Teachers' Pension Scheme – background

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The Teachers' Pension Scheme in England and Wales (TPS) is an unfunded, defined benefit public service occupational pension scheme.

This note looks at the development of the scheme to 2010, including reforms introduced in 2007. These included an increase in the normal pension age for new entrants (from 60 to 65) and increases in contributions - from 6% to 6.4% for employees and from 13.5% to 14.1% for employers. There would be a cap on employer contributions of 14% from the 2008 valuation onwards. A separate note looks at the current reforms SN 6731 *Teachers' Pension Scheme – current reforms*.

Contents

1 Current scheme

1.1 Overview of provisions

The Teachers' Pension Scheme in England and Wales (TPS) is an unfunded, contributory, final salary public service occupational pension scheme. The *Superannuation Act 1972* provides the legislative framework for this, with the detailed rules in regulations, in particular, the *Teachers' Pensions Regulations 2010* (SI 2010/990). Changes to the scheme were introduced on 1 January 2007, affecting new entrants from that date. Key features of the scheme affecting members before and after that date are summarised in the table below:[1]

[1] For a fuller summary see, Government Actuary's Department, Teachers Pension Scheme (TPS) Key features pre-post 1 January 2007

	Pre 2007 members	New entrants from 1 January 2007
Normal Pension Age	60	65
Members' contributions	6.4%*	6.4%*
Employer contributions	14.1%	14.1%
Members' Pension Benefits	1/80th final salary for each year reckonable service	1/60th for each year of reckonable service
Lump sum	Three times the pension (and more scope to take a higher tax-free lump sum and a lower level of pension)	Option to give up £1 of annual pension in exchane for £12 of tax free lump sum, up to a maximum of 25% of the fund value

**Variable at future valuations through the cost sharing mechanism*

Further details can be found in a leaflet for scheme members – "*Teachers' Pensions: Your Guide"* (September 2012).

The Scottish Teachers Superannuation Scheme is managed by the Scottish Public Pensions Agency. Although, occupational pensions are reserved to the UK Parliament,[2] Scottish Ministers have executive powers devolved to them.[3] This means Scottish Ministers have responsibility for the content of regulations governing the Scottish Teachers Superannuation Scheme, although the consent of the Treasury to the making of regulations is still required. The current regulations for the scheme are the *Teachers' Superannuation (Scotland) Regulations 2005,* as amended.[4] In addition to the contributions paid by both members and employers, HM Treasury underwrites the pension liabilities directly by providing AME support for net pensions in payment.[5] The Independent Public Service Pensions Commission pointed out that "although there has been scope for some variations in terms [of public service pension schemes] to meet local circumstances, but the resulting pension schemes have essentially been the same as those established by the UK Government."[6]

1.2 Costs and funding

Funding basis

Like most of the public service schemes, the Teachers' Pension Scheme operates on a pay-as-you-go (PAYG) basis.[7] This means that employer and employee contributions are paid to the sponsoring government department, which pays out pension benefits, netting off the contributions received.

The Teachers' Pension Scheme (TPS) is "notionally funded". This means that periodic valuations are carried out as though there was a fund. Contributions are set on the basis of these valuations. Gerald Rhodes in his 1965 report, "Public Sector Pensions", explains that notional funding as an arrangement was first developed for the Post Office (PO) scheme. The PO scheme had originally been part of the Civil Service scheme (a PAYG scheme). In order that the cost of pensions could be "fairly" represented in the PO accounts, it was

[2] Paragraph F3 of Schedule 5 to the *Scotland Act 1998;* The Orders made under the *Pension (Increase) Act 1971* (which provide for annual increases in public service pensions) are reserved to Westminster

[3] *The Scotland Act 1998* (*Transfer of Functions to the Scottish Ministers etc.) Order 1999* (S.I. 1999/1750)

[4] STSS annual account 2009-10, p2

[5] Source: HM Treasury

[6] Independent Public Service Pensions Commission: Final Report, 10 March 2011

[7] The main exception is the Local Government Pension Scheme, which is funded. The pension scheme for MPs (the Parliamentary Contributory Pension Fund) is also funded.

decided to conform as nearly as possible to normal commercial practice and to assess what the position would have been had the scheme been funded.[8]

The TPS was set up in the 1920s as a notional fund because it was decided that a real fund would be too expensive:

> The pension fund for teachers was set up in the 1920s. It was established as a notional fund to which teachers and their employers were required to contribute prescribed amounts towards the costs of pensions. Notional funding was preferred to real funding because the setting up of a real fund was considered too expensive at the time (though real funds were retained for other local government employees and for universities). Before that teachers' pensions were paid on a non-contributory basis similar to civil servants.[9]

The TPS regulations require an account to be maintained, known as the Teachers' Pension Account, to which contributions from members and employers are credited and from which expenditure on benefits is debited. A notional investment income is assumed on the balance in the account. However, contributions from members and employers are paid to the Exchequer, and the Exchequer effectively meets the cost of all benefits.[10]

