

# HEads Up



This is a very difficult time for pensions in the Higher Education sector, as the different schemes used grow further apart. All present their own challenges, but perhaps the biggest challenge of all is how to provide a joined-up approach for benefits to staff in different schemes.

## USS or them?

We're running a session at this year's BUFDG conference (at 1.30pm on Tuesday 27 March) where we will look at the challenges faced - cultural, regulatory and structural - in trying to reconnect pension provision for the sector, and look forward to a lively discussion of the issues. In the meantime, this issue of HEads Up looks at some of the key pensions issues the sector is facing. Naturally, many of these relate to the challenges posed by the Universities' Superannuation Scheme (USS) valuation, but they also apply more widely. Does defined benefit (DB) have a place in the future? If not, is defined contribution (DC) the only choice? Where could collective defined contribution (CDC) fit in? What is the best way to structure multi-employer schemes, to get the benefits without the downsides?

## The end of DB?

The private sector has largely moved away from DB pension provision for future service (though there is a very long tail of remaining DB benefits). So there hasn't been much focus on whether or not DB is fit-for-purpose as an ongoing benefit structure. Most discussion and regulation is on the issues created by the DB benefits built up in the past. Any consideration of DB as an ongoing benefit usually focuses only on the risks it poses for the employer, rather than its effectiveness as a form of benefit provision.



Guaranteed pension increases probably make up about one-third of the cost of future benefits.

Actually, under current legislation, DB has a huge problem – guaranteed pension increases. By law, DB schemes must provide pension increases for life, whereas DC schemes now have no requirements at all for the shape of the income members receive. In a DC scheme, members can (if they know how – which is a challenge in itself) use the value of their pension benefits very efficiently, and target the income to the stages of their retirement when they need or want more.

In a DB scheme, a huge proportion of the cost, is, by law, aimed at providing increasing income through life. DB schemes are generally in deficit because of falling investment return expectations and increasing life expectancy. So people are living longer, meaning their guaranteed increases last even longer, and reach even higher levels, and the lower investment returns make those very high payments in the far future even more expensive – a reduction of 0.5% on the annual expected return adds 5% to the cost of payments in 10 years' time, but 15% to the payments in 30 years' time.

### What other options are there?

The most obvious alternative to DB is DC. No risk to the employer, and complete flexibility for staff as to how they shape their benefits in retirement, meaning good targeting of resources, assuming staff receive advice and gain a good understanding of how best to use their DC pots.

However, under DC, staff take on all of the risk, and there is no option to spread the highs and lows out across the membership. So some staff will potentially do well, while others will lose out due to market volatility.

If the goal is to remove all employer risk, then moving to DC is the right option. But if your goal is to target resources better, given the inflexibility of DB income shaping, then there is no need to go that far.

### Cash balance schemes

A cash balance scheme can be a good middle ground. This is like a DB scheme before retirement, providing a guaranteed pot of money at retirement, with the employer taking the investment risk, and able to spread highs and lows across the membership. After retirement, though, it is like a DC scheme, with the ability to shape the income from the guaranteed pot in the best way.



**Guaranteed pension increases probably make up about one-third of the cost of future benefits.**

Do your staff understand how much the increases cost? Given the choice (and knowing the cost), would they choose to receive that level of increase, or a higher initial pension instead. For the same cost, they could get nearly 50% more pension without increases.

Arguably the guaranteed increases from a DB scheme provide very poor value for money for employers – potentially making future DB provision untenable.

## Collective defined contribution schemes

This is a popular model in the Netherlands and some other countries. As a concept, it could cover a very wide range of benefit structures. But whatever the structure, the aim is to have some mechanism for smoothing out market volatility for the members, which removes the 'winners and losers' nature of DC schemes, while creating little or no risk for the employer.

