UCEA
UNIVERSITIES & COLLEGES EMPLOYERS ASSOCIATION

REPORT ON HIGHER EDUCATION INSTITUTIONS AND THE LGPS 2019 VALUATIONS

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UCEA Report on Higher Education Institutions and the Local Government Pension Scheme 2019 valuations

Introduction

During May and June 2020 UCEA conducted a survey on the 31 March 2019 LGPS valuation results. The survey sought information on covenant assessments, funding, employer contribution rates and deficit management. The survey also included questions on whether or not any HEIs with LGPS have or are considering offering a defined contribution (DC) alternative and the impact of Covid-19.

This report sets out the results of the survey and also includes UCEA commentary which provides some additional context to the survey findings and information on work being undertaken by UCEA in relation to the LGPS.

Survey responses

There were 30 responses to the survey from institutions participating in 25 different LGPS funds across England. 27 responses were received from post-92 institutions and three responses came from pre-92 institutions that offer LGPS to groups of their professional services staff. The responding HEIs included both Scheduled and Admitted bodies.

Summary of survey findings

a. All responding HEIs confirmed that their LGPS funding level as at 31 March 2019 had improved in the three-year period since the 2016 valuations. Seven responding HEIs (23 per cent) reported that their LGPS funding level was 100 per cent or above at the last valuation date.

b. Two thirds of responding HEIs (20) offer LGPS to all new professional services staff while four HEIs offer LGPS to professional services staff up to or within certain grades, for example 1-6 with other professional services staff outside these grades offered an alternative scheme.

c. The median combined primary and secondary contribution[1] rate paid by responding institutions in 2020/21 is 19.6 per cent following conclusion of the 2019 LGPS valuations.

d. Twenty responding HEIs (66 per cent) stated that they had furloughed staff who are members of the LGPS.

e. Nine responding HEIs offer a DC scheme in place of LGPS for groups of professional services staff. A Further nine HEIs (30 per cent) are considering options to offer a DC alternative in the future

Conclusions

UCEA has conducted surveys after the last three triennial LGPS (England & Wales) valuations in 2013, 2016 and now 2019. Between the 2013 and 2016 surveys the majority of HEIs responding reported increases in their overall contribution rates over successive valuations with some institutions paying substantially higher employer contributions into the LGPS than the rates paid by employers in the other main HE pension schemes, including the Teachers' Pension Scheme (TPS) and the Universities Superannuation Scheme.

[1] While most institutions pay a secondary contribution that is either fixed or increases annually to address their notional deficit, we have expressed these amounts as a percentage of payroll where possible.

The 2019 valuations feel different to previous valuations for various reasons. Firstly, overall funding levels across the LGPS in England & Wales have improved, mainly due to positive investment returns, but also due to changes in scheme demographics. Additionally, administering authorities seem to have a better understanding of HEI business models and financial stability which has filtered through to responding institutions LGPS valuation results.

While the cost of future service benefits have increased as at 31 March 2019, reductions in secondary (deficit) contributions mean that most of the HEIs responding to our 2019 survey have found their employer contributions have stayed broadly similar to the 2016 valuation outcome or they have reduced. This is in stark contrast to the 2013 and 2016 valuations where the majority of HEIs faced increased LGPS contributions. You can see a comparison of median future service (primary) and deficit (secondary) contributions in Appendix 1 & 2.

Despite positive valuation outcomes in 2019 for many HEIs, there continues to be an appetite to introduce a DC alternative to LGPS. There are several reasons for this not just related to managing the costs, risks and lack of control associated with participating in a national public service defined benefit (DB) scheme. These reasons include changes in the profile and demographics of the HE workforce over recent years, with growing numbers of professional services staff wanting a more flexible and affordable retirement savings vehicle. In addition, other local employers generally offer a DC scheme, and it is increasingly common for other competitor HEIs, particularly across the pre-92's to offer DC to professional services staff.

Most HEIs that offer LGPS to professional services staff offer the TPS to their academics. The 2016 TPS valuations led to a 40 percent increase in employer costs. For many HEIs this is unsustainable in the long term, however there are significant barriers preventing post-92s reducing their TPS costs. One example is the requirement that researchers and those that teach and undertake research are included on the HEIs payroll in order to be counted on the REF return. This makes it difficult to recruit some teaching staff into a subsidiary because of the knock-on effects on REF and student staff ratios. It means that those post-92s that are considering how to manage their staff pension expenditure are restricted in their options for reducing TPS costs and have limited other options other than to focus on LGPS instead.

Overall, the significant regulatory barriers in place prevent the post-92s from having the same flexibility as the pre-92's when it comes to their pension offering. While there is a consultation proposal outstanding from summer 2019, that would allow Higher Education Corporations (HECs) to offer an alternative scheme for new joiners in place of LGPS, the government has not yet responded. At the time of writing we hope for a response in the Autumn of 2020.

