

University Accounting Assumptions

All universities will have just seen the end of another financial year. For those universities running their own defined benefit pension scheme, Self Administered Trust (SAT), this brings the need to set the assumptions for valuing pension liabilities under FRS17 for disclosure in the year-end accounts. Barnett Waddingham's recent survey of the disclosures made by universities gives an insight into the assumptions adopted at the financial position of these schemes for the 2008/09 year end and the increased impact pensions are having on the universities' accounts.

Funding position:

The average funding level of SATs in the survey as at 31 July 2009 was 73%, compared to 81% at 31 July 2005.⁽¹⁾ This could be explained by a number of factors such as a significant

increase in inflation expectations over the period, increased life expectancy and a decrease in the value of equities as a result of the turbulent markets during 2008 and 2009. Since July last year, equity markets have continued the recovery from the lows of March 2009 and inflation expectations have fallen back slightly. However, yields on long dated corporate bonds, which are used to set the discount rate for valuing liabilities, have fallen which increases the value placed on liabilities. This will negate much of the improvement in funding level that might otherwise have been expected in the 2009/10 year-end results.

Investment:

The volatile equity markets seen over the last two years haven't deterred university SATs from holding equities

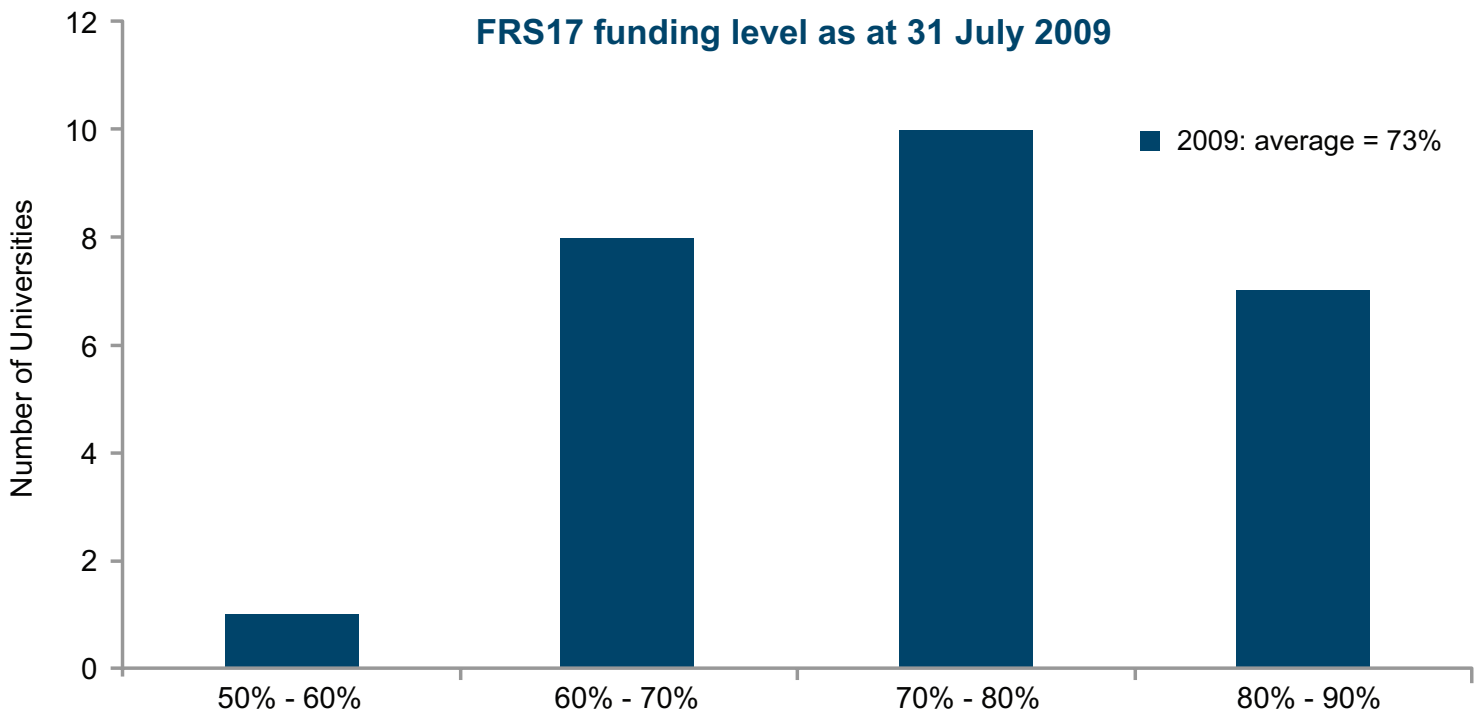
in their investment portfolio. Although there was a slight decrease in the equity weighting over the four years (71% in 2005⁽¹⁾ to 67% in 2009), this could well be simply due to the lower equity values pulling the weighting down.

