Teachers' Pension Scheme: Independent schools' costs to rise

27 October 2023

Independent schools that use the Teachers' Pension Scheme (TPS) will see their costs increase again, with the employer contribution rate set to increase by 5.0% of salaries to 28.68% of salaries from April 2024 onwards.

This increase is clearly unwelcome, if not unexpected, and comes at a time when many independent schools' budgets are already under pressure and with political risks on the horizon. The fact that the new contribution rate will apply from April 2024, rather than September to align implementation with academic years like in 2019, will be further unwelcome news.

Our viewpoint

We've known an increase was coming for some time and have had a broad indication of the likely rate being trailed since a Treasury statement in June. Amongst our clients there has been a mix of:

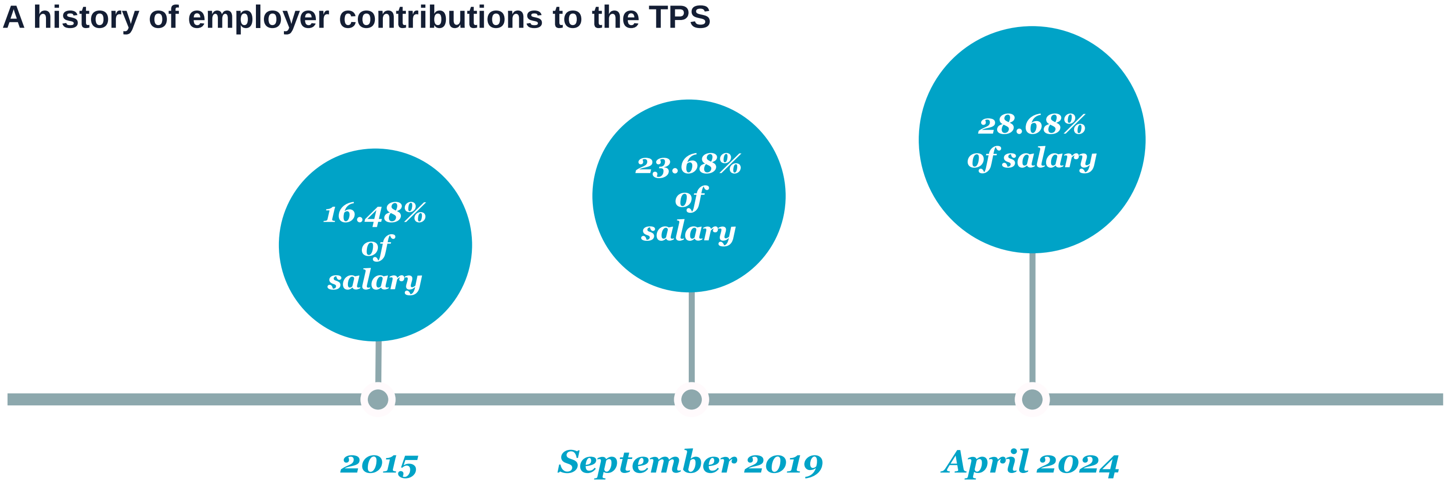
- waiting to see the actual rate before considering options in detail;
- starting work in earnest on the approach the school wishes to take; and
- in some cases getting going on consultations to try and implement proposals by April 2024.

What is clear, however, is that schools are seeing this as a tipping point – "wait and see" no longer seems to be an option for most. Even those schools that have taken action short of a full TPS exit so far will now need to consider how to respond to this new contribution increase.

So will we see another flurry of TPS exits? Perhaps. But the landscape is very different to when the last set of increases were announced – we have a cost-of-living crisis, union involvement is increasing, and a more nuanced set of options for schools has been developed. More than ever schools need to have a compelling rationale for change, and be able to justify their proposals as a proportionate response.

Schools should start by following the actions set out on the next page (we've also set out some background to the further cost increases on the page after). As ever, when considering the options to respond to a TPS cost increase, one size doesn't fit all. With so many permutations and possibilities, it is essential that schools consider the options based on their own specific objectives and circumstances.

A history of employer contributions to the TPS



The next pages set out immediate actions as well as some key considerations for schools in differing circumstances, followed by background to the further cost increases.

The actions schools should be taking now

All schools who currently have some or all teachers in the TPS, and have not done so already, should:

- **Budget for the increase in contributions from April 2024;**
- **Ensure key decision-makers are aware of the TPS cost increase;**
- **Plan the process for assessing the school's options (eg by setting up a working party);**
- **Map out constraints and consider the school's objectives.**

A clear rationale and business case for any proposed changes is essential, and in our experience a key part of this is setting up the governance process to be able to fairly consider the options available. Once a framework for making decisions has been established, some specific considerations for schools in different circumstances are set out below.