UCEA, on behalf of its member HEIs that participate in the LGPS, has been lobbying for greater flexibility for post-92s so that they can if they wish offer an alternative scheme under the rules rather than having to offer an alternative scheme via a subsidiary. UCEA has recently written to the government to reiterate our arguments that HECs should be allowed greater flexibility in the LGPS. We have also requested a meeting with the Minister responsible for LGPS at the Ministry of Housing, Communities and Local Government (MHCLG) to discuss this issue further.

2020 has been a difficult year for pension schemes due to the Covid-19 pandemic and it is perhaps with some relief that the LGPS valuations in England and Wales were dated 31 March 2019. In Scotland the LGPS valuations take place one year later so their valuation date is 31 March 2020. We await the results which should be released in late 2020 but it seems likely that LGPS funding levels will have worsened since 2019. However, looking to the future, there might be sufficient time over the course of the next two and a half years for funding positions to recover

before the next valuations in 2022/23. We will undertake a Scottish survey in early 2021 to collate the LGPS valuation results for the Scottish HEIs.

The government has also recently published a consultation on addressing the age discrimination in the LGPS related to the McCloud judgement which will add to the cost of the scheme going forwards, although this cost will be significantly lower than that to be borne by the unfunded public service pension schemes. During these times of uncertainty, it seems clear that there will be increasing moves away from LGPS to DC pension provision in the HE sector and the valuations in 2022/23 will pose a challenge for some HEIs in terms of affordability and sustainably going forwards.

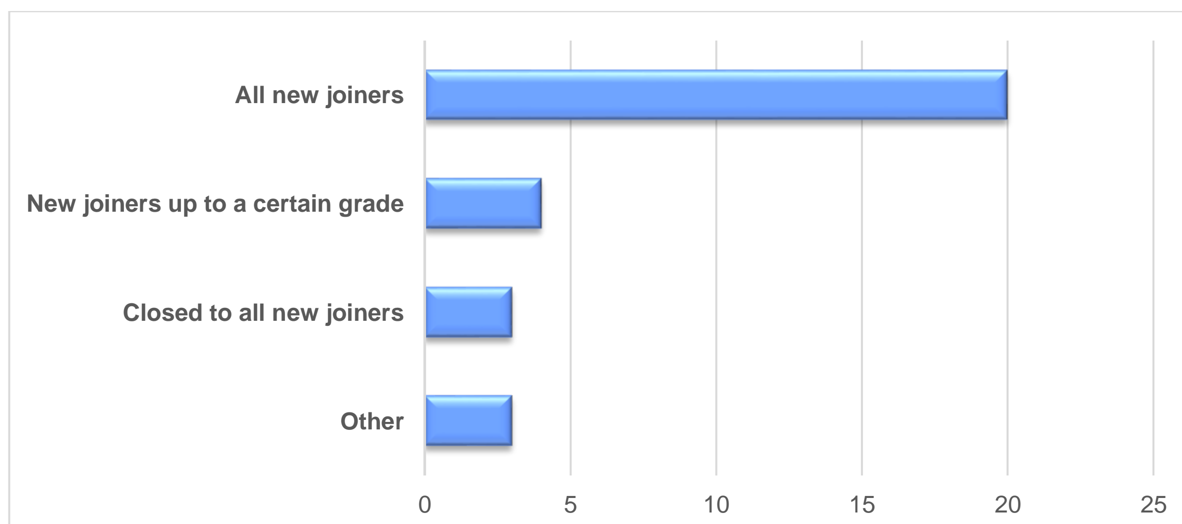
Finally, UCEA is very grateful to the HEIs that responded to this survey.

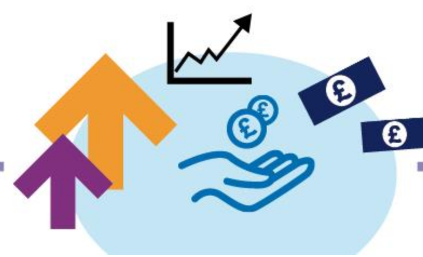
Background information
Survey responses were received from 30 HEIs that participate in 25 different LGPS funds across England. 23 responding HEIs are "scheduled bodies" meaning that they have a statutory obligation to enrol new professional services staff in the LGPS. While it is possible to offer an alternative pension scheme alongside the LGPS for those staff that choose to opt out, the only way these employers can automatically or contractually enrol new starters into a non-LGPS scheme is if their staff are employed through a subsidiary company. Four responding HEIs are "admitted bodies" and three HEIs confirmed that they are categorised as both scheduled and admitted bodies in different sections of the scheme.

Participating employers that are admitted bodies in the LGPS tend to have greater flexibility in terms of who they enrol in the scheme, though there is some evidence to suggest that admitted bodies are grouped together as weaker employers which can then feed into covenant strength, investment strategy and ultimately the cost of paying into the scheme.

