Information on...

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Pensions update for universities

Welcome to the latest issue of our pensions newsletter for universities. In this edition we focus on the pension issues currently facing universities including; changes to the regulation of public sector pensions, cuts in tax relief for high earners, the extended role of The Pensions Regulator (TPR), the abolition of contracting out, and investing in emerging market (EM) assets. We also look at the results of our 2013 detailed survey of university pensions accounting disclosures.

Introduction

The public sector is paying extra attention to pensions as a result of the Public Service Pensions Act 2013. In particular, TPR is looking to take on an expanded role regulating the standards of governance for schemes including the Local Government Pension Scheme (LGPS) and Teachers Pension Scheme (TPS) which will fall under its wing from April 2015.

In response to the Hutton report, the LGPS 2014 will be in place a year earlier than other public sector schemes, which is a significant achievement and will affect benefits for large numbers of staff.

A large proportion of universities run their own defined benefit (DB) scheme or Self-Administered Trust (SAT). SATs which are still open to future accrual are facing increasing costs due to the end of contracting-out. In an era when budgets are being squeezed, extra finances are needed to fund pension costs and governance costs. In addition, Finance Directors, Vice-Chancellors and other senior staff may be affected by the cuts in tax relief with more cuts to the annual allowance (AA) and lifetime allowance (LTA) from 6 April 2014.

However, there is positive news as the UK economy continues to recover in 2014. The government is clearly making pensions a top priority after the recent 2014 Budget announcements enabling individuals in defined contribution (DC) schemes to have more flexible access to their savings (subject to legislation) and offering free guidance on the range of options available to them at retirement. Auto-enrolment (the requirement for all employers to enrol their staff into a pension scheme) has been a bigger than expected success with the USS seeing a lower than expected opt-out rate of 15.5%. TPR has issued a new objective but with no clear steer on what this means for charities and not-for-profit organisations, what does it mean for a university?

How can Barnett Waddingham help?

We have experience of universities looking for ways to manage their pension liabilities. For SATs this might include working with trustees, introducing special arrangements and helping them prepare to be 'buy-out ready' by performing guaranteed minimum pension (GMP) reconciliations and data cleansing exercises. We also have specialist teams advising on auto-enrolment implementation, on tax charges for high earners and LGPS funds and other public-sector services.

We provide services and advice to many leading universities across the UK, including:

- Advice on Self-Administered Trusts (SATs)
- Pension Administration
- Investment Advice
- Pension Provision Reviews
- Auto-Enrolment Advice
- High Earner Pension Tax Advice

Specialist pensions tax advice for senior university staff

For the 2014/15 tax year the LTA reduces from £1.5m to £1.25m and the AA reduces further from £50,000 pa to £40,000 pa. This is an important change affecting all pension schemes, and all individuals in the sector should be aware of the changes. If an individual thinks that they are likely to be affected because they have pensions savings of more than £1.25m on 5 April 2014, they can apply for individual protection (IP14) which will give individuals greater flexibility in protecting their pension rights. The application process is expected to be opened in August 2014. IP14 would be based on the value of the individual's benefits as at 5 April 2014 (not exceeding £1.5m) and also allows for subsequent benefit accrual without individuals losing protection.

The circumstances under which IP14 can be applied for are complex and depend on what existing protection regimes are already in place. The deadline for 'Fixed Protection 2014' was 5 April 2014 so it is no longer possible to benefit from this regime. As always it is important to act as soon as possible to avoid deadlines being missed.

The further reduction in the AA could mean that more individuals are required to pay an annual tax charge if the value of their pension benefits increases more than the AA in a given year. A carry forward of unused allowance from the previous three tax years could help avoid a charge but the calculations can be complicated. This is particularly important for individuals who participate in more than one scheme as the limits apply to the aggregate of all their pension arrangements.

We are able to provide support and advice covering a variety of areas including a review of current and historic arrangements, retirement planning, life assurance advice and AA carry forward advice. Barnett Waddingham's Executive Pensions team has considerable experience in advising senior university staff on their pension benefits. We provide a bespoke and specialised service designed to meet each university's needs as well as each individual's requirements.

As the LTA reduces, more and more individuals may now face tax charges on their ongoing pension savings so get in touch with Bhargaw Buddhdev on 01494 788100 if you think you might be affected or have staff affected.

University Pensions Accounting Disclosure Survey 2013 results

The university schemes surveyed are SATs that are separate from the USS or any public sector arrangement.

We recently published the latest version of our annual survey of these universities' pensions accounting disclosures, covering the year to 31 July 2013. The disclosures of 36 universities were analysed, with areas of focus ranging from funding levels and pension costs to the assumptions used.

Comment

The average funding level of the 36 SATs had increased over the year to 31 July 2013, from 77% to 82%, which is even higher than the average position in 2011. The most likely cause of this improvement was the increase in the corporate bond yields over the same period as well as the strong performance of pension scheme assets over the year, mainly due to equity performance.

