



Department
for Education

Teachers' Pension Scheme Main Estimate 2018-19

**Memorandum to the Education Select
Committee**

March 2018

Teachers' Pension Scheme Main Estimate 2018-19

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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) Main Estimate for 2018-19. It includes information on the changes made in the Estimate since 2017-18 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 the Main Estimate

- 3 The TPS is an unfunded defined benefit scheme, in which payments to pensioners in the scheme are funded by contributions from current employees and employers in England and Wales, with the shortfall being financed by the Exchequer.
- 4 The scheme consists of largely demand-led expenditure and is dependent on a number of external factors, including decisions made by members of the Scheme. These factors, which are outside the control of the department, include membership numbers; salary levels; mortality rates; the age profile of members, and annual pension increases. For this reason, the TPS scheme budgets are not subject to Departmental Expenditure Limit (DEL) control totals; they sit within Annually Managed Expenditure (AME) and are classified as programme expenditure.
- 5 The budgets are based on:
 - cash forecasts of income and expenditure agreed between the Office of Budget Responsibility (OBR) and the Scheme's administrator;
 - contribution rates supplied by the Government Actuary's Department (GAD);
 - discount rates provided by HM Treasury.
- 6 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 2018-19 resource and cash control totals compared to the totals in the 2017-18 Supplementary Estimate controls.

Table 1 – Estimate control totals 2018-19

Annually Managed Expenditure	Supplementary Estimate 2017-18	Main Estimate 2018-19	Increase/ (Decrease)
	£million	£million	£million
Net AME- Resource	15,766.4	15,112.0	(654.4)
Net Cash Requirement	3,515.4	3,921.9	406.5

- 7 The £15.1 billion resource budget is a net budget that reflects the **long term cost** to the government rather than the pension benefits actually paid during the year. The cash pension payments are replaced by the following non-cash costs:
- **current service costs:** the amount we are setting aside, via the pension provision, to meet the future pension costs. This cost is based on total contributions paid into the scheme incremented using a formula agreed with GAD;
 - **interest on scheme liabilities:** the pension liability provided by the scheme actuary is calculated on a net present value basis, discounting the liability that falls due in future years. The interest charge over the year is the cost of “unwinding” this discount, and reflects the fact that pension liabilities in any given future year are 12 months closer to realisation than they were previously.
- 8 The £3.9 billion cash limit is the net position, based on estimated income, totalling £6.5 billion, flowing in from employers and employees and the £10.4 billion estimated pension benefits paid to retirees in the financial year.
- 9 The 2018-19 Estimate resource request is £0.7 billion lower than the 2017-18 request. This is mainly due to a reduction in the interest rate from 2.80% to 2.55% resulting in a lower Interest charge for the year.
- 10 Current service costs are a **non-cash** item as they relate to the provision for future pensions. Although the current service cost has increased, the contribution rate that determines cash receipts has remained constant. Contribution rates for employers used to inform the Current Service cost have remained constant at 16.4% and are not expected to be revised until 2019.
- 11 More information on the non-cash budgets can be found in paragraphs 22- 26.

Key Activities Supported by the Estimate

- 12 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.
- 13 The main retirement groups within 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); and
 - those members taking actuarially adjusted benefits (where a member accesses a reduced level of pension benefit by retiring earlier than their normal pensionable age).
- 14 Retirement and other pension benefits are set out in regulations made under the Superannuation Act (1972) and the Public Services Pension Act (2013) 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.

- 15 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 Acts. Contributions by employers are set at rates determined by the Secretary of State, taking advice from the scheme’s actuary (GAD).
- 16 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.
- 17 The data used to inform the Main 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 assumptions about the membership demographics; inflation rates; pay bill growth and average contribution rates.
- 18 The scheme is administered by Capita Business Services Ltd. The cost of administering the Scheme is included within the net resource requirement in the Scheme Estimate. The administration expenditure is offset by contributions received from employers in the form of a levy, currently 0.08% of salary, shown in the net resource requirement.

Detailed explanation of the changes to the Provisions

Detailed Breakdown of Expenditure

- 19 The Resource AME budget is a net budget that 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 the 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 years’ pension benefits; and
 - the **cash budget for other related payments**.

