

# Accounting for pension costs

Survey of Universities disclosures as at 31 July 2009

## Introduction

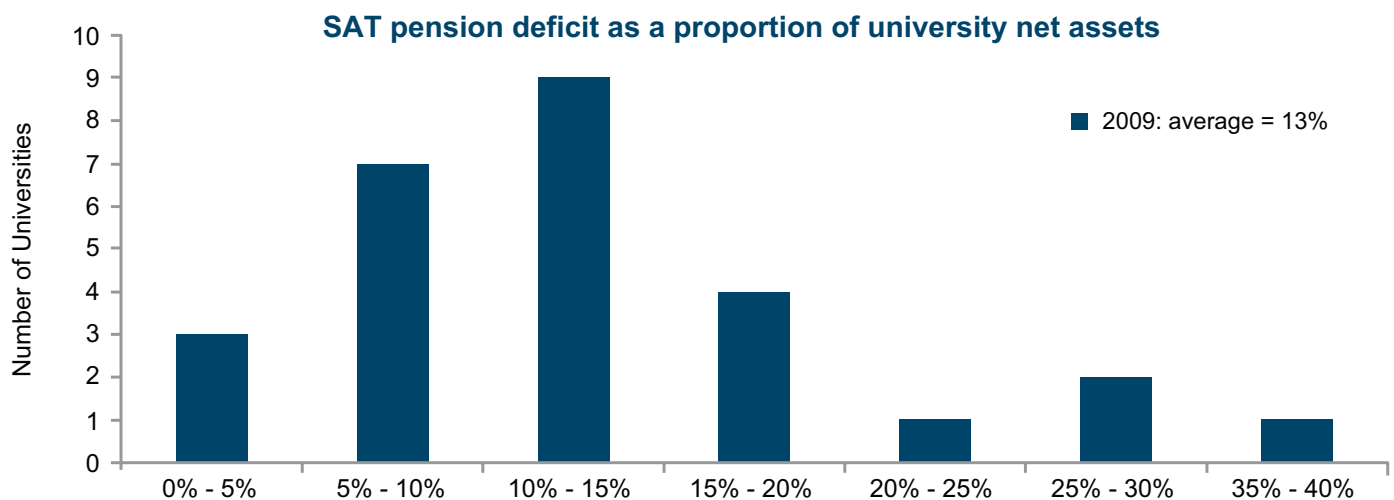
This is our first annual survey of the assumptions adopted by UK universities for determining the value of their pension liabilities for accounting purposes. As well as participating in the Universities Superannuation Scheme (USS) many universities operate their own occupational defined benefit schemes (which we will refer to as Self Administered Trusts) for non academic staff. This survey focuses on universities which operate Self Administered Trusts (SATs) and looks at the significance of these schemes in the context of the overall finances of the university as well at the assumptions used in their FRS17 disclosures as at 31 July 2009.

To enable us to make some historic comparisons we have used some of the data available in the *'Twenty questions about pension provision in higher education'* report written by the British Universities Finance Directors Group (BUFDG) based on accounts for the year-end 31 July 2005.

