5 January 2023

Briefing – Consultation on 2023/25 NHS payment scheme and standard contract

On 23 December 2022, NHS England (NHSE) launched the formal consultation on proposed changes to the NHS payment scheme (NHSPS) and standard contract. Both consultations will run until 27 January 2023. NHS Providers will submit responses to both consultation surveys. We encourage members to take part and share any feedback with Sandy.Cook@nhsproviders.org.

Key points

- NHSE is proposing to set the NHSPS for both 2023/24 and 2024/25, with a formula being used to update the cost uplift and efficiency factors for 2024/25. For 2023/24 NHSE has set the cost uplift factor at 2.9% and the efficiency factor at 1.1%.
- The cost uplift for pay inflation for 2023/24 is set at 2.1%, which is based on the indicative 2023/24 allocations. However, this is an estimate which will not be confirmed until the outcome of the pay review process and may therefore be subject to revision.
- The NHSPS sets out the various rules for four different payment mechanisms, with the aligned payment and incentive (API) approach applying to almost all relationships between commissioners and NHS providers. The fixed element of the API approach will continue to account for the majority of funding for most providers.
- Elective activity is excluded from the fixed element. Instead, commissioners and providers will agree elective activity targets in their contracts, and providers will be paid solely for the activity they deliver (at 100% of unit prices). Unlike in 2022/23, there is no marginal rate, nor any floors or ceilings for payment covering elective activity.
- The £30m API threshold is set to be removed under NHSE's proposals, with any activity outside the scope of the API subject to either a low value activity (LVA) block payment arrangement (for contracts with an annual value below (£0.5m) or a local payment arrangement. The NHSPS will include two different types of prices – unit prices for the API elective variable element and activity-based payment, and guide prices to inform benchmarking for local arrangements.
- The overall number of CQUIN indicators has been reduced from 23 to 17 to ease the administrative burden on providers. The CQUIN variable element would only apply to contracts worth more than £10m.
- NHSE will conduct a review into the purpose and content of the standard contract during 2023.

Summary

The aligned payment and incentive (API) approach

The broad design of the API remains relatively unchanged from the 2022/23 model, with separately defined "fixed" and "variable" elements. However, there are a number of key updates:

Duration: NHSE is proposing to set the payment scheme for both 2023/24 and 2024/25. Whilst the overarching framework of the payment system would remain the same, a formula would be used to update both the cost uplift and efficiency factors in 2024/25.

Scope: The consultation outlines that the scope of the API is set to be extended to cover virtually all relationships between commissioners and NHS providers for the years 2023/24 and 2024/25. The £30m threshold introduced in the 2022/23 payment system is set to be removed, meaning the API approach will only exclude low volume activity (LVA) arrangements or local payment arrangements.

Fixed element: As is currently the case, the fixed element will be agreed between commissioners and providers to fund a certain level of activity. The consultation sets out that such targets should be "stretching but achievable" and align with wider system targets. The fixed element is designed to provide sufficient cover for the majority of funding, including activity which is not covered by the elective variable element (e.g., outpatient follow ups).

NHSE has also published a guidance document outlining the range of payment mechanisms available, including an annex on setting the fixed element of the API – this includes guidance on baseline resets, activity growth, applying the elective recovery and convergence adjustments, and additional allocations for Covid-19 and to boost acute and ambulance capacity.

Variable element – elective activity: The 2023/25 NHSPS introduces revisions to the way in which elective activity is funded. Elective activity is excluded from the fixed element. Instead, NHSE is proposing that providers are paid 100% of unit prices for all elective activity delivered. Commissioners and providers will agree elective activity targets in their contracts. However, providers will only be paid for the activity they deliver (at 100% of unit prices). Unlike in 2022/23, there is no marginal rate, nor any floors or ceilings for payment covering elective activity.

Diagnostic imaging and chemotherapy delivery have also been added to the list of activities falling under the scope of the variable element relating to elective activity.

Variable element – CQUIN: The fixed element should continue to include CQUIN funding of 1.25% of the contract value, on the assumption that the full CQUIN criteria will achieved. If the CQUIN criteria are not met, the initial payment received under the variable element will be reduced. The CQUIN variable element would only apply to contracts worth more than £10m. The overall number of CQUIN indicators has been reduced from 23 to 17 for 2023/24 to cut the administrative burden of monitoring and reporting CQUIN achievement. The proposed list of CQUIN indicators for 2023/24 can be found here.

Specialised services: The payment system for specialised services commissioned directly by NHS England will not change, as NHSE has decided to delay delegating full responsibility for commissioning these services to ICBs until 2024/25. NHSE is proposing specific API rules on separate payment approaches for certain services including radiotherapy, chemotherapy, genomic testing and other specialised services.

