**Politician and stakeholder briefing on the impact of the recently announced contribution increases for university employers using public service pension schemes**

**Introduction**

On 6 September 2018, the Chief Secretary to the Treasury, Elizabeth Truss, provided an update to Parliament on the 2016 actuarial valuations of the public service pension schemes. She indicated that the assumptions which HM Treasury plans to apply to the valuations would lead to both an increase in member benefits and very substantial increases to employer contribution rates.

The increases in employer contributions are far beyond any expectation that the employers across all impacted sectors could have reasonably had. For example, from September 2019 employer contributions to the Teachers’ Pension Scheme (England & Wales) will increase by 44% (a 7.2 percentage point increase); with a similar increase by 5.2% percentage points being modelled for Scottish TPS.

The UK higher education (HE) sector employs some 419,590 staff. The TPS increase in England and Wales is estimated to involve additional costs to the affected universities of c.£130 million each year from September 2019 – the equivalent of taking the fees paid by 14,000 undergraduate students in England and spending that entire fee income on pension contributions. We estimate the annual additional cost to universities in Scotland to be around £8m each year (a 30% increase), to be borne largely across 8 universities. The proposed employer contribution increases will without doubt have a detrimental impact on these universities’ ability to enhance student experience and promote the economic wellbeing of their cities and regions at what is already a time of great uncertainty. As a result, both employers and trade unions are urging the Treasury to reconsider these contribution increases.

Universities are a vital part of the UK economy. Through a huge range of activities, UK universities generate more than £95 billion a year in output for the British economy and support 944,000 jobs at all skill levels. ​Universities attract valuable income and investment to all corners of the UK, acting as ‘anchor institutions’ which bring together employers and other parts of the education sector to support economic growth and deliver skills training across the UK. Given the importance of these institutions to communities across the UK, it is vital to secure the long-term economic sustainability of our universities.

In order to prevent damage to universities and students, UCEA is calling on the Treasury to defer the cost increases while it fully reviews the 2016 valuation and adjustment of the discount rate. It is also calling on the Government to be more flexible around the cost cap process and to provide guarantees around funding available to employers in HE to deal with additional costs. This briefing describes the problems facing UCEA members in public service pension schemes and our full recommendations for Government.

**Which universities are most impacted?**

UCEA represents 170 HE organisations as employers across the UK. Those most impacted by these proposed cost increases to their pension schemes include:

* 70 ‘modern’ (post-92) universities that are required to offer the Teachers’ Pensions Scheme (TPS) and the Local Government Pension Scheme (LGPS) to their staff. These modern universities are often at the forefront of efforts to widen participation in their communities and act as ‘anchor institutions’ for enhancing the economic health of their cities and regions.
* 41 university medical schools that offer the NHS Pension Scheme (NHSPS) to clinical academics (including 5 newly set up in the last year). These institutions are vital to delivering the nation’s need for clinical training of health professionals – nurses, doctors and dentists – at a time of acute shortage and need to build these skills. These institutions already find it hard to recruit and retain the clinical academics needed to sustain this delivery.

**What is the impact of the Treasury’s announcement on the schemes?**

The Government Actuary’s Department has been working with schemes on the 2016 valuations and indicative results have shown that:

* employer contributions will need to increase significantly, and
* for many schemes the cost cap has been breached as the cost of benefits to members has fallen. This requires action to improve pension benefits.

The indicative employer contribution rates for the schemes related to HE are:

|  |  |  |  |
| --- | --- | --- | --- |
| Scheme | Current employer contribution rate | Estimated new employer contribution rate | Increase in employer contribution rate |
| TPS (England & Wales) | 16.48% | 23.68% | 7.2% |
| TPS (Scotland) | 17.2% | 22.4% | 5.2% |
| NHSPS (England & Wales) | 14.38% | 20.6% | 6.22% |
| NHSPS (Scotland) | 14.9% | 19.9% - 20.9% | Est 5 – 6% |

Northern Ireland has to issue its own directions but we expect the results to be similar.

LGPS has a separate cost management process undertaken by the Scheme Advisory Board (SAB) in England and Wales but these changes will directly affect the LGPS in Scotland and Northern Ireland.

The employers we represent are clear that these contribution increases are neither affordable nor sustainable and demonstrate that the current valuation and cost management processes are not fulfilling their original purpose. This point was acknowledged by the Chief Secretary to the Treasury in her recent [letter](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/738850/180906_CST_to_TUC_on_draft_directions.pdf) to the TUC. UCEA has written to the Treasury to request that the valuation process be paused and an immediate review is undertaken.