A Working Group set up in 1997 looked at the funding basis and decided that no fundamental change. A change to a funded scheme, it said, would involve significantly higher costs for a period of almost fifty years:

> 2.6 The main advantages of real funded schemes were identified as being that the costs and benefits of such schemes are readily apparent, that their liabilities and assets are separated from the employer's business, thereby providing security for members' benefits, and that they are able to achieve the best possible rate of return from their investments owing to their broad investment basis. However, it was shown that these advantages could also be achieved by the present arrangements of the TPS.
>
> 2.7 In addition, an investigation by the GAD showed that the cost to the public purse of moving to a real funded scheme was likely to be very significantly higher than the cost of the TPS arrangements for a period of almost fifty years. The Department did not believe that a value for money case could be made in favour of real funding for teacher's pensions.
>
> 2.8 The Working Group reached consensus that no fundamental changes should be made to the funding basis of the TPS at this time. Nevertheless, some members thought that there might be a case for considering this issue again in the future.[11]

Contribution rates

The rate of members' contribution is in regulations.[12] Employer contributions are set on the basis of periodical reviews by the Government Actuary, which the scheme is required to

[8] Gerald Rhodes, Public Sector Pensions, page 108-9

[9] DfEE, Report of the working group for the longer term examination of the Teachers' Pension Scheme, July 1999, para 4.3

[10] The Teachers' Pension Scheme (England and Wales) Actuarial Review as at 31 March 2004, Report by the Government Actuary November 2006, para 1.3

[11] Report of the working group for the longer term examination of the Teachers' Pension Scheme, July 1999

[12] *Teachers' Pensions Regulations 1997* (SI 1997 No. 3001), regulation C3

conduct.[13] The contribution rate is assessed in two parts – a standard rate to cover the cost of accruing benefits, and a supplementary contribution to fund any deficit:

> First, a standard contribution rate (SCR) is determined. This is the contribution, expressed as a percentage of the salaries of teachers and lecturers in service or entering service during the period over which the contribution rate applies, which if it were paid over the entire active service of these teachers and lecturers would broadly defray the cost of benefits payable in respect of that service. Secondly, a supplementary contribution is payable if, as a result of the actuarial investigation, it is found that accumulated liabilities of the Account for benefits to past and present teachers, are not fully covered by standard contributions to be paid in future and by the notional fund built up from past contributions. The total contribution rate payable is the sum of the SCR and the supplementary contribution rate.[14]

The rate of member contribution increased from 6 per cent to 6.4 per cent from January 2007.[15] Further increases in member contributions, tiered according to pay, were implemented in April 2012 and April 2013.[16] The current employer contribution rate is 14.1%.[17]

Cost sharing/capping

As part of the reforms to the scheme introduced by the Labour Government, an agreement was reached on how to deal with future cost pressures. The June 2006 consultation document proposed a number of measures to secure the sustainability of the TPS. These included requiring any cost increases or savings from future valuations to be shared equally between employees and employers, and capping the employer contribution rate at 14% from the 2008 valuation onwards:

- the member contribution rate would increase by a further 0.2% as the members' share of the outcome of the 2004 TPS valuation taking it to 6.4%;
- the employer contribution rate would increase by 0.6% following the 2004 valuation taking it to 14.1%;
- there would be an equal division between members and employers of any cost increases or savings that may result from future valuations;
- there would be a ceiling of 14% on the employer contribution rate that would take effect from the 2008 valuation onwards;
- the equal division of cost increases or savings and the ceiling of 14% on the employer contribution rate would be reviewed in the light of any changes in the

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13 *Teachers' Pensions Regulations 1997* (SI 1997 No. 3001), regulation G4

14 DCSF, Teachers' Pension Scheme (England and Wales) – Financial Note, May 2008; See also, *The Teachers' Pension Scheme (England and Wales) Actuarial Review as at 31 March 2004, Report by the Government Actuary November 2006*, para 6.5-6; See also DfEE, Report of the working group for the longer term examination of the Teachers' Pension Scheme, July 1999, para 4.4

15 Details of contributions to the TPS in cash terms and as a % of pay from 2002-3 to 2006-07 can be found in HC Deb, 20 October 2008, c84W

16 See Library Note SN 6731 Teachers' Pension Scheme - current reforms

17 HC Deb, 21 November 2006, c30WS; "The Teachers' Pension Scheme (England and Wales) Actuarial Review as at 31 March 2004. Report by the Government Actuary. November 2006

> total contribution rate that arise from factors other than demographic experience, for example overriding legislative requirements.[18]

This agreement was introduced as part of the package of reforms which came into force on 1 January 2007.[19] The Labour Government said it would "deliver long-term sustainability through the reduction of taxpayer exposure to risks, principally those associated with improvements in longevity over and above improvements already anticipated."[20] The current Government has decided to replace cap and share with increases in employee contributions from April 2012.[21]