Assumptions:

The survey showed that there is a fairly wide distribution of inflation assumptions used by universities when valuing their SAT pension liabilities.

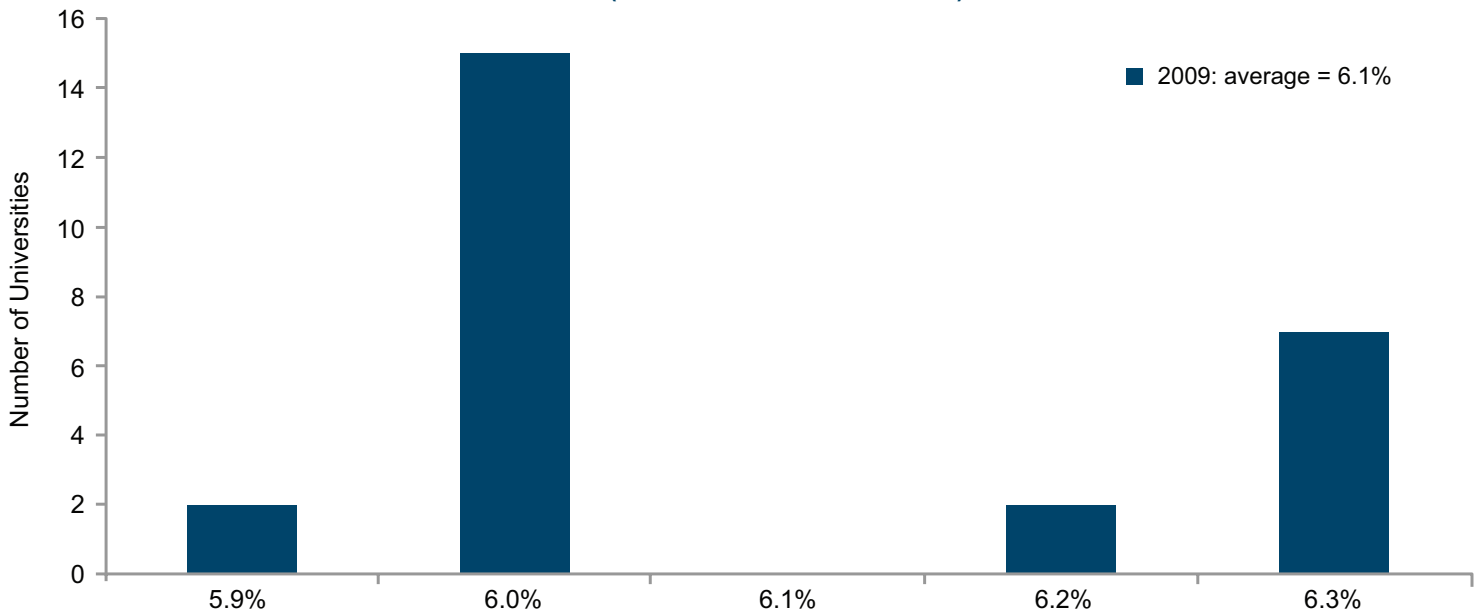
This may suggest that universities were taking into account the duration of their pension liabilities when setting the assumptions and differing opinions on the quantum of the inflation risk premium.