There are two main challenges with CDCs:

- The method for smoothing needs to be open, and understood by the membership, so they understand the overall concept. Ultimately this will look like a with-profits arrangement in some form, and so planning is needed to avoid the difficulties they have faced in the past.
- Smoothing volatility can work if it is actual volatility. But how do you tell the difference between a downturn that will come good, and the start of a long-term downward trend?

Our recent webinar looks at this in more detail, and covers some of the practical experience learned from the Netherlands. Visit our website to find out more.

## Multi-employer schemes

A multi-employer pension scheme at its most basic is one that provides benefits to staff of more than one employer. Often this will be to staff within the same group of companies, but more interesting are the schemes that allow employers that are separate entities. There are lots of schemes like this in the UK, and a wide range of ways they can be structured, striking a balance between:

- grouping all employers together to achieve maximum cost efficiencies
- ensuring all employers are treated separately to avoid cross-subsidies

Within the sector, institutions participate in a number of multi-employer schemes, in particular:

### The Teachers' Pension Scheme (TPS)

All employers are very much treated the same because everyone pays the same contribution rate. This means there will be cross-subsidies between employers – because someone with one membership will pay the same as someone with a younger membership, even though the true cost for the two populations will differ. However, because the scheme is unfunded (so is protected from market volatility), and underwritten by the Government, these cross-subsidies are not too concerning.

### The Local Government Pension Scheme (LGPS)

How this works can vary from fund to fund. Employers can be treated separately, or be in a pool with other employers, in which case there are cross-subsidies with the other employers in the pool. However, it is worth noting that there can be sharing between pools, or between employers not in pools, because there isn't any actual separation of assets – this is done on a notional (and approximate) basis. While this scheme is ultimately backed by Government, it is quite different to TPS because it is funded rather than unfunded, and employers are treated separately. This makes it much more risky than TPS to an employer.

## The Universities' Superannuation Scheme (USS)

This scheme is right towards the 'grouping all employers together' end of the spectrum. Employers pay the same amount towards deficits, regardless of how much of that deficit relates to their members (based on % of pensionable earnings), and pay the same towards future cost regardless of the age profile of their members. It is a 'last-man-standing' scheme, so if one employer leaves, the other employers take over responsibility for ensuring those 'orphan' liabilities are covered.

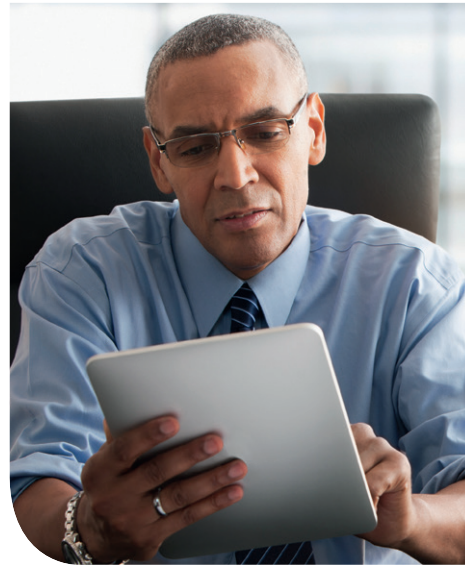
• The leaving employer will be asked on leaving to pay a debt that should ensure the benefits are covered, but that amount might not be recovered in full if the employer is insolvent.

Even if it is paid in full, unless the liabilities are secured with an insurance company, risk will remain in relation to those benefits which falls to the remaining employers.

Such last-man-standing schemes are quite common because they do mean you get full benefit from the efficiencies of a multi-employer scheme. But they weren't designed with the current legislative regime or scheme funding challenges in mind.

If the USS does move to DC for the future, as is the plan at the time of writing, this does raise some questions about the collaborative nature of the scheme, and create a potential opportunity to change this, should that be desirable:

- The new DC benefits could be set up in two different ways – either linked to the past DB benefits or not. If they are linked to the past DB benefits, this will mean any employer who wants to stop paying into the DC scheme will become liable to a cessation debt for the DB. Alternatively the DC could be completely separate, with employers free to choose whether they use the USS DC arrangement or not, still contributing to the DB deficit, but without being locked in to the DC.