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

Table 2 – Detailed changes in resource expenditure and income

Income / Expenditure	17-18 Supplementary Estimate (£million)	18-19 Main Estimate (£million)	Increase/ (Decrease) (£million)	2016-17 Actual Outturn (£million)
Income				
Employer Contributions	(3,979.5)	(4,042.7)	(632)	(3,965.2)
Employee Contributions	(2,325.4)	(2,371.0)	(456)	(2,320.9)
Transfers In	(16.9)	(17.1)	(0.2)	(21.1)
Other Income	(0.6)	(0.7)	(0.1)	(0.8)
Administration Levy	(19.0)	(19.7)	(0.7)	(19.3)
PRC Contributions	(3.2)	(2.6)	(0.6)	(4.0)
Total Income	(6,344.6)	(6,453.8)	(109.2)	(6,331.3)
Expenditure:				
Pension costs and associated payments				
Current Service Costs ²	12,192.1	12,181.9	(10.2)	7,873.2
Interest on scheme liabilities	9,855.0	9,344.4	(510.6)	9,752.4
Other Payments	3.7	4.8	1.1	2.7
Increase in liabilities due to transfers in	16.9	17.1	0.2	21.1
Increase in premature retirement provision	3.9	2.6	(1.3)	7.4
Interest on premature retirement provision ¹	22.2	(3.5)	(25.7)	(1.9)
Administration Fee	17.2	18.5	1.3	18.5
Total Expenditure	22,111.0	21,565.8	(545.2)	17,673.4
Net AME Total Resource	15,766.4	15,112.0	(654.4)	11,342.1

1 Interest on premature retirement provision in 2017-18 included a charge of £22m due to the change in rate used and is negative in Estimates due to a negative discount rate

2 Current service costs in 2016-17 were based upon a standard contribution rate of 32.3% rising to 49.3% in 2017-18.

21 A summary of previous years' outturn from 2011-12 to 2016-17 and the expenditure plans for 2017-18 and 2018-19 are shown in Annex A.

Basis of the forecasts and underlying assumptions

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

- The current service cost is based on a standard contribution rate of 49.3% (2017-18 49.1%) this figure is supplied by GAD; and
- The interest on scheme liabilities is based on the long term discount rate of 2.55% (2017-18 2.80%) notified by HM Treasury in PES Paper (2017) 10 Revised on 11 December 2017.

23 In addition to the financial rates, there are a number of planning assumptions around the scheme demographics applied by the Actuary. 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 and so, 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 increases in the staffing levels in the local authority maintained and academy trust sectors will be minimal. However, members working in independent schools, further education and higher education establishments collectively account for around 26% of the scheme membership and this could result in a deviation from the standard assumption.

24 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 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, 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.

Table 3 – Detailed Movement in Current Main Estimate between submissions

Income / Expenditure	2018-19 Estimate Per Submission in			
	Main Estimate 2017-18 (A) (£million)	Supplementary Estimate 2017-18 (B) (£million)	Main Estimate 2018-19 (C) (£million)	Movement (C-B) (£million)
Income				
Employer Contributions	(4,022.1)	(4,022.1)	(4,042.7)	(20.6)
Employee Contributions	(2,359.4)	(2,359.4)	(2,371.0)	(11.6)
Transfers In	(24.0)	(24.0)	(17.1)	6.9
Other Income	(0.6)	(0.6)	(0.7)	(0.1)
Administration Levy	(19.6)	(19.6)	(19.7)	(0.1)
PRC Contributions	(4.7)	(4.7)	(2.6)	2.1
Total Income	(6,430.4)	(6,430.4)	(6,453.8)	(23.4)
Expenditure:				
Pension costs and associated payments				
Current Service Costs	12,071.4	12,071.4	12,181.9	110.5
Interest on scheme liabilities	10,162.4	10,162.4	9,344.4	(818.0)
Other Payments	4.3	4.3	4.8	0.5
Increase in liabilities due to transfers in	24.0	24.0	17.1	(6.9)
Increase in premature retirement provision	2.4	2.4	2.6	0.2
Interest on premature retirement provision ¹	(1.8)	(1.8)	(3.5)	(1.7)
Administration Fee	18.5	18.5	18.5	0.0
Total Expenditure	22,281.2	22,281.2	21,565.8	(715.4)
Net AME Total Resource	15,850.8	15,850.8	15,112.0	(738.8)

Income

25 The majority of the cash income into the scheme comes from the contributions made by employers and employees. Key changes to note are as follows:

