSPA
Standardise end date for children's survivor pensions to 23	De minimis	Currently the end date varies according to time spent in higher education – see TAG06
Standardise period of full salary paid on death in service at 6 months	Nil on valuation assumptions	There is an issue about whether this will be permissible – see TAG06.
Civil partners pensions including retrospection to 1988	De minimis	This will have to be included as a result of legislation.

Description	Cost (saving)	Comments
Removal of cessation on re-marriage	0.1% of total pay	Past and future service, open and closed groups – see TAG04
Subtotal for 2006 package	**0.0% of total pay**	
Second: changes with effect from April 2013		
Implementation of NPA65 for future service of open groups	(1.00%)	This figure represents the difference between the current cost of benefits for the open groups and the cost at NPA 65, expressed as a projected percentage of total scheme pay in 2013. Future service only
Implementation of NPA 65 for future service of closed groups	(0.30%)	This figure represents the total savings forgone compared with moving this group to NPA65 expressed as a projected percentage of total scheme pay in 2013. Future service only.
Partner pensions for future service from 2013 (including lifetime pensions for partners)	0.15%	Open groups only, expressed as a percentage of total scheme pay in 2013.
Improvement in accrual rate to $^{1}/_{60}$ with commutation rate of 12 for 1	0.85%	Open groups only, future service from 2013 only expressed as projected percentage of total pay in 2013.
Indefinite protection for staff in closed groups	0.30%	See above
Subtotal for 2013 package	**0.00% of total pay**	
Packaging costs, rounding effects and summation of de minimis items	De minimis	
Combined cost of 2006 and 2013 changes*	**0.00%***	**Grand Total ***

* Note: This total represents the sum of figures arising over different time periods, and as such is based on a rather unusual conceptual framework. Care should therefore be taken in interpreting the Grand Total.

IIB Table of possible individual changes unlikely to fall within the cost envelope for existing members in 2006 who decide to remain in a closed scheme

Description	Cost (saving)	Comments
Giving existing members in open groups actuarially neutral late retirement factors based around NPA60 Giving existing members in open groups the right to partially draw down pension and have pensionable reemployment	0.65% of total pay in 2006 for future service and about 0.8% for past service	The expected costs for giving existing members the flexibilities permitted by the new IR rules are broadly equal to the costs of offering actuarially neutral late retirement factors. Providing these flexibilities would in effect bring the retirement age for costing purposes to NPA60 compared with an average retirement age of nearly 63 from the 1999 valuation experience.
Giving existing members in closed groups late retirement factors based around NPA55 Giving existing members in closed groups the right to partially draw down pension and have pensionable reemployment	0.55% of total pay in 2006 for future service and about 1% for past service	As for open groups, but based on an NPA55 compared with an average retirement age of nearly 61 from the 1999 valuation experience.
Increasing reference period for calculating final salary benefits to either best of the last ten years or alternative of best of last three or best three-year average of last 13. RPI indexation.	0.45% with an illustrative allowance for scheme differences and behaviour change	The purpose of this would be to encourage step down. Based on sample data, 0.1% past service plus 0.1% future service, ie 0.2% total, representing the estimated cost without any behavioural change arising from increased step down. These costs are likely to be at the low end as they are based on data from another scheme with more stable earnings patterns and do not allow for behaviour change. The likely extent of behaviour change is speculative but a possible total service cost of 0.45% has been modelled (on a slightly different basis from TAG08 figures). Open & closed groups included.

Description	Cost (saving)	Comments
Retrospection for Partner Pensions and pre 1988 widowers	0.30%*	See TAG04. Government policy is that retrospection should be funded by the membership collectively or individually rather than by the scheme. An alternative approach would be to offer staff the opportunity to buy retrospection (cost TBA). Open groups only, expressed as a percentage of total scheme pay in 2013
End Abatement	0.1%	The abatement formula to be developed for the new scheme may be appropriate and affordable for existing staff
Removing limits to years in the scheme for MHOs	0.2% of total pay (future service only)	The current limits for MHOs are 40 years by age 55 or 45 years by 60.This proposal would allow this group of staff to continue to increase their service for pension purposes. In the case of MHOs, this would mean that once the doubling limits have been reached, accrual would be at the normal rate.

* With a very approximate allowance for run-off of staff with pre-88 service up to 2013.

