Department for Education

Teachers' Pension Scheme Supplementary Estimate 2015-16

Memorandum to the Education Select Committee

February 2016

Teachers’ Pension Scheme Supplementary Estimate 2015-16

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Introduction

1 The purpose of this memorandum is to provide the Select Committee with additional information about the Teachers' Pension Scheme (TPS) Supplementary Estimate for 2015-16. It includes information on the changes made in the Estimate and how these relate to the scheme's budgets and control totals.

2 An explanation of key terms used in the Memorandum is provided in Annex B.

Summary of Supplementary Estimate

3 The TPS is an unfunded defined benefit scheme, in which payments from the scheme are funded by contributions from current employees and employers in England and Wales, with the difference being financed by the exchequer.

4 The scheme consists of largely demand led expenditure and is dependent on a number of external factors and decisions made by members of the Scheme which are outside the control of the Department. These factors include membership numbers, salary levels, mortality rates, the age profile of the scheme and pension increases. For this reason the TPS scheme budgets are not subject to Departmental Expenditure Limit (DEL) control totals. All the budgets are within Annually Managed Expenditure (AME).

5 The budgets are based on cash forecasts of income and expenditure agreed between the Office of Budget Responsibility and the scheme's administrator, using contribution rates supplied by the Government Actuary's Department (GAD) and discount rates provided by HM Treasury. The majority of the resource costs in the Estimate are non-cash costs related to the pension liability, rather than the pension benefits paid to retired teachers. The table below sets out the 2015-16 resource and cash control totals.

Table 1 – Estimate control totals 2015-16

Annually Managed Expenditure	Main Estimate £m	Supplementary Estimate £m	Change £m
Net AME Resource	13,092.3	12,293.5	(798.8)
Net Cash Requirement	3,675.7	3,675.8	0.1

6 The most significant factors driving the £798.8 million decrease in resource costs relates to the non-cash costs in relation to movements in the main pension liability. These include:

- an increase in the employers contribution rate used to estimate the current services costs;
- change in the interest charged due to a change in the opening liability;
- policy change in relation to the Guaranteed Minimum Pension.

More information on the non-cash budgets can be found in paragraphs 13 – 22.

Key Activities Supported by the Estimate

7 The sole activity supported by the Estimate is to service the provision of the pension scheme in accordance with the pension regulations. The TPS is a statutory, unfunded, contributory, defined benefit scheme with benefits based on final or career average salary and length of service. It is a voluntary scheme open to all teachers in England and Wales who meet the qualification criteria.

The main retirement groups from the TPS are:

- those members retiring on the basis of reaching normal pensionable age;
- those accessing their benefits early through agreement with their employer (i.e. premature retirement, where the employer pays a portion of the retirement costs);
- through members taking actuarially adjusted benefits (effectively staged retirement, where a member accesses a reduced level of pension benefit).

8 Retirement and other pension benefits are set out in regulations made under the Superannuation Act (1972) and are paid by public funds provided by Parliament. Pensions are increased annually in line with the Pension Increase Order issued by HM Treasury, which is currently based on the consumer prices index.

9 The members contribute to the scheme on a "pay as you go" basis. These contributions, along with those made by employers, are credited to the Exchequer under arrangements governed by the above Act. Contributions by employers are set at rates determined by the Secretary of State, taking advice from the Scheme's actuary (GAD).

10 Employee contribution rates and the tiering structure in place for the current financial year were developed in discussion with stakeholders, including HM Treasury, in response to the Government's parameters for increasing contributions received.

11 The data used to inform the Supplementary Estimate is based on the latest actuarial valuation of the scheme, the report for which was published in September 2015. The report is based on scheme data as at 31 March 2012. The next actuarial valuation is due to be completed in 2018, and will be based on scheme data as at March 2016.The forecasts have been updated to reflect recent activity and changes in assumption about the membership demographics, inflation rates, pay bill growth and average contribution rates.

12 The Scheme is administered by Capita Ltd. The cost of administering the Scheme is included within the administration costs control total in the Scheme Supplementary Estimate. This is a change to previous years, where it was included within the Estimates for the Department. The administration expenditure is offset by contributions received from employers in the form of a levy, currently 0.08% of salary.

