Independent schools briefing, Quarter 1 2023
TPS: Finally some news, but it's not good news

It's taken a long time, but we finally have some news on the direction of travel for Teachers' Pension Scheme (TPS) costs from 2024.

HM Treasury has published its response to the consultation on the SCAPE discount rate methodology for public service scheme valuations.

It is not good news for independent schools.

It now seems almost inevitable that there will be higher TPS costs to factor into budgets. With schools already facing pressures from higher energy costs and other running expenses – along with the looming spectre of VAT on school fees – this would be a most unwelcome extra burden.

In this briefing we discuss what recent TPS developments mean for independent schools, and what the options are.

What is the discount rate and has it changed?

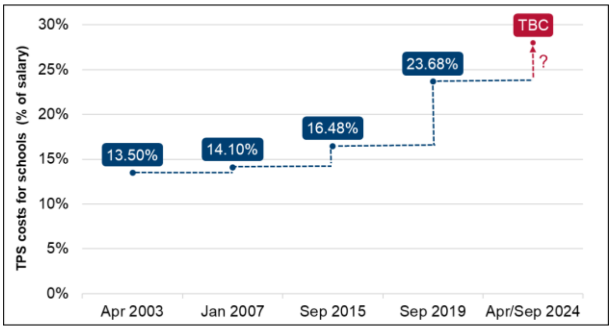
The **SCAPE discount rate** is one of the key assumptions used to determine TPS costs for schools, an issue we discussed in detail in our Q2 2020 briefing. For what it's worth, that briefing has stood the test of time fairly well.

SCAPE is used to discount projected benefit payments back to the present day. Think of it as a future return on investments. The lower the discount rate, the more money schools need to put aside today to meet future payments. This effectively means higher pension costs.

The approach since 2011 has been 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 – as illustrated in the chart in the next column.

A consultation proposing changes to this approach ended on 19 August 2021, with the Treasury only responding on 30 March 2023 that there will be no change to the economic growth method.

As recent forecasts predict a slowing of long-term economic growth, this means a reduction in the SCAPE discount rate from CPI + 2.4% pa to CPI + 1.7% pa – subject to confirmation from the Treasury. This change alone will drive up TPS costs for schools.



The last TPS valuation report from the Government Actuary's Department noted that each 0.25% pa reduction in the SCAPE discount rate would increase the contribution rate for schools by around 5% of pay. This shows how sensitive future TPS costs are to changes in this key assumption.

Are there any factors that might reduce costs?

Recent trends in mortality improvements indicate that **future life expectancies** will be lower than the assumption used in the last TPS valuation. The Covid-19 pandemic has of course had an influence, and higher than expected death rates have continued to the time of writing.

3.3% of the current 23.68% contribution rate was a cost 'correction' due to a breach of the TPS cost cap mechanism. A benefit improvement for members was expected, but instead, the money is going towards the cost of the **McCloud remedy** – an issue covered in our briefings from Q1 2021 and Q3 2022.

Lower future life expectancies will serve to offset some of the cost increase from the lower SCAPE discount rate. It can also be argued that the 3.3% of pay contribution going towards the McCloud remedy costs could fall away this time around –

but will the payments made so far cover the estimated costs?

It is unlikely that even these elements combined will offset the increase brought about by the lower SCAPE discount rate.

Does this latest news give us an answer?

No, but Treasury's signposting is very clear:

"The Government is aware that the updated SCAPE discount rate will generally lead to higher employer contribution rates for most unfunded public service pension schemes resulting from the 2020 valuations."

There are two major steps to come which will determine the new TPS costs for schools:

- The Treasury will publish "valuation directions", which are essentially a blueprint for valuing the TPS. These directions will detail all the financial and demographic assumptions to use – including confirmation of the SCAPE discount rate.
- The Government Actuary's Department will then use these directions to crunch the numbers and determine the new cost. Member experience will be analysed, which can move costs – such as short and long-term pay growth, mortality, and ill-health retirements – in either direction.

The current valuation timetable indicates that the new rates will be implemented in April 2024. However, this may (again) be delayed for schools until September 2024 to align with the academic year – particularly if the cost increase is dramatic.

Government has already committed to providing funding for increases in pension costs "*for employers whose employment costs are centrally funded through departmental expenditure*".

This all feels like déjà vu for independent schools.

What are the options for schools?

This is not a position independent schools want to be in. The risk of higher TPS costs appears to be getting closer to reality and only a 'rabbit out of the hat' of the Treasury might help.

Depending on the extent of the expected cost increases, 'no change' may no longer be an option for many schools. There are several strategy options schools can look at, such as:

- Adopting phased withdrawal, which we considered in our [Q4 2021 briefing]
- Full exit from TPS
- A more creative risk-sharing approach, using pay as a lever for controlling the overall cost of employing teachers (pay + pension + NI).

While some schools may prefer to wait until the contribution announcement before doing any work, we think there is a strong case for being proactive now – particularly in light of this news.

The two key decisions for schools are:

1. Which pension strategy to adopt
2. When to consult on / make any changes.

On timing, schools may want to make firm decisions now or make provisional decisions now then link them to the contribution announcement and other factors affecting financial budgets.

We often recommend that schools consider TPS strategy as a three-term project. For example:

- **Term 1**: Pension training for governors, followed by time to develop and agree a pension strategy with a business case for change, where needed.
- **Term 2:** Meaningful and robust consultation with affected staff.
- **Term 3**: Implementation of new pension scheme and contractual changes (if needed).

While some schools will seek to make changes, others may aim to manage finances and preserve the TPS for recruitment and retention purposes.

Pension strategy is not one-size-fits-all. Each school is unique, with its own culture, values, cost base, financial position and plans for investment.

Developing an effective pension strategy which provides the school and its staff with a solid platform for a positive future requires time and care.

First Actuarial's support for schools

We help independent schools develop their pension strategy and manage pension change projects. We provide training, modelling, Defined Contribution (DC) design, DC provider selection and consultation support services. Everything a school needs.

Find out more about **our services for independent schools**. To discuss any of the areas explored in this briefing, **contact our specialist team for independent schools**.

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