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News on pensions and other business risks within the **Higher Education Sector**

HEADS UP

Our Higher Education (HE) experience stretches over 20 years and includes advice across a top-tier client list, spanning the UK.

Our expertise extends across the Universities Superannuation Scheme (USS), Local Government Pension Scheme (LGPS), Teachers' Pension Scheme (TPS) and other nationwide schemes. We also advise extensively on university Self-Administered Trusts (SATs) and defined contribution (DC) schemes.

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In this issue:

Find out more at:
www.barnett-waddingham.co.uk/highereducation

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Uncertain times

This is a time of quite significant change and uncertainty for the Higher Education (HE) sector. This can be quite disconcerting, especially in a sector which is used to having much more certainty about the future. As actuaries, our focus is on helping our clients understand and manage risk and uncertainty.

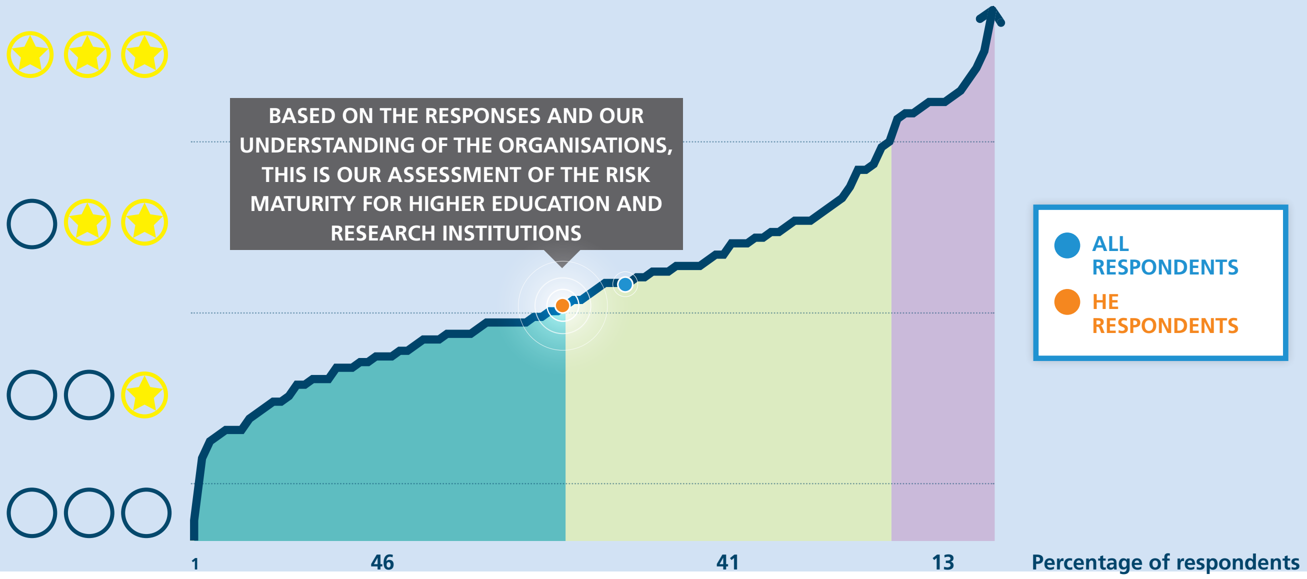
At the time of writing, the Higher Education and Research Bill is making its way through Parliament, and the Queen has just given Royal Assent to the Article 50 Bill, clearing the way for formal talks to start on Britain's exit from the EU. We do not know exactly what impact both of these will have on the sector, but it is clear that in ten years' time, the sector will have changed (to a greater or lesser extent).

Our Business Risk team have carried out a survey of risk management practices across the UK and looked at where the HE sector sits compared to other sectors. The chart below shows where the average HE institution sits (the orange dot – based on those who responded to our survey), compared to the range of approaches we saw across the UK market as a whole. This suggests institutions are reasonably well-placed with a similar 'risk maturity' compared to the average across the UK (the blue dot) – just in between our '1 star' band ('core compliance') and our '2 star' band ('positively engaged'). We expect that with the increasing uncertainty in the sector, institutions are likely to be continuing on a path, moving up this chart, probably well into the 'positively engaged' 2-star band.

Taking this a step further, we have been looking at what the key risks are for universities, to identify ways in which those risks can be measured and modelled. This is an important part of taking effective risk management decisions – because it means you can illustrate the impact of decisions and compare the effectiveness of different options. To kick this off, we have carried out a research project with undergraduate and postgraduate students from the University of Liverpool, digging deeper into an institution's financial and reputational risks.

At Barnett Waddingham, we specialise in pensions advice and this is one area that is likely to come under the microscope for institutions. Generally, increased uncertainty might lead to a closer look at all risks, including pensions, but there are also a number of specific pensions issues at the moment, which are looked at in the rest of this update.

This chart shows the cumulative proportion of respondents to our business risk survey who currently meet our '1 star' (core compliance) and '2 star' (positively engaged) risk maturity bands.



For further details on this survey and how to increase your risk maturity score please visit our website: **www.barnett-waddingham.co.uk/HERiskSurvey**

Focus on **pension schemes**

Defined benefit (DB) schemes can create significant financial risk - in this section we look at the issues faced by the main DB schemes in the sector.

USS

With the Universities Superannuation Scheme (USS) actuarial valuation results due later this year, this is likely to be a hot topic for the next few months. The headline news is that if the same funding approach is taken as in 2014 (a big 'IF'), then the deficit will have increased significantly, as well as the cost of future benefits. Expect a lot of discussion about the approach to setting assumptions for the valuation, how to invest to fund the benefits, what level of risk is acceptable, and potentially further changes to benefits.