- It becomes more likely that, over time, the allocation of the deficit between employers will change. At the moment, this is split based on pensionable earnings – so wholly in relation to your active members. Actually much of the deficit will relate to deferreds and pensioners, and some employers will have more 'mature' USS memberships than others, so moving to a different deficit split could have a huge impact on the contributions payable. This is something best dealt with at the time of the change, rather than allowing a system to evolve over time without being thought through.

## Outsourcing your administration

The modern world of pensions is complex. HE institutions will, as noted above, have several different pension arrangements, incorporating defined benefit, defined contribution and auto-enrolment schemes. This all adds further complexity, and means there can be a lot of demand on your HE Pensions Manager and their team.

In-house administration teams are often small and specialised, and there is a clear knowledge risk if a key member of staff leaves the university. With this in mind, more trustees of Self-Administered Trusts are looking to outsource the responsibility of member administration to a third-party provider.

⋮ Outsourced administration services should be self-sufficient, hassle-free and add value.

Third-party administration companies (TPAs) can offer a professional and flexible service which adapts to the ever-changing laws and regulations of the pensions world, and the complexities of HE institution pension schemes. Services can be tailored to the specific needs of your HE institution to ensure they work seamlessly as an extension of your in-house team – offering a ‘one-team’ approach for your members.

Quality of service is important for any pension scheme, and TPAs have an abundance of experienced administrators, as well as technical specialists who are experts in pension legislation, and remain up to date with legislative changes affecting pension schemes. Clear communication of pension benefits to members is essential, and TPAs offer specialist teams who can tailor communications to the needs of your HE institution, incorporating your university logo so they look like part of your overall employee benefits package.

⋮ TPAs use specially developed pensions software which ensures accuracy of benefit calculations, and a quality service to members and trustees alike.

This software may also allow the TPA to carry out a full audit of the data during transition, helping trustees review the quality of their data in accordance with the Pension Regulator’s guidelines.



There can be a lot of demand on your HE Pensions Manager and their team.

Many in-house teams continue to store their member correspondence in paper files. This poses not only a data protection risk, but also a considerable risk of the files being lost or damaged. TPAs should be able to bulk-scan your paper records and hold them electronically. This allows the administrators easy access to all historic correspondence, to further ensure accuracy and quality, and ultimately, to ensure members are paid the benefits they are entitled to.

The changing landscape of the pensions industry, and its technology, means people have come to expect immediate access to all aspects of their financial affairs. Most TPAs can accommodate this by offering online access for trustees and members. This allows you to issue communications electronically, and means members can review their details and calculate their potential benefits instantly online, and in their own time.

Moving to a third-party administration provider is a big commitment that you should not undertake lightly. It can be a time-consuming and complicated process. But working with an experienced TPA, who is a good fit for your institution, the transition, both for trustees and members, can be seamless and pain-free.



.....

Online access allows members to review their details and calculate their potential benefits instantly online, and in their own time.

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



**Paul Hamilton FIA**  
Partner and Head of Higher Education

✉ [paul.hamilton@barnett-waddingham.co.uk](mailto:paul.hamilton@barnett-waddingham.co.uk)

☎ 0333 11 11 222

[www.barnett-waddingham.co.uk](http://www.barnett-waddingham.co.uk)

Barnett Waddingham LLP is a body corporate with members to whom we refer as "partners". A list of members can be inspected at the registered office. Barnett Waddingham LLP (OC307678), BW SIPP LLP (OC322417), and Barnett Waddingham Actuaries and Consultants Limited (06498431) are registered in England and Wales with their registered office at Cheapside House, 138 Cheapside, London EC2V 6BW. Barnett Waddingham LLP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries for a range of investment business activities. BW SIPP LLP is authorised and regulated by the Financial Conduct Authority. Barnett Waddingham Actuaries and Consultants Limited is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.