Annex H

NHS Pension Scheme

Pensions review - overview of papers prepared by GAD at the request of Review's technical advisory group

The Technical Advisory Group (TAG) of the NHSPS Review Team has commissioned the Government Actuary's Department to undertake a number of costings and other analyses of possible changes to the NHSPS that it has decided to investigate. The results of GAD's costings, together with some observations and comments on the potential changes are set out in GAD papers (in addition to this one), a list and brief description of which are set out in Table 1. These are available on the NHS Employers website, www.nhsemployers.org.

The development of the attached TAG papers was born out of the desire of the TAG to have written advice on important aspects of the review in order to help facilitate their discussions. At the outset it was not envisaged that the written advice would ultimately form a comprehensive and unified package for wider disclosure. Consequently, the information contained within the papers has not necessarily been set out in the manner of a formal structured report, and there may, for example, be inconsistencies in the style of presentation between different papers.

The set of papers do however form a single group to the extent that many of the actuarial assumptions used for the costings are not restated in every paper. The content and presentation of each paper has been subject to considerable discussion at TAG meetings and the final form of the papers reflects TAGs requirements in these areas. At the request of the TAG, the methodology and assumptions underlying each paper has been reviewed by Hilary Salt FIA at First Actuarial plc.

The papers were prepared with a view to their being subsequently made available to the Steering Group (SG) of the NHSPS Review, and to the members of that group and their advisors. The information and costings contained in the papers have been supplied to meet the specific requirements of the TAG and is not intended to be put to any other use. In particular, third parties should not rely on the advice contained therein.

Table 1: summary of papers prepared by GAD for the TAG

Title: TAG01\new\survival\final **Date: 26 August 2004** **Date signed-off: 21 September 2004** **Groups covered: new entrants** **Options covered:** (1) Pensions for life to widows and widowers (2) Civil registrations (3) Pensions for co-habiting partners (4) Pensions for co-habiting partners and nominees
Title: TAG02\new\baseline\final **Date: 26 August 2004** **Date signed-off: 21 September 2004** **Groups covered: new entrants** **Subject:** baseline for costing of options for new entrants
Title: TAG03\new\accrual\final **Date: 26 August 2004** **Date signed-off: 21 September 2004** **Groups covered: new entrants** **Options covered:** (1) $^{1}/_{60}$ accrual rate for members with commutation at 9, 12 or 15 for 1 (2) $^{1}/_{80}$ + $^{3}/_{80}$ accrual rates with option to convert more pension to lump sum (3) $^{1}/_{120}$ accrual rate for contingent spouses

Table 1: summary of papers prepared by GAD for the TAG (continued)

Title: TAG04\existing\survivors&accrual\final **Date: 26 August 2004** **Date signed-off: 21 September 2004** **Groups covered: existing members** **Options covered:** (1) broadly as TAG01, but including past and future service (2) broadly as TAG03, but including past and future service
Title: TAG05\existing\baseline\final **Date: 26 August 2004** **Date signed-off: 21 September 2004** **Groups covered: existing members** **Subject:** baseline for costing of options for existing members
Title: TAG06\existing&new\misc death benefits\final **Date: 16 December 2004** **Date signed-off: 5 January 2005** **Groups covered: existing members and new entrants** **Options covered:** (1) increasing the death-in-service lump sum to 3x pay for all categories (2) increasing the death-in-service lump sum to 3x pay for those with no surviving partner (3) re-defining the upper age limit on the payment of children's pensions (4) changing the definition of the periods during which higher initial pensions are payable to surviving spouses on death (5) illustrative service reduction factors for members who remain in a closed scheme from 2006 and then opt to buy back service for unmarried partner benefits in 2013 (6) illustrative service reduction factors for members who remain in a closed scheme from 2006 and then opt to buy back service for pre-1988 widowers' benefits in 2013

Table 1: summary of papers prepared by GAD for the TAG (continued)

