

Annex C2: Financial Improvement Trajectories, Financial Recovery Fund and Marginal Rate Emergency Tariff

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1. Introduction

We are making significant changes to the operation of the Financial Recovery Fund (FRF) for 2020/21. This annex describes in detail how the FRF will operate, as well as the interactions between the FRF, financial improvement trajectories, sanctions and Marginal Rate Emergency Tariff (MRET) funding.

2. Financial improvement trajectories

2.1 Updates to financial improvement trajectories

All organisations and systems will be notified by letter of their updated financial improvement trajectories for 2020/21. The trajectories will be updated to reflect the impact of material changes to costs, proposed changes to the debt regime, and the national tariff. The largest adjustments nationally are those relating to Clinical Negligence Scheme for Trusts (CNST) contributions and to align with the updated assessment of Market Forces Factor (MFF) changes as calculated in the 2020/21 tariff impact assessment. There has been no change to the MFF methodology.

2.2 Net-neutral trajectory adjustments

Systems may agree changes to their organisations' financial improvement trajectories for 2020/21 on a net-neutral basis, subject to approval by the relevant Regional Director. Systems that intend to propose any net-neutral changes should engage with their regional team at an early stage, as these changes will need to be finalised two weeks prior to the submission dates detailed in the Operational Planning and Contracting Guidance timetable, at the latest.

3. The Financial Recovery Fund

3.1 Entitlement for CCGs and providers

All organisations with deficit financial improvement trajectories (before FRF) will be notified by letter of their FRF allocations for 2020/21.

At least 50% ('the System Percentage') of each organisation's total FRF allocation will be linked to the performance against the financial improvement trajectory of the system(s) of which the organisation is a member ('System FRF').

The remainder of each organisation's total FRF allocation will be linked to the performance against its own financial improvement trajectory ('Organisation FRF').

We will consider, with the agreement of the organisations, system and regional team involved, requests to increase the System Percentage so that a greater proportion of organisations' allocated FRF is linked to the performance of that system.

In exceptional circumstances, and again with the agreement of the organisations, system and regional team involved, we will also consider requests to change the composition of the system to which FRF entitlements are linked.

As with net-neutral changes, systems that intend to propose any increases to their System Percentage or to change the composition of the system should engage with their regional team at an early stage, as changes will need to be agreed two weeks prior to the submission dates detailed in the Operational Planning and Contracting Guidance timetable, at the latest.

3.2 Measurement of financial improvement trajectories and bottom-line performance

Entitlement to FRF will be based on full-year bottom-line financial performance against financial improvement trajectories, as defined below and within the financial planning templates.

- An organisation's financial improvement trajectory is measured excluding receipt of MRET funding (for providers) and FRF (for CCGs and providers), so that an organisation will not be penalised twice for a single issue (that is, where an

organisation has a proportion of its funding withheld because of a financial performance failure, this will not also contribute to it missing its financial improvement trajectory).

- A provider's measure of financial performance for FRF entitlement will be calculated using the 'adjusted financial position' as reported within the planning/in-year reporting forms.
- A CCG's measure of financial performance for FRF entitlement will be calculated using the 'in year underspend/deficit' as reported within the planning/in-year reporting forms.
- As per the 2019/20 policy with regards to provider control totals, no gains on the disposal of assets will be allowed to count towards performance against the financial improvement trajectory.
- A system's financial improvement trajectory and performance will be calculated by summing the financial improvement trajectories and performances of that system's constituent organisations (or the relevant proportions for organisations that span more than one system).
- Organisations which do not set a plan to meet their financial improvement trajectory remain eligible for FRF, tapered as appropriate, based on their actual financial performance

3.3 Tapering of FRF

If an organisation does not meet its full-year financial improvement trajectory, its entitlement to Organisation FRF will be reduced by £1 for every £1 of its underperformance (up to a maximum of its allocated Organisation FRF), subject to the additional entitlement rules described in section 3.4.

If a system does not meet its full-year system financial improvement trajectory, the system's entitlement to System FRF will be reduced by £1 for every £1 of system underperformance (up to a maximum of the total allocated System FRF within the system). The resulting available System FRF will then be distributed to the organisations within the system pro-rata according to the relative size of those organisations' FRF allocations.