Schools that remain fully in the TPS

Don't jump to any conclusions – carefully consider the full range of options available, including those which do not involve a full exit from the TPS. Consider how these options affect your costs, your future risks, and your teachers. If you decide to consult with your teachers about changes, it's really important to have considered the perspective of your teachers and to be able to tell them that you have. If pension changes are necessary, consider whether to be a first mover, or whether to wait and see how others respond first. We did see a "first-mover advantage" following the 2019 TPS cost increases – might we see that again?

To date we have seen schools reap huge benefits from communicating any proposed pension changes clearly and thoughtfully to their teachers, supported by a robust business case. We fully expect this to continue to be an essential component of a successful process. Our checklists to help schools make robust decisions here and undertake successful consultations with teachers about pension changes here may well be of interest.

Schools where some action has been taken short of a full TPS exit

Consider whether the new increase now prompts further action. For those that applied a salary reduction in the past for teachers who wished to remain in the TPS, might you need to consult once more on a further salary adjustment?

We have worked with a number of schools who have implemented structures to mitigate the risk of the increase we are now seeing. For schools that have taken such action, consider how any current risk mitigation mechanisms should operate in practice, including / as well as whether higher TPS costs could influence salaries.

Consider any cost disparity between teachers who remain in TPS and those who are not. Does this need to be reviewed? Is it likely to affect the pension option that teachers choose under a "parallel schemes" approach? Could this introduce pressure to increase the pension offering for new teachers (for schools that have entered phased withdrawal) and for those now in a school's defined contribution (DC) alternative? Does this prompt schools that are in phased withdrawal to propose changes for their teachers who are in TPS?

The response to further TPS cost increases must consider what was communicated / agreed as part of any changes that have already been made. This is particularly true where the proposals included a TPS cost increase mitigation mechanism, for example an agreement to limit future salary increases for teachers who remain in the TPS.

What is "action short of a full TPS exit"?

There are lots of different options available, but two of the most common are:

- **Parallel schemes:** Where an alternative defined contribution (DC) scheme is offered alongside the TPS, with teachers able to choose between the two.
- **Phased withdrawal:** Where an alternative DC scheme is offered alongside the TPS, but it is a one-way street with new teachers and those who leave the TPS only able to join the DC scheme.

You can read more here.

Schools that have exited the TPS

Key actions are likely to be monitoring the responses of others and, if necessary, reviewing reward packages. It is possible that an increase in TPS contributions will affect the local recruitment / retention market, and could put pressure on the school to increase DC pension contributions.

Schools that have exited the TPS will be very relieved that their actions will mean no direct impact from the increase in TPS costs. Nevertheless, these schools must still be aware of the potential for TPS changes to alter the competitive landscape for teaching staff.

Understanding changes in TPS costs

The current review of TPS contributions

The exact cost of providing TPS benefits is unknown – it will depend on factors like what inflation is and how long people live. However, the Government aims to ask teachers and schools to pay contributions now that are a "fair" reflection of what those ultimate costs might be. This is assessed regularly through a valuation (or actuarial valuation) and is in effect a 4-yearly financial health check of the TPS.

The current valuation was carried out with an effective date of 31 March 2020 and has taken longer than usual, in large part due to the time spent resolving age discrimination issues across all the public service pension schemes like the TPS and the NHS Pension Scheme (you can read more about the McCloud legal case here).

Why are contributions increasing, and will they increase again in future?

By far and away the biggest reason contributions will increase from April 2024 is because expected future UK economic growth is lower than at the last valuation.

One of the key assumptions that needs to be made in calculating TPS contributions is something called the "SCAPE discount rate". It is important because it converts future pension promises into "present day" terms.

The SCAPE discount rate is based on expected future UK economic growth. Perhaps unsurprisingly those expectations have reduced further since 2019. In particular, the SCAPE discount rate has reduced by 0.7% pa, from inflation plus 2.4% pa to inflation plus 1.7% pa. This reduction alone has increased schools' costs by 15.6% of salaries. A similar change in the SCAPE discount rate at the previous valuation was a key reason for the 2019 increase in contributions.

This increase has been offset to a degree by other factors, such as reductions in assumed future improvements in longevity and the reversal of benefit improvements that had been expected at the previous valuation.

In terms of whether contributions will increase again, that's all but impossible to know at this stage. What we can say is that the contribution rate will change at subsequent valuations, be that up or down, and that it depends on so many factors outside teachers' or schools' control.

Want to find out more?

To date, we've supported over 100 independent schools in relation to the TPS.

Our specialist team can help you with all aspects of the TPS, from helping you decide what to do through to support in a consultation with your teachers if that is what you decide is right. If you'd like to discuss how we can help you, please visit **https://teacherspensions.lcp.uk.com** or get in touch with one of the experts below.




Richard Soldan
Partner
020 7432 6631
richard.soldan@lcp.uk.com

Luke Hothersall
Partner
020 7432 6796
luke.hothersall@lcp.uk.com

Nikki Ayriss
Partner
01962 672920
nikki.ayriss@lcp.uk.com

Andy Thompson
Partner
020 7432 0616
andy.thompson@lcp.uk.com