HFMA briefing
November 2019

Final pay controls

Accounting and governance issues

Background

From 1 April 2014, final pay controls were introduced for all members of the 1995 section of the NHS Pension Scheme who retire with entitlement to officer benefits.

In summary, this means that if a member receives an increase to pensionable pay in any of the three years prior to them retiring or transferring out of the scheme that is more than specified amount then the employer is liable for a final pay control charge in the year that the individual retires or transfers out.

Although final pay controls have been in place for over 5 years, the number and value of liabilities was initially minimal, however the number of charges is now starting to increase.

How it works

These liabilities only relate to members of the 1995 section of the NHS Pension Scheme who retire with entitlement to officer benefits or who transfer out their NHS pension to another pension scheme. This includes 1995/2015 transition members.

If a member receives an increase to pensionable pay that means that it is more than an amount called the 'allowable amount' in any of the three years prior to their last day of service, the employing authority that awarded the increase in pay will be liable for a final pay control charge.

The allowable amount for a relevant year is determined by comparing the pensionable pay for each of the three years prior to retirement with two other calculated amounts. The allowable amount is the lesser of:

- the member's pensionable pay in the relevant year or

- the allowable amount in the previous year[1] plus (CPI % + 4.5%) or
- the allowable amount in the previous year[2] plus the percentage increase in the member's pensionable pay for the current year compared with the previous year.

The employer is liable for the difference between:

- NHS pension benefits payable on the allowable amount and the NHS pension benefits payable on the amount that pensionable pay exceeds the allowable amount multiplied by a factor provided by the scheme actuary plus
- the pension lump sum based on the allowable amount and the lump sum based on the allowable amount.

The employer will be invoiced by NHS Pensions the month after the quarter in which the employee has been awarded their pension or has transferred out of the scheme.

Where an employee has two or more employers, the one that increased the pensionable pay will be liable. If the invoice is not paid, then interest and an administrative levy is added to the charge.

The NHS Business Services Authority have produced a factsheet[3] on these requirements which includes a worked example. The final pay control arrangements are set out in regulation D3 of the NHS Pension Scheme Regulations 1995[4] (see the Appendix to this briefing).

Why is this an issue now?

The final pay control arrangement was set up to mitigate against the risk that employers would award employees large pay increases just before they retired in order to boost their pension. It was introduced in the same year that independent bodies were admitted to the NHS Pension Scheme. There was also a concern that employees would withdraw from salary sacrifice schemes just before they retired which would increase their pensionable pay and therefore their pension on retirement. Without the final pay control, these decisions made by employers and employees would, in effect, be paid for by the NHS Pension Scheme.

These arrangements apply to all employers that have members in the NHS Pension Scheme – including independent contractors, primary care providers as well as NHS providers and commissioners.

However, members are reporting that they are receiving final pay control invoices for staff who have received clinical excellence awards and pay increases as a result of standard career progression moving up increments in the agenda for change bands.

According to guidance issued by the Government's Actuary's Department[5] where a final pay control charge is, in full or in part, the result of a clinical excellence award, the Advisory Committee on Clinical Excellence Awards (ACCEA) should pay all or part of the resulting invoice.

From 1 April 2018, according to the consultation response on the proposed amendments to the NHS Pension Scheme[6], any increase to an employee's pensionable pay as a result of the *Framework agreement on the reform of agenda for change*[7] are ignored for the purposes of the final pay control calculation[8].

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[1] In the third year before retirement, the base year pensionable pay is increased by February CPI plus 4.5%
[2] In the third year before retirement, this amount is not used
[3] NHS Business Services Authority, *NHS Pensions – final pay controls and employer charge factsheet*, 2018
[4] National Health Service Pension Scheme Regulations 1995 (SI 1995/300)
[5] Government Actuary's Department, *NHS Pension Scheme final pay control factors and guidance*, March 2015
[6] DHSC, section 8 of the *Consultation response – the NHS Pension Scheme, additional voluntary contributions and injury benefits (amendment) regulations 2019*, March 2019
[7] NHS Employers, *Framework agreement*, June 2018
[8] This is an amendment to regulation D3 of the National Health Service Pension Scheme Regulations 1995 (SI 1995/300) by section 6 of the National Health Service Pension Schemes, Additional Voluntary Contributions and Injury Benefits (Amendment) Regulations 2019 (SI 2019/418) – see the appendix to this briefing for the full regulation D3

The Department for Health and Social Care (DHSC) also announced in its response to the consultation on the amendment to the 1995 regulations that they will review the final pay control policy in conjunction with the NHS Pension Scheme Advisory Board.

Can it be managed?