Title: TAG07\existing&new\misc accrual & contributions\final **Date: 16 December 2004** **Date signed-off: 6 January 2005** **Groups covered: existing members and new entrants** **Options covered:** (1) introducing an optional lower accrual rate with a lower member contribution rate (2) introducing a "free year" of benefit accrual, so permitting pensionable career breaks (3) increasing the member contribution rate for manual staff from 5% to 6% of pensionable pay (4) introducing a lower 5% member contribution rate for staff in Agenda for Change Pay Bands 1 and 2
Title: TAG08\existing&new\misc scheme flexibilities\final **Date: 16 December 2004** **Date signed-off: 24 December 2004** **Groups covered: existing members and new entrants** **Options covered:** (1) adopting a longer reference period and different averaging period for the final pay definition on which benefits are calculated (2) allowing actuarial enhancement of benefits taken after the Normal Pension Age (NPA) (3) allowing draw-down of pension whilst continuing in employment, either before or after NPA (4) improving protections for staff whose pay reduces in the run-up to retirement (5) changing the provisions for abatement of pension (6) late retirement factors from age 60 or 63 for members remaining in a closed scheme from 2006 to 2013

Table 1: summary of papers prepared by GAD for the TAG (continued)

Title: TAG09\existing\NPA 55 groups\final **Date: 26 October 2004** **Date signed-off: 16 November 2004** **Groups covered: existing members in closed NPA55 groups** **Options covered:** (0) NPA increased by 10 years to 65, no benefit improvements, no change to limits on service or doubling threshold (1) NPA increased by 5 years, no benefit improvements, no change to limits on service or doubling threshold (2) As (1), but incorporating improvement (a) above (3) As (2), but also incorporating improvement (b) (4) As (3), but maximum of 40 years service before age 60 (5) As (4), but doubling threshold for MHOs increased to 25 years
Title: TAG10\existing\practitioners\final **Date: 4 November 2004** **Date signed-off: 23 December 2004** **Groups covered: existing members in "Practitioner" groups** **Subjects covered:** Approaches to achieving parity with other groups of members in the effects of benefit changes
Title: TAG 11\Age60\final **Date: Not applicable** **Date signed off: 27 November 2004** **Groups covered: existing members** **Subjects covered:** A critique by First Acturial of the approach taken by the Goverment Acturary in costing current benefits at age 60

Table 1: summary of papers prepared by GAD for the TAG (continued)

Title: TAG12\existing&new\assumed retirement patterns **Date: 8 December 2004** **Date signed-off: Not applicable** **Groups covered: existing members and new entrants** **Subjects covered:** An explanation of the rationale behind the approach taken to valuing age retirement liabilities
Title: TAG13\existing&new\CARE **Date: 16 December 2004** **Date signed-off: 6 January 2005** **Groups covered: existing members and new entrants** **Subjects covered:** The possibility of introducing a career average instead of final salary pension arrangement

Annex I

Glossary of terms

This glossary is provided to help employers and members comment on the issues arising in the NHS Pension Scheme Review and should not be taken as a guide to entitlements under the current pension scheme. References in italic indicate a separate entry.

A Day	The appointed day for implementation of a specific set of changes to be made to a scheme.
ABS	Annual benefit statements. Produced every year, these provide an estimate of the likely level of retirement benefits at normal pension age.
Abatement	Within the NHS Pension Scheme, the method of restricting the amount of pension NHS pensioners can secure if they return to NHS employment. NHS Pension Scheme abatement rules set a maximum threshold of pension and re-employment earnings for re-employed NHS pensioners. This uses the pensionable pay figure at retirement which is compared with the pension and re-employment earnings. If pension and re-employment earnings exceed pensionable pay at retirement, then the pension is reduced pound for pound
Accrual	The method of building pension benefits. In the NHS Pension Scheme the current accrual rate is $^1/_{80}$ of pensionable pay for each year of membership.
Actuarial adjustment	The adjustment made to a pension where it is expected to be paid for a longer or shorter time than normal. The most common actuarial adjustment is a reduction when a member retires before a pension scheme's *normal pension age (NPA)*, to allow for the fact that the pension will be paid for longer than expected.
Actuarial enhancement	See *Actuarial adjustment*