Table 1. Worked example of Organisation and System FRF elements with tapering loss (before the application of additional entitlement rules)

Total FRF Allocation	£10m	
	Organisation FRF	System FRF
Percentage of total FRF allocation	50%	50% (System Percentage)
Split of allocated FRF	£5m	£5m Total System FRF in system = £20m Organisation's System FRF makes up 25% of the total System FRF within the system
Performance against trajectory	Organisation performance against organisation trajectory: £(3)m	System performance against system trajectory: £(12)m
Tapering loss of FRF due to underperformance	Organisation underperformance x £1 £(3)m x £1 = £(3)m loss of FRF	System underperformance x £1 £(12)m x £1 = £(12)m loss of FRF
FRF entitlement	£5m + £(3)m = £2m	In the system: £20m + £(12)m = £8m Organisation (distribution subject to agreement by the system in line with additional entitlement rules): 25% x £8m = £2m

3.4 Additional entitlement rules

From 2020/21 we will simplify the 'offset' mechanism currently available to Integrated Care Systems (ICSs) and expand it to all systems. As a result, systems that meet their financial improvement trajectories will automatically be entitled to all of the FRF (both Organisation and System) allocated to their constituent organisations.

Organisations that fail to meet their financial improvement trajectories will not automatically be entitled to System FRF. Systems will agree with the relevant regional team how these amounts should be distributed between the organisations in the system.

Similarly, organisations that fail to meet their financial improvement trajectories will not automatically be entitled to elements of their Organisation FRF that are only earned by virtue of the 'offset' commitment above (i.e. Organisation FRF that would have been lost or tapered had the system not met its financial improvement trajectory). Again,

systems will agree with the relevant regional team how these amounts should be distributed between the organisations in a system.

Where systems and regional teams do not agree the distribution of the amounts described above, these amounts will be distributed between the organisations in the system that meet their financial improvement trajectories pro-rata based on the size of FRF allocations. Where no agreement is reached and there are no organisations with FRF allocations that meet their financial improvement trajectories, the amounts will be retained centrally.

For organisations that span more than one system, FRF entitlements will be calculated separately for each of the systems of which the organisation is a member.

3.5 Summary

Table 2. Summary of FRF entitlements under various outturn scenarios

		System		
		Delivers trajectory	Misses trajectory: Some System FRF remains after tapering	Misses trajectory: All System FRF lost after tapering
Organisation	Delivers trajectory	All Organisation FRF available to organisation. All System FRF available to organisation.	All Organisation FRF available to organisation. Tapered System FRF available to organisation.	All Organisation FRF available to organisation. No System FRF available to organisation.
	Misses trajectory: Some Organisation FRF remains after tapering	Tapered Organisation FRF available to organisation and system agrees distribution of Organisation FRF lost through tapering. System agrees distribution of System FRF.	Tapered Organisation FRF available to organisation. System agrees distribution of tapered System FRF.	Tapered Organisation FRF available to organisation. No System FRF available for organisation.
	Misses trajectory: All Organisation FRF lost after tapering	System agrees distribution of Organisation FRF. System agrees distribution of System FRF.	No Organisation FRF available to organisation. System agrees distribution of tapered System FRF.	No Organisation FRF available to organisation. No System FRF available for organisation.

4. Payment of FRF

To improve cashflow, FRF will now be phased equally between quarters (25% per quarter) and the quarterly payments are to be made in the quarter to which they relate. Payment values will be based on the rules described in this section.

For Q1, FRF will be paid based on the organisation's submitted final plan performance against the financial improvement trajectory, with any tapering loss applied. If an organisation and associated system plan to deliver their full-year financial improvement trajectories, the organisation will be paid 25% of its allocated FRF in Q1. The payment is to be made as soon as possible after submission of the plans. However, for operational planning purposes, organisations should plan to receive the Q1 payment in month 2.

For Q2, FRF will also be paid based on the submitted final plan performance against the financial improvement trajectory, with any tapering loss applied. The payment is to be made on or around the first working day of the quarter.