The short answer is not really. In the instances where the allowable amount is breached simply due to standard career progression or clinical excellence awards, it is not in the control of the NHS body. However, where the final pay control charge relates to clinical excellence awards then the employing body should ensure that the ACCEA is invoiced for the element resulting from the award.

Where NHS bodies consider that the charge has been based on an increase to pay as a result of the reform to agenda for change (from 1 April 2018), they may be able to challenge the basis on which the charge has been calculated by confirming the pay scale that the member has changed from and the scale that they have moved to[9].

NHS bodies cannot take into account the likelihood of an employee retiring when making decisions about promotions or pay awards as this is likely to be discrimination.

Accounting

Under IAS 37 a provision is ‘a liability of uncertain timing or amount’ where a ‘liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits’.

In the case of final pay controls, NHS bodies will have a liability when an employee takes their pension and their pay increases in the three years preceding their retirement are above the allowable amount. Finance teams are finding that they are only aware of the liability when the invoice arrives from the NHS Business Services Authority.

To manage this possible cost pressure, finance teams need to consider whether they can identify whether there is a possible liability at an earlier stage. To do this, the finance team will need to:

- identify members of the 1995 part of the NHS Pension Scheme
- identify when one of these members either takes their pension or transfers their pension to another scheme
- calculate the likely liability based on that members pensionable for the past four years and the February CPI rate[10] for the appropriate year (a worked example is available in the NHS Business Authority’s factsheet).

This is all information that the NHS body should hold but they will need to take a view as to whether the cost of identifying the cost pressure is outweighed by the limited action that they can take once the liability has been identified.

[9] NHS Business Services Authority, *Final pay control and the 2018 agenda for change pay revision*, accessed 11 November 2019

[10] CPI rates are available from the Office of National Statistics website. The CPI 12-month inflation rates were as follows February 2016 - 0.3%, February 2017 - 2.3%, February 2018 - 2.7%, February 2019 - 1.9%

Appendix: Regulation D3 of the National Health Service Pension Scheme Regulations 1995

The 1995 Regulations (SI 1995/300) set out the way that the 1995 part of the NHS Pension Scheme is managed.

Section D3 deals with the final pay control. It was inserted into the regulations by The National Health Service Pension Scheme (Amendment) Regulations 2014 (SI 2014/570). The section was subsequently amended by:

- s5 of the National Health Service Pension Scheme (Amendment No.2) Regulations 2014 (SI 2014/1607)
- s4 of the National Health Service Pension Scheme and Additional Voluntary Contributions (Amendment) Regulations 2017 (SI 2017/275)
- s6 of the National Health Service Pension Schemes, Additional Voluntary Contributions and Injury Benefits (Amendment) Regulations 2019 (SI 2019/418)

Based on these amendments, the current regulation D3 is as follows:

(1) This regulation applies where a member becomes entitled to a benefit in accordance with regulation E1, E2A, E3A, E3C, E5 or L1 and the Secretary of State determines that the member's final year's pensionable pay determined under regulation C1(6) exceeds the allowable amount.

(2) For the purposes of this regulation—

(a) Year 1 is the year in which the member ceases to be in pensionable employment or dies, whichever occurs first;

(b) Year 2 is the year immediately preceding Year 1;

(c) Year 3 the year immediately preceding Year 2.

(3) The allowable amount in respect of Year 1 is the lower of—

(a) the member's pensionable pay for Year 1, and

(b) the allowable amount for Year 2 increased by the lower of—

(i) the aggregate of 4.5% and the percentage (if any) by which the consumer prices index for the February before the start of Year 1 is higher than it was for the previous February, and

(ii) the percentage increase in the member's pensionable pay for Year 1 compared with Year 2.

(4) The allowable amount in respect of Year 2 is the lower of—

(a) the member's pensionable pay for Year 2, and

(b) the allowable amount for Year 3 increased by the lower of—

(i) the aggregate of 4.5% and the percentage (if any) by which the consumer prices index for the February before the start of Year 2 is higher than it was for the previous February, and

(ii) the percentage increase in the member's pensionable pay for Year 2 compared with Year 3.

(5) The allowable amount for Year 3 is the lower of—

(a) the member's pensionable pay for Year 3, and

(b) the member's pensionable pay for the year immediately preceding Year 3 increased by the aggregate of 4.5% and the percentage (if any) by which the consumer prices index for the February before the start of Year 3 is higher than it was for the previous February.

