Stormy seas for pension plans?

Jon Drysdale asks whether your NHS pension is secure in the eye of the financial storm of recently implemented changes

With many a negative story on mortgage borrowing in the national press and savings rates at a historically low level, many dentists are wondering in which direction their financial planning is heading. With a raft of recent changes made to the NHS pension scheme, here we discuss its benefits and consider whether the scheme remains one of the best.

Retirement mainstay

Dental practitioners with predominantly NHS income should continue to see the NHS Superannuation scheme as the mainstay of their retirement planning. In fact, other than GPs, dentists are the only self-employed professional group, who benefit from an employer’s pension scheme.

The benefits for dentists are sometimes misunderstood and should be differentiated from the main NHS ‘final salary’ scheme. In practice, many dentists will have an NHS pension based on a combination of two different sources of income – practice principal earnings and associate earnings.

Pension benefits:

Initial career phase (associates): Pensionable NHS earnings for associate dentists should be based on the amount of contract allocated to them by their principal. A nominal 43.9 per cent is used. For example, if an associate is allocated a contract amount of £182,232, they should have ‘NHS earnings’ of £80,000. (Bear in mind this is not necessarily the amount of income they will be paid – this will depend upon the agreement they have with their principal.)

Let us assume the associate had 10 years of associate earnings before becoming a practice principal. On that basis, their total associate (NHS) earnings will be £80,000 x 10 = £800,000. The resulting pension will be 1.4 per cent of total associate earnings resulting in a pension of £11,200 per year, for life.

Secondary career phase (principal dentists): The final pension is based on 1.4 per cent of total career average re-valued earnings (CARE). For principals ‘NHS earnings’ are effectively their contract value less a fixed percentage (56.1 per cent) to allow for non-pensionable ‘expenses’. For example a principle with NHS ‘earnings’ of £100,000 would have a contract of £227,790.

Let us assume that the dentist in question enjoys a level contract value of £227,790 and therefore annual NHS earnings of £100,000 for 25 years. CARE in this situation would be £2.5 million. The resulting annual pension will be 1.4 per cent of £2.5 million per year, for life.

Total career pension using the case study above gives a total pension of £46,200 per year from 60, for life. The earnings on which the pension is based are ‘uprated’ to allow for inflation and the resulting pension is index-linked to keep pace with inflation after retirement.

There are many variables that will come into play, not least the size of the NHS contract and the length of service.

Further NHS pension scheme benefits include an optional tax-free lump sum, discretionary ill-health benefits, death-in-service benefits including a lump sum and partner/dependents pensions.

What changes mean

For those who joined the scheme before April 2008, the retirement age remains at 60. For those joining after April 2008 the retirement age is 65. To compensate for the later retirement age, the accrual rate was increased from 1.4 per cent to 1.87 per cent. All members now have increased flexibility on retiring and returning to work, with options to increase the lump sum at the expense of pension.

On a less positive note contribution levels were increased in April 2008 from the standard six per cent. Dentists now contribute from 6.5 per cent to 8.5 per cent dependent upon NHS income levels. Added years purchase has been replaced by the less attractive additional pension purchase.

Despite recent changes, the NHS pension scheme remains one of the best available. However, with life expectancy steadily increasing, the cost of funding the scheme is an increasing burden to the NHS and ultimately a drain on UK Treasury funding. It remains to be seen if the changes implemented in April 2008 will be enough to prevent cost cutting further dilution of scheme benefits.

A note of caution

For dentists with private fee income, it’s good to remember that the NHS pension accrues only from NHS income. Those practitioners with increasing private fee income should take independent advice on mitigating the resulting loss of NHS pension benefits.

Further information on the NHS pension scheme can be found at www.nhbsa.nhs.uk/pensions. The NHS pension scheme advises that: “If you are in any doubt about the pension arrangement that will be the best one for you, you should seek independent financial advice”.

There are further related subjects that dentists should seek independent financial advice on. These are: The ‘Lifetime limit’ on pension funds, annual allowance for pension contributions, early retirement options and the nomination of beneficiaries for death in service benefits.

About the author

Jon Drysdale is a qualified mortgage adviser, an independent financial adviser and a director of Practice Financial Management Ltd (PFM), an ASPD member. ASPD members offer professional, objective and practical advice and services, based on experience within the industry, to dental practices and other businesses within the dental sector. ASPD members include solicitors, accountants, banks, financial advisers, valuers and sales agencies, insurance brokers and leasing and finance companies. For more information on the ASPD, call 0800 458 6775 or visit www.aspd.co.uk. To contact PFM, visit www.pfmdental.co.uk.

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NHS pension plan in the eye of the financial hurricane

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