Two thirds of responding HEIs enrol all new professional service joiners into the LGPS, with four HEIs stating that they enrol certain grades of staff into the scheme with other grades offered an alternative DC scheme.

Figure 1: Staff enrolled into LGPS by responding HEIs





“The University established a wholly-owned subsidiary company, with effect from 1 April 2017 to employ the majority of new Professional Support and Contract Research staff at grade 5 and below from that date. The DC scheme operated by the subsidiary was also available for staff who had previously opted-out of a defined benefit arrangement”.

“Grades 1 – 6 professional support staff are now in a DC scheme within the Universities and Colleges Retirement Savings Scheme master trust”

Employer covenant assessment
Our survey asked various questions relating to employer covenant assessments. Most LGPS funds will assess the financial strength of participating HEIs to determine the degree to which the HEI can be relied upon to fund any LGPS deficit and meet future service pension liabilities. This support reflects the legal obligation and financial ability of the HEI to make contributions to the LGPS not only on a regular basis, but also on a contingent basis should certain adverse events materialise.

Many responding HEIs will have been asked to provide information to their local fund, including audited accounts and financial forecasts, as part of a covenant assessment - the outcome of which is important as covenant strength may affect both the timing (e.g. length of recovery period) and the amount (e.g. if investments strategy is linked to covenant strength) of employers’ contributions. In some cases HEIs deemed to have a weaker employer covenant have been faced with significant increases in contributions over previous valuations.

17 responding HEIs (57 per cent) discussed employer covenant assessment with their local fund, with six of these HEIs advising that the outcome of their assessment differed from the 2016 valuation. One HEI stated that the outcome of their assessment had led to a weaker covenant rating and impacted on their contribution rates while the other HEIs stated that their covenant assessment had led to an improvement in their assessed covenant with a positive impact on funding and/or cost of benefits.

“There were a number of factors that changed. The consultation paper which included the option for universities to opt-out of a LGPS was deemed by the actuary/pension fund that the university could be a flight risk. The fact that the government stated that they wouldn't bail out a university if they were in financial difficulties meant universities were deemed as financially less secure than other statutory bodies. We had our maximum time horizon reduced from 19 to 15 years and the stabilised contribution rate was removed. In addition, our pension actuary decided to group us with the local colleges, which probably meant they didn't fully understand the difference between the two groups in terms of risk and income generation.”

“The Fund adopted a different Funding Target for Colleges and Universities and subsidiaries for the 2019 valuation. Whilst the Administering Authority adopted a general approach of assuming indefinite investment in a broad range of assets of higher risk, a reduction was made to the discount rate to reflect concerns about the covenant strength of Colleges and Universities. The College and University's Intermediate rate was introduced, there are two different intermediate rates dependant on the Funds actuary's assessment of the College and University's covenant strength. AON assessed the University's covenant strength and assessed it to be strong.”

“2016 assessment Medium risk (in service discount rate 3.9%). 2019 assessment (post review) Lower risk (in service discount rate 4.3%)”

“We were assessed at the 2019 valuation as Medium risk, however the comparison to previous valuations is possibly not equitable. Our fund has approved and implemented a new funding target aimed at providing an equitable assessment of Scheduled and Admitted bodies - detaching the risk usually associated with those admitted body employers who are typically not underwritten by other institutions, therefore our own covenant assessment has become stronger as a result.”

“The fund introduced a new categorisation for low risk admission bodies who were continuing long run members of the fund and of appropriate financial standing. This allowed a more appropriate discount rate to be used than the previous blanket approach for admission bodies.”

“The University produced for, and presented to, the Fund Actuary a pack of information to support the covenant assessment. This set out the information requested by the actuary, but also provided a number of additional pieces of information to contextualise the University's strong financial position and performance (recognising that the actuary needed guiding through understanding the extent of risk in a sector which does not measure success based on profit).”

UCEA comment:
While there were responding HEIs that reported an improvement in their covenant assessment and it is clear that many LGPS funds are starting to have a better understanding of the HE sector, the risks the sector faces and individual HEI’s business models, there is still significant inconsistency in how different local funds have assessed HEI covenant strength. There may be several reasons for this including:

- the level of resource the fund is prepared to (or can afford to) expend in order to understand the HE sector and their HE employer,
- The actuarial firm that the fund uses as different actuarial firms can take differing approaches to HEI covenant assessment,
- the size of the HEI compared to other participating employers within their fund,
- the number of HEIs and other tier 3 employers within a local fund, and,
- the relationship between the HEI and its local fund.