Actuarial reduction	A reduction to retirement benefits which are paid before the normal pension age. In the NHS Pension Scheme, from the age of 50 (the current minimum pension age) members can apply for the early payment of retirement benefits; this is described as *voluntary early retirement (VER)*. Where benefits are paid before the age of 60 (the current normal pension age) they are 'actuarially reduced' to reflect the that that they will be paid longer than planned for. The factors used in working out the reduction are produced by the Government Actuary's Department (GAD) and mean that benefits paid from age 50 will reduce by around 5% a year. For example, VER at 50 means a member will retain around 60% of the pension and 75% of the lump sum that would have been paid at 60.
Additional voluntary contributions (AVCs)	Extra payments of scheme contributions, to buy years and days of membership or to invest in pension arrangements outside the main occupational pension scheme in order to top up retirement benefits.
Added years	Additional years of scheme membership for pension purposes bought by paying extra contributions. Members of the NHS Scheme who will not complete 40 years' membership by their normal pension age may be eligible to purchase membership in this way.
Annuity	Insurance contract that guarantees to pay annual amounts for a fixed period. For example, some *defined contribution* pension schemes provide a pension for members by buying an annuity for them when they retire.
Buy-out policy	The policy of buying scheme members a deferred *annuity* to secure pension rights that have been built up in a scheme.
CARE	Career average revalued earnings. Retirement benefits are built up on an annual basis and revalued typically in line with either national average earnings (NAE) or the retail price index (RPI)
Career average scheme	A *defined benefit scheme* which pays a pension based on the average of a member's pensionable earnings throughout their whole career. For example, the NHS Scheme does this for self-employed members of the Scheme such as GPs.
Calendar service	This is the actual length of scheme membership.

Commutation	Giving up part of the pension in exchange for a lump sum, i.e. scheme members 'commute' part of their pension. Many occupational schemes have a single accrual rate with rules which specify how much lump sum can be given up. For example, if the commutation factor was 12:1, members would get £12 cash in the lump sum payment for every £1 per year of pension given up in exchange.
Concurrency	Simultaneous active membership of both a *personal pension scheme* and an *occupational pension scheme*.
Closed groups	The group of NHS Scheme members who have special retirement rights. These were withdrawn from 6 March 1995 for new entrants. Those with special retirement rights are described as a 'closed group' because no new members were included after the closure date.
Deferred benefits	Pension scheme benefits which have been earned in a scheme, but which have not yet been paid. For example, people who have been members of the NHS Scheme but leave the service before retirement, will normally have deferred benefits which are paid when the person reaches normal pension age.
Defined benefit (DB) scheme	A pension scheme where the scheme rules define the level of benefits payable rather than the level of contributions and the scheme's investment returns.
Defined contribution pension scheme (DC)	A pension scheme where the benefits are determined by the level of contributions to the scheme and their subsequent investment growth. Defined contribution schemes also usually provide a pension by buying an *annuity* for members when they retire.
Direction employers	Non-NHS employers who the Secretary of State has directed can operate the NHS Scheme for eligible employees. For example, charities that indirectly support the wider NHS by providing palliative care or Care in the Community may be direction employers.
Draw down	'Draw down' allows members to apply for part of their retirement benefits without stopping work – not currently available in the NHS Pension Scheme. Currently members must retire in order to apply for retirement benefits. Draw down would normally be available from the minimum pension age, which is currently age 50 but which will increase to 55.

Dynamisation	The method of building pension benefits for NHS Pension Scheme contractors (general medical and dental practitioners). Benefits are based on pensionable earnings throughout their whole career which is brought up to a current value. The factors used are based on the average estimated increase in GP contractor pay. Currently the pension is based on 1.4% of all the revalued earnings. Three times the pension is also paid as a tax-free lump sum.
Earnings cap	The maximum annual level of pensionable earnings that may count towards calculation of retirement benefits. The cap was set at £102,000 for 2004/05. It does not apply to people who joined a pension scheme before 1989.
Enhance	The method of increasing pension benefits. For example, in the NHS Pension Scheme, retirement benefits paid on the ground of ill-health may be 'enhanced' to increase membership to the amount the member would have secured had they been able to work to the normal pension age. Retirement benefits may also be enhanced where they are taken later than at the normal pension age.
Employing authority (EA)	Employers who operate the NHS Scheme, i.e. NHS trusts/PCTs/strategic or special health authorities, GPs and *direction employers*.
Final salary	The level of earnings in a period close to retirement, used to calculate retirement benefits. For example, the NHS Scheme uses the best of the last three years' *pensionable pay* for members other than self-employed contractors such as GPs.
Financial Services Authority (FSA)	The independent regulator for financial services business.
Flexible retirement	The facility for people to phase in the transition from work to retirement, for example the ability to *draw down* pension or to *step down* to a job that carries less responsibility
Group personal pension	An arrangement for employees of a particular employer to participate in a *personal pension scheme*, usually on common terms and conditions with an employer's contribution.
Guaranteed annuity	An *annuity* where payments are guaranteed to continue for an agreed period of up to 10 years even if the person dies before the end of the period.
Life expectancy	The estimated likely length of life at a particular age. May be based on the general population or take account of individual factors such as lifestyle and illness.

