

As the negotiations into the finer points of the Hutton Report on Public Sector Pensions continue between government and unions, there is increasing talk amongst NHS Pension members about the anticipated increase to contributions from 2012/13.

Specifically, the chatter seems to centre on the question of whether or not the NHS Pension Scheme remains good value for money. It is Hampton Dean's view that the NHS Pension Scheme remains excellent value for money for the vast majority of members and the following seeks to explain why. In our view and as we have explained in previous articles, only those doctors who have had to apply for [Fixed Protection](#) of their pension benefits should consider moving away from the NHS Pension and then, only as a consequence of that Fixed Protection.

The problem that we, as Independent Financial Advisers, have is that it is an easy thing to say that the scheme remains good value for money and a much more difficult thing to articulate why we hold that view.

In order to try to show you why we remain unwavering in our conviction that this remains the best pension scheme available to you, the following tables build towards a 'worse case scenario'. In keeping with that premise, we have assumed the increased employee contributions and specifically, the highest level of those anticipated contributions at 10.9% as recommended by the Hutton Report.

We have then added in the possibility of overfunding the pension in a given year and incurring additional taxation. Finally, we have added in the scenario of overfunding the entire pension fund and incurring additional tax at retirement.

The full list of those anticipated contributions is contained in Table 1 below.

**TABLE 1**

Pay (FTE)	Old contribution charged on whole pensionable salary.	New contribution charged on whole pensionable salary.
£21,176 - £26,557	6.5%	7.1%
£26,558 - £48,982	6.5%	7.7%
£48,983 - £69,931	6.5%	8.5%
£69,932 - £110,273	7.5%	9.8%
Over £110,273	8.5%	10.9%

Normal day to day membership of the scheme paying 10.9% personal contributions.

The key as to whether or not the NHS Pension is good value for money is a comparison in real terms of the money paid in against the possible money that would be paid out. Of course, in order to manage that, we must make certain assumptions, not least of which is life expectancy. As the proportion of money out is always the same for members of the same version of the scheme, we have used the highest expected cost.

The example in Table 2 below is for a Hospital Doctor in the 1995 (80ths) version of the NHS Pension, earning £130,000 and paying 10.9% of superannuable income into the scheme. We have deliberately used a high earner to build the worse case scenario mentioned.

In Table 2, we have tried to show the total output of the pension value based upon each £100 of contribution to the scheme. A £130,000 salary at 10.9% would mean a £14,170 gross personal contribution and would create benefits of £130,000/80 pension, plus a 3x pension lump sum for every year of membership.

So, £100 of gross contribution would produce a gross pension of £11.46 pa and a lump sum of £34.38. The contribution would receive 40% tax relief and we have assumed that the pension would be taxed at 40% as well. The net contribution would therefore be £60 and the net benefits, £6.88 pa plus £34.38. Given the guarantees that exist within the NHS pension Scheme as regards spousal and dependents benefits, index-linking of pensions and the fact that benefits are paid monthly in advance, we have assumed an annuity rate of 3.5% pa to give a lifetime cash equivalent value.

This makes the total pension worth  $£6.88 \div 3.5\% = £196.46$  plus the £34.38 giving £230.84 across a lifetime. The 3.5% annuity rate is approximately what a 60 year retiree would get, taking benefits from their invested pension, on the same basis as is offered by the NHS, detailed above. Using that figure, we know that a fund of £230.84 would produce the lump sum and pension benefits required. As there is no NHS Pension fund, this is the only way of estimating the value of benefits.

**TABLE 2**

	Cost	Pension	Tax Free Lump Sum	Lifetime Value
Gross	£100	£11.46 pa	£34.38	
Net	<b>£60</b>	£6.88 pa	£34.38	<b>£230.84</b>

So, on a straightforward membership basis, even at the highest contribution level, the NHS Pension Scheme represents extraordinary value for money when compared to other alternatives.

**The effects on the cost of contributions if the Annual Allowance is exceeded.**

But what if, as a result of membership of the scheme this particular member found that they had inadvertently overfunded their annual allowance to the extent that they had to pay tax at 40% on the amount of overfunding. As illustrated in Table 3 below and discussed in previous articles, HMRC have their own way of valuing the Public Sector pensions when measuring whether or not they have breached the lifetime allowance.

As a reminder, the pension increase, from one year to the next is multiplied by 16 and added to the lump sum to see if the total comes to more than the maximum allowable of £50,000 pa after allowing for inflation. If, over the current and 3 previous tax years, the total contribution uses all available allowance, any excess is then added to income as if it were earnings and taxed at the individual's highest rate.

As this example concerns specific inputs of £100 units, we have assumed that the entire £11.46 pa pension, when multiplied by 16 and added to the £34.38 lump sum to get the equivalent value of membership, exceeds the £50k limit and is subject to additional tax. This is in keeping with our 'worst case scenario' and in practice, not all of the pension contribution would represent an increase in the pension and the situation would be somewhat better than painted here. In this 'worst' case, the amount of tax that would be charged would be,  $40\% \times ((16 \times 11.46) + 34.38)$  which comes to £87.10 of additional tax.

Once this is added to the £60 net cost to give the true cost of that year's membership, it comes to £147.10 per £100 of payment.

**TABLE 3**

	Cost	Pension	Tax Free Lump Sum	Lifetime Value
Net	£60	£6.88 pa	£34.38	£230.84
With Annual Allowance tax	<b>£147.10</b>	£6.88 pa	£34.38	<b>£230.84</b>

Even in this situation, the output significantly outweighs the input and, whilst no-one would welcome the additional tax, it is apparent that even in this scenario, the NHS Pension Scheme remains excellent value for money.

**The effects on your pension of overfunding the Lifetime Allowance.**

Now let's consider the worst case scenario. Let's assume that, not only does this particular doctor breach the Annual Allowance for contribution, giving rise to a substantial tax bill and consequent increase to the cost of membership, but they also breach the Lifetime Allowance of £1.5m which increases the tax on the output of the scheme.

Again, as a reminder, in order to establish whether or not a Public Sector employee's pension has exceeded the Lifetime Allowance, HMRC multiply the total pension by 20 and add the lump sum and any other pension funds that the retiree may have. Any excess is then subject to taxation. In this instance, there would be additional tax to pay of 25% on the income and 55% on the lump sum. So, the £11.46 pa gross pension becomes £5.16 pa net of both taxes and the £34.38 lump sum becomes £15.47. The total output of the scheme therefore becomes £162.81, using the same calculation as previously shown. Table 4 illustrates this.

**TABLE 4**

	Cost	Pension	Tax Free Lump Sum	Lifetime Value
Net	£60	£6.88 pa	£34.38	£230.84
After Annual Allowance and Lifetime Allowance tax	<b>£147.10</b>	£5.16 pa	£15.47	<b>£162.81</b>

Even in this circumstance the NHS Pension Scheme remains good value for money, albeit only marginally.

So, in conclusion, the NHS Pension remains good value for money for the vast majority of members. Even when we test it to destruction by piling every possible negative scenario onto it, it still gives back more than it costs. Consequently, it remains Hampton Dean's core advice that NHS Pension Scheme members should not be tempted or persuaded to leave the scheme without other good reasons for doing so.