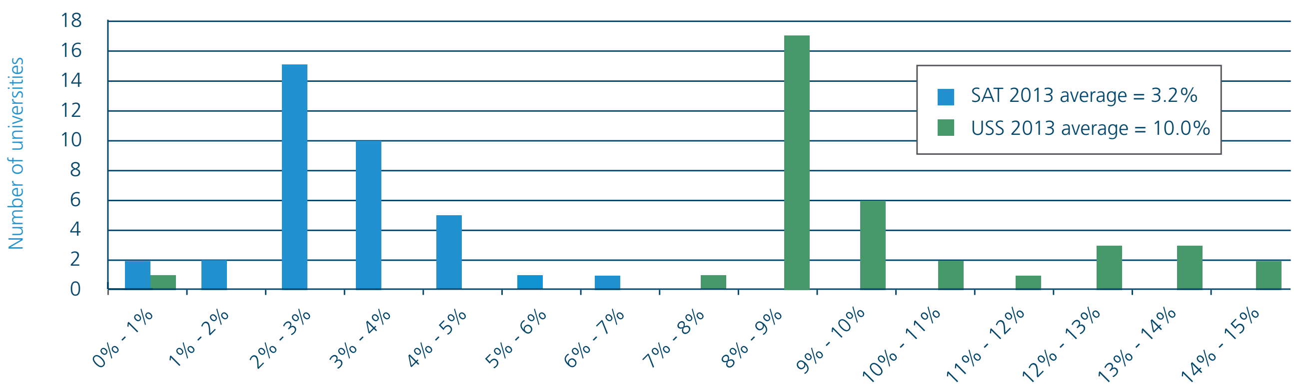
The improvement in the position has been offset by a significant increase in inflation over the year as the index increased from 2.7% p.a. to 3.4% p.a.. As a large proportion of SAT benefits would be linked to inflation, this has offset the strong performance of the assets.

The survey results also imply that many universities are making an upwards adjustment to their discount rate to allow for the duration of their liabilities with the average discount rate used being 0.3% p.a. higher than the index yield.

In terms of the cost of the pension schemes to their respective university sponsors, our analysis shows that the total employer contributions to the SATs surveyed, as a proportion of total staff costs, decreased fractionally compared to the previous year, from 3.3% to 3.2% whilst the contributions to the USS remained unchanged at 10%.

To request a copy of the full survey results or to discuss any of these issues further, please see our website or contact Nick Griggs on 01242 538500.

SAT and USS employer contributions as a proportion of total staff costs



Source: Barnett Waddingham

Contracting-out to end in 2016

The reform of the State Pension system is planned to take place in April 2016 when the current structure will be replaced by a single flat-rate pension of around £144 per week (in today's prices) for everyone with a 35-year National Insurance Contributions (NICs) record. As a consequence of this change, the ability to contract-out of the State Second Pension (S2P) via a salary-related scheme will cease. This follows the abolition of contracting out of DC schemes in 2012. Rebates of NICs enjoyed by employers (3.4% of relevant earnings) and employees (1.4% of relevant earnings) by virtue of being contracted-out will be abolished – although an increase in employers' National Insurance bills will be partially offset by a £2,000 'Employment Allowance' from April 2014.

Employers should start thinking now about the effect of the end of contracting-out on their schemes and how to avoid an increase in costs. Our research indicates that almost 90% of SATs are still open to future accrual in some form and would be affected by these changes. The results of the 2014 USS valuation will shed some light on how it plans on dealing with these changes but things may be more complicated for other schemes such as the LGPS. While most private sector funds can amend their benefit provision to deal with the changes, LGPS funds are currently excluded from this provision and could face an increase in contributions unless further amendments are made.

We have experience in helping universities review benefit design and their options for future pensions provision. We have already seen changes in SATs benefits following the move by USS to a Career Average revalued Earnings (CARE) scheme in 2011. Will there be further benefit changes as a consequence of the end of contracting-out?

Please get in touch with Jon Bridger on 01242 538500 if you would like any further information.

Section 75 Debt for SATs

Many SATs are also multi-employer schemes. As these schemes close to future accrual there is more risk of individual employers triggering a Section 75 debt. We have worked with a number of participating employers of SATs to help manage their liabilities and any potential debts. This could be through careful fund management or a special arrangement including Flexible Apportionment Arrangements and Withdrawal Arrangements. These types of arrangements allow institutions to withdraw their participation in a scheme without triggering a section 75 debt.

If you think you may possibly be involved in a similar situation, please get in touch with Nick Griggs on 01242 538500.

GMP reconciliation - the time to reconcile is nigh

The abolition of contracting out for DB schemes in 2016 will require schemes to reconcile their GMP liabilities regardless of whether the scheme has closed to future accrual or is winding up. GMP reconciliation is a project to ensure that the GMP liability on the scheme records agrees with that held by HM Revenue & Customs (HMRC) and involves comparing the GMPs held on the scheme's records to those held by HMRC, investigating any discrepancies between the two sets of figures.

