Barnett Waddingham
a true partnership approach

Spring 2015

# Pensions update for universities

**Welcome to the latest issue of our pensions update for universities. Pensions remain at the forefront of discussions, with changes to the USS, LGPS and TPS potentially resulting in universities conducting significant reviews of their overall benefit provision as well as dealing with changes as a result of the abolition of contracting out and the prospect of undertaking complex GMP reconciliations.**

Other current issues include the impact of the move to accounting standard FRS102, further issues in tax relief for senior staff, the performance and increased use of diversified growth funds and the pensions flexibilities announced by the 2014 Budget.

## Changes to the USS

Following the move of the Local Government Pension Scheme (LGPS) and Teachers' Pension Scheme (TPS) to Career Average Revalued Earnings (CARE) benefits, the latest proposals for the changes to Universities Superannuation Scheme (USS) (due to enter consultation in spring 2015) include closing the final salary section entirely to move to CARE benefits for the first £55,000 of a member's salary, with benefits from any proportion of salary above that threshold being provided via a defined contribution (DC) section.

Those universities managing Self-Administered Trusts (SAT) that have historically benchmarked their benefit provision against the USS, LGPS or TPS may therefore be considering making similar changes in moving to CARE, if they have not already done so following the introduction of CARE for new joiners to the USS after 1 October 2011. This would mean that universities who provide benefits both through their own SAT and through wider schemes are able to maintain consistency amongst different groups of employees.

Moving to a DC arrangement for salaries above a specified threshold adds an extra level of complexity to SATs and may not be necessary for those that have an upper salary threshold. However, an additional aspect is that the USS will make it possible for members at all salary levels to voluntarily contribute an extra 1% of their salaries into the DC section and this may again prompt universities to review existing AVC arrangements.

» Further details on this and other options for benefit changes are available in this note or by contacting Nick Griggs on **01242 538500** or **corporateconsulting@barnett-waddingham.co.uk**

### How can we help?

We have considerable experience of working within the university sector. For SATs this might include working with trustees on an ongoing basis, introducing special arrangements and helping them prepare to be 'buy-out ready' by performing guaranteed minimum pension (GMP) reconciliations and data cleansing exercises.

We have also provided independent advice to universities on their SAT and other pension arrangements. We also have specialist teams advising on DC pensions, on tax charges for senior staff and LGPS funds, TPS benefits and other public-sector services.

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

- actuarial and investment advice on SATs
- pension administration to SATs
- pension provision reviews
- DC pensions advice
- senior staff pension tax advice
- LGPS and TPS benefit consultancy services

» If you would like to discuss how Barnett Waddingham can help

# Corporate accounting issues for universities

Currently, under FRS17, organisations with USS liabilities that are unable to identify their share of the pension scheme's assets and liabilities are able to account for their liabilities on a DC basis.

This means that these organisations may be recording a pension expense equal to the contributions which they are required to make to their schemes in their company accounts. As a result the pension scheme asset or liability does not appear on the organisation's balance sheet.

However, the introduction of FRS102 for accounting periods commencing on or after 1 January 2015 now impacts on these organisations, and could require recognition of additional liabilities even if a DC accounting basis is used. Specifically, where a commitment has been made to a deficit recovery plan for a pension arrangement, a liability equal to the present value of those future deficit payments will need to be recognised on the balance sheet and any changes in this recovery plan following a valuation would need to be recognised as an additional pension expense (or credit).

We recommend planning for any change as early as possible by speaking to auditors and pension advisers to understand the potential size of the additional liabilities.

For more information on other accounting issues please see our Current Issues in Pensions Financial Reporting (31 July 2014) newsletter which is specifically aimed at those involved in the preparation of pension disclosures of University Self-Administered Trusts (SATs).

> We recommend planning for any change as early as possible by speaking to auditors and pension advisers to understand the potential size of the additional liabilities.

## University pensions accounting disclosure survey 2014 results

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

We recently published our sixth annual survey of these universities' pensions accounting disclosures, covering the year to 31 July 2014. The disclosures of 35 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 35 SATs decreased slightly over the year to 31 July 2014, from 83% to 81%. The most likely cause of this was the reduction in bond yields over the year, leading to lower discount rates being used to value the liabilities. The effect of this was offset to an extent by strong asset performance and deficit contributions paid by the universities.*

*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, increased compared to the previous year, from 3.3% to 3.6% whilst the contributions to the USS also increased from 10% in 2013 to 10.2%.*

» To request a copy of the full survey results or if you would like to discuss the issues raised in this section in more detail please contact Nick Griggs on **01242 538500** or **corporateconsulting@barnett-waddingham.co.uk**.