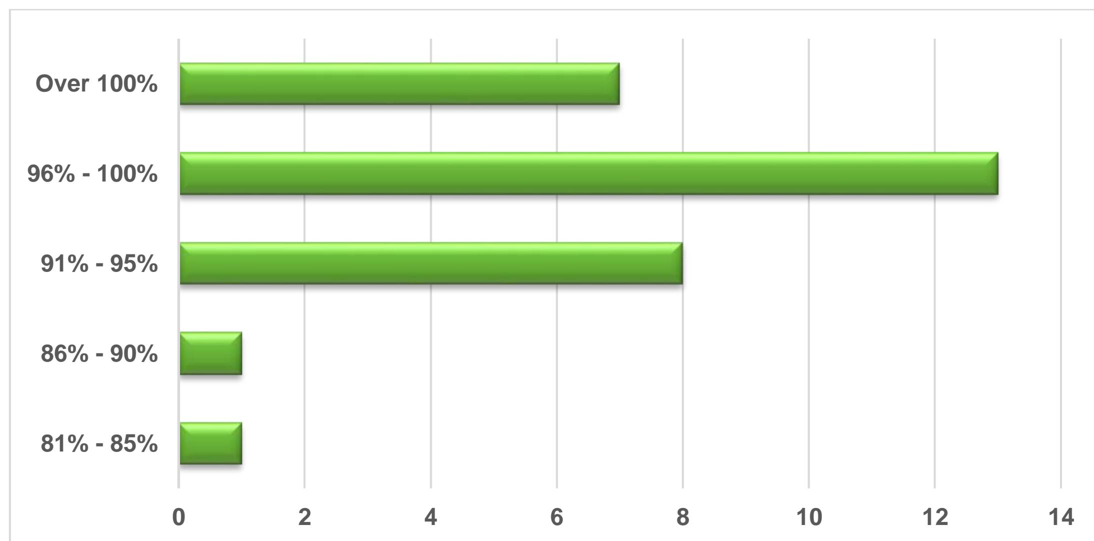
UCEA will consider how best to raise issues regarding the inconsistency in covenant assessments of HEIs in the LGPS at national level.

31 March 2019 valuation results
Prior to publication of the 31 March 2019 valuation results it was clear that many LGPS funds were reporting improvements in their overall funding position which had helped to reduce deficits. However, it was also clear that the cost of future benefits had also risen. This position is reflected at individual HEI level, though importantly all responding HEI have confirmed that their overall LGPS funding level was higher than reported as part of the 2016 valuations. There was one HEI that had a funding level of 116 per cent as at 31 March 2019. This institution’s 2020/21 combined primary and secondary employer contribution rate remained at a similar level to the rate paid in 2019/20 (the last year of contributions relating to the 31 March 2016 valuation) despite the HEI having a notional surplus. However, the fund actuary advised that the HEI in question would see a

reduction in its contributions over the next six years. There was also one other responding HEI that reported a funding level of 100 per cent or over and an overall contribution rate that reduced over the period April 2020 to March 2023. These have contributed to the fall in the median employer contribution rate from 2021/22 to 2022/23.

"Assets have grown, returns improved and some assumptions have had a positive impact(especially lower life expectancy). Assets have grown from £1.5bn to £1.9bn. Liabilities have increased from £1.9bn to £2.1bn. Deficit has reduced from £0.5bn to £0.2bn. As a result, the scheme has moved from 75% to 90% funded. This has allowed rates to be frozen (and reduced for a small number of employers)"

Figure 2: HEI LGPS funding levels 31 March 2019



The median primary (future service) employer contribution rate paid by responding HEIs following the 2019 valuations is 18.7 per cent between 2020/21 to 2022/23. This compares to a median rate of 14.5 per cent paid by HEIs that responded to our survey on the 2016 valuation results.

The combined primary and secondary contribution rates (i.e. including deficit contributions) expressed as a percentage of payroll is 19.6 per cent in 2020/21 (20 per cent in 2019/20 which was the final year of contributions following the 2016 valuations) but this reduces to 19.5 per cent in 2022/23. This reflects lower deficit contributions payable for certain HEIs that have a notional surplus as at 31 March 2019.

"Contribution rate has increased whilst deficit payments were reduced. The total contribution rate hasn't changed significantly for the next 3 years."

"*4.1% funding level improvement from 2016 to 2019. 15.1% contribution rate compared to 13.0% for previous 3 years."*

The survey results show that 29 out of 30 responding HEIs discussed their 31 March 2019 valuation results with their fund, with several HEIs reporting that these discussions led to positive changes to risk categorisation and contribution rates/recovery periods.