**Why has this happened?**

*Valuation discount rate*

The valuation result is mainly driven by the assumptions set centrally by the Treasury – in particular, the discount rate. The rate of CPI +3% set in 2011 was expected to be reviewed in 2016 and it was announced as part of the 2016 Budget that the rate would be reduced to CPI +2.8%. This was expected to result in employer contribution increases of around 2% from 2018 and this is what employers will have planned in budgets and the forecasts provided to HE sector regulators.

While challenging, employers had enough time to plan for this change but that has not been the case for this latest announcement that the discount rate would be reduced further to CPI +2.4% from April 2019. Though the Government has reserved the right to review the discount rate “out of-cycle” in the event of a significant change in circumstances, there had been no indication that HM Treasury intended to review the rate before the next 5 yearly review was due in 2021 so this recent change was completely unexpected.

The Treasury sets the discount rate in line with the long term GDP forecast from the Office for Budget Responsibility (OBR). We accept that long term GDP is the basis for setting the discount rate and it was noted that, as part of the 2010 consultation, the Government considered the process for future reviews. However, the Government also recognised the importance of stability in a discount rate used to set contribution rates that will impact on employment decisions.

In addition, we would argue that making changes based on long term GDP forecasts at a time when this measure is likely to be more volatile than usual is injecting an element of unpredictability to the cost of public pensions which goes against the original aims of the Hutton report and the cost management process. The March 2018 [OBR report](http://cdn.obr.uk/EFO-MaRch_2018.pdf) which the Treasury has based this decision on itself states that there is a considerable range of potential GDP outcomes, in particular due to the uncertainty surrounding Brexit. Therefore, we would question the case for reviewing the discount rate at the current time.

*Cost management process*

Following the [final report](https://www.gov.uk/government/publications/independent-public-service-pensions-commission-final-report-by-lord-hutton) of the Independent Public Service Pensions Commission in 2011 (the ‘Hutton report’), an employer cost cap was introduced to share the risks of unexpected costs between members and employers on a 2% “cap and collar” basis i.e. if costs rise or fall by more than 2% changes have to be made to bring the cost back to the level of the cap.

The cost management process was created to share risk between employers and members, with members bearing the risk of demographic change, salary assumptions or member profile changes. This time the fall in cost of the career average benefits is due to the impact of long term public sector pay restraint and the decline in improvements in longevity assumptions. It was anticipated that breaching the cost cap would be an extremely rare event. However, it has actually been triggered the very first time it has been tested.

The cost cap regulations allow for the value to members to be brought back in line with the cap through either changes to benefits, changes to member contributions or some other means. However, the Treasury has informed the Department for Education that changes to member contributions are not permissible without a corresponding adjustment being made to the department budget to ensure the cash yield to the Treasury remains the same. This prevents the SAB from fully exercising its duty to consider how the value of benefits should be maintained. Employers would strongly argue that all avenues for rectification should remain open to the SAB and believe a move to reduce member contributions would be viewed positively by staff; the TUC has itself endorsed this point.

**What could be the impact on universities?**

The planned contribution increases in line with the 2016 Budget already represented a significant rise in universities’ cost base coming on top of, for many, a series of increases in the required employer contributions to LGPS, which is the scheme most modern universities are required to offer their non-academic staff. Such pension costs also have had to be provided for alongside other government policy-driven increases in employment costs including:

* the increase to National Insurance due to changes to the State pension,
* the apprenticeship levy, and
* the immigration skills charge.

The scale of a 44% increase in employer costs is unprecedented. The short timeframe over which universities would need to find this additional and ongoing funding is an exceptional challenge which is being received by institutions with shock and dismay. This is of course at a time when universities’ main income sources are fixed / capped. Furthermore, the delay in the Treasury announcing these figures makes it almost impossible for employers to plan.

The increase in TPS (England & Wales) alone will cost the affected HE institutions an additional c.£130 million in employer contributions in the first year with the cost increasing to c.£150 million by 2023. In 2019 this is equivalent to the entire fees from over 14,000 undergraduate students in England. In most cases the employer contribution increase will apply from April 2019, but for the TPS the Treasury has permitted a delay until September 2019 to align with the academic year, however this comes at an additional cost.

Universities are knowledge-based industries with a very high proportion of their expenditure necessarily going on staff. While it is recognised that sustainable investment in staff is fundamental to the ongoing success of the HE sector, it is inevitable that a large and unplanned for cost increase such as the contemplated increase in employer pension contributions to TPS from next September can, for many institutions, only be met by reducing expenditure on staff. This, in turn, will result in an inevitable impact on what can be delivered to students.

