Independent schools briefing, November 2023
2020 TPS valuation – A deep dive into the results

The anticipated and feared 2020 Teachers' Pension Scheme (TPS) valuation results are now confirmed; the Government Actuary's Department (GAD) has published the valuation report.

The Department for Education (DfE) has stated that ***the employers' contribution to the TPS will increase by 5% of salaries from April 2024. As we now know, the new employer rate will be 28.68% of salaries.***

There is some relief for directly funded scheme employers, but even this is only promised for 2024/25. ***DfE's only comment is that they hope previous communications will have prompted schools to make plans to manage the increase***.

At First Actuarial, we like to understand the detail before advising our clients. So in this briefing, we discuss the numbers behind the headlines.

Why does the valuation report state that the employer rate has increased by 5.8% of salaries?

Confusingly, page 2 of the valuation report states that the new employer rate of 28.6% (leaving the 0.08% administration levy to one side) is 5.8% higher than the previous rate of 22.8%. The final two numbers here do not seem to fit with the narrative.

During the previous valuation exercise, a decision was made to postpone the introduction of the new employer rate from April 2019 to September 2019.

The consequence was a higher rate than would have otherwise been the case. A change in April 2019 would have meant an employer rate of 22.8%. However, the five-month deferral increased the new rate by 0.8% to the recognised figure of 23.6%.

Was the outcome the worst case scenario?

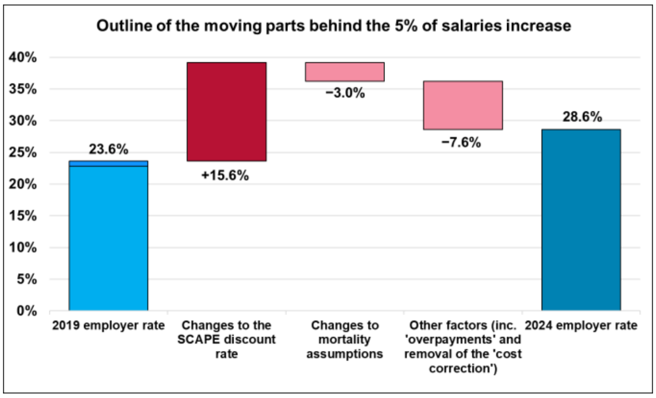
Absolutely not. We discussed the importance and sensitivity of changes in the SCAPE discount rate in our [Q1 2023 briefing].

As long-term projections of economic growth have fallen, so has the SCAPE rate. This in turn has increased the value of pension liabilities. In isolation, the change in the SCAPE rate increases the employer rate by a huge 15.6% of salaries. With no other factors in play, this would have resulted in a rate for schools of nearly 40% of salaries. Thankfully, we are not in that place.

There are three main offsetting factors.

1. Future life expectancy is assumed to be around 0.5–0.9 years lower (depending on age and sex) since the previous valuation.
2. There has been a material overpayment of contributions and some employers may question the equity of overcharging during this period.
3. During the previous valuation, there was a 'cost correction' (worth 3.3% of salaries), reflecting a potential benefit improvement in the event of a breach of the cost cap mechanism. As the cost of the McCloud remedy – an issue we covered in our [Q1 2021] and [Q3 2022] briefings – was separately taken into account, no breach arose. However the benefit improvement cost was still charged as an estimate of the McCloud cost. This cost correction has now fallen away, with the McCloud costs assessed differently – the result being a lower addition to the employer rate.

The chart below illustrates some of these changes:



Is the TPS in deficit?

There are two ways of looking at this.

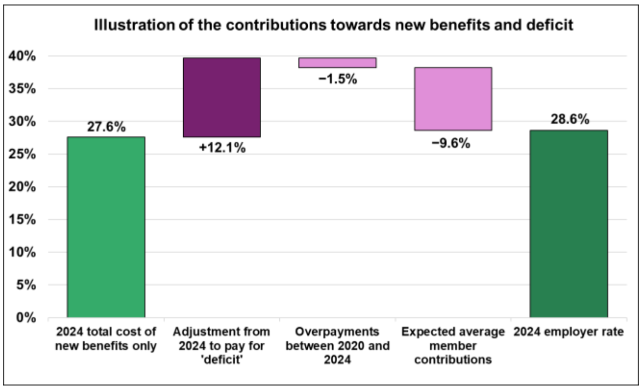
The annual TPS accounts show the cashflows in and out of the scheme. For 2022/23, the contributions paid by employers and members (£9.2bn) didn't meet the payments made to pensioners and beneficiaries (£10.9bn).

While HM Treasury needs to use wider tax revenues to plug the gap, this does not mean a deficit payment from employers. The TPS deficit is a notional concept as the scheme is unfunded. Under the SCAPE mechanism, the funding position is tested against a notional pool of assets established (as a paper exercise) in the mid-2000s and based on estimated liabilities at the time. Although the SCAPE discount rate has fallen, these notional assets have remained tied to a historical liability assessment – and a deficit has developed and grown.

The table below shows the notional funding position for both the recently published valuation and the one before. It is these (notional) deficits that drive the employer deficit payments.

(£bn)	31 March 2020	31 March 2016
Notional assets	222.2	196.1
(Liabilities)	(262.0)	(218.1)
Surplus / (deficit)	**(39.8)**	**(22.0)**

The chart below shows how part of the employer rate includes contributions towards the notional deficit, which is scheduled for payment over 15 years. It is notable that the employer share of the cost of new benefits is just 18% of salaries (27.6% less 9.6%).



We expect this new employer rate to be in force for only three years. The effective date of the next valuation is 31 March 2024 and ordinarily the employer rate comes into force three years later. The 2020 valuation was delayed by the McCloud judgement and the review of the employer cost cap.

Could anything change before April 2024?

As we flagged up in our **Q2 2023 briefing**, there remains the potential for further legal action around the treatment of additional liabilities arising from the McCloud judgement. While some trade unions lost the last round of the long-running battle, there is still time for that loss to be appealed. However, given the publication of the TPS 2020 valuation report, it seems clear that the 5% of salaries increase will be imposed regardless of any further legal proceedings. Any further action, if successful, is more likely to influence future valuation results than the 2024 contribution increase.

Does a higher contribution rate mean better benefits for members?

No. The final salary scheme closed on 31 March 2022 and all members now build up career-average scheme benefits. The level of these benefits has not improved since they were first introduced on 1 April 2015 and are still based on a 1/57th accrual rate with benefits payable from State Pension age. The change in contribution rate is triggered by factors mentioned earlier in this briefing rather than any improvement in benefits.

What will the 2024 valuation have in store?

It would be a brave move to predict where the employer rate will land next time. Unless there is a reversal in the country's recent economic fortunes, it's hard to see cost pressures easing. But adding in the uncertainty over the longer term effects of Covid-19, and a potential change of government before then (these valuations being undoubtedly a tool which can be used for political ends), it's conceivable that we could end up with a material swing in either direction.

This will be the focus of a future briefing.

First Actuarial's support for schools

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

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**.

Dale Walmsley, Partner and Actuary
0161 348 7464 / 07361 361 312
dale.walmsley@firstactuarial.co.uk

first actuarial