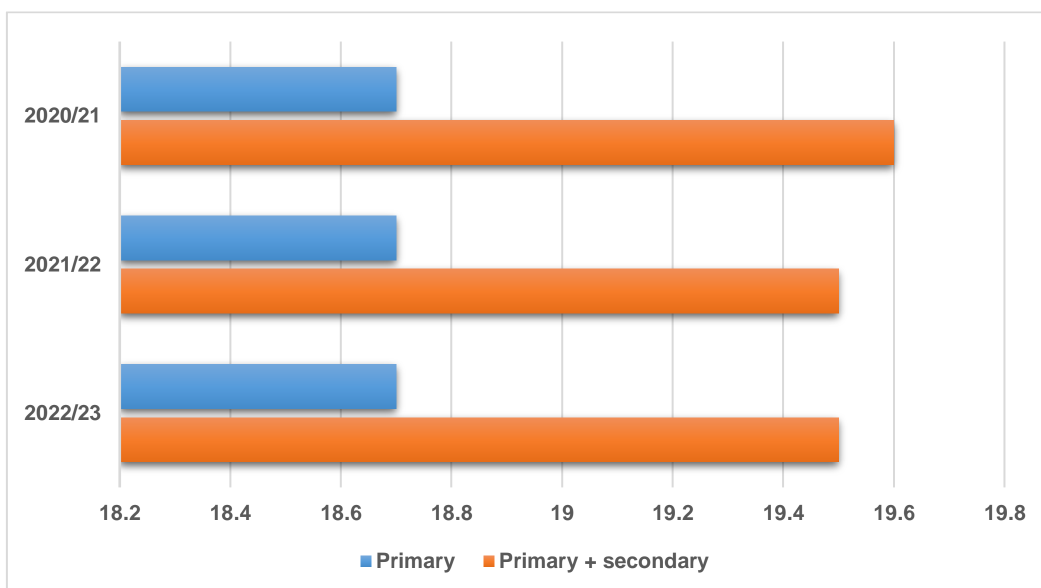
"We had discussions to better understand the valuation outcome and what assumptions had been made and were satisfied that they were prudent and did not lead to any changes in rates or deficit."

"Our initial risk rating was Medium, this was changed to Lower following two discussions with the actuary (Aon). We provided additional contextual and financial information so that they could reassess the rating."

"The results of our 2019 Valuation Employer Results Report Draft showed that our funding position had improved but our employer contribution rate remained the same. We requested a lower employer contribution rate which the fund agreed to. The draft had a total employer percentage of 22.2% which was changed to 19.2%."

"The discussions and the provision of financial forecast information resulted in a reduction in both employer contribution rates and deficit reduction."

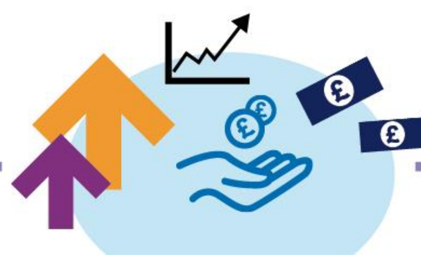
Figure 3: Median HEI employer contribution rates



UCEA comment

UCEA continues to recommend that where possible HEIs take time to discuss their valuation results with the fund actuary to ensure the assumptions that have been applied are appropriate for them and that contribution structures and deficit repayment terms are mutually acceptable. In the past, provision of new, updated financial information including evidence of secure income streams, has led to positive changes in employer costs following publication of provisional valuation results. It is encouraging to see that most of the responding HEIs discussed their valuation results with their fund, including the covenant assessment.

While responding HEIs have reported better than expected outcomes in terms of their contributions rates, rather worryingly, one fund seems to have taken a negative view of the potential ability for scheduled employers to offer an alternative to LGPS for new joiners and UCEA will consider this issue as part of i's work to push for greater flexibility for HEIs that have a statutory obligation to offer LGPS.



One point of concern is that in 2019 the increase in funding levels and corresponding reduction in deficit payments has masked a significant increase in the cost of future service benefits. Given the current economic circumstances it cannot be assumed that such a significant improvement in funding levels will be seen in 2022, and it is also unlikely that future service costs will fall in the short term, so further increases in employer contributions may be seen in 2023 and beyond. It also does not bode well for the outcome of the Scottish LGPS valuations later this year.