For subsequent quarters, FRF payments will also be made on or around the first working day of the quarter. The value of these quarterly payments will be based on the latest available year to date (YTD) and forecast outturn (FOT) financial performances against the YTD or full-year trajectories, respectively (whichever has the highest adverse variance).

Where the expected value of the FRF to which an organisation is entitled changes between quarters (for example, because YTD or FOT financial performance improves), that organisation will be paid the relevant share (i.e. 25% at Q1, 50% at Q2 etc.) of the full-year FRF to which they are likely to be entitled to, less any amounts already paid in previous quarters.

Following submission of final accounts:

- Additional payments will be made to those organisations who are entitled to more FRF than they have been paid during the year. Where possible, payments will be transacted by increasing FRF payments in subsequent financial years.
- Providers that have been paid FRF during the year to which they are not entitled will either repay these amounts or it will be converted to DHSC financing.

- CCGs that have been paid FRF during the year to which they are not entitled will have that FRF taken back through an adjustment to the allocation, with the resulting overspend being added to the CCG's cumulative financial position.

Table 3. Example scenarios for how FRF may be paid in year.

Total FRF allocation £12m – profiled at £3m per quarter					
	Q1	Q2	Q3	Q4	After submission of final accounts
Scenario 1:	Submits a plan consistent with trajectory	Submits a plan consistent with trajectory	Latest YTD performance and FOT meet trajectory	Latest YTD performance and FOT meet trajectory	Year end performance meets trajectory
	Paid £3m in Q1	Paid £3m in Q2	Paid £3m in Q3	Paid £3m in Q4	No further adjustment
	Meets trajectory profile criteria so paid all allocated FRF during the year.				
Scenario 2:	Submits a plan consistent with trajectory	Submits a plan consistent with trajectory	Latest YTD performance and FOT do not meet trajectory and no FRF is expected to be earned	Latest YTD performance and FOT do not meet trajectory and no FRF is expected to be earned	Year end performance meets trajectory
	Paid £3m in Q1	Paid £3m in Q2	No payment in Q3	No payment in Q4	Paid £6m after year end
	Does not receive any FRF in Q3/4 due to not meeting the profile criteria in those quarters (all YTD FRF is lost through tapering due to the YTD/FOT underperformances). However, meets the full-year trajectory at final accounts so receives the total full-year FRF allocation less any amounts already paid in Q1/2.				
Scenario 3:	Submits a plan consistent with trajectory	Submits a plan consistent with trajectory	Latest YTD performance and FOT meet trajectory	Latest YTD performance and FOT do not meet trajectory and no FRF is expected to be earned	Year end performance does not meet trajectory and no FRF is earned
	Paid £3m in Q1	Paid £3m in Q2	Paid £3m in Q3	No payment in Q4	To repay £9m after year end or convert it to DHSC financing.
	Year end performance does not meet the trajectory (with the full-year FRF lost through tapering due to the year-end underperformance) so the organisation will be required to repay all FRF payments made to it in earlier quarters or have it converted to DHSC financing.				
Scenario 4:	Submits a plan consistent with trajectory	Submits a plan consistent with trajectory	Latest YTD performance and FOT do not meet	Latest YTD performance and FOT do not meet	Year-end performance does not meet trajectory and

			trajectory, but full-year FRF entitlement is expected to be £10m	trajectory, but full-year FRF entitlement is expected to be £10m	FRF entitlement is £10m
	Paid £3m in Q1	Paid £3m in Q2	Paid £1.5m in Q3	Paid £2.5m in Q4	No further adjustment.
<p>During Q3 and Q4 the organisation will be paid 75% and 100%, respectively, of the FRF to which it is expected to be entitled at the year-end, less any amounts it has already been paid. The FRF to which the organisation is expected to be entitled is calculated using whichever of YTD and FOT financial performance has the highest adverse variance against the YTD or full-year trajectory, respectively.</p> <p>The FRF to which the organisation is entitled to at year-end is consistent with what was expected at quarters 3 and 4. No further post-accounts adjustments are due.</p>					

NB: For simplicity, the total FRF has not been split out into the Organisation FRF and System FRF elements.

