Independent schools briefing, Quarter 3 2022
Teachers' Pension Scheme: Valuation update

The effective date of the Teachers' Pension Scheme (TPS) valuation is 31 March 2020.

The main purpose of this valuation is to determine the contribution rate payable by schools from April 2024. There is not enough information available at present to predict the outcome, which will depend on both economic and political factors.

In this briefing we take stock, discussing recent developments and their possible impact on the valuation. We also provide guidance on how to plan ahead.

Consultation on the discount rate methodology

The discount rate is the key assumption used to determine TPS costs for schools, an issue we discussed in detail in our **Q2 2020 briefing**.

For the TPS, the SCAPE discount rate is used to discount projected benefit payments back to the present day. The lower the discount rate, the higher pension costs are today.

The current approach is to link the SCAPE discount rate to long-term forecasts of the UK's economic growth. This measure has decreased over time and has been the main factor in rising TPS costs.

A consultation on changing this methodology ended on 19 August 2021, but we are still waiting for a response from HM Treasury.

The importance of the outcome of the SCAPE discount rate consultation cannot be understated, and will be a key driver of costs for schools from April 2024.

For example, the last TPS valuation report showed that a relatively modest 0.25% pa reduction in the SCAPE discount rate would trigger a cost increase of over 5% of pensionable pay.

Employer cost cap and McCloud

Since our **Q1 2021 briefing**, there have been some developments on these issues. But first, a recap.

The employer cost cap floor breached during the last valuation. This triggered benefit improvements for TPS members, despite pre-existing cost increases for schools – an outcome that the Government Actuary called "*somewhat perverse*". However, due to the uncertainty around the McCloud age discrimination case, these benefit improvements were suspended.

McCloud remedy part 1: The final salary scheme closed to all benefit accrual from 31 March 2022, with all subsequent benefits building up in the CARE scheme.

McCloud remedy part 2: Eligible members (essentially those in active service on 31 March 2012) will automatically have their service in the CARE scheme between 1 April 2015 and 31 March 2022 switched back to the final salary scheme. However, at retirement, members will be able to switch back to CARE should they choose to – the so-called '*deferred choice underpin*'.

Legislation to remedy the past has not yet been enacted but must be in place by 1 October 2023.

When the cost cap breached, this would ordinarily have triggered a benefit improvement for CARE scheme members. However, the cost cap breach will now be used *to pay for* the McCloud remedy.

A number of trade unions applied for a judicial review as they felt that members were paying to correct a legal judgment which ruled against government. This was granted on 4 July 2022.

As yet, there is no timescale for the judicial review of the cost cap mechanism, and it could take several months. A judicial review that falls in favour of the member representatives *could* lead to both CARE scheme benefit improvements and the McCloud remedy – which will come at extra cost.

Impact of high inflation

The TPS uses the Consumer Prices Index (CPI) measure of inflation to:

- Increase pensions in payment
- Revalue leaver benefits before retirement
- Revalue CARE benefits for active members (at 1.6% above CPI inflation).

The TPS applies CPI inflation uncapped. This aspect of scheme design is far more generous than most private sector schemes, which commonly cap inflationary increases at either 5% or 2.5% each year for pensions in payment, or over the whole of the term to retirement for revaluation.

> The TPS is a generous scheme for its members, providing an inflation-proofed guaranteed income for life. As the SCAPE discount rate is derived from CPI inflation, the current high inflationary environment may not lead directly to higher pension costs – but until we see HM Treasury's valuation directions (a blueprint on how to value the TPS) we won't have a clear picture on the full valuation approach.

Impact of changing life expectancies

Recent trends in future mortality improvements indicate that they will not be as high as previously thought – as was the case with the 2016 valuation.

The impact of the Covid-19 pandemic brings further uncertainty around future mortality rates.

> Expectations are that future life expectancies are not increasing as fast as anticipated, which will drive TPS costs down. However, any change to the SCAPE discount rate may have a much bigger impact than mortality.

Phased withdrawal

Since legislation to allow phased withdrawal was passed on 1 August 2021, independent schools have been able to close the TPS to new teachers.

While phased withdrawal will not necessarily lead to significant cost savings in the short term, it can help schools reduce TPS membership and mitigate risk.

> Phased withdrawal has become a popular topic in governors' meetings in the last year. Although it may seem attractive because it doesn't unsettle current teachers, it does create a two-tier teaching workforce.

Effective use of the autumn governors' meeting

Governing bodies would benefit from working proactively on pension strategy and monitoring developments. Although there is no timetable in place, there is an expectation that TPS valuation results may appear in the first half of 2023, ahead of changes to school costs scheduled for April 2024.

> We recommend making effective use of governors' meetings in the autumn term and debating pension strategy robustly.
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> Following a long period with very little concrete information on the TPS valuation, independent schools will have some foresight when HM Treasury responds to the SCAPE discount rate consultation.
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> We strongly recommend that pension strategy be high up the governors' agenda in autumn 2022 so that informed discussions can take place ahead of potentially difficult financial decisions in 2023/24.

Further information

First Actuarial is a nationwide firm of pensions actuaries and consultants. We support independent schools with all their pensions issues.

We help independent schools develop their pensions strategy and manage pension change projects. We also provide training, modelling, DC contribution design, DC provider selection and consultation support services.

Our team offers a unique blend of public service pensions expertise, consultancy and communication skills.

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