2 Labour Government's reforms

2.1 Reform process

Working group for the longer term examination of the TPS, 1997

On 29 July 1997, Stephen Byers, the then Minister for School Standards at the Department for Education and Employment (DfEE), announced that changes would be made to the early retirement provisions of the TPS. Furthermore, the Government would be inviting representatives of the Teachers' Pension Scheme and their employers to join them to look at a range of issues suggested by teachers' unions, teachers' employers and others.[22] A working group with members drawn from teacher and employer representatives, DfEE and the Government's Actuary Department was established in November 1997. Its terms of reference were:

> To examine the current provisions of the Teachers' Pension Scheme and consider whether changes are needed to meet the best interests of the education service consistent with affordability to the public purse. In particular to consider:
>
> - whether it is still appropriate to have a single undifferentiated scheme covering schools, further education and higher education;
> - whether it is still appropriate to have a notionally funded scheme for teachers;
> - whether modifications of the current pattern of benefits for teachers might better meet their needs and those of the service;
> - whether individual teachers might be given greater flexibility to make extra contributions for extra benefits;
> - whether teachers should be allowed to take an actuarially reduced pension at their own request; and
> - the development of a scheme which would make teaching more attractive as a profession for new entrants.[23]

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[18] DfEE, First class, adaptable, sustainable. Teachers' Pension Scheme England and Wales: Consultation, para 4.10.1

[19] *Teachers Pensions Regulations 1997* (as amended), regulation G5

[20] HC Deb, 26 July 2007, c105WS.

[21] Letter from Chief Secretary to the Treasury, Danny Alexander, to TUC General Secretary, Brendan Barber, 18 July 2011; For more detail see Library Standard Note SN 5252 *Pensions: cost capping and sharing* and SN 6137 *Public service pension contributions*.

[22] HC Deb 29 July 1997 c 130W

[23] DfEE press notice, "Clarke announces outcome of teachers' pensions review," 27 July 1999

The outcome of the review was announced on 27 July 1999.[24] The working group's final report was published on the same day.[25]

On the question of separating the scheme for different education sectors, the working group concluded that there was no clear case for this and found little evidence of cross subsidy between the various sectors. It also reached consensus on the question of the notional fund. It concluded that the cost to the public purse of moving to a real funded scheme would be significantly higher than the current arrangements for a period of almost fifty years. It therefore decided to recommend that no fundamental changes should be made to the funding basis of the scheme.

The working group did not reach conclusions on the issues of whether teachers should be given greater flexibility to make extra contributions for extra benefits or whether modification of the current patterns of benefits would be desirable. On the final question of whether development of the scheme would make teaching more attractive as a profession for new entrants, the group concluded that "detailed improvements to the present level and structure of teachers' pensions do not appear to be a critical factor in teacher recruitment".[26]

The issue of whether to allow teachers the option of an actuarially reduced pension at their own request proved very controversial. The working group was unable to reach a consensus: representatives of employers were in favour of an actuarially reduced option while teachers' representatives were opposed. The final report from the working group, published in July 1999, summarised the two arguments thus:

> 2.20 The employers' representatives put forward a paper supporting the introduction of actuarially reduced pensions (ARPs), as an option for management to use to increase their flexibilities as well as those of teachers. They stressed that this option was already available to other public sector schemes. They understood the concern expressed by teachers that some employers would unreasonably use this discretion. The employers' representatives would, therefore, expect the regulations to specify that employers would not unreasonably refuse to exercise this discretion. In addition, the employers' representatives stated that they were aware of cases where individual teachers would welcome this flexibility, and that this option should be introduced at the earliest opportunity.
>
> 2.21 The teachers' representatives were opposed generally to the introduction of ARPs and the employers' proposal as they feared their introduction would represent a worsening of teachers' early retirement provisions. The teachers' representatives also maintained that a decision on ARPs should be deferred until the results of the Inland Revenue's (IR) consultation on flexible retirement arrangements are known.

The Government consulted further on specific proposals for actuarially reduced pensions. It proposed that after the age of 55 a scheme member might apply for early retirement. The pension payable in these circumstances would be based on final salary and the number of years of service in the normal way but reduced to take into account the increased length of time it would be payable. The employer would be able to withhold consent for early retirement on these terms for no more than six months. Following this additional consultation, the Government accepted the principle of actuarially reduced pensions within the scheme.

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24 *Ibid*.