# Administration – update on GMP reconciliations

As discussed in our last update, from April 2016 all defined benefit (DB) schemes still open to accrual will cease to contract-out and will be required to reconcile their GMP liabilities with the records held by HMRC.

Following this, from December 2018 HMRC is planning to send individuals information about their contracting-out history. This means that all outstanding GMP discrepancies will need to be rectified by that time. There is a lot of work for schemes to do before then. We have significant experience in helping trustees with GMP reconciliation exercises. We are able to help our existing clients as well as schemes with in-house administration teams who are looking for professional support in a specialist area.

Recognising the tight timescales involved HMRC has launched a Scheme Reconciliation Service (SRS) to enable schemes to start comparing their non-active GMP amounts (i.e. for deferred and pensioner members) in advance of the scheme ceasing to contract-out in April 2016.

We can import the data supplied by SRS onto a scheme's pension administration system in order that the scheme administrator can help trustees understand how their GMP records stack up against those held by HMRC.

This can help determine a suitable tolerance level, plan next steps in the reconciliation project and assist greatly with setting appropriate fee budgets. Having HMRC and scheme data separately identifiable during the process along with 'agreed' data will allow flexible reporting throughout, as well as following, a GMP reconciliation process.

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We can work with trustees to establish their scheme's starting position for any reconciliation via a 'State of Play' report.

It also allows 'point in time' analysis to take place in the event of future queries from members. It should also be noted that SRS will become the HMRC Shared Workspace (SWS) once schemes start to do their reconciliation. Initial queries are done in bulk and answered in bulk by HMRC. One further set of bulk queries can then be sent and HMRC will load these onto Shared Workspace to be reviewed on an individual basis.

Active members will be 'closed' by HMRC on 5 April 2016 and reconciliations for those members will commence with effect from December 2016, although current information can be accessed through another HMRC system. This makes it even more sensible for schemes that are still open to act now on reconciling their non-active membership so that they leave time for this further work from December 2016.

We can work with trustees to establish their scheme's starting position for any reconciliation via a 'State of Play' report. Using this information we will help trustees identify the amount of work required to undertake the reconciliation taking into consideration their attitude towards cost and risk along with their tolerance for accepting variances in scheme and HMRC's records.

> **The main risks arising relate to data and the effect of any errors on the cost of future contributions or insurance premiums, as well as reputational risks to schemes and their trustees resulting from incorrect benefits being paid.**

We have sophisticated and robust systems and procedures in place to enable us to efficiently interrogate data and raise queries with HMRC at the same time as reporting progress to trustees, which enables us to keep costs at a manageable level.

» If you would like to discuss how Barnett Waddingham can support you in undertaking your GMP reconciliation exercise please contact Carole Ward on **universities@barnett-waddingham.co.uk**.