Over the past few years, higher education institutions have already faced significant challenges around their financial sustainability. Borrowing has significantly increased from 19.8% of income in 2009-10 to 30.9% in 2015-16. In 2016-17, 64% of UK universities experienced a fall in their surplus (or increase in deficit) with the median surplus falling from 3.9% to 2.9%. We estimate that the number of post-92 universities in deficit will double as a result of the implementation of these pension contribution increases.

The Treasury has offered funding to cover the additional cost to some employers over the 2019-20 period. Funding beyond this period will be considered within the Spending Review. However, DfE has suggested support for schools would be prioritised and it is not clear whether DfE or DHSC are intending to include universities in such funding support or where the cost would come from in subsequent years. Clarity on this point needs to be obtained quickly and consideration should be given to how any additional funds can be shared fairly between different employer groups.

The responses to UCEA’s initial consultation on the above challenges demonstrate the serious threat they pose to institutions across the UK. For instance:

* “We envisage a necessary reduction in the region of 5% of teaching workforce alongside reductions in spend on facilities and resources available for students to support their learning.”
* “An increase of over 7% in one go is disproportionate to the ability to absorb such an increase and will impact on staffing …[we] have already had to face substantial downsizing in the last few years.”
* “It goes without saying that most of the income for this university and other post-92 HEIs comes from student fees (over 40% of our income is essentially fixed as it comes from Home UG student fees); and that the scope for alternative sources of income is limited. If the changes go ahead as planned, impact on staff numbers, student services and future plans for investment in the student experience will be inevitable and significant.”
* “The university estimates that the TPS increase will be £1.3m pa, representing an overall increase on the pay bill of circa 2%... the university has no option but to implement a sizeable savings programme, and expects that we may need to shed around 120 staff. It is impossible to envisage a situation where these cuts will not impact adversely on the student experience.”

**Concerns specific to the HE sector**

As well as the serious concerns that universities have about the impact this will have on student experience, there are a number of particular concerns for HE employers:

* TPS is more extensively used in the post-92 or ‘modern’ universities and these are institutions that tend to have a high dependency on tuition fee income (or teaching grant in Scotland). Such universities are often also a major economic actor in their city or region and at the forefront of widening participation. The freezing of the upper cap for tuition fees in England for 2018-19 and 2019-20 means that the greater proportion of university income cannot increase to meet these externally driven cost pressures. For many post-92 universities these proposed employer contribution increases will push them into deficit at a time when surpluses are vital.
* Many of the modern post-92 universities employ small numbers of staff who transferred from pre-92 universities. In some cases they were allowed to remain in the Universities Superannuation Scheme (USS) but they retain a statutory right to move to TPS; an issue likely to be highlighted if TPS benefits increase. If their last USS member leaves the scheme the cessation debt would be triggered for that employer which could require the university to fund their share of the scheme deficit – likely to be a bill of several million pounds. This is an issue that many universities are monitoring with concern.
* Scheme members in HE tend to be at the higher end of the salary spectrum and as such an increase in benefits could compound the current impact of the Lifetime and Annual Allowances already disproportionately affecting higher education staff in TPS and NHSPS. This could lead to further opt outs or additional early retirements with the commensurate loss of senior skilled staff in disciplines which are already struggling, for example in the recruitment of clinical academics by medical schools.
* An increase in TPS benefits at a time of industrial unrest in the HE sector would not be welcome. Comparisons are understandably being made between the TPS and USS and staff will find it difficult to understand why university employers feel the need to consider benefit reductions in order to control rising costs in the USS when the Treasury is proposing to increase benefits for their colleagues in TPS institutions.

**What are UCEA’s recommendations?**

We have written to the Chief Secretary to the Treasury to request:

1. That the 2016 valuation process be paused to allow for Government Actuaries Department (GAD) to do a full review of the valuation process and the implementation of the cost cap. The then Chief Secretary for the Treasury suspended the 2008 valuations while a review and consultation on the discount rate were undertaken. These were then superseded by the 2012 valuations. Alternatively, we suggest that the Treasury does not have to review the discount rate at this point.
2. That in managing the ‘cost cap’ processes, the Scheme Advisory Boards be allowed to negotiate any potential changes to member benefits or contributions, without the threat of a deduction being made from departmental budgets regarding employee contributions.
3. That the position regarding additional funding be clarified before the results of the valuations are finalised, including confirmation that all affected employers including universities will be supported by additional funding from both DfE and DHSC and that these additional pension costs will also be taken into account when setting these departmental budgets as part of the next Spending Review.

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