Figure 4: Primary contribution rates paid by responding HEIs

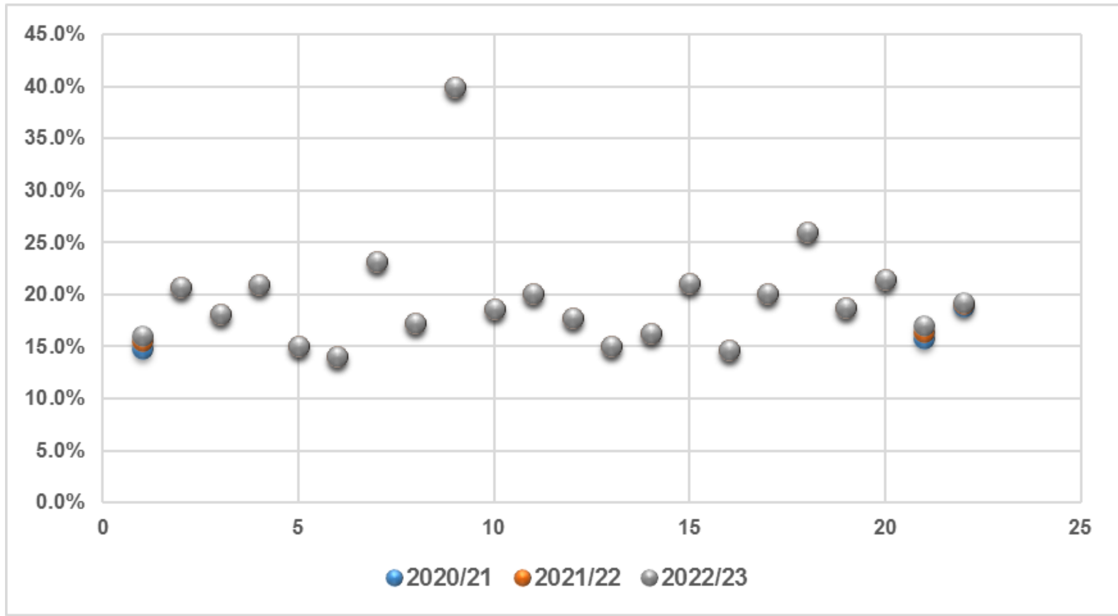
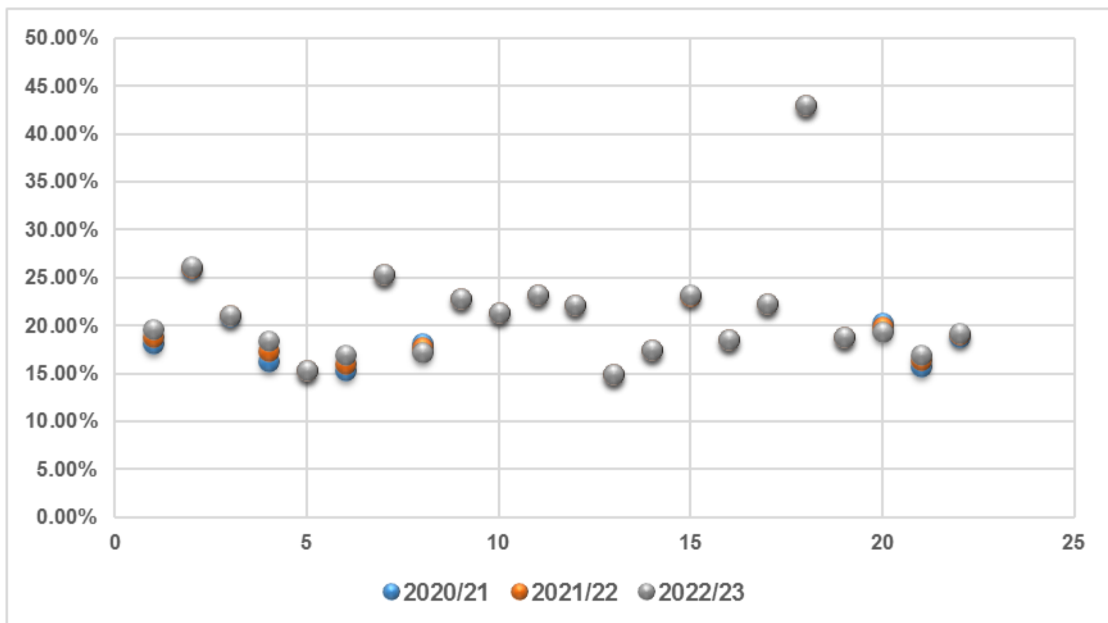