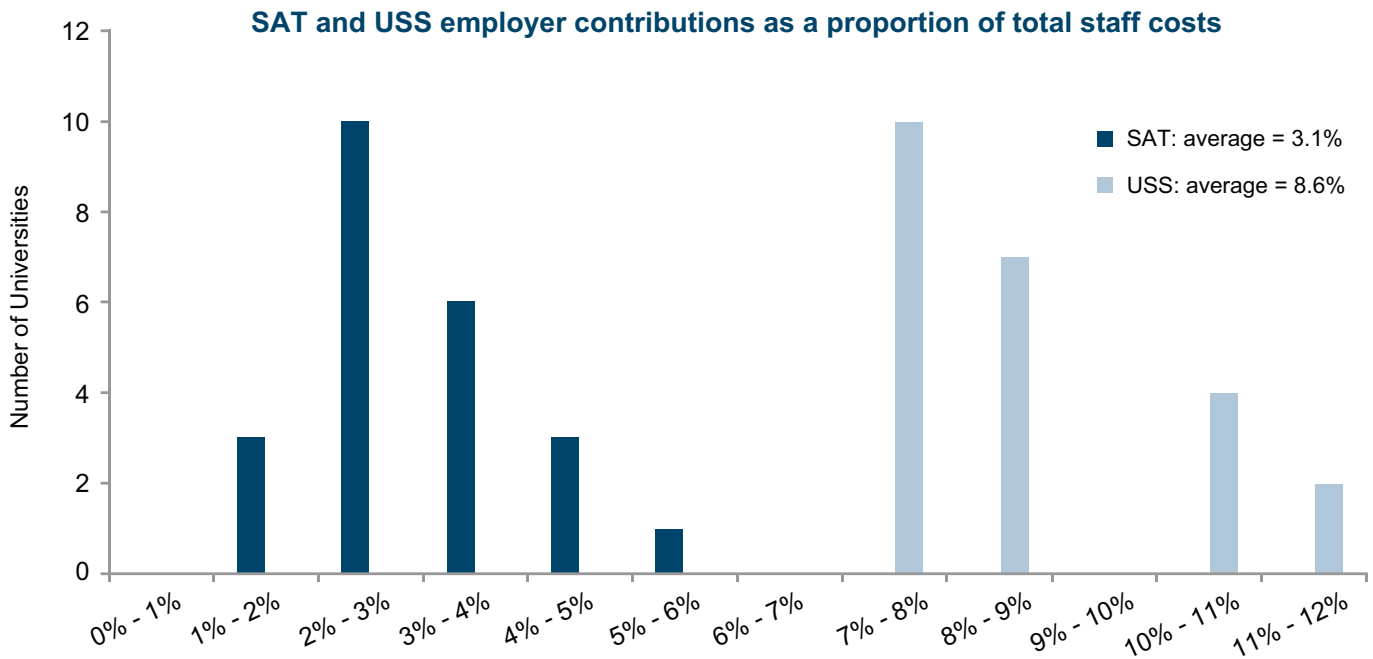
This survey is based on data in the published accounts of universities with financial years that ended on 31 July 2009. The figures in this survey are based on a sample of 26 universities whose accounts showed they operate SATs.

## How much of a burden are these schemes?

For the universities in our survey the pension deficit represents an average of 13% of the net assets of the university (excluding the SATs pension deficit). The chart below shows how this proportion can vary significantly between individual universities.

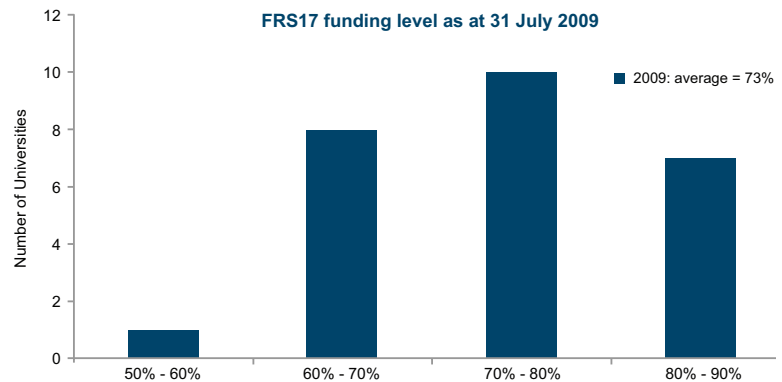


For the universities in our survey that contribute to both SATs and the USS, we found that the contributions made to SATs represent an average of 3.1% of total staff costs. The chart below shows how the contributions to SATs compare with contributions made to the USS for these universities.



## Surplus / deficit

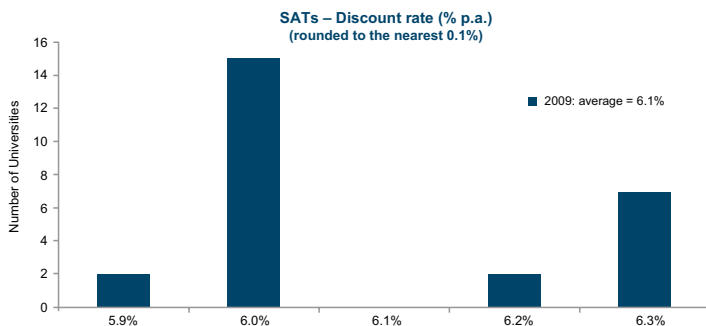
The average FRS17 funding level for the universities in our survey is approximately 73% at 31 July 2009. This compares with approximately 81% at 31 July 2005. Reasons for the decrease in funding level over this period could include the significant increase in inflation expectations over the period, increased life expectancy and a decrease in the value of equities as a result of the turbulent markets during 2008 and 2009.



## FRS17 Assumptions

### Discount rate

The discount rates used by the universities in our survey for their Self Administered Trusts (SATs) are set out below.



Year ending	Index yield* % p.a.	Average discount rate % p.a.
31 July 2005	5.1%	5.1%
31 July 2009	6.0%	6.1%

\*iBoxx over 15 year AA-rated corporate bond index.