5. FRF treatment in the operational planning templates

A new worksheet is present in both the CCG and provider financial planning templates which calculates the organisation's planned entitlement to Organisation FRF and System FRF – '08f. FRF and Traj' in the provider template and '14. FRF' in the CCG template. These worksheets have the same structure and calculations in both templates. The templates have been prepopulated with the organisation's total FRF allocation, the organisation's financial improvement trajectory, the organisation's membership of system(s), the System Percentage for the system(s) and the total System FRF in the system(s). Organisations will not be able to override the prepopulated values, or the calculations associated with them.

The worksheet calculates the organisation's allocated System FRF based on the System Percentage (the proportion of the organisation's total allocated FRF that is linked to system performance). The System Percentage will be the same for all of the organisations within a given system. Where an organisation spans more than one system, the allocated System FRF will be calculated for each of those systems based on the agreed system membership and System Percentages.

The allocated Organisation FRF is then taken as the balancing figure between the total allocated FRF and the total calculated allocated System FRF values.

After the planning template has been completed and the full-year performance against the organisation's financial improvement trajectory (excluding MRET/FRF where relevant) is available in the first table on the worksheet, the system performance against the system trajectory will need to be entered in the yellow input cells for each of the systems that organisation is a member of, in the system tables on the worksheet. The value to be entered should be the over/(under)performance of the system against its system trajectory excluding MRET and FRF.

Systems will need to be involved in this process to ensure that the same system over/(under)performance value is entered into the planning templates for all organisations within the system. Where the entered values are inconsistent, or are not the sum of the constituent organisations' over/(under)performances, the calculation of

available System FRF may be incorrect. Incorrect financial planning submissions will need to be corrected and resubmitted as part of the plan review process.

A System Reconciliation Tool will be provided to systems that will allow them to consolidate organisation operational plans for review before submission. This will assist in calculating a system performance against trajectory, as well as checking that the system performance entered into the organisation planning templates are consistent.

The allocated System FRF is calculated for each of the systems that the organisation is a member of based on the agreed prepopulated values for the organisation's percentage membership of the system and the System Percentage for that system. Where a system has an agreed change to the membership or System Percentage, an update to the financial planning templates for all organisations within that system will be required. This update will most likely take place via the release of a macro fixer.

The Organisation FRF will be calculated based on the organisation and system performances, as per table 2 above. The Organisation FRF is calculated at an individual system level as entitlement to this Organisation FRF can be dependent on system performance (in the case where a system meets its system financial improvement trajectory). Where an organisation spans multiple systems, the organisation's allocated Organisation FRF and underperformance is split across those systems based on the agreed system membership percentages.

Based on the Organisation FRF and System FRF that the organisation is entitled to, an income profile is calculated on the worksheet:

- These values must be used as the monthly profile for FRF income on worksheet '08. Op Inc (source)' in the provider financial planning template in order to pass validations. Income should be planned for in the last month of each quarter. As cash payments are to be made in advance of this, the planned cash payments should be recognised as deferred income until the last month of each quarter, with the appropriate adjustments on the Statements of Financial Position and Cash Flow.
- The CCG financial planning template is to be completed on the basis of excluding FRF, so the calculated planned profile for any available FRF is for information only and not to be included elsewhere in that template.

As described above, entitlement to some FRF may require systems to agree how it should be distributed. For planning purposes, these amounts should not be included within an organisation's financial planning templates.

6. FRF treatment for the purposes of in-year reporting - providers

For in-year reporting purposes, the cash payments are being made in advance of the recognition of income, and so should be recognised as deferred income until the last month of every quarter when the deferred income should be released to the Statement of Comprehensive Income (SoCI) as income.

Any FRF payments received earlier in the year to which the organisation is not expected to be entitled are to be either repaid or converted to DHSC financing.

As described above, entitlement to some FRF may require systems to agree how it should be distributed. Organisations should not include these amounts until agreement has been reached on its distribution between the relevant organisations, the system and the relevant regional team.

7. FRF treatment for the purposes of planning and in-year reporting – CCGs

The CCG planned profile excluding FRF will need to be phased across the four quarters for the purposes of quarterly assessment. The default phasing profile for the financial plan will be an equal split of allocations and expenditure across each quarter, other than reserves and contingencies which should be phased into month 12. CCGs should make sure that their plans are phased realistically, including the profile of allocations, expenditure, efficiency schemes and the phasing of contingencies and reserves.