Figure 5 Primary plus secondary contribution rates paid by responding HEIs



LGPS and Covid-19

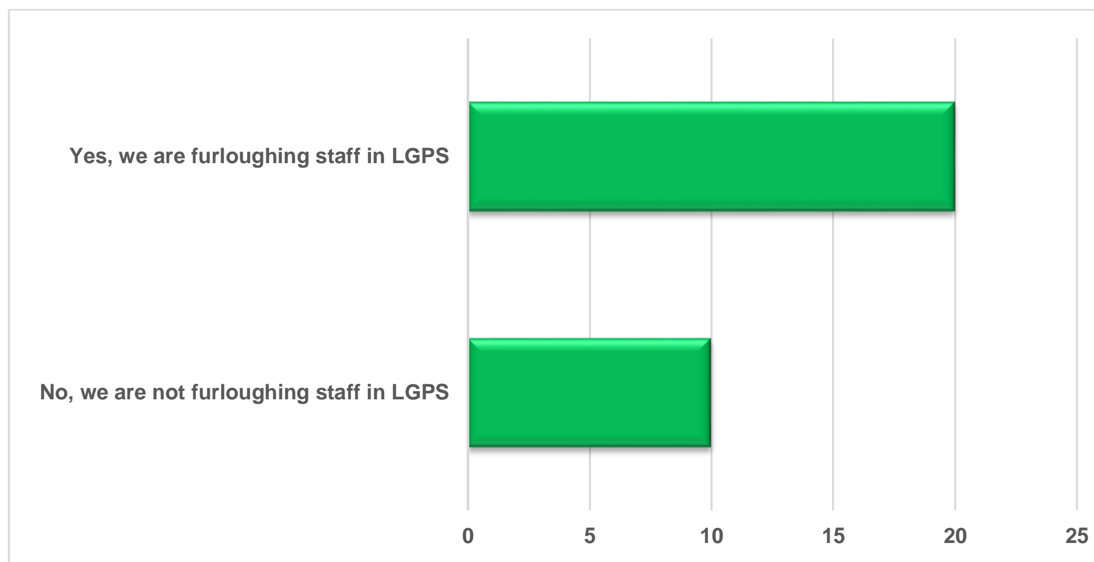
Our survey was undertaken during the Covid-19 pandemic, so we decided to include a couple of questions on the impact of the coronavirus outbreak on HEIs that participate in the LGPS.

Responses to the survey confirm that two thirds of HEIs (20) were furloughing staff in LGPS. Eight HEIs who said they were furloughing staff stated that they estimated the numbers involved were 100 or over – the highest being c400 individuals.

“Small numbers of Estates and Library staff, some externally funded researchers, catering/nursery and Innovation Centre staff have been furloughed up until end of June on full pay. Less than 100 staff members in total.”

“Our University has furloughed approximately 40 staff from our sports village however, the staff members have maintained full pay as the University is paying a top up on top of furlough.”

Figure 6: Furloughing of HE staff in LGPS



Just one responding HEI stated that they had held discussions with their local fund in light of Covid-19. This was just a general discussion on what options may be available if it was considered necessary in the future. This tallies with conversations we’ve had with other HEIs who have wanted to understand options to manage short term cashflow including in relation to pension contributions.

Under the LGPS regulations an employer can ask their local fund whether they can defer employer contributions as long as the full annual amount required from the employer to the LGPS is paid within the financial year. We are not aware of any HEI that has discussed this option with their fund or implemented such an arrangement.

UCEA comment

It is UCEA’s understanding based on some of our other HE sector surveys on the Job Retention Scheme that most institutions that have furloughed staff have/are topping up salaries to 100 per cent. In this scenario there should be no impact on pension accrual for staff who are furloughed and are members of the LGPS.

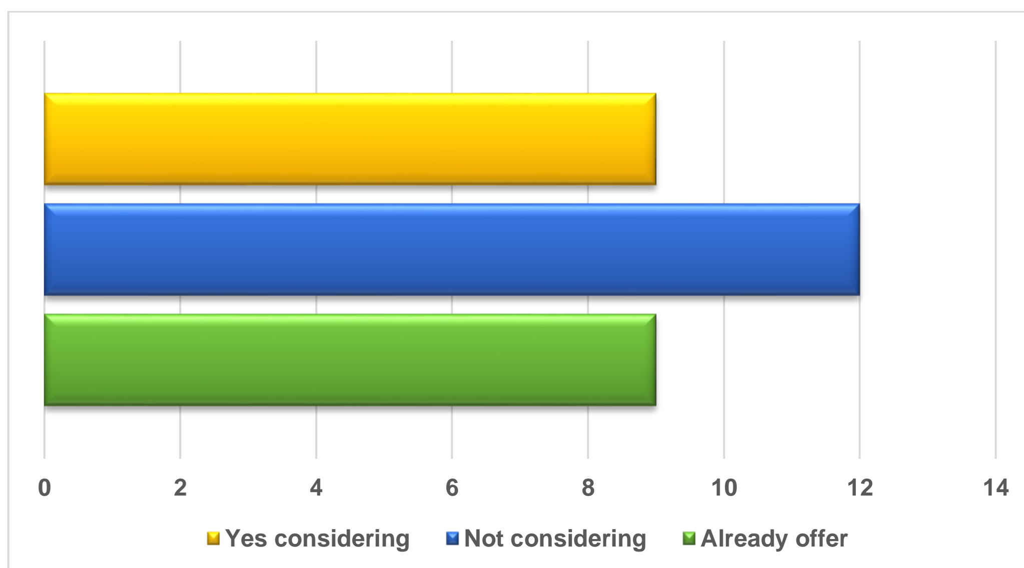
Any furloughed staff who receive less than 100 per cent of salary will accrue a slightly lower pension but may drop down a contribution tier and pay a lower employee contribution rate as a result. Anecdotally, we are hearing that opt-outs across the HE sector pension schemes have increased during lockdown.