Detailed explanation of the changes to the Provisions

Detailed Breakdown of Expenditure

13 The Resource AME budget is a net budget which mainly consists of non-cash budgets.

The key components are:

- the non-cash movement in the pension provision, i.e. current service cost (the amount we set aside for the expected future payments required to settle the obligation resulting from employee service in the current year), use of provisions, interest on scheme liabilities, costs of transfers in and out and cost of enhancements;
- the non-cash movement on the Premature Retirement Compensation provision. This provision is for the additional costs of early retirements;
- the cash budget for employers' and employees' contribution income which is collected by employers and paid into the scheme. These contributions buy future year's pension benefits;
- the cash budget for other related payments.

14 Table 2 below provides a breakdown of the changes in the Resource AME budgets.

Table 2 – Detailed changes in resource expenditure and income

Income	**Main Estimate £m**	**Supplementary Estimate £m**	**Variance £m**	**Outturn 2014-15 £m**
Employers Contributions	(3,704)	(3,729)	25	-3350
Employees Contributions	(2,358)	(2,323)	(35)	-2349
Transfers In	(36)	(33)	(2)	-31
Other Income	(1)	(4)	3	-2
Other Income - Admin Fee	0	(2)	2	0
PRC Contributions	0	(5)	5	(8)
Total Income	**(6,099)**	**(6,096)**	(3)	(5,740)
Expenditure				
Current service cost	8,908	8,435	473	8,106
Other costs	3	16	(13)	0
Administration Charge	14	21	(7)	0
Transfers In	36	33	2	31
Interest On Scheme Liabilities	10,216	9,867	348	10,855
Increase in premature retirement provision	11	9	1	11
Interest on premature retirement provision	3	5	(2)	4
Total Expenditure	**19,191**	**18,389**	**802**	**19,005**
Net AME Resource	**13,092**	**12,294**	**799**	**13,266**

15 A summary of previous year's outturn and the expenditure plans from 2014-15 to 2016-17 are shown in Annex A.

Basis of the forecasts and underlying assumptions

16 The key financial assumptions used to calculate the non-cash costs are:

- The current service cost is based on a standard contribution rate of 33.8%, this figure is supplied by GAD;
- The interest on scheme liabilities is based on the long term discount rate of 3.55% notified by HM Treasury in PES Paper (2014) 09 in December 2014.

17 In addition to the financial rates, there are a number of planning assumptions around the scheme demographics applied by the actuaries. The Department is not the employer of the scheme members, so it has no direct influence over the volume and structure of the teaching workforce. This makes it difficult to accurately predict income and expenditure. Consequently when forecasting, we can only respond to changes in historic trends in member behaviour, allied to general assumptions about expected changes in the workforce. We have prepared the forecasts on the assumption that the staffing levels in the local authority maintained and academy trust sectors will remain relatively stable. However, members working in further education and higher education establishments, and also independent schools, collectively account for 30% of the scheme membership which could result in a deviation from the standard assumption.

18 Capita maintain a record of active members via an annual return completed each year by employers participating in the Scheme. This is used to provide a table of members by age profile. The age profile is then used to calculate the number of members likely to retire in each age group based on past and/or emerging trends. This profile is updated annually and used to calculate the future pension costs. The remaining population is rolled forward to provide the age profile for the following year and adjusted to take account of mortality and new starter rates. This process is repeated for each of the subsequent years covered by the forecasting exercise. Due to the time needed to collect the information from the employers and cleanse it, the data used relates to the previous financial year.

Changes to net resources

Income

19 The majority of the cash income into the scheme comes from the contributions made by employers and employees. In September 2015 the level of contributions from employers was increased from 14.1% to 16.4%, based on cash received to date. We are expecting contributions to be £25m higher than expected. This is offset by lower than anticipated contributions from employees of £35m.

20 In September 2015, the Scheme commenced charging a levy on salaries in relation to the recovery of administration fees; the levy is currently set at 0.08%. We have included a nominal amount of £2m in the supplementary estimate to recognise this income, as HM Treasury have only recently agreed to our accounting proposals, leaving no time for a more accurate reflection of income.