Any alternative plan and trajectory phasing other than those submitted in final plans will be subject to sign off by NHS England and NHS Improvement regional teams. Regardless of the expenditure profile, allocations should always be profiled in line with expenditure to give an even distribution of the planned bottom line across the year.

CCG's entitlement for quarterly payment of FRF will be calculated with reference to submitted plans or being on trajectory from both a year to date and forecast perspective, depending on the quarter, as described in section 4.

Where CCGs are eligible for FRF earned to be released this will be transacted through an allocation change (RTF process) on a quarterly basis and should be accounted for in the normal way for non-recurrent allocations adjustments.

Where a CCG has received quarterly FRF payments during the year but does not deliver its agreed trajectory at year end, it may cease to be eligible for some or all of the FRF received, in which case the FRF will be taken back through an adjustment to the allocation, with the resulting overspend being added to the CCG's cumulative financial position.

8. Criteria attached to the receipt of MRET

8.1 Summary of requirements

To be eligible for access to allocated MRET funding, providers must agree their financial improvement trajectories in 2020/21.

8.2 How receipt of MRET should be treated in-year

Providers that have accepted their financial improvement trajectories for 2020/21 should account for MRET in accordance with the monthly phasing included in the financial planning returns (equal twelfths adjusted for rounding at the end of each quarter).

Release of MRET will be subject to a quarterly review process in advance. Access to funding will be determined through our monitoring process and agreed by our Chief Financial Officer before any funds are paid.

The Q1 MRET payment will be made to providers by the NHS England and NHS Improvement national team as soon as possible after submission of final plans.

Subsequent quarterly MRET payments will be made on or around the 11th working day of the first month of each quarter.

Providers that have not signed up to their financial improvement trajectories and associated conditions by Quarter 1 2020/21 but do so at a later date will forfeit eligibility to receive earlier quarters of MRET in 2020/21.

9. Treatment of sanctions

The NHS Standard Contract sets out, where a provider agrees a financial improvement trajectory with NHS England and NHS Improvement, how the operation of certain contractual sanctions will be suspended for 2020/21. The suspension is described in Service Condition 36.38 of the NHS Standard Contract (full length), currently under consultation until 31 January 2020.

This measure affects the financial sanctions which would otherwise apply where providers fail to deliver certain national standards set out in Schedules 4A and 4B of the Particulars of the Contract. The national standards in those Schedules for which sanctions remain active for all providers in 2020/21 are those covering mixed sex accommodation, cancelled operations, the duty of candour and 52-week wait breaches.

Local sanctions

In accordance with the principles established in the joint dispute resolution process, local sanctions can only be applied if agreed between commissioners and providers. If agreement cannot be reached, the default position is that no local sanctions can be applied. If local sanctions are agreed, they are outside the scope of the sanctions' suspension arrangements.

Commissioner powers

The suspension of sanctions in specific circumstances does not affect the ability of commissioners to use other levers available in the NHS Standard Contract to manage the general performance of providers (including, for instance, the provisions contained within the full length versions of General Condition 9 (GC9) on Remedial Action Plans (RAPs) and Service Condition 28 on Information Breaches).

However, although commissioners should monitor and manage providers' performance, they must not withhold or retain funding under GC9 if providers fail to achieve the trajectories in full. The Contract includes a provision at GC9.26 to make clear that financial sanctions must not be applied in the above circumstances.

10. Breakeven and surplus trust scheme

In the letters setting out trajectories, the scheme for providers that deliver breakeven and surplus financial improvement trajectories is also described. 50% of the scheme will be contingent on aggregate system performance.

- For providers with a breakeven or surplus control total (before sustainability funding) in 2019/20 delivering a breakeven or surplus position in 2020/21, a one-year transitional reward payment worth 0.5% of relevant income.
- For providers with a deficit control total in 2019/20 (before sustainability funding) reaching breakeven by 2023/24, a reward payment of 0.5% of relevant income at the end of the year in which breakeven is achieved and at the end of the subsequent year, provided financial performance is maintained.

No tapering will apply to this scheme, and providers should not record any income from this scheme in their operating plan submissions. Additional guidance is to be provided in-year.