Greater flexibility in NHS Pension Scheme accrual rates—an answer to taxpayers' prayers?

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Pensions analysis: The Department for Health and Social Care (DHSC) is examining how it can improve the flexibility of senior NHS staff pensions to discourage them from retiring early or refusing work to avoid tax charges following the reduction in the lifetime allowance and the introduction of the tapered annual allowance. Under DHSC's proposals senior clinicians will be able to set their level of pension accrual each year while remaining within the NHS Pension Scheme (NHSPS). . Kelly Beattie, managing associate at Womble Bond Dickinson, discusses the ramifications and effectiveness of the proposals, which she says have wider ramifications for other public sector pension plans and many private sector plans.

Original news

'Flexible pensions to help NHS senior staff avoid tax charges', LNB News 11/09/2019 65

The DHSC has launched a consultation on proposals to increase the flexibility of senior NHS clinicians' pensions. The increased flexibility will enable them to control their pension growth level, avoiding tax charges which currently push them to early retirement and turn down extra shifts. The consultation closes on 1 November 2019.

What is the reasoning behind the proposed changes to the NHS pension scheme? How do they propose to tackle the key problems?

There has been widespread concern that pensions tax changes are forcing experienced staff out of the NHS. The British Medical Association (BMA) has referred to a 'perfect pensions storm' caused by the interaction of the reduction in the lifetime allowance and the introduction of the tapered annual allowance. Senior clinicians are managing their pensions tax liability by reducing workloads—turning down extra responsibilities and/or retiring early—thereby affecting NHS service capacity and patient care.

To tackle this problem, the government is proposing more flexibility around pension accrual including an arrangement to allow senior clinicians to set their level of pension accrual each year. Clinicians would choose an accrual level based on a percentage of the normal scheme accrual level in 10% increments with an equivalent adjustment to the clinician's contribution rate. For example, the clinician elects 30% accrual for 30% contributions (subject to a minimum level of 10% or the clinician would need to opt out). Clinicians would then have the option of 'fine tuning' their chosen accrual rate by increasing it later in the scheme year (once they have a better understanding of their earnings for that year which tend to be difficult to predict), subject to paying any additional contributions required. NHS employers would have the option to pay clinicians any unused employer contributions as salary.

Clinicians would also be able to ascertain how their choices would affect pensions growth, through:

• a change to the 'scheme pays' mechanism by which members can pay an annual allowance tax charge through a reduction to their scheme benefits, so that clinicians can see the impact on their benefits in the year the tax is paid

• a new pensions modeller that could be tailored to the clinician's personal circumstances

How effective do you think the proposed changes will be? Do they go far enough?

If clinicians have to opt out of the NHSPS (as they currently do if they wish to manage their pensions tax accrual), they will lose an assortment of associated benefits—such as death benefits and ill health benefits—plus the value of the contributions made to the scheme by their employer. The proposed changes would enable clinicians to manage their pensions tax accrual without losing these other benefits and also retain a proportion of the employer's contributions.

The proposals to 'fine tune' accrual do not include an option to decrease accrual rates during a scheme year and so clinicians will need to take care not to set their accrual rate too high initially. However, setting it too low could mean that clinicians who decide to increase their accrual may find that they do not have the funds available to meet the backdated payments required.

Clinicians would need to invest more time in managing their pensions accrual which may not happen in practice and so they could still default to working fewer hours or retiring early.

As employers are not required to pay clinicians any unused employer contributions, clinicians could still see a cut to their overall benefits package, in addition to receiving a smaller pension.

In general, this is also 'tinkering at the edges' of the broader problem identified by the BMA. The combination of the tapered allowance and the reduced lifetime allowance has complicated the tax situation for many employees both in, and outside of, the public sector.

In accepting there is a problem for clinicians, the government opens the question of whether the basic systems in place that have led to this problem are simply wrong and should there be a broader simplification of what has become a disincentive for many key workers saving into their pensions? This is however a political question, how far can the government play favourites?

Are there any issues these changes would raise? If so, what would be the impact? What other possible changes could be on the horizon?

The main issue is likely to be the administrative headache of keeping track of a large number of pension accrual limits each year. This will be exacerbated by the option to alter accrual rates part way through a year as administrators would need to ensure that the correct rate has been applied to the whole year and that any additional contributions required from clinicians and their employers are obtained. While more information will be available to the clinicians, there is an increased risk that the information provided may not be accurate.

Regarding future change, the government has said that it will 'review how the tapered annual allowance supports the delivery of public services such as the NHS'. Following the recent consultation on changes to the Teachers' Pension Scheme to allow a phased withdrawal by independent schools, this option could be put forward for employers in the NHSPS who are not legally required to offer their employees membership of the scheme.

Do you see other types of pension schemes being changed to allow for personalised pension growth level selection?

Although it is the NHSPS that has made the news, the underlying problem extends more widely and affects other public sector pension plans and many private sector plans.

A '50:50 option' has existed in the Local Government Pension Scheme (LGPS) since 2014, albeit not for the same reasons. Once the NHSPS consultation has concluded the government may look to offer greater flexibility in accrual rates to LGPS members. Having previously argued that employers in the private sector already have flexibility around pensions accrual, it seems less likely that the government will seek to make changes in the private sector.

But the political issue here is more complex as private sector employees and employers may see this as yet another example of there being one rule for the public sector—defined benefit pensions, funded in many cases through general taxation—and another rule for the private sector which, due to weight of regulation and the economic climate, has long since had to abandon defined benefit provision in favour of alternatives.

The 'cash alternative' approach (providing employees who have opted out with the option of receiving the employer's pension contributions as additional pay instead) is already being offered by many companies in the private sector to avoid pensions tax charges or retain pensions tax protections. But, of course, private sector employers have more experience of continuing or replicating the associated benefits that would otherwise have been lost.

Interviewed by Samantha Gilbert.

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