

Changing the measure of public sector pensions

In his emergency budget, the Chancellor announced a significant change in the management of public sector pension schemes, such as the NHS pension scheme. This may deliver a significant blow to your benefits on retirement. From April 2011, pension payments will increase in line with the consumer price index instead of the retail price index.

Background

When you retire from the NHS you are normally entitled to a cash lump sum payment and an annual pension which you receive until you die. In some cases the pension continues to be paid after death to a surviving spouse, registered civil partner and/or children. Each year these payments increase in line with inflation so that your pension retains its buying power. Historically the increase has been dictated by the increase in the retail price index but from next year the consumer price index will become the guiding measure.

What's the difference between retail price index and consumer price index?

Both the retail price index and the consumer price index are measures of inflation and both track the change in prices of a set basket of goods and services that a typical household might buy each month. The main difference is that the retail price index includes housing costs and council tax whereas the consumer price index does not. The two measures are also calculated slightly differently. The net result of these differences is that the retail price index is generally higher than the consumer price index. However, both measures can go up or down and the difference between them may vary.

What does this mean for my pension?

If you receive an NHS pension your annual payment increases in April each

year. The NHS Pension Scheme calculates the increase in pension payments based on annual inflation figures to September of the previous year. According to current estimates the government expects the retail price index to be 1% higher than the consumer price index at the end of 2010. The expected value of the retail price index in September 2010 is 4.2%. Therefore we might expect increases of about 3.2% to NHS pensions which are in payment from April next year.

The following example shows what this will mean for someone currently taking an NHS pension:

Dr Collins has been drawing his NHS pension since 2006. His current annual pension is £65 000. In April 2011 Dr Collins' pension will increase in line with inflation under the rules of the pension scheme.

Previously, Dr Collins' pension would have increased in line with the rise in the retail price index. If we assume the increase would have been 4.2%, Dr Collins' pension would have increased to £67 730 from April 2011. However, using the consumer price index as a measure of inflation, Dr Collins' pension might increase by only 3.2% to £67 080. This means that Dr Collins has lost out on £650 of pension income over a single year.

Looking further ahead, based on government inflation projections, Dr Collins might have seen his pension increase to £79 667 by April 2016 based on the retail price index as a measure of inflation. By using the consumer price index projections, however, his pension might increase to just £74 205 by April 2016. Dr Collins could therefore be worse off by £5462 per year by April 2016 according to the government's projections.

How will I be affected?

Clearly your NHS pension pot will no longer be of the same value from April 2011 and that in itself might be enough to make you look at alternative ways of saving for your retirement. However, this change in calculating increases to pensions already being paid might be just the tip of the iceberg.

The government has asked the Public Service Pensions Commission to under-

take a review of public sector pension schemes with a view to making them 'sustainable and affordable in the long-term'. An interim report is expected later this year, ahead of a final report due before the budget in 2011. The change of the inflation measure could be a signal of things to come as the government seeks to reduce the costs of pension schemes like that of the NHS.

Throughout this review, the Chancellor has promised to protect pension rights which have already been built up. However, the change from retail price index to consumer price index inflation will have an impact on existing pension rights as well as those which have yet to be accrued.

The review is also charged with exploring and reporting on:

- The growing disparity between public service and private sector pension provision
- The need to ensure that future pension provision is fair across the workforce
- How risk should be shared between the taxpayer and employee
- Wider government policy intended to encourage adequate saving for retirement and longer working lives.

The overall effects of the review are likely to be highly significant for members of all public sector pension schemes.

Also in the pipeline are potential changes, announced in the emergency budget, to the way in which tax relief is granted on pension contributions for those with higher earnings. However, until the government's investigations in this area are completed, presumably before the budget in 2011, it is difficult to determine the impact on particular individuals.

Given all of the potential changes which may be anticipated with the NHS Pension Scheme, it is vital that you remain informed about what is happening to your pension benefits. Expert advice is essential in order to make sure you have the standard of living you would want to have in retirement. **BJHM**

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