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University Accounting Assumptions cont.

SATs – Discount rate (% p.a.)
(rounded to the nearest 0.1%)



There was less variation in the discount rate assumption with the majority of universities using an assumption of 6.0% p.a. for valuing SAT pension liabilities at 31 July 2009, which was equal to the yield on a standard index (*the iBoxx Over 15 Year AA rated Corporate Bond Index*).

This direct relationship was also evident in 2005 where the average discount rate of 5.1% p.a. was also the same as the index yield at 31 July 2005.⁽¹⁾

Although the range of discount rates used in 2009 was fairly narrow, the sensitivity of the figures to the discount rate moving from the bottom to the top end of the range could still result in a 5% plus reduction in the reported FRS17 liability.

Life expectancy:

The life expectancy assumptions adopted by the universities in the survey were equivalent to a range of between 18 and 23 years for a male aged 65. Variations in life expectancy assumptions between schemes can normally be explained by differences in the make-up of the

membership in terms of factors such as the amount they earn or the job they do. However, it is perhaps surprising that there is such a variation in the survey results as it might be expected that the make-up of the membership would on average be similar across all universities.

Size of deficits:

One useful comparison is the universities' SAT deficit to total university net assets (excluding the pension deficit). For the majority of universities this proportion is below 15% although, perhaps worryingly, a few are higher than 25%.

These deficits may improve slightly come the reporting of the 09/10 year-end result but having such a large deficit in proportion to university total net assets could become an issue for universities.

Pension contributions:

For the universities in the survey the contributions to SATs represent around 3% of total staff costs. This compares to around 8% of the total staff cost for contributions to the Universities Superannuation Scheme.

The continuing economic instability and the growing financial concerns facing universities after recent Government budget announcements mean that universities more than ever need to make careful and informed decisions about their pension arrangements.

(1) Source: "Twenty questions about pension provision in higher education" - British Universities Finance Directors Group survey, August 2006.

In June 2010 the Pensions Regulator (tPR) issued further guidance on member record-keeping following a consultation earlier this year.

This guidance further emphasised the importance of good record-keeping and noted that progress on both take-ups and results within the industry has been limited. The guidance sets out a strengthened approach to regulating this area of pension administration.

In summary, the guidance includes the following measures:

- recommends specific targets for standards of common data
- use of regulatory powers to investigate standards within schemes including sampling schemes for data audit
- potential enforcement action where there is a breach of legislation
- a deadline of December 2012 for the resolution of outstanding data issues and
- enhancement of the education material on its website

So what does this all mean in practice and will university schemes face any specific challenges in adopting this guidance?

Pension administrators are used to working with limited data on an 'as and when' basis. When a deferred member comes to retire they would seek to replicate the benefits before revaluing them up to retirement. If data was incomplete or inaccurate, they would research each case on a member by member basis. Research options would involve looking through archived paper files, if there are any, or referring back to the company to see if they had any archived files, or perhaps asking the member if they have any paperwork.

From a cost point of view this may be manageable for smaller schemes but, where larger numbers are involved, this

kind of exercise can be expensive and time-consuming, as has been seen in wind-up situations or transfers to the Pension Protection Fund (PPF), where applicable.

Until now, data cleansing exercises have tended to take place out of necessity during wind-up, buy out or PPF transfer. Previously, this has been the point at which a discussion starts between the pension administrator and the trustees as to what to do going forward. Now tPR wants these issues to be addressed sooner.

The cost of undertaking a full data cleanse can be high. As with the majority of the Guidance Notes and Codes of Practice, tPR states that this should not mean unreasonable costs to the trustees.

