



Hypothetical calculations

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Introduction

This factsheet is for members who have service in the final salary scheme and also have a break in service.

Reckonable service and calculations

Within the Teachers' Pension Scheme reckonable service is defined as any service that counts towards benefits in the final salary (80ths or 60ths) scheme. Retirement benefits are calculated based on a member's total reckonable service (as mentioned above) in years and days along with their final average salary. This is known as a "reckonable calculation".

Reckonable calculation methods

There are two methods of calculating the final average salary for members who were in pensionable (reckonable) service on or after 1 January 2007 and who have a payable date on or after 1 January 2008. Both calculations are undertaken to find the most beneficial average salary to be used for the pension award.

- 'Method A' uses the full-time salary rate in the final 365 days of pensionable service. If a salary in the final three years of pensionable service exceeds the equivalent salary rate in the previous year by the greater of 10% or a fixed amount which is revalued annually (currently £6272.00 for FY 2020/2021), the increase is restricted to whichever is higher (either 10% or £6272.00) for the purpose of calculating the average salary.
- 'Method B' uses the average of the best consecutive three years of revalued salaries from the last ten years of pensionable service prior to leaving pensionable employment.

If a member leaves pensionable (reckonable) service before 1 January 2007, the final average salary calculation is:

- The best consecutive 365 days out of the last 1095 days.

For pension benefits that were calculated for a payable date within the period 1 January 2007 to 31 December 2007, all three calculations are undertaken and compared and the most beneficial is used in the calculation of the pension award.

What is a hypothetical calculation and when would it be used?

Hypothetical calculations were introduced by the Pensions (Increase) Act 1971 to members who, after completing sufficient service to qualify for retirement benefits, had a break in pensionable service and then at a later date returned to pensionable employment.

A hypothetical calculation will only be used when a member has had a break in pensionable service. However, if the member doesn't have sufficient service to qualify for benefits before the break in service, a hypothetical calculation will not apply.

There are two different hypothetical calculations, one of which will be performed depending on the member's circumstances.

Calculation 1: 'Unrestricted' Hypothetical Calculation

The calculation is based on the total reckonable service at retirement but uses an average salary calculated up to the date of the break in service (the deemed date). Once the retirement benefits have been calculated Pensions Increase (PI) is then added from the deemed date to the payable date of the retirement benefits. This is called an "unrestricted" hypothetical calculation.

Calculation 2: 'Restricted' Hypothetical Calculation

However, if the average salary calculated up to the date of the break in pensionable (reckonable) service is greater than the average salary calculated at retirement, only pensionable (reckonable) service the member has completed in the final salary scheme up to the break can be used in the hypothetical calculation. Pensions Increase (PI) is then added to the retirement benefits that have been calculated from the deemed date up to the payable date. This is called a "restricted" hypothetical calculation.

In short, if the average salary at retirement is higher than the salary at the break in service it will be an unrestricted hypothetical calculation. However, if the average salary at retirement is lower than the average salary at the break it will be a restricted hypothetical calculation. When undertaking a comparison, the normal "reckonable calculation" will continue to use the full amount of pensionable (reckonable) service with the final average salary. If the 'hypothetical' retirement benefits (including PI) are higher than those produced by the 'reckonable' calculation (including any PI if applicable), the 'hypothetical' calculation of retirement benefits is put into payment. We therefore choose a 'best of' calculation.

Individuals in the career average scheme with a final salary link

Hypothetical calculations don't apply to career average benefits as they are not based on a final average salary.

Members who transitioned from the final salary schemes to career average have "Salary Link" protection, meaning the salaries earned in career average service are used in the final average salary calculation for final salary benefits. A hypothetical calculation will, therefore, apply if there are any breaks in pensionable service whilst in career average service. This assumes the member did not have a break in service of more than five years prior to transitioning into the career average scheme. If the individual had an earlier break in service in the Teachers' Pension Scheme final salary scheme and had sufficient qualifying service at the point of that break, they will continue to have a hypothetical calculation.

However, if a transition member has a subsequent break in service of more than five years while in career average service, the final salary link will end at the beginning of this break.