Best practice tariffs (BPTs): The proposal is to have two different types of BPT – one for elective activity BPTs and others be agreed on an annual basis. BPTs relating to elective activity would be paid using unit prices. For all other BPTs, providers and commissioners would agree additional funding at the outset of the year to factor in BPT delivery - this would be included within the fixed payment (with no in-year adjustments).

Variation: Any variations to the API model will require the approval of NHSE. It is possible for commissioners to agree separate elective activity targets with each provider within the system, as long as in aggregate the overall commissioner target for the system is met.

Other payment mechanisms

- Low volume activity (LVA) block payment arrangements are set to cover all contracts with an annual value of less than £0.5m, with the exception of services provided by ambulance trusts and other excluded services. Payments will be calculated based on average data collected from a three-year period with slightly different approaches between acute services and mental health/community services, as some services are not captured as part of secondary uses service (SUS) data. Additionally, non-NHS providers' activity will be out of scope for LVA arrangements.
- Activity-based payments will be the default payment mechanism for non-NHS providers where unit prices are available.

- Where activity is not covered via any other payment mechanism, then **local payment agreements** will be agreed between commissioners and providers. NHSE expects unit and guide prices will form the basis of such arrangements.

Prices – cost uplift and efficiency

Elective activity covered by the API's variable element will be covered by mandatory unit prices. Non-elective guide prices will be published to inform the benchmark for local negotiations to determine the fixed payment. These prices have been primarily based on updating the 2022/23 national tariff prices as follows:

Cost uplift factor: A cost uplift factor of 2.9% has been used to increase national tariff prices from 2022/23 for inflation. This uplift factor is based on a set of assumptions for inflation on key costs (e.g. pay, drugs, capital etc.) which are then weighted to determine an overall cost uplift factor.

The cost uplift for pay inflation for 2023/24 is set at 2.1% which is based on the indicative 2023/24 allocations. However, this is an estimate which will not be confirmed until the outcome of the pay review process and may therefore be subject to revision. The uplift for other items is based on the latest GDP deflator rate for 2023/24 of 3.2%, as published by the Office for Budget Responsibility in November 2022, which NHSE have uplifted to an assumption of 4%.

Efficiency factor: The efficiency factor, which adjusts costs downwards, is set to be 1.1% for 2023/24. This is consistent with the efficiency levels contained within the NHS long term plan, although it is expected that the overall efficiency requirement will be higher than the 1.1% efficiency factor incorporated within the NHSPS.

2024/25 uplift: NHSE is proposing to use formulas to update the cost uplift and efficiency factors for 2024/25 in the same way as 2023/24. The formulas will be based on a broad range of recent data to determine the appropriate adjustment.

Market forces factor (MFF): The 2022/23 national tariff moved to the fourth stage of the five-stage glidepath set out following the review of the MFF in 2019/20. For 2023/24, NHSE is not proposing to move to the final stage of the glidepath. Instead, NHSE will update the data underpinning the MFF to data from 2017-2020, rather than 2014-2017. The result of this change is that all NHS providers will receive new MFF values for 2023/24 and beyond.

Excluded items

NHSE suggests excluding certain items from the core payment mechanisms, such as high-cost drugs and devices. NHSE plans to add 87 drugs to the high-cost drug list and four devices to the high-cost devices list. Further details can be found in Annex DpA.

Impact assessment

As part of the wider consultation on the 2023/25 NHSPS, NHSE published an impact assessment on its proposed policy changes. This includes two separate appraisals: a short qualitative assessment of the proposals and a more detailed quantitative assessment of the impact on provider income levels.

NHSE sets out that the blended payment approach proposals are supported by both providers and commissioners. The changes to the funding of elective activity should be more straightforward than 2022/23 and act as a real incentive to help drive up activity levels. Concerns have been raised that the removal of the £30m threshold for the API model to apply will result in an increased administrative burden for trusts, especially for contracts of relatively small value. There is some concern that the variety of payment approaches within the NHSPS will restrict patient choice as provider collaboration increases. However, NHSE considers that the proposals will have no significant impact on patient choice.

Based on the quantitative analysis conducted by NHSE, NHS providers' revenue from the NHSPS will increase to £42.8bn in 2023/24. This is an uplift of £0.7bn (1.7%) from 2022/23. Only approximately £322m in NHSPS priced revenue will flow to non-acute trusts. Independent providers are set to receive approximately £1.6bn in NHSPS priced revenue, a 1% uplift from 2022/23. However, as contract values must be negotiated between providers and commissioners these estimates are only indicative.