Expenditure on pension costs

21 The main expenditure budgets within pension costs are the current service cost and the interest on the scheme liability; it is these budgets that have changed most. The key changes are:

- Current service costs: this budget has reduced by £473 million due to a combination of two factors being:
  - The estimated current service costs are based on the contribution rates which are supplied by GAD and applied to pensionable pay. The Main Estimate was based on the 14-15 rates, as 15-16 rates were not available when the Main Estimate was prepared. We have updated our current service costs calculation to reflect an increased employer contribution rate from 1 September. As a result, the current service cost will be £673m lower than forecast in the Main Estimate.

    Current service costs are calculated as (total contributions) divided by (combined employer and employee contribution rate) which is then multiplied by standard contribution rate.
  - Current Service costs have been affected by change in Government Policy in relation to Guaranteed Minimum Pensions. We have been advised by GAD that this change would increase past service costs by £200m;
- Interest on scheme liabilities: this £348 million reduction reflects the updated opening liability, which was lower than that in the Main Estimate.

Net Cash Requirement

22 The cash flow forecasts provided by the scheme administrator suggested that there was no need to revise the cash flow. However, a change within the debtor calculations has led to a small increase in the cash flow of £0.1m.

Provisions and Contingent Liabilities

Provisions

23 The scheme has two provisions for future liabilities:

- the main pension liability, which was estimated at £275.6 billion at 31 March 2015 by GAD;
- the premature retirement compensation provision, which was estimated at £170.9 million at 31 March 2015. This provision is to meet the cost of on-going compensation payments for people retiring before their normal retirement age which are paid as part of the monthly pension payment, but recovered from employers on a quarterly basis.

24 Further details of the pension scheme's liabilities are published in the Teachers' Pension Scheme for England and Wales Annual Report and Accounts 2014-15 (HC 47).

Contingent liabilities

25 In the unlikely event of a default by the approved Additional Voluntary Contributions provider, the Scheme will guarantee pension payments. The potential liability as at 31 March 2015 was estimated £73.1m. This guarantee does not apply to members who make payments to other institutions offering Free Standing AVCs.

Departmental Accounting Officer

26 This Memorandum has been prepared with reference to the guidance in the Estimate Manual provided by HM Treasury and available on the House of Commons and Scrutiny Unit website. The Departmental Accounting Officer (DAO) has personal responsibility for the content in the memorandum and formal approval of the memorandum has therefore been obtained prior to submission to the Select Committee.

Annex A

Budgetary Limits Outturn and Plans 2009-10 to 2016-17

	Outturn						Plans	
	2009-10	2010-11[1]	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17[3]
AME Resource - Programme[2]	10,457	(10,414)	11,710	10,542	10,649	13,287	12,294	14,308
Net Cash Requirement	2,139	2,533	3,079	3,302	3,361	3,592	3,676	4,072

[1] The decision to uprate public service pensions using the Consumer Price Index rather than the Retail Price Index resulted in a one-off credit of £22.2 billion to the past service costs in 2010-11 financial year.

[2] Pensions income and expenditure outturn and plans are classified as programme, including the fee for administering the scheme charged by the Department for Education.

[3] Data for 2016-17 does not include changes made in respect of increased employers contributions or the guaranteed minimum payment. This data will be updated in the Main Estimate 2016-17.

Annex B

Explanation of key terms used in the Memorandum

Annually Managed Expenditure

The Estimate for a Pension Scheme only includes Annually Managed Expenditure which is primarily demand led and is generally less predictable and controllable.

Scheme Liability

This is calculated in the previous year’s accounts and represents the starting position for the latest year.

Interest on Scheme Liabilities

The pension scheme liabilities calculated in the previous year are now one year closer to being realised, therefore an Interest charge is used to calculate this increase in the value of the liability.

Current Service Cost

This is the value of future pensions accrued by employees who have worked and contributed to their pension in the year.

Past Service Cost

These result from any back dated changes to pension entitlements.

Enhancements

These arise from the award of extra years’ service which are not usually worked by employees, normally on early retirement or the purchase of added years.

Transfers in / out

These come from members who have transferred their pension benefits either to or from another pension arrangement.