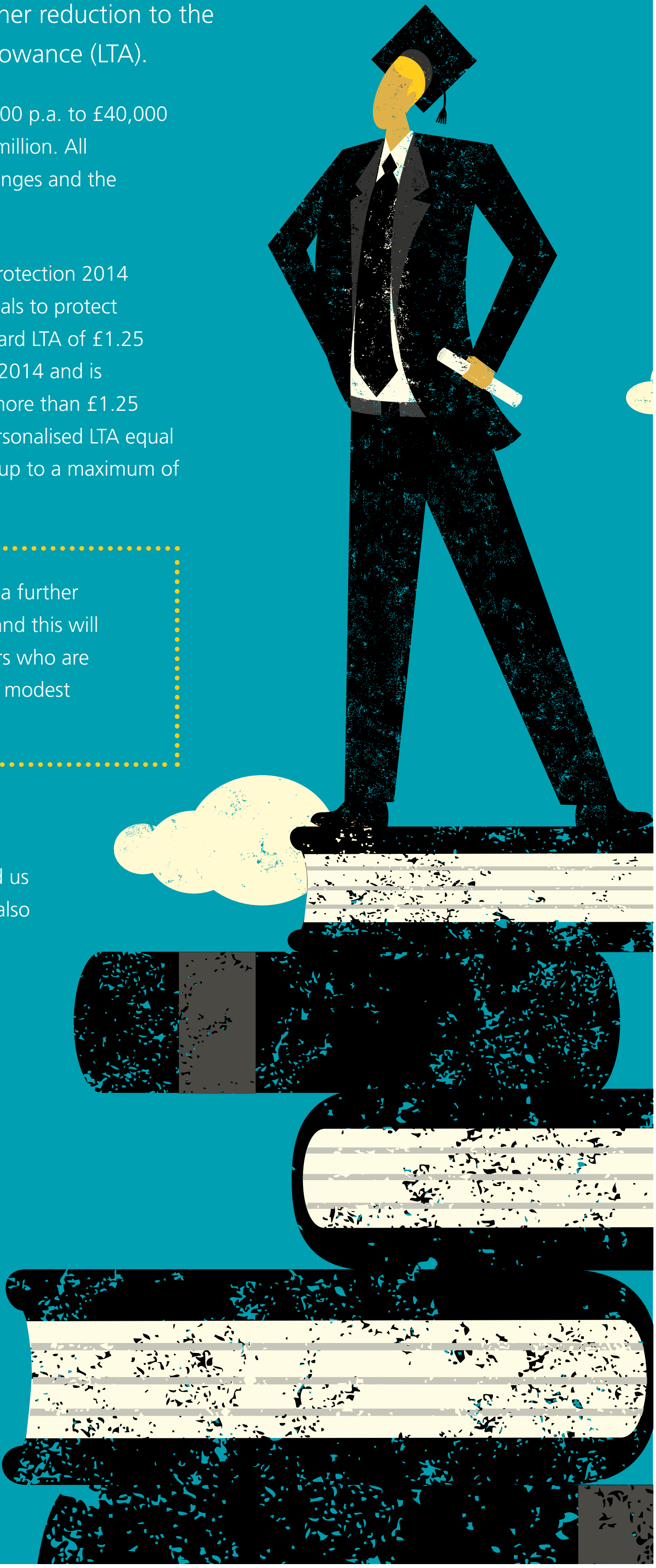
# Specialist pensions advice for senior university staff

There have been substantial recent changes in pensions' legislation affecting high-earners, in particular the further reduction to the Annual Allowance (AA) and the Lifetime Allowance (LTA).

For the 2014/15 tax year, the AA reduced from £50,000 p.a. to £40,000 p.a. and the LTA reduced from £1.5 million to £1.25 million. All individuals in the sector should be aware of these changes and the potential implications.

In August HMRC opened applications for Individual Protection 2014 (IP2014). This presents a new opportunity for individuals to protect their pension savings if they exceed the current standard LTA of £1.25 million. IP2014 will apply retrospectively from 6 April 2014 and is available to individuals who held pension savings of more than £1.25 million on 5 April 2014. IP2014 gives individuals a personalised LTA equal to the value of their pension savings on 5 April 2014 up to a maximum of £1.5 million.

The 2015 Budget included the announcement of a further reduction in LTA to £1 million from 5 April 2016 and this will create a further wave of pension scheme members who are affected, including more who perhaps have more modest earnings but long periods of service.



Our Executive Pensions team has considerable experience in advising senior university staff on their pension benefits. A number of universities have asked us to help their senior management team with this and also to provide guidance to their staff to ensure they are aware of the changes surrounding pension benefits and to enable them to make informed decisions on their retirement provision. We provide a bespoke and specialised service designed to meet each university's needs as well as each individual's requirements.

» Please contact Bhargaw Buddhdev on **01494 788100** or **bhargaw.buddhdev@barnett-waddingham.co.uk** if you would like to discuss any of the above in more detail. Or visit our website **www.barnett-waddingham.co.uk/executive-pensions** to find out more about the service we offer in this area.

# The future of DGFs

## Have they done what they said and how will they perform in the future?

Over the past ten years the use of Diversified Growth Funds (DGF) by DB pension schemes has increased significantly during a period when we have seen huge variations in market conditions; from the crash associated with the global financial crisis to a near six-year equity bull market. Does the rationale for holding DGFs still hold true a decade on and in the face of a changing economic environment?

### How would we rate DGFs' performance over this period?

Given the market backdrop we consider performance over two distinct periods:

**2006 - 2009**

For those early-launched funds this was a test of their mettle – could they provide returns and downside protection in the face of one of the largest recessions seen since the 1930s? For a number of funds this proved too much, with some falling heavily and some ultimately closing. However, the majority fared reasonably well given the market backdrop and in general whilst they underperformed their targets during late 2007 and 2008 the falls were not significant. The absolute return funds fared best.

**2009 - 2014**

This was a very different market environment, with equities currently nearly six years into a bull run despite the continued weak economic backdrop. With the benefit of hindsight this period proved an easy time to meet their targets – funds just needed to avoid cash and remain invested. As a result the vast majority met their performance targets, with those funds that focused on market returns tending to perform best.