25 DfEE, *Report of the working group for the longer term examination of the Teachers' Pension Scheme*, July 1999

26 *Ibid*, para 2.24

The final regulations were laid on 9 March 2000 and the provisions came into force on 30 March 2000 and 1 April 2000.[27]

Proposal to increase the pension age, 2002

The Pensions Green Paper, *Working and saving for retirement,* published in December 2002, asked for views on the proposal that the pension age throughout the public service should be raised from 60 to 65.[28] The Pensions White Paper, *Action on occupational pensions*, published in June 2003, confirmed that the Government would be going ahead with this proposal.[29] By the end of 2006 all new staff would join on the new conditions. The pension rights of existing staff already accrued from past service would be fully protected. Reviews by the individual schemes would decide "how the higher pension age will apply to the future service of existing staff and how to ensure that transitional arrangements are fair and balanced".[30]

A consultation document on *Simplifying the taxation of pensions,* published at the same time as the Pensions Green Paper in December 2002, announced the Government's intention of raising the minimum age at which a pension could be taken from 50 to 55 by 2010.[31] The results of the consultation, published in December 2003, confirmed that this would go ahead.[32] Schemes would be free to decide how and when to move to the minimum age of 55 by 2010. People with a contractual right, in place in December 2003, to a pension between the ages of 50 and 55 would be able to keep it. Legislation increasing the minimum pension age to 55 was contained in the *Finance Act 2004*. It applies to all private pensions, not just the public service schemes. Details of the transition to the higher minimum pension age were left as a matter for individual scheme reviews.

A Teachers' Pensions Review Group, comprising representatives of scheme managers, employer and teacher associations and the Government Actuary's Department, was established with the following terms of reference:

1. To consider how the provisions of the TPS can be modernised in the light of contemporary circumstances, Government policy, pension taxation framework, age equality and diversity legislation and the needs of teachers and their employers.

2. To ensure that amendments or developments to the scheme mean that members and employers continue to view the TPS as a valuable part of the overall remuneration package.

3. To ensure the TPS supports the priorities as set out by the DfES and the National Assembly for Wales on recruitment and retention (taking account of any difference in requirements of the schools, FE and HE sectors).[33]

In an article in the *Times Educational Supplement* in July 2003, the then Schools Minister, David Miliband, made five promises to teachers about the proposed review of the TPS:

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27 *The Teachers' Pensions (Amendment) Regulations 2000*, SI 2000/665
28 Cm 5677, paras 65-69, (Internet Archive, retrieved September 2013)
29 Cm 5835, paras 32-34, (Internet Archive, retrieved September 2013)
30 Ibid, para 34
31 HM Treasury and Inland Revenue, Simplifying the taxation of pensions: increasing choice and flexibility for all, December 2002
32 HM Treasury and Inland Revenue, Simplifying the taxation of pensions: the Government's proposals, December 2003
33 Teachernet, TPS review group

I can give all serving teachers five clear guarantees.

- Serving teachers who are currently aged 50 and over will not be affected by changes to the existing pension arrangements.

- Pension benefits earned before the new arrangements start will not be affected. Any changes made will not affect pension benefits already earned from past service.

- Teachers will still be able to retire at, before or after sixty as they do now. At retirement, pension and lump sum benefits will take account of the number of years of service the teacher has worked before and after the changes.

I plan to consult fully on the changes with teachers, their union representatives and employers.

The review will also examine what other benefits and flexibilities can be introduced into the pension scheme.[34]

He went on to say:

> All public sector pensions will have to change — and final salary schemes are becoming rarer for new private sector employees. So the Teachers' Pension Scheme (TPS) will still be an attractive feature of the overall remuneration package when it comes to recruitment.
>
> The review comes as teacher salaries are rising rapidly and the Workload Agreement will cut the numbers of hours worked. Recruitment to initial teacher training has risen for three years running and the number of teachers working in maintained schools in England is the highest since 1982.
>
> Change is needed to ensure teachers keep a quality scheme. But we are making no snap decisions. This is a chance to modernise the TPS in a way teachers will value. I believe we can make the changes flexibly and creatively, commanding the confidence of existing and future teachers alike.[35]

Progress Report, July 2004

In July 2004 the DfES published a progress report which outlined a number of options for moving forward with the review and sought to dispel some of the common fears expressed by members about possible changes.[36] It offered certain "guarantees and assurances" to serving teachers:

> In June 2003 the Government announced that in the future (from 1 September 2006 for new teachers and much later for serving teachers, not earlier than 2013) the pension age for public sector schemes, including the Teachers' Pension Scheme, would rise from 60 to 65. To clarify what this means for members of the Scheme and to allay any concerns, the DfES can offer the following guarantees:
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> - If you will be aged 60 on or before 31 August 2013 your pension benefits *will not* be affected by the proposed changes: *guaranteed.*

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[34] "Minister's five pledges to you," *Times Educational Supplement*, 18 July 2003

[35] *Ibid.*

[36] DfES, *Modernisation of the Teachers' Pension Scheme – a progress report*, July 2004

- Pension benefits relating to your past and present service (until the proposed changes are put into practice) will not be affected by the higher pension age: *guaranteed.*

- You *will* still be able to retire at, before or after 60 as you can now: *guaranteed.*

- A full consultation will take place before any changes are made: *guaranteed.*

- We will examine the scope for introducing improved benefits and flexibilities: *guaranteed.*

- Teachers in their 30s and 40s will not lose 20 to 25 per cent of their pensions if they retire at 60.