(6) An excess employer contribution is determined as follows—

Step 1: find Amount A, which is the difference between the member's final year's pensionable pay and the allowable amount for that year

Step 2: calculate Amount B, which is the amount of the pension payable to the member as if the member's final year's pensionable pay consisted only of Amount A increased by an amount equal to any increases that would be due under the Pensions (Increase) Act 1971 on a pension of that amount

Step 3: calculate Amount C, which is the amount of the lump sum payable to the member as if the member's final year's pensionable pay consisted only of Amount A increased by an amount equal to any increases that would be due under the Pensions (Increase) Act 1971 on a lump sum of that amount

Step 4: multiply Amount B by the applicable factor to find Amount D

Step 5: in the case of a member who is entitled to a benefit under regulation L1, multiply Amount C by the applicable factor to find Amount E

Step 6: add together—

(a) Amount D and Amount E, in the case of a member entitled to a benefit under regulation L1;

(b) Amount C and Amount D, in all other cases,

to find the amount of the excess employer contribution.

(7) Where the member's final year's pensionable pay exceeds the allowable amount by reason only of it including an amount in respect of a national award recommended by the Advisory Committee on Clinical Excellence Awards, the body responsible for the funding of that award must pay the excess employer contribution.

(8) Paragraphs (9) and (10) apply where Amount A found under Step 1 of paragraph (6) includes both—

(a) an increased pay award from the member's employing authority, and

(b) a national award recommended by the Advisory Committee on Clinical Excellence Awards.

(9) Where—

(a) the inclusion of both of the awards referred to in paragraph (8) in the member's pensionable pay in Year 3, Year 2 or, as the case may be, Year 1 means that pay is the member's final year's pensionable pay in accordance with regulation C1(6), but

(b) the exclusion of the award referred to in paragraph (8)(b) from the member's pensionable pay in the year identified in sub-paragraph (a) would result in a different one of those years being so identified,

the Secretary of State, after consulting the Scheme Actuary, is to determine the proportion of the excess employer contribution determined in accordance with paragraph (6) to be paid by the member's employing authority and the body responsible for the funding of awards recommended by the Advisory Committee on Clinical Excellence Awards: the determination of the excess employer contribution is to take account of the award referred to in paragraph (8)(b).

(10) Where the inclusion of both of the awards referred to in paragraph (8) in the member's pensionable pay in Year 3, Year 2 or, as the case may be, Year 1 means that pay is the member's final year's pensionable pay in accordance with regulation C1(6), and the exclusion of the award referred to in paragraph (8)(b) would not result in a different one of those years being so identified, the amount of the excess employer contribution determined in accordance with paragraph (6) (and taking account of the amount referred to in paragraph (8)(b)) payable by the member's employing authority and the body responsible for the funding of awards recommended by the Advisory Committee on Clinical Excellence Awards is to be determined in accordance with paragraph (11).

(11) The amount of the excess employer contribution payable by the member's employing authority and the body responsible for the funding of awards recommended by the Advisory Committee on Clinical Excellence Awards is to be determined as follows—

Step 1: find Amount A in accordance with Step 1 of paragraph (6)

Step 2: find Amount F, which is the difference between—

(a) the member's pensionable pay for the member's last year of pensionable employment as if that, and the member's pensionable pay in previous years, did not include the award referred to in paragraph (8)(b), and

(b) the allowable amount for that year as if the member's pensionable pay for previous years had not included the award referred to in paragraph (8)(b)

Step 3: divide Amount F by Amount A and express the result as a percentage: that is the percentage of the excess employer contribution payable by the member's employing authority

Step 4: subtract the percentage found under Step 3 from 100% to find the percentage of the excess employer contribution payable by the body responsible for the funding of awards recommended by the Advisory Committee on Clinical Excellence Awards.

(12) The amount of an excess employer contribution must be paid to the Secretary of State within 1 month of the Secretary of State notifying the payer of its liability for that amount: but the Secretary of State may exceptionally specify that it is to be paid within some other period.

(13) Where a payer fails to pay all, or any part, of the excess employer contribution it is liable to pay, the Secretary of State is to give that payer a written notice ("a late payment notice") specifying all of the following—

(a) the amount of the excess employer contribution that is unpaid;

(b) the amount of any interest due on the amount referred to in paragraph (a);

(c) the amount of the supplementary charge arising from the late payment of the excess employer contribution;

(d) that the amounts in (a) to (c) are to be received by the Secretary of State within 1 month of the date of the notice.

(14) Where a payer fails to comply with a late payment notice, the Secretary of State may issue a further late payment notice amended to take account of that failure.

(15) Where a member has pensionable employment with more than one employing authority during the years referred to in paragraph (2), this regulation applies to each such employment separately.

(16) In the case of a member in part-time employment, this regulation is subject to regulation R5.