From our experience of administering university pension schemes, the main area where we have spent time cleansing data is in the accurate historical recording of working hours for members working on a part-time basis. There are many different working patterns in an educational environment which take account of term based working and different patterns within these terms. It is essential that the administrator really understands the employment contracts in place in order to correctly calculate benefits.

For example, a member may work term-time only, but on a full-time basis, which will be treated as part-time service just like a member working term-time only, but on a part-time basis. In these cases the administrator will also need to understand how the holiday entitlement is treated in terms of pay and hours worked. There will also be members working throughout the year on either a full-time or part-time basis and members whose contractual hours are more than the standard hours.

Whilst all industries employ part-time staff who may be members of a scheme, in our experience the education sector probably presents the most complex to administer.

When the historical data has been clarified, it is then essential to be able to record this data on a pension administration system in a way which will facilitate automated calculations.

It is highly inefficient to record such data as 'notes' to a member's record, as this practice leads to manual calculations and the inherent risk of errors, as well as the potential for inaccurate valuation data.

Once the historical data has been brought up to date it is then essential to have a procedure in place to maintain this accuracy. The annual update is a good opportunity to do this but care still needs to be taken with any mid-year changes, especially if there has been more than one.

In conclusion, it is hoped that tPR's latest approach will encourage a much broader take-up of the guidance. The first stage is for the pension administrator to report the data quality to the trustees and then engage in a discussion with their advisers as to how to address any data issues. A plan of what to do going forward should be drawn up and regular updates provided to the trustees so that they are ready to answer any questions raised by tPR.

Barnett Waddingham has incorporated tPR's guidance and reporting into its pension administration system, Penstream. This is for the benefit of our existing clients to enhance their ongoing pension administration service.

In addition, it has also been designed to link in with the new client implementation procedures to produce a data quality report at outset and can be used to provide a standalone data check service for any pension scheme.



The University and College Liaison Group was set up to provide a specific focus on the Higher and Further Education Sectors within Barnett Waddingham, recognising the size and importance of the Sectors, together with their unique natures.

The Group has a huge amount of experience in administering university and college pension schemes and in liaising with university and college employers. They keep abreast of university and college matters and concerns affecting and regarding pension schemes, such as affordability issues and pressures to change pension scheme arrangements to provide sustainability of pension provision.

As a result, this Group has a good understanding of the issues and pressures affecting the Higher and Further Education Sectors and work closely with our teams who provide university and college services to ensure that a responsive and supportive service is delivered, reflecting the needs of the employers and their pension scheme members and the environment in which they are operating.

On 27 July the Treasury issued a discussion document on an alternative approach to restricting pensions' tax relief to replace the highly complex high earners pensions' tax legislation which will potentially affect those earning over £130,000 a year and which will otherwise come into effect on 6 April 2011. The paper sets out the proposal and range of policy and design issues that need to be determined so that alternative arrangements can be agreed.

The consultation closes on 27 August and the full document is available at: www.hm-treasury.gov.uk/consult_pensionsrelief.htm.

In summary, the proposed changes will be good news for some, but are likely to mean that more university staff will be caught by the restrictions. The new proposal centres around a substantial reduction in the Annual Allowance, the amount by which a pension pot may grow in a year before attracting additional tax, from the current level of £255,000 to around £30,000 to £45,000, with an increase in the multiplication factor from 10 to between 15 and 20, in order to achieve the same level of tax income to the Treasury.

It is not yet known how the increase in the value of the pension will be calculated each year, but for staff that are in a final salary scheme like the USS, it is possible that they could be affected if their pension entitlement grows by £2,000 in a year.

Tax relief may be capped at 40% and changes may also be made to the Lifetime Allowance and enhanced protection arrangements.

The Government is intending to confirm its approach by the end of September, with draft Regulations issued in the autumn for consultation and legislation included in the Finance Act 2011 so as to be effective from 6 April 2011.

Individuals may wish to keep an eye on developments and to consider their future pension requirements as matters progress in order to make the most of the tax relief available to them. Anti forestalling arrangements remain in place.

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