> Every serving teacher will get a personalised pensions' statement.[37]

The progress report highlighted the security and good quality of public service schemes, including the teachers' scheme, and argued that in return for this, the scheme should be constantly reviewed to ensure that costs were contained:

> 3 […] The Government intends to continue to offer teachers and other public service employees good quality defined benefit pension schemes. The fact that public service pensions are backed by a Government guarantee makes them the most risk free and secure pension arrangements in existence.
>
> 4. These pension commitments do, however, represent a considerable cost to taxpayers. That is why it is important that public service occupational pension arrangements are kept under review: justified in relation to practice elsewhere and contribute to a cost effective remuneration package. [38]

The progress report concentrated on the issue of raising the pension age, but also outlined ways of increasing the flexibilities available to teachers over the way in which they plan for their retirement, both in terms of the scope for building higher pension benefits and the ways in which teachers manage the transition from work to retirement.

Consultation Document, September 2004

The DfES launched its formal consultation on the TPS on 17 September 2004, with the publication of *Modernisation of the Teachers' Pension Scheme (TPS): consultation on possible scheme changes*. When the consultation was launched, the then Schools Standards Minister, David Miliband, said:

> We want teachers' pensions to be secure and attractive and the aim of today's consultation is to increase the choice and flexibilities available to individual members. We are looking to make changes in a way that finds the right balance between ensuring the long term viability of the scheme and providing increased choice and flexibility over the ways in which teachers can plan ahead for retirement. I am committed to the Teachers' Pension Scheme remaining a valuable part of teachers' and lecturers' remuneration package.[39]

In his introduction to the consultation document, Mr Miliband went on to explain:

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[37] Teachernet, TPS review group

[38] DfES, 'Modernisation of the Teachers' Pension Scheme (TPS), Progress Report', July 2004

[39] DfES press notice, "Teachers and lecturers to have their say on changes to pension scheme", 17 September 2004

> The consultation document sets out a number of possible changes that could be made to the TPS. Some improvements could be introduced as part of the move to a higher pension age without any increase in the 6% contribution paid by TPS members. Additional improvements could still be possible, but these would have to be associated with a higher member contribution. A number of specific questions about different aspects of TPS can be found at the end of the consultation document. I hope that you will let us have your views.[40]

The consultation document contained twelve possible options for changes, summarised in the following table. The approximate increase in the standard contribution rate (SCR), associated with some benefit improvements, was provided to illustrate the costs assumed for some of the proposals:[41]

While welcoming some of the options for change, doubts were expressed by teachers' organisations about whether an increase in contribution rate to cover any changes would be sustainable. Sue Johnson of the Association of Teachers and Lecturers said:

> Teachers will not take kindly to the suggestion of increased contributions at the same time as an increase in their retirement age. Demanding larger payments would lead to some opting out altogether. There is a limit to how much people will pay when they are coming in with high levels of debt.[42]

On 15 November 2004, the NASUWT – as part of the TUC's wider lobbying against raising the public service pension age – asked MPs to oppose the proposed pension reforms. General Secretary, Chris Keates, said:

> NASUWT members have come to Westminster to deliver the message to their MPs that while they fully support the reform of public sector pensions to facilitate flexible retirement, they strongly oppose any package which increases normal retirement age, worsens benefits and breaks the pension promise made to existing staff…
>
> The Government's proposed changes will seriously damage teacher motivation and morale and could worsen recruitment and retention at a time when the Government is emphasising raising educational standards.[43]

The consultation closed on 10 December 2004. A document containing a summary of the responses to the consultation was subsequently published in March 2005.[44] The responses indicated support for the following:

- Improvements in **dependants' benefits** such as death in service and children's pensions, and widow(er) and partner benefits payable for life;
- Provision of more **information** about the Teachers Pension Scheme (TPS);
- The options detailed in paragraph 3.9.6 concerning **new flexibilities** in the TPS, but nearly half of respondents agreed subject to no change to the pension age;
- Change in the **accrual rate** to 1/60ths from 1/80ths and for there to be an option to 'buy in' service so that all their service would be calculated on a 1/60th basis;

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40 DfES, *Teachers' Pension Scheme Modernisation Review*, 17 September 2004, p2

41 Ibid, para 3.3

42 "New row over pensions", *Times Educational Supplement*, 29 October 2004

43 NASUWT press notice, "NASUWT members to press MPs to oppose pension reforms", 15 November 2004

44 'Teachers' Pension Scheme Modernisation Review. Analysis of the responses to the Consultation document', March 2005

- **'Winding down'** was seen by most as a right and not an option; and that this should be met with support from Head teachers and HR managers to help scheme members make informed decisions. There was also a view from teachers' representatives that any increased costs associated with 'winding down' should be met by the employer;

- Drawing some pension **benefits from age 55** while remaining in work in a reduced capacity;

- Allowing scheme members to **move to new arrangements** in advance of 2013, but this was again in the context of opposition to the increase in pension age;

- A **service and age related benefit structure** for compensating loss of employment should remain in place; and