Lifetime allowance (LTA) The amount on which the Inland Revenue will allow tax relief on a scheme member's contributions. Current proposals will allow a lifetime allowance of up to £1.5 million rising to £1.8 million in 2010.

Lump sum A tax-free one-off payment. For example in the current NHS Scheme a tax-free lump sum is paid at retirement equal to three times the annual pension.

Marginal rate The rate of income tax that would apply to an additional pound of income; normally the same as an individual's highest rate of income tax.

Member An employee who is a member of a pension scheme.

Mental Health Officer (MHO) A person who qualified for the *special retirement rights* granted to specified NHS staff who worked in the mental health field. MHO status includes accelerated accrual of benefits after 20 years in this type of employment, i.e. two years' membership for every year actually worked, and a normal pension age of 55. These special retirement rights were withdrawn for new entrants after 6 March 1995.

Minimum pension age The youngest age at which pension benefits may be taken. This is currently at the age of 50 in the NHS Scheme, except for retirement on the grounds of ill-health which can apply at any age.

Money purchase (MP) Contributions made by a member to secure pension benefits in a *defined contribution scheme*. Contributions are invested and the returns from the investments used to buy an *annuity* at retirement. Some *defined benefit schemes* also provide a money purchase facility to allow members to buy additional pension rights in this way. In the NHS Scheme, in-house money purchase facilities are available from Halifax/Equitable Life Assurance Society, Standard Life and the Prudential.

Mutuality Within the NHS Pension Scheme, the principal whereby all scheme members and employers join together to fund a package of pension benefits for a *defined contribution rate*. This acts like an insurance scheme where benefits such as ill-health retirement are available but may not be needed by all members.

National average earnings (NAE) The average growth in national earnings across the UK.

Net pay arrangement The arrangement by which employers deduct pension contributions from employees' pay before applying income tax so that employees receive tax relief on pension contributions at their *marginal rate*.

Normal pension age (NPA)	The age at which a pension scheme assumes its members will normally apply for a retirement pension. Most schemes allow members to retire earlier or later if they wish.
Notional whole time pay (NWT Pay)	The equivalent *pensionable pay* that a part-time worker would receive if they were working full-time.
Occupational pension scheme	A pension scheme for staff working for a particular employer or related employers.
Open groups	The group of active NHS Scheme members which excludes those who have left the scheme with a deferred pension and NHS pensioners.
Part-time membership	Years of membership of a pension scheme built up by a part-time worker. In the NHS Scheme, the amount of part-time membership is converted to the equivalent amount of full-time membership in order to calculate retirement benefits. For example, members working half the normal number of full-time hours would be credited with six months' membership for each full year worked.
Pension	The regular payment made by a pension scheme to its retired members. For example, the current NHS Scheme provides regular monthly payments to retired members which provide an annual income based on $^1/_{80}$ of their *final salary* (best of the last three years) or, for self-employed members such as GPs, their *career average salary*.
Pensionable pay	This is the pay which is used by a pension scheme to determine contributions to the scheme and pay-related benefits from the scheme. In the NHS pensionable pay can be less than actual pay because overtime payments and some allowances are not normally pensionable.
Pension-sharing on divorce	An arrangement whereby pension rights are shared between both parties to the divorce under a pension-sharing order, an agreement or equivalent provision in accordance with the Welfare Reform and Pensions Act 1999.
Personal pension scheme	A pension scheme, membership of which is not dependent upon a contract of employment. For example, several insurance companies run personal pension schemes. Some members of *occupational pension schemes* also take out a personal pension to top up their retirement pension.