It is a complex and time consuming process which can take anything up to two years to complete. HMRC has stated that all reconciliation activity must be completed by December 2018 at the latest so trustees must act quickly and be aware of the significance of this work and the tight timescales.

Furthermore, with GMP equalisation on the horizon, the reconciliation will be required so that equalisation can be applied to accurate records. We therefore recommend discussing this issue with trustees and their advisers now as HMRC will be inundated with requests for this information and they have implemented a strict priority system.

Our administration team has vast experience and knowledge in the reconciliation field. We can offer advice and guidance as well as the ability to undertake these exercises on behalf of trustees or administrators.

See our website for further information and the full article or contact Carole Ward on 01527 300000.

A new objective and extended coverage for TPR

A new government aim was announced with the Pensions Bill 2013 to ensure that the pensions regime is flexible and not a 'brake on investment and growth' of an individual company. With this in mind, TPR has released a new draft statutory objective in relation to Scheme Funding "...to minimise any adverse impact on the sustainable growth of the employer."

This new objective is therefore an important focus for all schemes in the long term and should be kept in mind in the short term whilst changes are being made to scheme governance. You might ask, what does 'sustainable growth' mean in the context of a university? After speaking with TPR we understand this does not mean that they must focus strictly on profit and growth, but that the employer engages with the trustees of the scheme from an early stage to help them to understand how the employer intends to maintain the current level of support.

TPR has historically mainly governed private-sector schemes. However, with the Public Service Pensions Act 2013 receiving royal assent, the role of the TPR will extend to govern other schemes including LGPS funds and TPS from 2015. It is anticipated that the new code of practice will be laid before parliament in autumn 2014. The changes mean that these schemes face a significant task in following TPR guidelines and a making any necessary changes. LGPS 2014 also commences on 1 April 2014 and other public-sector schemes will follow by April 2015. This reform (as a result of the Hutton report) will significantly change the way that pension is built up.

Please get in touch with Jon Bridger on 01242 538500 if you would like any further information.

Emerging markets - opportunities in the acronyms

From undertaking a detailed review at the published accounts of the SATs, it is evident that equities are still heavily invested in by these schemes with on average 62% of assets reported as being held in equity assets. LGPS funds also target around 65% equity allocation. These equities will usually be split between EM assets and developed market (DM) assets. Both LGPS funds and USS invest in EM assets, in particular, the USS invests almost 20% of its equity portfolio in EM assets.

Since the turn of the century EM assets have provided investors with higher returns relative to DM assets. 2013 however, provided a salutary warning to investors about the dangers of assuming a good thing will last forever as EM assets, both equities and bonds, significantly underperformed DM assets. It is useful to understand what is classed as an EM, as it may well be different to an emerging economy. Indeed an emerging economy may not be emerging in the sense that investor's may think. If you focus on the equity market, the FTSE EM index is relatively highly concentrated, with the five largest economies accounting for nearly 70% of the index. When making a passive allocation to EM equities, investors are really choosing to make an allocation to China, Taiwan, Brazil, South Africa and India.

Pension funds have commonly invested into EM economies with the aim of gaining access to the higher growth rates that have persisted over the past 20 years and are expected to continue to persist in the future. There are clearly some countries within the EM universe that face significant difficulties and growth and returns in those is likely to be subdued going forward. However, we find it very hard to come up with an argument that investors should not gain exposure to almost half of the world's GDP.

The issue here is not to pull out of investments in EM economies, but how should exposure be gained. We believe the distinction between emerging and developed markets is becoming increasingly out-dated as the composition of emerging indices no longer solely represents those faster growing economies of the world that they were arguably invented for. Whilst this may have been appropriate when the EM index of countries accounted for one-sixth of global GDP and had fledging financial markets, it seems less valid now they are approaching one-half of global GDP. Employers should therefore be thinking away from the indices and on a more global basis.

We believe EM mandates need to be actively managed or investors could turn out to be disappointed. This could be achieved by allocations to global mandates managed without reference to indices or to specific funds targeted towards EM economies.

To request a full copy of article above or to discuss any of these issues further, please see our website or contact Matt Tickle on 01242 538500.

2014 Budget

The *2014 Budget* included a number of measures to improve the flexibility of DC pensions, which will have important consequences for DB arrangements. The consequences are not all good, but do present opportunities overall.

The key change is to end the effective requirement to purchase an annuity with DC funds at retirement. This has three main consequences for DB schemes:

- Universities wishing to close a DB scheme to accrual and offer a DC scheme instead will have an easier sell to their employees with this new DC flexibility.
- Some members will want to transfer their existing DB benefits to DC in order to access the flexibility although the extent of Government restrictions on transfers out of DB schemes is not yet known.
- Where an option is already available at retirement to transfer to an immediate annuity, or a bulk exercise for over-age-55s is under consideration, the reduced appeal of annuities relative to the new flexibility has clear implications for the advice given to members and the likely take-up rate.

Visit our *Corporate Consulting blog* for our thoughts on how the budget will impact pension scheme sponsors.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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