Cyngor Cyllido Addysg Uwch Cymru
Higher Education Funding Council for Wales

Higher Education and Pensions

Higher Education Institutions’ Pension Schemes

1. Higher education institutions in Wales are members of a range of pension schemes, many of them UK wide, designed to provide pensions for staff when they retire. These schemes are funded by contributions made by both the employee and the employer but there are differences in the nature of the schemes. There are variations in the *type* of pension benefits that retired staff receive, and the *way* the schemes are managed, funded and accounted for in the financial statements of the HE institutions.

2. The two main forms of pension scheme are described as ‘defined benefit’ and ‘defined contribution’. Defined benefit schemes are also further described as funded or unfunded schemes. Funded schemes have separate funds managed by trustees (separate to the employer). They oversee the investment of contributions received from employees and employers with a view to maximising the return which is earned by the money in the scheme in order to meet the costs of pension payments to retired employees. Unfunded schemes do not have a stand-alone fund for receiving contributions and from which to pay pensions to retired members.

3. With **defined benefit schemes**, employees and their employers contribute to the scheme. The employee knows what pension they will get (in terms of any lump sum on retirement and monthly pension) *irrespective* of what they have paid into the scheme. Their benefits are typically calculated on the basis of:

   - their salary at the point of retirement, or perhaps over the final 12 months of employment; or their average salary over a longer period; and
   - the number of years that they have worked and contributed to the pension scheme.

4. With **defined contribution schemes**, employees make a contribution, usually supplemented by their employer, to the scheme. When they retire, the value of the contributions over the years, plus any investment return that the contributions have earned, is calculated and the monthly pension is determined by the investment value of that sum, minus any which is taken as a lump sum.

5. Funded defined benefit schemes are typically higher risk for employers because their financial sustainability relies on the scheme having enough income and assets to meet the current and forecast future liability for pension payments to retired employees. To make sure that such schemes are on track to earn sufficient income to meet these liabilities, the trustees are required to have a formal valuation, known as an actuarial valuation, of the scheme normally once every three years. This is a requirement of the statutory Pensions Regulator, who can also require the trustees to increase levels of contributions to the scheme if the value of the scheme funds is insufficient to meet the scheme liabilities. Actuarial valuations are based on a range of assumptions including forecast returns on investment, income from contributions and pension recipients’ mortality rate. Scheme valuations are very sensitive to changes in these assumptions.

6. The main pension schemes that Welsh higher education institutions are members of are in the table below.

	Defined Benefit	**Defined Contribution**
Funded	• University Superannuation Scheme (USS) • Local Government Pension Schemes (LGPS) • In-house schemes	• National Employment Savings Trust (NES) • In-house schemes
Unfunded	• Teachers' Pension Scheme (TPS) • National Health Service Pension Scheme (NHSPS)	

7. The financial statements of each higher education institution provide further details about their pension schemes.

8. The way in which pension schemes ensure that they have enough money to meet the costs of pensions for retired scheme members varies. Funded schemes are run by trustees who oversee the investment of pension contributions with a view to maximising the return which is earned by the money in the fund. Unfunded schemes do not have a stand-alone fund and include Government schemes such as the Teachers' Pension Scheme and the NHS Pension Scheme. Employers and employees pay their pension contributions directly to the exchequer, and pensions are subsequently paid directly by the exchequer.

9. There are significant differences between the way in which the costs of defined benefit, defined contribution, funded and unfunded schemes are accounted for by member organisations, and differences in the way in which the schemes are presented in the financial statements of scheme members. All of these variations between schemes mean that the financial implications of pensions for scheme members are not presented on a consistent and comparable basis for all schemes in their financial statements.

Current Challenges

10. The amount of money required to be paid into defined benefit pension schemes, normally as monthly contributions from employees and employers based on a percentage of pensionable pay, changes from time to time as a result of the actuarial valuation of the schemes. It is possible for the valuation to conclude that a scheme has enough assets to cover its liabilities and consequently result in either no change or a reduction in future contributions. However, the experience for most defined benefit schemes in recent years has been that the valuation results in the schemes being in deficit with more liabilities than assets and therefore a greater level of contribution is required to meet the scheme's liabilities. The increase in liabilities is partly due to the fact that we are all living longer and therefore retired employees are drawing their

pension for a longer period of time. At the moment, most higher education pension schemes need increased levels of contribution.