Preservation	The preservation of benefits for members who leave a pension scheme before retiring can also be referred to as *deferment*. Benefits are index linked so they keep pace with inflation. Some schemes set a minimum period of membership before pension rights are preserved. For example, the NHS Scheme requires members to have two years' membership before their pension rights are preserved and benefits can be held in the Scheme until their *normal pension age*.
Protected rights	Rights to continue to receive benefits from a pension scheme irrespective of future changes to the scheme. For example, part of a person's pension which is funded by a rebate of National Insurance contributions in return for forgoing part of the state earnings related pension (SERPS) or the second state pension (S2P), is protected
Refund of contributions	Most occupational pension schemes offer a refund of contributions for membership of less than two years. In the NHS Scheme, a tax payment and a deduction to buy the member back into the state pension scheme is payable from the refund. For membership of over two years, pension rights may be transferred to other pension arrangement or left in the Scheme until normal pension age.
Retained benefits	Retirement benefits deriving from an earlier period of employment or self-employment, which have not been transferred.
Retail Price Index (RPI)	An indicator which provides an economic tool to monitor inflation. The RPI figures focus on the rate of change in prices. NHS pensions are increased each year in line with the RPI.
SD Number	Each member of the NHS Pension Scheme is allocated a Superannuation Department number. This number is prefixed SD followed by the year of the member's birth. This SD Number or the National Insurance number can be used to trace individual membership records.
Serious ill-health commutation	The facility for members with severely reduced *life expectancy* to withdraw the full value of their pension benefits as a *lump sum*.
Special classes	NHS Pension Scheme members who have special retirement rights. These members include nurses, midwives, health visitors and physiotherapists who have a normal pension age of 55 and *Mental Health Officers (MHOs)*.

Special retirement rights	See *Special classes*.
Stakeholder pension	A type of *personal pension scheme* which meets set criteria, including a ceiling on charges and flexibility.
Step down	To move to a job that is less onerous or with less responsibility. Normally means a reduction in pensionable pay.
Tax-free lump sum	Scheme benefits which can be taken as a cash payment, which is not subject to income tax. See also *lump sum*.
Transfer	The transfer of membership from one pension scheme to another. There are strict conditions that determine when and how this can be done. In the case of the NHS Scheme, transfers into the Scheme must be made within 12 months of joining or rejoining the Scheme.
Trivial commutation	The facility for people to convert small amounts of pension into a lump sum payment by *commutation*.
Unfunded unapproved retirement benefit scheme (UURBS)	A retirement benefits scheme that is not approved by the Inland Revenue and does not attract tax relief. Such a scheme may be useful alongside a normal pension scheme where members exceed the *earnings cap*, but still wish to save for their retirement. The NHS Scheme does not currently operate an UURBS.
Vesting	The creation of rights to draw benefits from a pension scheme. In the NHS Scheme vesting occurs after two years' membership. Before this point, no benefits are paid but there may be a *refund of contributions*. After this point members have rights in the Scheme which may be transferred to another scheme or taken as benefits when they retire.
Voluntary early retirement (VER)	The application for retirement benefits before the normal pension age. In the NHS Pension Scheme the current minimum pension age is 50 and members can apply for retirement benefits with an *actuarial reduction* or with no reduction if the employer agrees to meet the cost.
Wind down	To wind down to final retirement normally means that a member may reduce his or her hours for a period before final retirement. In the NHS Pension Scheme this would typically involve members moving from full-time to part-time employment.

The NHS Pension Scheme Review Consultation
Response form

NHS Employers

Annex J

☐ Please tick if you would like your response to be kept confidential

Name ____

Job title ____

Organisation ____

Address ____

Are you replying on behalf of:

☐ Your organisation ☐ As an individual ☐ Other (please specify) ________________

Use the space provided below for your comments and continue on additional sheets if necessary.

The Review partners seek views on the issues contained in section 4, in particular:

- the Government's intention to increase the normal pension age to 65 for public sector workers
- its appropriateness for the NHS
- ways in which the NHS can retain its older workforce and the issues it needs to address in doing so.

Please return your response form to:
NHS Pension Scheme Review, NHS Employers,
29 Bressenden Place, London SW1E 5DD.

You may also complete this form online at
www.nhsemployers.org

All responses must be received by 11 April 2005.

A part of the NHS Confederation
working on behalf of the NHS

The Review partners would welcome views on the funding issues set out in section 7, recognising the firmly held view of the staff side that *all* the savings from the proposed change to NPA should be made available for improvements and the Government position that savings should be made.

