



Comparison of TPS Career Average scheme and Defined Contribution schemes

Summary

This technical note compares the outcomes from a defined contribution (DC) pension compared to what the member would have received from the TPS career average section (which all members are expected to enter from 1 April 2022).

Under reasonable assumptions, the DC pension provides an income of between **17** and **66** per cent of what the member would have received from the TPS career average section. The key factor is the amount contributed to the DC scheme.

Commentary

The relativities between the TPS career average section and a DC pension will vary based on rate of return, earnings growth, contribution level and member age. However, under all reasonable assumptions a DC pension cannot provide anywhere near equivalent benefits to the TPS.

The experience in the UK pension system is that employers have moved from defined benefit to defined contribution to save money. There is the possibility, however unlikely, that the total current contribution rate of 26 per cent is maintained (16.4 per cent from the employer and 9.6 per cent from the employee) until retirement. In this case the TPS career average pension still provides a superior outcome.

Assumptions

TPS Career Average scheme

- Scheme continues to provide a pension of 1/57 of earnings per year, indexed to retirement at CPI+1.6 per cent while the member remains in teaching.
- 3 illustrative career paths are provided
- Contribution is at scheme required rate.
- Pay increases are the same as CPI inflation for the remainder of the member's career (so the figures are in today's terms).
- Member retires at age 65 with a state pension age of 68 (requiring an actuarial reduction of 3 per cent a year where this is younger than the member's 'normal pension age' for retirement on a full pension).

Defined Contribution

- Fund attracts a real return (i.e. above inflation) of 4 per cent net of charges (so, assuming CPI at 2 per cent and charges at 0.5 per cent a year, the nominal return is 6.5 per cent before charges).

- Contribution is at statutory minimum level of 8 per cent (employee 5 per cent, employer 3 per cent), an intermediate level of 15 per cent (employee 5 per cent, employer 10 per cent) and the former contribution level of 26 per cent (employee 9.6 per cent, employer 16.4 per cent in the second two examples). Contribution amounts do not change.
- Pay increases are the same as CPI inflation for the remainder of the member's career (so the figures are in today's terms).
- Member retires at age 65 and purchases annuity designed to mimic TPS pension structure ie joint life basis including survivor's pension at 50 per cent following member's death (TPS pays 37.5 per cent of pension after death) and inflation indexation.
- Annuity rate is 2.55 per cent (taken from the Money Advice Service Website Annuity Calculator)

Examples

Example 1 – 45 year old, paid on UPS3 outside London and fringe area. Salary = £41,604 in May 2021

TPS CA pension:

1/57 of £41,604 = £729.89 a year. The total pension before actuarial reduction is £17,317.77 a year. A reduction of 3 per cent a year for three years means the member gets 91 per cent of the total amount, so £15,759.17 a year.

DC pension example A (8 per cent total contribution)

8 per cent of £41,604 = £3,328.32 which is sum invested each year.

Final value of the fund including investment return at age 65 is £103,075.41

Pension of £2,632.55 a year

This is 16.70 per cent of the pension payable in the TPS Career Average section.

DC pension example B (15 per cent total contribution)

15 per cent of salary is invested each year.

Final value of the fund including investment return at age 65 is £193,266.40

Pension of £4,936.02 a year

This is 31.32 per cent of the pension payable in the TPS Career Average section.

DC pension example C (26 per cent total contribution)

26 per cent of salary is invested each year.

Final value of the fund including investment return at age 65 is £334,995.09

Pension of £8,555.77 a year

This is 54.29 per cent of the pension payable in the TPS Career Average section.

Example 2 - 30 year old, entrant in May 2021 at M1. Progresses each year on Main Pay Scale. Once M6 is reached passes immediately through threshold on to Upper Pay Scale and progresses once every two years until UPS 3 salary of £41,604 is reached at age 41.

TPS CA pension:

The total pension before actuarial reduction is £32,269.99 a year.

A reduction of 3 per cent a year for three years means the member gets 91 per cent of the total amount, so £29,392.72 a year.

DC pension example A (8 per cent total contribution)

8 per cent of salary is invested each year.

Final value of the fund including investment return at age 65 is £234,108.62

Pension of £5,979.13 a year

This is 20.34 per cent of the pension payable in the TPS Career Average section.

DC pension example B (15 per cent total contribution)

15 per cent of salary is invested each year

Final value of the fund including investment return at age 65 is £438,953.66

Pension of £11,210.88 a year

This is 38.14 per cent of the pension payable in the TPS Career Average section.

DC pension example C (26 per cent total contribution)

26 per cent of salary is invested each year

Final value of the fund including investment return at age 65 is £760,853.01

Pension of £19,432.19 a year

This is 66.11 per cent of the pension payable in the TPS Career Average section.

Example 3 – 35 year old, paid on M6 outside London. Salary is £36,961 in May 2021. Receives £5,000 additional responsibilities payment (in 2021 terms) at age 40**TPS CA pension:**

The total pension before actuarial reduction is £32,269.99 a year.

A reduction of 3 per cent a year for three years means the member gets 91 per cent of the total amount, so £25,323.77 a year.

DC pension example A (8 per cent total contribution)

8 per cent of salary is invested each year.

Final value of the fund including investment return at age 65 is £189,794.59

Pension of £4,847.35 a year

This is 19.14 per cent of the pension payable in the TPS Career Average section.

DC pension example B (15 per cent total contribution)

15 per cent of salary is invested each year

Final value of the fund including investment return at age 65 is £355,684.55

Pension of £9,088.79 a year

This is 35.89 per cent of the pension payable in the TPS Career Average section.

DC pension example C (26 per cent total contribution)

26 per cent of salary is invested each year

Final value of the fund including investment return at age 65 is £616,832.40

Pension of £15,753.90 a year

This is 62.21 per cent of the pension payable in the TPS Career Average section.

Impact on net pay on moving to a lower DC contribution

Members are sometimes encouraged to agree to a move to a DC pension as it will lead to a reduction in pension contributions and therefore an increase in their net pay. In some cases, members are even put on a higher pay scale as a reward for abandoning the TPS.

The NEU believes this is a false economy. Members will not achieve the gains in net pay they expect because pension contributions are deducted from pay before income tax and National Insurance Contributions are applied. Members are almost certain to face large pension losses.

Consider the member in **Example 1** above.

If gross pay is £41,604 with a 9.6 per cent TPS employee contribution, and the income tax and NI thresholds are £12,570 and £9,564 respectively then net pay is:

$(£41604 * .904) = £37,610.02$ minus

Income Tax: $(£37610 - £12570) * .2 = £5,008.00$

National Insurance $(£37610 - £9564) * .12 = £3365.52$

Net pay = £29,236.49

If the member moves to a DC scheme with a 5 per cent employee and 10 per cent employer contribution then net pay is:

$(£41604 * .95) = £39523.80$ minus

Income Tax: $(£39523.8 - £12570) * .2 = £5,390.76$

National Insurance $(£39523.8 - £9564) * .12 = £3,595.18$

Net pay = £30,537.86

The difference in net pay per month is £108.45 a month $(£30,537.86 - £29,236.49) / 12$

However, the member will be on course for a pension of £4,936 a year against over £15,000 a year in the TPS. So just over a thousand pounds a year in extra pay now against over ten thousand pounds a year lost pension in retirement.

If the member gets a 5 per cent pay rise for abandoning the TPS then the net pay difference is £220 a month – again, around £2,500 a year now versus over £10,000 a year in retirement.

NEU Employment and Bargaining Department

June 2021