Pay Freeze 2021

The unintended (or perhaps not) consequence for pensions.

Executive Summary

Employers should alter the annual pay of any teacher affected by a pay freeze by £1 a month for a minimum of 1 month in order to ensure their pensions do not lose out on the index-linking of their Final Salary Pension schemes.

The cost to employers is minimal and they bear no liability for the pensions thus protected. If cost is essential then raising the annual salary for 1 month, down the next and back to normal in a third will maintain the total amount paid for the year at the same level whilst ensuring employees do not miss out on index-linked calculations. The DFE have confirmed that they have no problem with backdating the change to 1 September 2021.

The Issue

The final salary schemes add inflation when working out the best 'final salary' that will be used in calculating the pension. The problem is that the addition of inflation is **only** done from the date on which a teacher's salary changes.(Regulation 37)[1]

Examples from the 2010-13 Pay Freeze

If you have staff whose pay did not change in the last pay freeze of 2010 to 2013 then their pension benefit statements will demonstrate the issue, examining these - with their permission of course - are probably the best independent example(s) you can obtain. The 'revalued' values are shown in the PDF download of the statement, like this one:

Average Salary Year	Scheme Arrangement	Date From	Date To	Qualifying Service (Days)	Reckonable Service (Days)	Original Salary (£)	Revalued Salary (£)	Salary Revalue Index (%)	Salaries Used (Methods)
1	Career	01/04/17	31/08/17	153	153	47,588.00	47,588.00	0.00	Method A

Final Salary

The final salary scheme uses two methods to work out the final salary and the pension calculation then uses the best of those two.

Method A: The last 365 days salary

Method B: The average of the best 3 consecutive years from the last 10 years where the salaries are revalued to account for inflation

[1] https://www.legislation.gov.uk/uksi/2010/990/made/data.pdf

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The current situation is that, after more than 10 years of below inflation pay rises or freezes, many teachers' best 3 years are those from 10, 9 and 8 years ago.

The current proposed pay freeze could have the same effect in another 10 years on current staff.

Inflation: 2010-2013 up to 2020

Each year the Government publishes the inflation multipliers that are used to adjust pensions and the salary figures used in working out a teacher's 'final salary'.[2]

Year	Inflation Multiplier
2010	1.2325
2011	1.1856
2012	1.1404
2013	1.1137

Any teacher whose pay was frozen over those years will see their 2010 pay increased by only the 2013 figure, around 10% less!

Worked Example

Case A: Teacher on £40,000 for the academic years September 2010 to September 2013.

		Teachers Pension Calculation		IF pay had changed by £1	
Year	Actual Salary	Inflation Multiplier	Revalued Salary	Inflation M.	Revalued S.
2010	40,000	1.1137	44,548	1.2325	49,300
2011	40,000	1.1137	44,548	1.1856	47,424
2012	40,000	1.1137	44,548	1.1404	45,616
2013	40,000	1.1137	44,548	1.1137	44,548

Method B Final Salary Comparison

Teacher Pension: (44548 + 44548 + 44548) / 3 = 44,548
Pay Changed by £1: (49300 + 47424 + 45616) / 3 = 47,446

The difference is 6.5%.

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[2] https://www.gov.uk/government/publications/public-service-pensions-increase-2020

On a pension of £20,000 a year that is over £100 a month less.

Note: The actual salaries don't make any difference to the percentage loss, however the effect of this pay freeze does depend on inflation rates over the next few years .

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Relevant Quotes:

Regulation 37.—

(1) This regulation applies to a person if—

(a) the person was in pensionable employment on or after 1st January 2007, or

(b) the person was paying contributions under regulation C9 of TPR 1997 or regulation 19 (election to pay contributions by a person serving in a reserve force) on or after that date.

(2) The average salary of a person (P) to whom this regulation applies is the greater of—

(a) P's relevant salary during the last 365 days of P's average salary service, and

(b) the average annual rate of P's relevant salary during P's best salary period multiplied by A/B.

(3) But if P has average salary service of less than 365 days, P's average salary is the average annual rate of P's relevant salary during such service.
(4) In calculating the period mentioned in paragraph (2), no account is to be taken of a leap day.
(5) But where P's average salary service ends on or after the leap-day in a leap year, account is to be taken of that leap day in calculating those periods.
(6) Except as provided in paragraphs (7) and (8), P's best salary period is the 1,095 consecutive days of P's average salary service falling within the period of 10 years ending on the last day of P's average salary service (the "10-year period") during which P's increased relevant salary is the greatest.
(7) Where P has more than 365 and less than 1,095 days of average salary service falling within the 10-year period, P's best salary period is the number of days of P's average salary service falling within the 10-year period.
(8) Where P has more than 365 days of average salary service but has less than 365 days of average salary service falling within the 10-year period, P's best salary period is the last 365 days of P's average salary service.
(9) P's increased relevant salary during any period is P's relevant salary during that period calculated as if P's relevant salary during any relevant salary period were increased by the amount (if any) by which, immediately before the end of P's average salary service, it would have been increased if it had been an official pension within the meaning of section 5(1) of PIA 1971 beginning, and first qualifying for increases under that Act, on the same day as the relevant salary period ended.
(10) In paragraph (9) a "relevant salary period" means a period during which the rate of P's relevant salary does not change.
(11) A is the average annual rate of P's increased relevant salary during the best salary period.
(12) B is the amount to which the average annual rate of P's relevant salary during the best salary period would have been increased up to the last day of P's average salary service if it had been an official pension within the meaning of section 5(1) of PIA 1971 beginning, and first qualifying for increases under that Act, on the same day as the best salary period ended.
[3]

[3] https://www.legislation.gov.uk/uksi/2010/990/made/data.pdf

Inflation Index Multipliers

Relevant multipliers for the years 2010-2013 to adjust for inflation to April 2020[4]:

Year	Inflation Multiplier
2010	1.2325
2011	1.1856
2012	1.1404
2013	1.1137

[4] https://www.gov.uk/government/publications/public-service-pensions-increase-2020

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