Our recent webinar looking at these issues in more detail can be viewed here: **www.barnett-waddingham.co.uk/usswebinar**

The effect of these discussions on your institution will depend upon whether you have a large number of staff in the USS, or relatively few. Those with more staff are likely to be interested to follow this debate quite closely, and understand how the decisions being taken affect their position.

Where the exposure to USS is lower, there are still things to consider – in particular should you continue to offer USS benefits to new staff? Often there will be a choice between the USS and Teachers Pension Scheme (TPS), and as TPS is an unfunded public sector scheme, this is often a much more attractive proposition for an employer in terms of risk profile - and TPS benefits may look more attractive too.

TPS

As already mentioned, TPS is a government-backed scheme, and it is 'unfunded', so it has no assets, which, in particular, makes its funding level much less volatile. It is therefore much less likely to cause any significant problems for institutions, and the main question that can arise in respect of this scheme is – are we using it enough? That said, like all schemes, the cost of benefits is increasing, but the next change to contributions is not scheduled until 2019.

LGPS

We are seeing a lot of questions around the Local Government Pension Scheme (LGPS) at the moment, probably because funds (other than those in Scotland, which are a year later) have been announcing the contribution rates payable from April 2017. The sorts of things people are thinking about are:

- Is the LGPS still the right scheme to use? (Though making changes can be difficult.)
- Can we understand what we are being asked to pay, and what our obligations are in the future?
- Is the way we are/are not pooled with other employers in the LGPS beneficial?

SATs

Many universities have their own DB self-administered trusts (SATs). Some of these are open to new staff, but others have closed to new entrants or even closed to everyone. These will be facing similar issues to those faced by the USS, but on a smaller scale, and based on the individual scheme's situation.

Company Accounting

The cost of these pensions schemes pass through the institution's accounts in one form or other. July 2016 was a particularly bad time to be looking at a pension scheme on a company accounting basis, as the discount rates used were at their lowest at that point (following the EU referendum) – they have since recovered a little bit.

Where institutions are accounting for the USS deficit as the present value of future contributions, this is less volatile with market conditions, but be aware that the balance sheet position can change significantly following an actuarial valuation, if the deficit contributions required changes significantly. In practice, the USS valuation is unlikely to be signed off ahead of this financial year end, so it will be the 2018 balance sheet positon that is affected.

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Focus on **staff**

Turning now to the other key risk in the sector, Reputational Risk. From a pensions point of view this translates to attracting, retaining and motivating high quality staff, which can enhance the institution's reputation.

DB vs DC

The biggest question from an employee's point of view on pensions is whether the scheme offered is DB or DC. A pension is a very long term investment, which creates a lot of uncertainty around how much benefit will eventually be received for a given contribution.

A DB scheme, such as the ones discussed above fixes the end point, by defining what level of pension the employee will receive (based on their service and salary etc.) – and the uncertainty then becomes the amount of money needed to provide that benefit. This, in turn, translates into risk for the employer of deficits arising, requiring increased contributions, because the amount estimated to be enough no longer looks sufficient.

A DC scheme fixes the amount that is put in – the contributions – moving the uncertainty to the amount of benefit to be received. Generally DC schemes are seen as being less attractive to staff due to the higher uncertainty around retirement incomes. However, it is also worth remembering that there is a lot more flexibility for employees, which can be really valuable in the right circumstances.

This flexibility can have tangible benefits in terms of the contributions employees are asked to pay, potentially opening up pensions provision to a wider range of staff, including those unable (or unwilling) to afford the DB scheme contributions. Less tangible immediately, but potentially much more valuable in the long term is the ability to shape the retirement benefits in a way to suit the employee. With people living longer, the guaranteed increases available in DB schemes are very expensive to provide, but are they actually valued by staff? Do people really need the same spending power in their 90s as they do in their 60s and 70s? DC schemes enable the employee's pension assets to be targeted to their retirement needs in a potentially much more efficient way.

Webinar: engagement

The main problem with the extra flexibility of a DC scheme is that for employees to get the full benefit of the flexibility, they need to be able to understand the different options available to them. In this, as in many other areas, the key to success is good engagement with staff.

We hosted a webinar on this subject, considering, in particular, the impact of the new DC benefits within the USS on senior staff.

Webinar: high earners

In the sector, many questions have been raised around the tax implications of the Annual Allowance and Lifetime Allowance for higher earners. Our recent webinar helps to answer some of the key questions.

You can view all of our recent webinars for trustees here:
www.barnett-waddingham.co.uk/trusteewebinars

How can we **help?**

Our expertise extends across the Universities Superannuation Scheme (USS), Local Government Pension Scheme (LGPS), Teachers' Pension Scheme (TPS) and other nationwide schemes. We also advise extensively on university Self-Administered Trusts (SATs) and defined contribution (DC) schemes. Please get in touch to find out how we help both trustees of SATs as well as areas covered in this newsletter and more generally.

About **Paul Hamilton**

Paul Hamilton, Partner and Head of Higher Education sector at Barnett Waddingham, has particular expertise in the education sector; advising multi-employer schemes; and helping clients successfully negotiate the pensions terms in public sector outsourcing contracts. His commercial focus and communication skills ensure his clients understand the relevant dynamics of their pensions responsibilities – whether advising a small employer who has had little previous pensions advice, or an experienced trustee board on an unusual issue.

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