However, almost all lagged equity returns. This is to be expected and it is 'correct' that at a time when equities soar DGFs are not designed to keep pace. Our criticism on their performance is that history may yet show that DGFs failed to make enough hay during the sunny times of the last five years to protect them during potentially fallow periods over the coming years.

We also feel that in the past three to five years managers have shifted a greater focus onto their volatility target and less onto returns (although return targets in general have still been met). This seems in part to have been in response to the actions of investors who have favoured those managers with a greater focus on capital preservation; some of whom were still reeling from heavy equity losses on the back of the global financial crisis.

### What should schemes look for in their DGF manager going forward?

Whilst the DGF characteristics each scheme needs will vary, we feel the following are desirable across the board if a particular fund is going to generate the desired returns in the future:

- **Flexibility** – we feel it will be necessary in the future to be dynamic, this is a characteristic that's not been required over the past five years but feel it will be needed over the next five.
- **Wide opportunity set** – being able to invest in areas outside of the traditional equity and bond markets may be crucial in being able to deliver required levels of returns.
- **Greater focus on manager skill** – given our concerns over the level of market returns, and linked with the two points above, we think this will be key.

Trustees should re-assess their overall return requirements, how these are going to be achieved and the role their DGF manager or managers play within the portfolio.

» For more information on diversified growth funds, the wider investment market and our thoughts on the challenges ahead, you can read this note or contact Matt Tickle on **01242 538547** or **matt.tickle@barnett-waddingham.co.uk**

# Update on the pensions flexibilities announced in the 2014 Budget

The Government announced that, with the exception of members of unfunded public sector pension schemes, it would not ban members of DB pension schemes from transferring into DC schemes to make use of the flexibility created by the 2014 Budget. This may be good news for employers looking to manage their DB liabilities, and for members looking to take advantage of new flexibilities in DC schemes.

Members will need to receive regulated advice before they transfer if the value of the benefit is over £30,000 (previously, such advice has only been a requirement where the transfer process was initiated by the employer). This will mean that members have sufficient knowledge to make the most suitable decision for themselves but this advice would ordinarily be paid for by the member, except where the transfer is from DB to DC within the same scheme or as a result of an employer-led incentive exercise, in which case the employer will need to meet the cost.

**Universities who want to be on the front foot should look at the choices their schemes offer to members.**

Members will be most likely to consider their choices in the run-up to retirement, and schemes can make this easier by quoting transfer value options as standard at the point of retirement. Universities may also want to provide easy access to the required independent financial advice so that members can feel confident in taking decisions regarding their own pension savings. Depending on the circumstances of their scheme, universities may want to provide this additional support to members, especially if they consider that high take-up rates will have a positive effect on the funding of the scheme.

It is also vital to the take-up rate that there are solutions available for members who do not want to access all their pension savings in one lump sum. Income drawdown is currently a niche market. Pension providers are working hard to develop products to reach wider markets to coincide with the new freedoms, and these must be clear and simple if they are to be a success.

The announcement put the prospect of enhanced transfer value exercises back on the table. If properly managed, and with engagement with scheme trustees and best practice advice to members, these exercises can allow employers to better manage their DB scheme liabilities while being of benefit to members in certain circumstances.

However, it will also be important for universities and other employers to consider the possible cashflow implications of a sharp increase in transfer requests and they may wish to take additional advice around this if they think that take-up of any options or additional flexibilities will be high.

**The Government was intending to consult on whether to allow – in full or in part – the new flexibilities to apply directly to DB schemes, i.e. without the requirement to transfer.**

The chief advantage of this would be ease of use by members and reduced administration costs over time. However, depending on how the exchange of accrued DB pension for cash might work, this could be another valuable opportunity for employers to manage their DB liabilities and reduce cost and we await any further development with interest although it now seems unlikely that a consultation will be released before the general election in May 2015.

The introduction of the new flexibilities and the extension of this in the 2015 Budget with the announcement that a secondary market could be created to enable pensioners to sell on annuity streams, means that pensions remain at the forefront of people's minds and media reports. Universities will need to be ready to provide information and additional communications to their members regarding what is offered through their schemes and where those members can obtain further information and advice.

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If you would like to discuss this in more detail, please find our representative Annemarie Allen at the BUFDG conference on 12-14 April 2015. Alternatively contact us via the following:

universities@barnett-waddingham.co.uk 07595 655258 www.barnett-waddingham.co.uk