(17) For the purposes of this regulation an increase in pensionable pay during Year 3, Year 2 or, as the case may be, Year 1 is to be ignored where the Secretary of State is satisfied it arises as a result of—

(a) the member taking up a new employment with a new employer: provided the Secretary of State is satisfied that the employer in question is a new employer;

(b) the ending of a salary sacrifice arrangement made before 1st April 2014: for these purposes a salary sacrifice arrangement is one under which the member gives up the right to receive an amount of pensionable pay in return for the provision of a benefit in kind including, but not limited to, a benefit consisting of a motor car or other vehicle, meals, care or vouchers."

(18) If the Secretary of State is not satisfied that the employer in question is a new employer, that employer is to be treated as an employing authority liable for an excess employer contribution in accordance with this regulation.

(19) An increase in a member's pensionable pay due to the acceptance of a transfer payment in the circumstances described in regulation C1(5) shall be ignored for the purposes of this regulation.

(19A) An increase in a member's pensionable pay solely due to an increase in the national minimum wage is to be ignored for the purposes of this regulation.

(19B) An increase in a member's pensionable pay pursuant to the "Framework agreement on the reform of Agenda for Change" adopted on 27 June 2018[11] is to be ignored for the purposes of this regulation."

(20) In any particular case the Secretary of State may direct that, for the purposes of this regulation, "employing authority" includes one or more of—

(a) the transferee under a transfer of staff order pursuant to—

(i) in the case of England, section 28(4)(b) of, or paragraph 29(3) of Schedule 4 to, the 2006 Act;

(ii) in the case of Wales, section 22(4)(b) of, or paragraph 8 of Schedule 3 to, the 2006 (Wales) Act;

(b) without limiting sub-paragraph (a), a successor, transmittee or assignee of an employing authority's business or functions.

(21) For the purposes of this regulation—

(a) a "payer" is the person who is liable to pay all or part of an excess employer contribution to the Secretary of State in accordance with this regulation;

(b) the pensionable pay to be taken into account by the Secretary of State for a year or part of a year referred to in paragraph (2) will be derived from the pensionable pay for that period recorded in scheme year pension records provided to the Secretary of State in accordance with paragraph (5) of regulation U3;

(c) where the member is in pensionable employment for less than 12 months pensionable pay for that year means—

(pensionable pay/number of days pensionable employment) x 365

[11] The Framework agreement covers the years from 1 April 2018 to 31 March 2021 and sets out, in Annex A, the new pay structure for those years. The Framework agreement can be found at www.nhsemployers.org/your-workforce/2018-contract-refresh/framework-agreement.

(d) no account is to be taken of increases in pensionable pay prior to 1st April 2014 or more than 1095 days prior to the member's last day of pensionable employment,

(e) the applicable factor is to be determined from time to time by the Secretary of State having considered the advice of the Scheme Actuary and having obtained the Treasury's consent;

(f) if the percentage increase in the consumer prices index referred to in paragraphs (3), (4) and (5) is less than zero, it will be regarded as a percentage increase of 0% for the purposes of this regulation;

(g) a benefit referred to in paragraph (1) means—

  (i) in the case of regulation E2A, a benefit including the effects of any increase in pensionable service referred to in paragraph (4) of that regulation;

  (ii) in the case of regulation E5, a benefit including the effects of any reduction referred to in paragraph (2) of that regulation;

(h) for the purposes of making any payment it is liable to pay under this regulation, the body responsible for the funding of awards recommended by the Advisory Committee on Clinical Excellence Awards shall have the same liabilities and duties as an employing authority under these Regulations in respect of that payment.

(i) "national minimum wage" means the single hourly rate prescribed by the Secretary of State pursuant to section 1(3) of the National Minimum Wage Act 1998.

About the HFMA

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff working in healthcare. For 70 years it has provided independent support and guidance to its members and the wider healthcare community.

It is a charitable organisation that promotes the highest professional standards and innovation in financial management and governance across the UK health economy through its local and national networks. The association analyses and responds to national policy and aims to exert influence in shaping the healthcare agenda. It also works with other organisations with shared aims in order to promote financial management and governance approaches that really are ‘fit for purpose’ and effective.

The HFMA is the biggest provider of healthcare finance and business education and training in the UK. It offers a range of qualifications in healthcare business and finance at undergraduate and postgraduate level and can provide a route to an MBA in healthcare finance. The association is also an accredited provider of continuing professional development, delivered through a range of events, e-learning and training. In 2019 the HFMA was approved as a main training provider on the Register of Apprenticeship Training Providers and will be offering and developing a range of apprenticeships aimed at healthcare staff from 2020.

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