11. The **long-term affordability** of defined benefit schemes is very challenging and most employers, particularly in the private sector, have closed their defined benefit schemes to new members, with new staff offered defined contribution schemes instead. Higher education institutions are not seeking to close their main defined benefit pension schemes, most notably the USS, but they do need to manage their future costs.

12. The **actuarial valuation** of the USS at 31 March 2017 was a total deficit of £7.5bn compared to a deficit of £5.3 billion following the previous valuation in 2014. Higher education institutions have had to make provision in their financial statements for 2018/19 for the total value of their future contributions to the deficit recovery plan put in place by the USS trustees to reduce this deficit. This has resulted in many institutions reporting a financial deficit in the statement of comprehensive income (more commonly known as the income and expenditure account) in their financial statements.

13. Individual higher education institutions who are members of the USS, and their management, cannot separately determine their own contributions to the scheme. It is the trustees of the USS scheme who have to respond to the outcomes of the actuarial valuation in order to satisfy the UK's Pensions Regulator, and they ultimately have to confirm the contributions to be paid to the scheme. USS member HE institutions are required to pay contributions in future both to reduce the current scheme deficit and also to ensure that ongoing contributions are sufficient to cover the increase in scheme liabilities. Further details about the USS scheme valuation and the response from the employers' representative body UCEA are available on their websites.

14. The fact that **additional contributions** are going to be required from HE institutions for their various pension schemes has implications for their financial statements. For unfunded defined benefit schemes, these increased levels of contribution will show as additional expenditure each year for the foreseeable future, until a future actuarial valuation concludes that contribution levels can be reduced. This means that higher education institutions will face the challenge of generating sufficient additional income to meet these additional pension costs each year as well as annual inflationary increases in all the other costs they have to meet.

15. For funded defined benefit schemes, such as the USS, in addition to having to pay **increased pensions contributions** in future years, higher education institutions are also required to account for their share of the scheme deficit by making a provision for these future costs. This deficit provision represents the total value of the additional contributions which they will be making over the next ten years or more to eliminate the scheme deficit, and this total value is included as operating expenditure in their 2018/19 income and expenditure account, even though they will actually be making the payments annually spread over the coming years. This is a way of presenting pension costs that is a requirement of the Financial Reporting Standards that govern the way HE institutions prepare their financial statements. This presentation is required by the accounting rules to reflect the fact that the HE institutions' commitment to pay additional contributions in future to eliminate the scheme deficit is a contractual commitment.

Consequently the HE institutions' share of the scheme deficit is provided for in full so that their reserves are reduced to recognise this contractual commitment. This will mean that, for many HE institutions that are members of the USS, this pension deficit provision is going to result in their financial statements reporting very substantial losses in the year 2018/19, even though the cash payment impact will *actually* be more evenly spread over at least the next 10 years. In fact, this pension adjustment has nothing to do with operational performance and should not be interpreted as such.

16. The USS has recently had a further actuarial valuation as at 31 March 2018 as a result of the ongoing dispute between HE institution staff and employers on this issue, and that shows a much reduced deficit. Although unfortunately this actuarial valuation was not confirmed in time to be reflected in the 2018/19 financial statements, it will be included in 2019/20, when there will be a positive adjustment made to the pension deficit provision and in the income and expenditure account.

The large deficits reported in the 2018/19 financial statements of many HE institutions in Wales are therefore mainly due to these **one-off pension charges to the income and expenditure account and do not reflect a crisis in their operating performance**. Those deficits are not a reflection of the cash or day-to-day spending position of HE institutions, nor do they mean that spending has been significantly higher than income. They are a reflection of accounting practices to show the increase in USS pension liabilities. These liabilities are future commitments to payments to reduce the pensions deficit, and not current expenditure.

More

BUFDG guide to HE finances

www.bufdg.ac.uk/understanding-finance/a-new-guide-to-understanding-he-finance/

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