Procedure by Teachers' Pensions where a hypothetical calculation applies

Teachers' Pensions will apply hypothetical calculations at the point retirement benefits are taken. Hypothetical calculations act as an 'underpin' for members who leave pensionable service, although the nature of the underpin will vary depending on the particular circumstances of the member.

Independent financial advice

Hypothetical calculations can be extremely complex and we recommend that members obtain independent financial advice on this matter.

Calculation example 1

Julie - Unrestricted hypothetical calculation

In this example, Julie's average salary on leaving all service on 31 December 2007 (£46,192.15), with a 'deemed date' of 1 January 2008, is higher than the average salary at the break in service on 30 June 1996 (£35,573.46), with a deemed date of 1 July 1996. Hence this is an unrestricted hypothetical calculation, which gives rise to a pension (£16,507.13 per annum) that is higher than the reckonable calculation (£15,746.56 per annum).

A) 80th Scheme Reckonable Calculation

Inputs		Outputs	
Years	25	Gross Pension	£14,876.40
Days	279	Reduced Pension	£12,392/04
Average Salary	£46,192.15	Pension including PI	£15,746.56
Date of Birth	29/10/1962	Lump Sum	£37,176.13
Deemed Date	01/01/2008	Lump Sum PI Amount	£10,063.57
Payable Date	29/10/2018	Lump Sum + Lump Sum PI	£47,239.70
		Early Retirement (AAB) Factor	0.833
		PI factor	1.2707

B) 80th Scheme Hypothetical Calculation

Inputs		Outputs	
Years	25	Gross Pension	£11,456.60
Days	279	Reduced Pension	£9,543.35
Average Salary	£35,573.46	Pension including PI	£16,507.13
Date of Birth	29/10/1962	Lump Sum	£28,630.05
Deemed Date	01/07/1996	Lump Sum PI Amount	£20,891.34
Payable Date	29/10/2018	Lump Sum + Lump Sum PI	£49,521.39
		Early Retirement (AAB) Factor	0.833
		PI factor	1.7297

In A, the final average salary of £46,192.15 is used against the total reckonable service of 25 years 279 days to arrive at a pension (including Pensions Increase) of £15,746.56 per annum and an automatic lump sum of £47,239.70. The alternative calculation (B) uses the average salary applicable at the time of the break in service of £35,573.46 and the total service of 25 years 279 days to provide a pension of £16,507.13 (including Pensions Increase) per annum and a lump sum of £49,521.39.

Therefore, the hypothetical calculation is most beneficial to the member and these are the benefits that will be put into payment.

Calculation example 2

Adam - Restricted hypothetical calculation

In this example, Adam's average salary on leaving pensionable service on 31 December 2007 (£46,192.15), with a 'deemed date' of 1 January 2008 is lower than the average salary at the break in service on 30 June 1996 (£50,000.00), with its deemed date of 1 July 1996. Adam was a Head Teacher, but after a career break returned to classroom teaching eventually leaving teaching for good on 31 December 2007. A restricted hypothetical calculation is undertaken in this case, but the pension based on the reckonable calculation (£15,746.56 per annum) is higher than the restricted hypothetical (£11,706.83 per annum).

A) 80th Scheme Reckonable Calculation

Inputs		Outputs	
Years	25	Gross Pension	£14,876.40
Days	279	Reduced Pension	£12,392/04
Average Salary	£46,192.15	Pension including PI	£15,746.56
Date of Birth	29/10/1962	Lump Sum	£37,176.13
Deemed Date	01/01/2008	Lump Sum PI Amount	£10,063.57
Payable Date	29/10/2018	Lump Sum + Lump Sum PI	£47,239.70
		Early Retirement (AAB) Factor	0.833
		PI factor	1.2707