- The option to purchase **'additional pension'** without the need for an earlier break in service and also to have the ability to buy additional benefits within the TPS scheme to address different personal circumstances;

And a lack of support for the following:

- Teachers and their representatives are generally opposed to the **increase to 65 in pension age;** the increase is, however, supported by employers;

- An **increase in contributions** to cover proposed changes;

- Changes to **ill health retirement** arrangements. Scheme members were not prepared to pay more to ensure a higher rate of enhancement;

- A **one-off options exercise** to move to the new arrangements – respondents preferred the idea of moving to the new arrangements at any time of the individuals choosing before 2013; and

- Removing the **Current Added Years** provision except for members of the Reserved Forces only. The removal of this provision for other members was seen as detrimental; it would mean staff could not take career breaks to study, be a carer, or work abroad and maintain membership of the TPS.

Public Service Pension Scheme Framework Agreement, October 2005

All the public service pension scheme reviews were dominated by the pension age question. By the spring of 2005, threatened public service strikes (including a possible teachers' strike) against the Government's imposition of a higher pension age persuaded the Government to promise a "fresh start" on discussions with unions on 18 March 2005. The strikes were called off and a "pensions summit" held on 31 March 2005. Following this summit, the then Secretary of State for Work and Pensions, Alan Johnson, and General Secretary of the TUC, Brendan Barber, issued a joint statement. A process of discussion and negotiation would now take place "overseen by special sessions of the Public Services Forum, with both sides committed to finding negotiated solutions."[45]

An agreement was reached at a meeting on 18 October 2005 that would allow current teachers retain a normal pension age of 60 while new scheme entrants would retire at 65. The PSF agreement contained four "framework principles for scheme negotiations". This included the principle that existing scheme members would "have the right to suffer no

[45] TUC press release, 31 March 2005, Statement from Alan Johnson and Brendan Barber

detriment in terms of their normal pension age and will retain their existing pension provision unless individual or collective agreements within sector specific negotiations are reached which allow changes to those provisions or transition to new schemes." New entrants would be offered "pensions in the new schemes negotiated through the sector specific discussions."[46] The Agreement went on to list eight features the new schemes should have:

> 5. New schemes should continue to guarantee defined benefit provision, linked to an individual's earnings. Schemes should also offer indexation to protect retired members against rises in the cost of living.
>
> 6. All changes to schemes should be equality-proofed before implementation.
>
> 7. New schemes should be designed with the objective of increasing appropriate take-up especially amongst part-time and lower paid workers and others who are eligible but where participation in the scheme may be lower currently.
>
> 8. As people live longer, healthier lives, it is likely more will choose to continue working for longer. This makes it crucial that schemes give greater flexibility than in the past to those who wish to use part-time work as a stepping stone to retirement, and also greater recognition to service by those who chose to work beyond typical retirement ages.
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> 9. For the purposes of calculating accrual of pensions, 65 will be the reference age (the "NPA") for new entrants to the new schemes entering employment after the implementation date. But not all new members will want to work longer, and all new scheme members will continue to have the right to retire at age 60. All new scheme members who under the new arrangements would retire on a lower pension than they would under existing rules will be offered the opportunity to increase contributions so members can continue to retire on a full pension at age 60. Those who wish to continue to work to the new normal pension age will be able to do so at the standard contribution rate.
>
> 10. Government will make available approximately 1% of pay roll to improve benefits in the new schemes, such as improved survivor benefits, or to deal with transition arrangements/protection for existing scheme members.
>
> 11. Scheme specific negotiations should take account of the special physical and mental demands of many public sector jobs, and the resultant continuing importance of early retirement provision for those with ill health.
>
> 12. The PSF will review the operation of these principles early in the New Year.[47]

Reactions to the agreement were mixed. The National Union of Teachers (NUT) welcomed the deal, stating:

> This agreement is a significant achievement and has been reached as a result of the sustained campaign by the NUT, other teacher and public service unions together with central co-ordination and assistance provided by the TUC. Earlier in the year, NUT members showed their preparedness for action in support of the campaign to protect teachers' pensions. Your determination has brought this success.[48]

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46 Public Services Forum, Final Principles, October 2005

47 Ibid

48 *NUT News 22: Pensions Protected*, 18 October 2005

However, news reports variously stated that the deal was a "feeble climbdown" and that the Government had variously "caved in" and committed "abject surrender".[49]

Consultation Document, May 2006

The PSF Framework Agreement reached in October 2005 meant that the review of the TPS had to be re-opened on the basis of the agreed principles. On 17 May 2006, a further consultation document – *First Class, Adaptable, Sustainable: Teachers' Pension Scheme England and Wales* - was issued. This contained a package of reforms "agreed between teacher and lecturer unions, employer representatives and Government". The Executive Summary explains how the cost of retaining the pension age of 60 for existing members has been "dealt with equitably between existing members and new entrants":