At 31 July 2009, the yield on the iBoxx over 15 year AA-rated corporate bond index was approximately 6.0% p.a. (2005: 5.1%) and this was by far the most popular discount rate used by the universities in our survey with 15 universities (58% of universities with SATs) employing it in their pension liability calculations. The range of assumptions used was fairly tight with all universities in the survey using discount rates within the range 5.9% p.a. and 6.3% p.a. However, due to the sensitivity of the figures to the discount rate moving from the bottom to the top end of this range could result in a 5%+ reduction in the FRS17 liability.

From the BUFDG report on accounts with a year-end of 31 July 2005, the mean discount rate used was 5.1% p.a. which indicates that many universities were again using a discount rate that was very close to the index yield at the effective date.

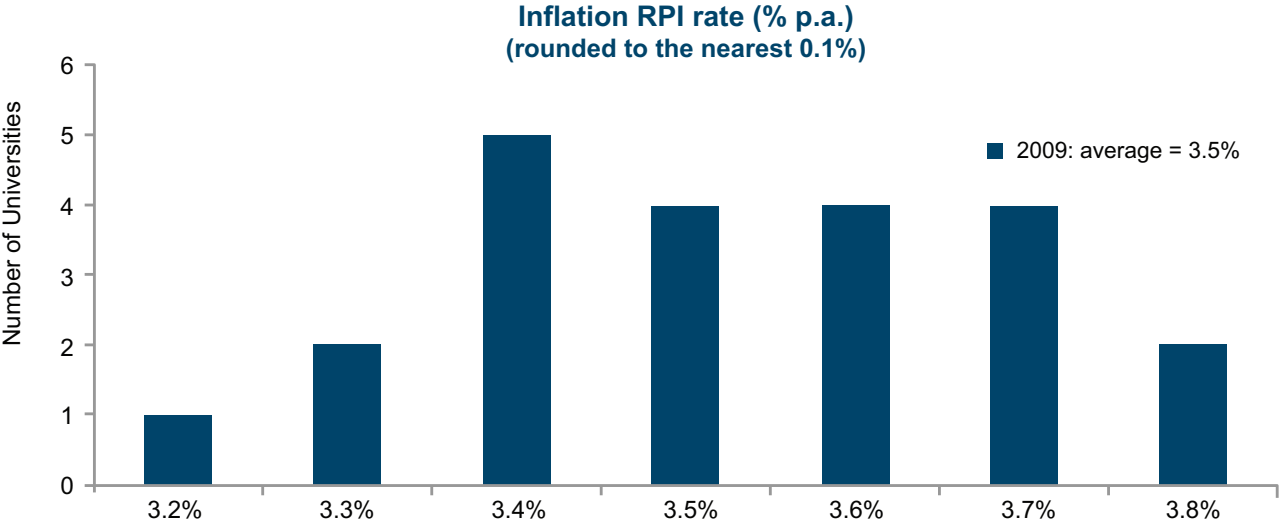
## Inflation rate

The Bank of England implied 'inflation spot rate' at 20 years (based on the difference between fixed interest gilts and index linked gilts) was 3.7% p.a. Most universities in the survey assumed that inflation would be slightly lower, with the average at 3.5% p.a. A possible explanation is that some allowance is being made for an "inflation risk premium" which is based on a view that demand for index linked gilts keeps the yield on these securities artificially low, and implied inflation artificially high.

Year ending	Inflation spot rate* % p.a.	Average inflation assumption % p.a.
31 July 2005	2.8%	2.7%
31 July 2009	3.7%	3.5%

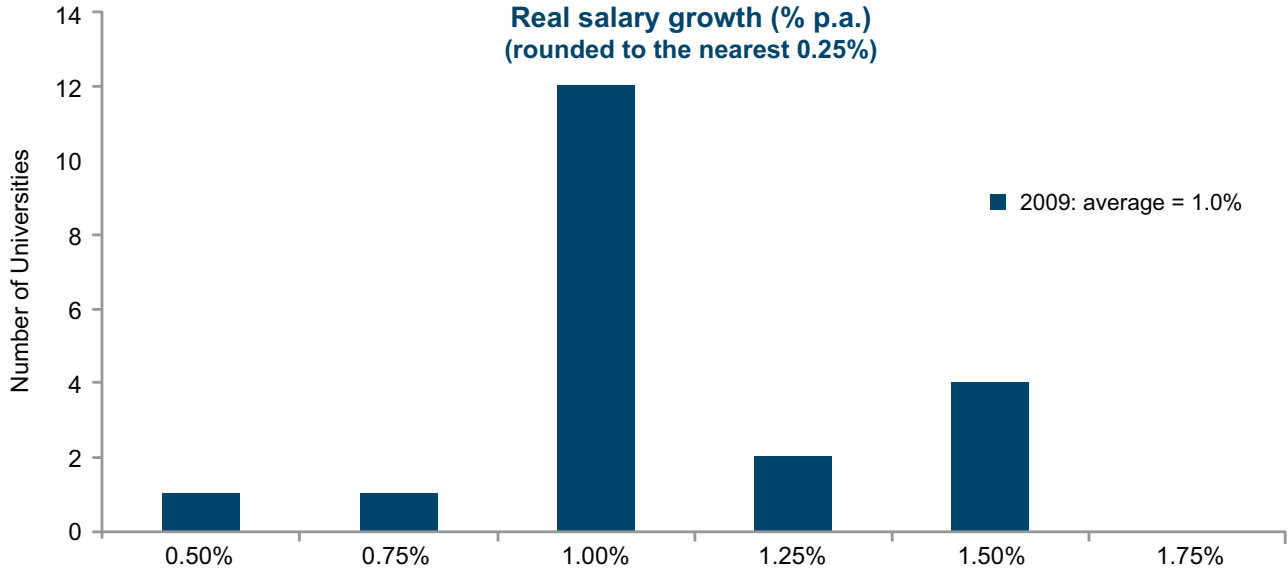
\*Bank of England implied 'inflation spot rate' at 20 years.