B) 80th Scheme Hypothetical Calculation

Inputs		Outputs	
Years	13	Gross Pension	£8,125.00
Days	0	Reduced Pension	£6,768.13
Average Salary	£50,000.00	Pension including PI	£11,706.83
Date of Birth	29/10/1962	Lump Sum	£20,304.38
Deemed Date	01/07/1996	Lump Sum PI Amount	£14,816.10
Payable Date	29/10/2018	Lump Sum + Lump Sum PI	£35,120.48
		Early Retirement (AAB) Factor	0.833
		PI factor	1.7297

In A the final average salary of £46,192.15 is used against the total reckonable service of 25 years 279 days to arrive at a pension (including any Pensions Increase) of £15,746.56 per annum and an automatic lump sum of £47,239.70. In the alternative calculation (B), as the member's salary at the break in service of 30 June 1996 is higher than his salary on leaving in December 2007, only the service up to the break at 30 June 1996 is used in the calculation i.e. 13 years. This gives rise to a restricted hypothetical calculation providing a pension (including any Pensions Increase) of £11,706.83 per annum and a lump sum of £35,120.48.

In this case the reckonable calculation is most beneficial to the member and these are the benefits that will be put into payment.

Calculation examples

Scenario A – An example without a requirement for a comparison between reckonable service and hypothetical calculations.

2005 - 2015		2015	2020	2035
FS £25,000		CA	Reckonable final average salary = £30,000	

There's been no break in pensionable (reckonable) service. The final average salary of £30,000 (i.e. the greater of the last 365 days or best 3 consecutive years revalued average salaries in the last 10 years) at the end of pensionable service (2035) will be used in the calculation of final salary pension benefits. Pensionable (reckonable) service in the final salary scheme, up to 31 March 2015 before the member joined the career average scheme on 1 April 2015, will be used in the calculation of final salary pension benefits:

Calculation:

Reckonable average salary: Accrual rate based on £30k at 2035 applied to final salary service up to 31 March 2015.

Scenario B

2005 -2015		2015	2018	2020	2035
		CA	Average salary = £30,000	Reckonable final average salary = £30,000	

There's a break in career average pensionable service. As the average salary at the break in career average pensionable service (£35k) is higher than the reckonable final average salary (£30k), this will be a restricted hypothetical, applied to final salary pensionable (reckonable) service before the break in career average pensionable service. The restricted hypothetical will apply to the same pensionable service as the reckonable salary, i.e. up to the point the member left final salary pensionable (reckonable) service:

Calculations - Highest of:

Hypothetical: Accrual rate on £35k salary at 2018 applied to final salary service up to 31 March 2015, revalued from 2018 (if 80th Scheme, the lump sum also revalued).

Reckonable average salary: Accrual rate on £30k at 2035 applied to final salary service up to 31 March, 2015. No revaluation up to 2035.

Scenario C

2008		2010 -2015	2015- 2018		2020	2035
FS average salary = £35,000 Break between 2008-2010			CA Aaverage salary = £40,000 Break between 2018-2020		Reckonable final average salary = £30,000	

There's a break in both final salary and career average service.

First break: As the average salary at the break in final salary pensionable (reckonable) service (£35k at 2008) is higher than the reckonable final average salary (£30k at 2035), this will be a restricted hypothetical, applied to pensionable service before the break in final salary pensionable (reckonable) service up to 2008. Pensions Increase will be applied to the benefits calculated as at 2008, up to 2035.

Second break: As the average salary at the break in career average pensionable service (£40k in 2018) is higher than the reckonable final average salary (£30k at 2035), this will be a restricted hypothetical, applied to all final salary pensionable (reckonable) service up to 2015. Pensions Increase will be applied to the benefits calculated as at 2018, up to 2035.

Calculations - Highest of:

Hypothetical 1: Accrual rate on £35k applied to final salary pensionable (reckonable) service up to 2008, revalued from 2008 (if 80th scheme, the lump sum will also be revalued).

Hypothetical 2: Accrual rate on £40k applied to final salary pensionable (reckonable) service up to 2015, revalued from 2018 (if 80th scheme, the lump sum will also be revalued).

Reckonable average salary: Accrual rate based on £30k at 2035 applied to final salary pensionable (reckonable) service up to 31 March, 2015. No revaluation up to 2035.