Standard Contract

NHSE has also launched the consultation on proposed changes to the 2023/24 standard contract. As for the NHS payment scheme consultation, the deadline for responding to the online survey is 27 January 2023.

The standard contract remains in place for 2023/24 for commissioners to use for all secondary healthcare services. However, NHSE acknowledges in the consultation notice that the contract may need to change in future to further reflect system working more broadly across the NHS. During 2023, NHSE will conduct a review into the standard contract and its purpose.

Changes to national waiting time standards

To reflect the new priorities set out in 2023/24 operational planning guidance, NHSE is proposing to update a portion of the national waiting times standards set out in the standard contract, including:

- Amending the maximum RTT waiting time to no more than 65 weeks by March 2024, this is updated from 104 weeks in the 2022/23 contract.
- Updating the threshold for four-hour standard for A&E waiting times from 95% to 76% to be achieved by March 2024.
- Altering the standard for mean category 2 ambulance response times to no more than 30 minutes. This was previously no more than 18 minutes.
- Retaining the 28-day cancer faster diagnosis standard but setting out that this is to be achieved by March 2024.

Other changes to the standard contract

Payment and reporting: The largest change to the 2023/24 draft contract is that the API rules will apply to all trust contracts by default. Further changes include the removal of some specific financial sanctions and reporting requirements, and discontinuing the financial risk-sharing arrangements for the charging of overseas visitors.

Clinical services: new additions to the contract include items on peri-operative care, outpatient services, maternity and neonatal services and patient safety.

Workforce: NHSE is proposing to alter the language on compliance with race and disability equality standards to promote a "focus on improvement" and "transparency". The contract is also set to include new requirements on promoting staff health and wellbeing.

Procurement of medicines and devices: the contract wording will be amended to compel trusts to purchase medicines through national frameworks where these are available. Trusts will also be expected to procure high-cost devices from NHS Supply Chain subject to availability.

Greener NHS: For 2023/24, with specific reference to all contracts worth over £5m, trusts must ensure that suppliers publish a carbon reduction plan.

NHS Providers View

Aligned payment and incentive approach: variable element and elective activity

Trusts will welcome the provision of guidance for establishing the fixed element of the API approach.

Providers had previously raised concerns about the functioning of the elective recovery fund over 2022/23, including the most appropriate marginal rate for reimbursement and the financial implications of recouping payment should they fail to meet activity targets. We are keen to hear from providers as part of this consultation about their views on the potential operational and financial implications of the elective variable element proposals.

It is unclear how best to drive a significant increase in elective activity via the financial framework. Trusts and systems faced major operational pressures in 2022/23, and the acute sector is currently facing significant obstacles to increasing productivity.

There are a wide range of views among NHS finance professionals about the impact financial incentives have on funding prioritisation decisions at the system level. It is important that realistic activity targets are built into the financial framework for variable payments, and that financial incentives do not disproportionately skew funding and resourcing towards additional elective activity at the expense of mental health and community services. Mental health providers in particular note the lack of additional funding available to expand capacity.

Pay assumptions

As we flagged following the publication of the 2023/24 planning guidance, it is unclear whether systems will be provided with additional funding if next year's pay settlement exceeds budgeted allocations. We await the pay review bodies' recommendations for the 2023/24 pay award, but remain concerned that additional national funding shortfalls may be generated unless government commits to fully funding future pay awards.

Mental health and community providers also remain concerned about how tariff uplifts for pay costs will be passed on. The cost weighting used in the national tariff uplift assumes an average cost build up which is representative of all provider organisations. We recognise there are difficulties in identifying the costs base for non-acute trusts given less comprehensive datasets compared to acute providers, and in disaggregating pay inflation from non-pay cost pressures. However, the cost profile of community and mental health providers is different to acute providers, and a higher percentage of costs goes towards pay than acute trusts.

Cost uplifts: inflation and the market forces factor

NHSE has assumed a higher GDP deflator for 2023/24 than the Office for Budget Responsibility's estimate, given that NHSE's previous forward-looking estimate undervalued the level of inflation across the sector. Although the GDP deflator is a less narrow measure of inflation than the consumer prices index (CPI), there remain concerns about the extent to which it accurately captures the level of inflation across public services. In addition, there are mixed views across the provider sector about the methodology used to calculate the market forces factor.

CQUIN

Trusts value that CQUIN indicators have been streamlined over recent years, with a focus on ensuring they are realistic and achievable, and that there is evidence of clinical buy-in for existing and new indicators. Finance teams have also made the point that meeting CQUIN targets often requires additional investment, and that new data monitoring requirements can create additional cost pressures. Providers do however welcome NHSE's efforts to reduce the administrative burden placed on providers as part of the data collection and monitoring process.