> A key element of those [PSF] principles was that scheme reforms would include a pension age of 65 for new entrants. Existing scheme members could retain a pension age of 60 so long as the cost of providing that protection was met by the membership. The package of reforms set out in this document meets that requirement. All parties were, however, keen to ensure that the way in which the cost of allowing existing members to retain a pension age of 60 was dealt with equitably between existing members and new entrants. This has been achieved through an agreement under which all scheme members will pay the same contribution rate of 6.4%, but new entrants who would have a pension age of 65 would benefit from an improvement in the rate at which their pension builds (the accrual rate). Whilst existing members will retain an accrual rate of 1/80th of salary for each year of service, with a lump sum of 3 times their pension, the accrual rate for new entrants would be 1/60th of salary for each year of service, with complete flexibility over the amount of lump sum taken within the overriding limits set by HMRC.
>
> The 2004 valuation of the TPS has identified a requirement for the contribution rate to increase by 0.8% from 1 January 2007. As part of the cost sharing arrangement that has been agreed with unions and employer representatives, this would be addressed through an increase in the member contribution rate of 0.2% (this is included in the total member contribution of 6.4% set out in the preceding paragraph); and an increase in the employer contribution rate of 0.6%. Both increases would take effect from 1 January 2007.[50]

The intention was that the new scheme would come into effect on 1 January 2007, with the following changes applying to both new entrants and existing members:

- Benefits payable to nominated dependent partners (opposite-sex and same-sex);
- Spouses', surviving civil partners and nominated dependent partners' pensions paid for life;
- Revised ill-health retirement package – tiered approach with a higher level of benefits for total incapacity and lower level of benefits for partial incapacity;
- The better of the last year's salary or the 're-valued (in line with the Retail Price Index (RPI)) average of the best three consecutive years salary in the last ten years of service' to be used for calculating benefits at retirement;

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[49] See, for example: "Retirement age pact 'is a feeble climbdown'", *Daily Telegraph*, 19 October 2005; "Ministers cave in over public sector early retirement", *The Times*, 19 October 2005; and "Abject surrender over public sector pensions", *Financial Times*, 19 October 2005. The issue is discussed in more detail in Library Standard Note SN 02209, Public service pension age.

[50] DfES, First Class, Adaptable, Sustainable – Teachers' Pension Scheme England and Wales: Consultation, August 2006

- A facility to purchase up to £5,000 of added annual pension;
- An increase in the death grant to 3 times salary;
- Phased retirement arrangements that would enable TPS members under defined circumstances to continue working as a teacher within the TPS while drawing down some or all of their accrued pension benefits; and
- Increase in contribution rate from 6% to 6.4% for the employee and from 13.5% to 14.1% for the employer

Different rules would apply to existing members and new entrants in the following areas:

- Existing members retain a Normal Pension Age (NPA) of 60. New entrants on or after 1 January 2007 have an NPA of 65;
- The minimum retirement age will be increased to 55 (except on grounds of ill health) with immediate effect for new entrants on or after 1 January 2007, but only from 2010 for existing members;
- New entrants will receive a pension based on 1/60th of salary for each year of pensionable service with the flexible option to take up to 25% of 'fund value' after commutation as a tax free lump sum by surrendering £1 of annual pension for £12 of lump sum. Existing members will retain the 1/80th accrual rate with a separate lump sum which accrues at 3/80th a year. They will however be given more scope to take a higher tax free lump sum and a lower level of pension.

The report of the consultation shows that respondents were supportive overall:

> Overall respondents were supportive of the proposals in the consultation. They welcomed the additional flexibility that the proposals offered them in planning for their retirement.
>
> Respondents generally agreed with the timing of the changes although a few felt that more time was needed. The introduction of automatic scheme membership was welcomed as this would avoid part time members of staff forgetting to 'opt in'. Respondents liked the proposed option for changes made to the salary used for calculating pension benefits.
>
> Respondents agreed with proposals for buying additional pension benefits. There was some concern over the cost of additional pension but this was when seen in comparison with the existing arrangements for past added years (PAY). Comment - the fact that the two arrangements are materially different in that PAY benefits are dependant on salary at retirement and the additional pension benefits are for a pre-determined amount will be addressed through communications with employers and members.
>
> Respondents agreed with the proposals for phased retirement although some were mistakenly concerned that existing 'stepping down' arrangements would not be honoured. Overall both additional pension and phased retirement were seen as helpful for teachers planning retirement.
>
> A number of respondents requested consideration of allowing 100% of the Teachers' Additional Voluntary Contribution (TAVC) scheme fund to be taken as a tax free lump sum in a similar way to the Local Government Pension Scheme (LGPS). Comment - There is, however, a material difference in the two AVC arrangements; the LGPS AVC is an integral part of the main scheme (in-house AVC scheme) whereas the TAVC is a

separate arrangement governed by a different set of regulations and contractual relationship. This precludes the TAVC fund from being included within the main scheme lump sum calculations for the purposes of calculating the 25% maximum.