The LGPS does have the 50/50 option which would allow a member to pay half the contributions for half the accrual but it seems that staff are opting of LGPS in full rather than taking up this option. We have no information on whether HEIs are communicating the existence of the 50/50 option to members in these cases, but the Scheme Advisory Board is intending to review 50/50 communications to improve member awareness.

Alternative pension schemes to LGPS

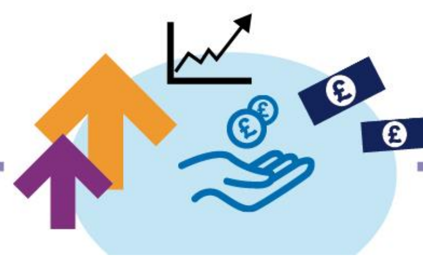
There were nine responding HEIs (30 per cent) that said they offer a DC alternative to LGPS while a further nine said they considering offering an alternative scheme. There were 12 HEIs that stated they had no plans to offer a DC alternative.

Figure 7 Responding HEIs and a DC alternative



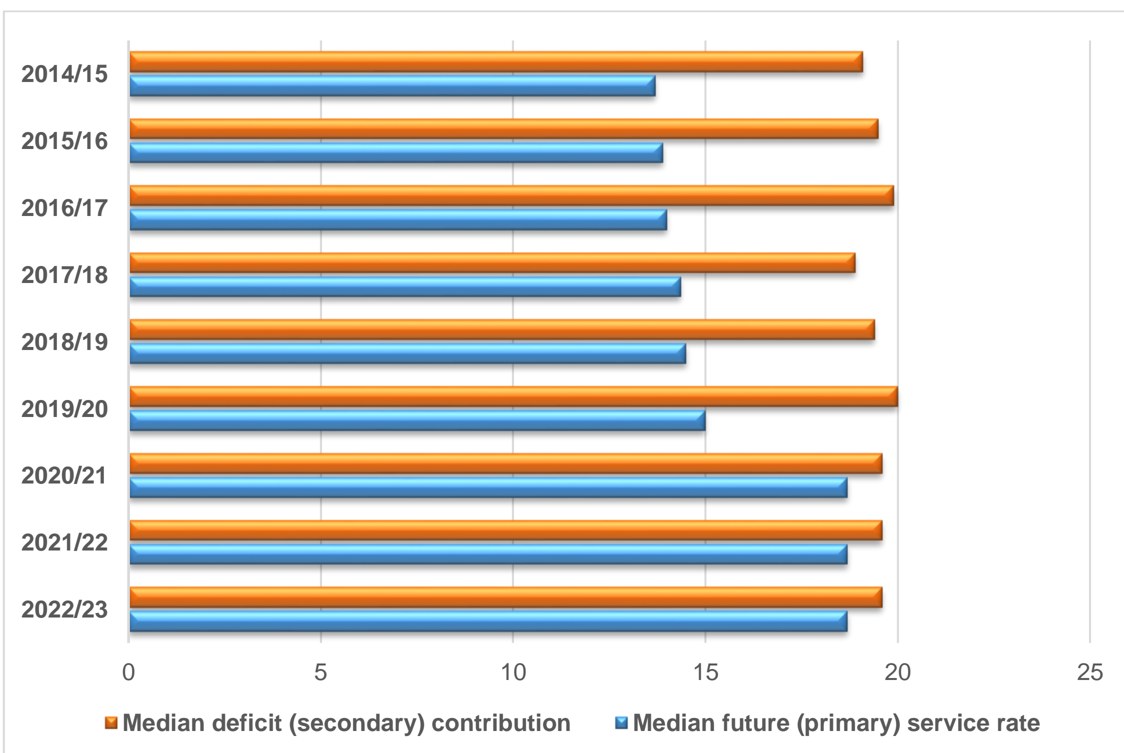
"We are considering looking at an alternative pension scheme, initially for those employees that have opted out. While the LGPS is an excellent benefit, we may have to consider extending those eligible to the alternative pension scheme, should costs escalate to the point that the defined benefit pension scheme becomes unaffordable."

"The University will offer an alternative DC scheme for newly appointed professional services employees from 1st August 2020. The additional DC scheme will apply to all newly employed professional services employees in senior management, administrative, professional, knowledge transfer partnerships and facilities roles and therefore will not affect other University employees within academic, research or technical roles. A new subsidiary will be the employer of any new professional services staff effective from the agreed date of launch of the new pension scheme, which will be 1st August 2020. The T&Cs for employees will be the same as those of the University with the exception of the pension offering. Employees will be offered a defined contribution scheme with Legal and General."



Appendix 1: Median future service (primary) employer contribution payable by HEIs over the last three LGPS (E&W) valuations

Appendix 2: Median future service (primary) and combined future service and deficit (secondary) contributions payable by HEIs over last three LGPS (E&W) valuations.



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