- **Contributions:** increase of £32.2 million. This movement is driven by the information provided to the OBR and is influenced by pay and workforce growth. It should be noted that employee's contribution rates are tiered based on salary. The tiers were set up so that the average contribution rate would be 9.6%. However, salary progression has not been as high as expected and the average rate seen is closer to 9.5%. This lower rate has been used to inform all estimates following the 2017-18 submission;
- **Transfers into the scheme:** a reduction of £6.9 million. Scheme transfers have been decreasing and we are anticipating that this trend will continue. This has been reflected in the data submitted to the OBR; and
- The balancing reduction in income (£1.9 million) is due to a number of small changes which have been reflected in the OBR submission.

Expenditure on pension costs

26 The main expenditure budgets within pension costs are the current service cost and the interest on the scheme liability. The key changes to note are as follows:

- **Current service costs:** the current service cost are based upon the rates supplied by GAD and applied to pensionable pay. They are the non-cash resource set aside for future pensions. The rate for 2018-19 has increased from 49.1% to 49.3%. This movement has led to an increase in resource requirement of £49.3 million from the previous submission. The remaining balance (£61.5 million) is due to the OBR update;
- **Interest:** we were advised of a reduction in the interested rate in December 2017 from 2.8% to 2.55%; a reduction of £818 million;
- **Transfers into the scheme:** a reduction of £6.9 million. Scheme transfers have been decreasing and we are anticipating that this trend will continue. This has been reflected in the data submitted to the OBR.

Transfers into the scheme affect both income and expenditure due to the requirement to increase the provision to reflect the transfer; and

- The balancing reduction (£1.3 million) is due to changes to a number of small changes reflected in the data submitted to the OBR.

Net Cash Requirement

27 The cash flow projections provided by the scheme administrator are the basis of the estimated amount of cash the Exchequer will be required to provide to finance this year's pension payments.

28 Table 4 shows how the net cash requirement is calculated.

Table 4 – Reconciliation of net resource limit to net cash requirement

	£million	2018-19 Main Estimate £million
Net Resources		15,112.0
<u>Deduct non-cash budgets:</u>		
Current service costs	(12,181.9)	
Interest on scheme liabilities	(9,344.4)	
Increase in liability due to transfer in	(17.1)	
Increase in premature retirement provision	(2.6)	
Interest on premature retirement provision	3.5	
	<hr/>	(21,542.5)
Add cash pension related payments		
Pension benefit payments	10,357.9	
Payments to other pension schemes for transfers out	33.5	
Premature retirement compensation payments	9.7	
Movement in debtors	1.1	
Movement in creditors	(49.8)	
	<hr/>	
Movement in working capital		10,352.4
Net cash requirement		3,921.9

Provisions and Contingent Liabilities

Provisions

29 The scheme has two provisions for future liabilities:

- main pension liability: GAD has estimated that the main pension liability will be £361.5 billion at 31 March 2018 (£347.2 billion 31 March 2017); and
- premature retirement compensation provision: this was estimated at £235.0 million on 31 March 2017 (£240 million 31 March 2016). The scheme has taken liability from the Employer upon receipt of an actuarially calculated sum in respect of people retiring before their normal retirement age.

30 Further details of the pension scheme's liabilities will be published in the Teachers' Pension Scheme for England and Wales Annual Report and Accounts 2017-18, which will be published later in the year.

Contingent liabilities

31 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 2017 was estimated at £47.1m. This guarantee does not apply to members who make payments to other institutions offering Free Standing AVCs (this figure will be updated in the 2017-18 Annual Report and Accounts).

Departmental Accounting Officer

32 This memorandum has been prepared with reference to the guidance in the Supply Estimates 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 been obtained prior to submission to the Select Committee.

Budgetary Limits Outturn and Plans 2011-12 to 2018-19

Budgetary Limits	Outturn¹ 2011-12	Outturn 2012-13	Outturn 2013-14	Outturn 2014-15	Outturn 2015-16	Outturn 2016-17	Plans 2017-18	Plans 2018-19
Annually Managed Expenditure Resource Programme ²	(10,414)	11,710	10,578	10,649	12,125	11,342	15,766	15,112
Total Resource	(10,414)	11,710	10,578	10,649	12,125	11,342	15,766	15,112

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

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

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.