The Review partners would welcome views on the strong recommendation that the proposed new scheme should improve the accrual rate, as expressed in 8.7–8.12.

Views are also sought on which of the two alternative defined benefit options are favoured, the retention of final salary pensions or the extension of career average pensions to all NHS staff, set out in section 8.13–8.31.

The Review partners also seek views on the pensionable pay definition to be used should CARE be adopted, as explained in 8.17–8.19.

The Review partners welcome views on the recommendation that there should be no limits on membership or restrictions below the Inland Revenue allowances, as set out in 8.32–8.33.

The Review partners would welcome views on the issue of career breaks set out in 8.34–8.36, and in particular the proposal that recognition of career breaks should be available at the employer's discretion.

The Review partners welcome views on the recommendation in 8.37–8.40 that the new scheme provides partner pensions.

The Review partners welcome views on the recommendation, as described in 8.41, that the partners of members who die in service should receive a payment at salary level for six months and, if the scheme cannot provide this or equivalent benefits, then employers should be asked to meet the costs of paying this.

The Review partners welcome views on whether partner pensions should be improved in the new scheme, including ending cessation of survivor pension on remarriage as described in 8.42.

The Review partners welcome views, laid out in 8.43, on whether the new scheme should pay all children's pensions to 23 or have restrictions after the age of 17 until 23.

The Review partners would welcome views on section 8.44–8.45

- increasing death in service lump sum benefit to members
- allowing multiple nominees for death in service lump sum
- paying an additional year's lump sum payment where no dependant's pension is payable.

The Review partners would welcome views on the recommendation that there should be flexibilities of step down, draw down, pensionable reemployment and enhanced pensions for late retirement in the new scheme, set out in 8.46–8.56. Views are also sought on the preferred approach to supporting step down in the new scheme.

The Review partners seek views on how abatement should be addressed, as outlined in 8.57–8.60.

The Review partners welcome views on the proposed additional pension purchase arrangement including the issue of contribution limits and limits on the overall amount of pension purchased, set out in 8.61–8.70. Views are also sought on the suggestion of removing added years arrangements in the new scheme.

The Review partners welcome views on which of the three approaches to MPAVCs expressed in sections 8.71–8.76 should be taken.

The Review partners seek views on their recommendation, as expressed in 8.77–8.80, that practitioner pensions should continue to be on a CARE basis and that the accrual rate for the practitioner scheme should be set to maintain the current relationship with the main scheme.

The Review partners would welcome views on the options for employee contribution rates as set out in 8.81–8.84.

The Review partners welcome views on the approach to ill-health retirement expressed in section 8.85–8.89.

The Review partners would welcome views on the consensus that scheme coverage should be extended, as proposed in 8.90–8.96, for both the new and existing schemes. Views may also inform the wider debate on public service scheme coverage.

The Review partners seek views on the recommendation that the highest priorities are improving the accrual rate, providing end career flexibilities and partner pensions, as set out in section 8.

The Review partners seek views on the possible extension of protection by three to five years, as set out in 9.1–9.4.

The Review Partners welcome views on the recommendation that protection for special class groups be maintained as expressed in section 9.5–9.6.

The Review partners would welcome views on the option set out in 9.7–9.9 for existing members who choose to transfer to the new scheme.

The Review partners would welcome views on the package of improvements set out in annex G.

The Review partners welcome views on the two transition options set out in section 9.18–9.24 for moving to a new scheme.

The Review partners welcome views on the options for rejoiners, as set out in 9.25–9.28.

The Review partners would welcome views on the retrospection issues expressed in section 9.29–9.30.

The Review partners welcome views on section 10 on how changes might be better communicated both locally and centrally.

The Review partners would welcome suggestions on the approach to training and development and the drawing up of literature in support of the scheme.

Given the number of employers (11,500), of which the majority are GP practices, the Review Partners would welcome ideas on ways to improve the data accuracy and updating of records

The Review partners would welcome views on the how best the NHSPA can support its various stakeholders (particularly employers, staff and trade unions)in implementing the changes in pension arrangements.

The Review partners would welcome views on the implications of the changes in the pension scheme for NHS employers.

The Review partners would welcome views on the recommendation that the pension scheme should change the description of the employment groups to reflect widely used NHS staff categories.

The Review partners would welcome any other views you might have on the NHS pension scheme.

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