Respondents welcomed the proposals for surviving partner benefits as this removed the differences in treatment under the existing provisions. Some individuals, who were single with no family responsibilities, questioned the value of scheme wide family benefits, however, this needs to be viewed alongside the benefits provided by the 'group' arrangements e.g. a relatively low member contribution rate for all members in a high quality scheme.

Respondents agreed with the two tiered approach to ill health retirement benefits, believing that the proposed system would benefit those most in need.

The majority of respondents agreed with the changes to contribution rates as they felt the increases were justified by the improvements to the scheme.[51]

Legislation

The *Teachers' Pensions etc. (Reform Amendments) Regulations 2006* (SI 2006 No. 3122) were laid before Parliament on 7 December 2006, and came into force on 1 January 2007.

A useful summary of the key provisions before and after 1 January 2007 can be found in a Government Actuary's Department factsheet, *Teachers Pension Scheme (TPS) Key features pre-post 1 January 2007*.

2.2 Expected impact

The Labour Government estimated its reforms would result in savings in employer contributions of around £280 million a year in 2007-08, or some 8% of the pre-reform employer cost.[52]

The National Audit Office (NAO) produced a report on the impact of the 2007/08 reforms to the civil service, NHS and teachers' schemes. The NAO found that the financial impact of the changes comprised three main elements of cost savings, offset in part by other changes which add to the costs:

i. an immediate increase in employee contribution rates, which accounts for 8 per cent of savings in 2059-60, but starts before the other elements (Figure 8) and so contributes 15 per cent of total savings in the whole period to 2059-60 (Figure 9) and 32 per cent in the spending review period to 2014-15;

ii. an increase in the normal pension age for new employees, from 60 to 65 in most cases, which accounts for 43 per cent of savings in 2059-60 but has a delayed impact (Figure 8) and so contributes only 25 per cent of savings over the whole period (Figure 9) and one per cent over the spending review period;

iii. cost sharing and capping, which has not yet had an impact but, if it works as expected, will account for 49 per cent of savings in 2059-60 (Figure 8), 60 per cent over the whole period (Figure 9), and 67 per cent over the spending review period; and

51 DfES, First Class, Adaptable, Sustainable - Consultation

52 HC Deb, 28 October 2008, c1014W; PPI, An assessment of the Government's reforms to public sector pensions, October 2008, page 27

iv. other changes (Figure 13 on page 30), including pension enhancements agreed alongside the higher normal pension age (see paragraph 1.11), have the largest impacts at the start and end of the projection period, so are projected to absorb 25 per cent of the annual savings from the three main elements in 2059-60, 12 per cent over the period to 2059-60, and 81 per cent over the spending review period.[53]

The NAO said:

> We estimate that the 2007-08 changes will reduce costs to taxpayers in 2059-60 by 14 per cent compared to what they would have been without the changes. In net present value terms, using the Treasury's discount rate of 3.5 per cent above increases in RPI, aggregate savings over all years in the period to 2059-60 are equivalent to £67 billion in 2008-09 prices. Savings peak at 0.2 per cent of Gross Domestic Product (GDP) in 2047-48, lying between 0.1 and 0.2 per cent of GDP from 2025-26 onwards (Figure 1 overleaf). The peak occurs because of a temporary reduction in numbers of retirements as the changes start to delay the age at which employees retire. Beyond 2059-60, annual savings will initially remain at 14 per cent, rising slowly from 2065-66. As a consequence of the changes, overall costs to taxpayers will stabilise at around 1.0 per cent of GDP, close to their current levels.[54]

Its conclusion on value for money was that:

> 14 By making changes in 2007-08 to pension schemes for civil servants, NHS staff and teachers, the Treasury and departments overseeing the schemes acted to tackle potential future growth in costs to taxpayers. As a result of the changes, which are on course to deliver substantial savings, long-term costs are projected to stabilise around their current levels as a proportion of GDP. The changes are also set to manage one of the most significant risks to those costs, by transferring from taxpayers to employees additional costs arising if pensioners live longer than is currently projected.[55]

Both the Institute for Fiscal Studies (IFS) and the Pensions Policy Institute (PPI) have looked at the impact of the reforms on the value of the pension scheme to individuals.[56] This analysis has been updated for the Independent Public Service Pensions Commission, to take account of the Conservative-Liberal Democrat Coalition Government's decision to use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) for the price indexation of public service pensions from April 2011.[57] The current reforms to teachers' pensions are discussed in Library Note SN 6731 *Teachers' Pension Scheme – current reforms.*

[53] NAO, 'The impact of the 2007-08 changes to public service pensions', HC 662, December 2010, p24
[54] NAO, The impact of the 2007-08 changes to public sector pensions, HC 662, 8 December 2010, para 5
[55] Ibid
[56] Disney R, Emmerson C and Tetlow G, *The value of Teachers' Pensions*, IFS Working Paper W09/07, p8; PPI, *An assessment of the Government's reforms to public sector pensions*, October 2008
[57] Independent Public Service Pensions Commission: Interim Report, 7 October 2010, para 2.15-6