The assumptions adopted are significantly higher than they were in 2005, when the average was 2.7% p.a. which reflects increased expectations for future inflation. There is a fairly wide distribution of assumptions around the average, which may suggest that universities were taking into account the duration of their pension liabilities when setting the assumptions.



## Salary increases

Some universities may use a scale for promotional salary increases in addition to a general salary growth assumption and therefore a comparison of the disclosed salary increase rate assumptions may not be like-for-like in all cases. We have nevertheless shown below the disclosed salary increase assumptions used relative to the assumed rate of price inflation (i.e. real salary growth). The average real salary growth assumption was 1.28% p.a. in 2005 and 1.0% p.a. in 2009. This decrease could be due to some universities seeking to target a consistent salary increase assumption in nominal terms rather than real terms.

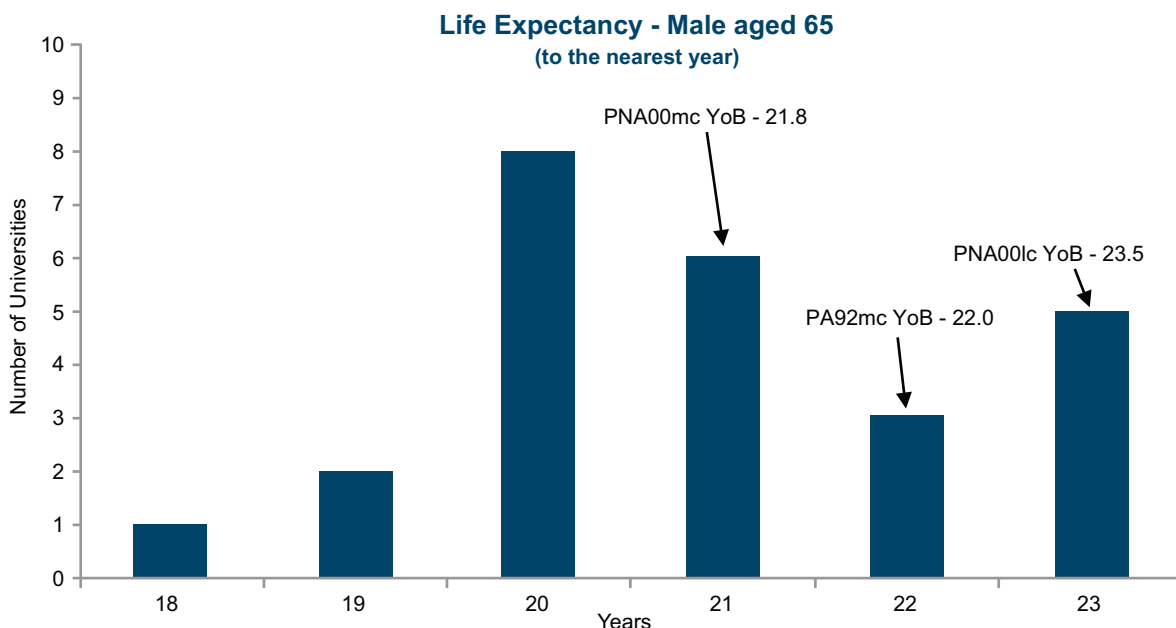


## Life expectancy

The majority of universities in this year's survey disclosed information on their life expectancy assumption, either by stating the assumed life expectancy or by referring to the mortality tables used allowing comparisons to be drawn.

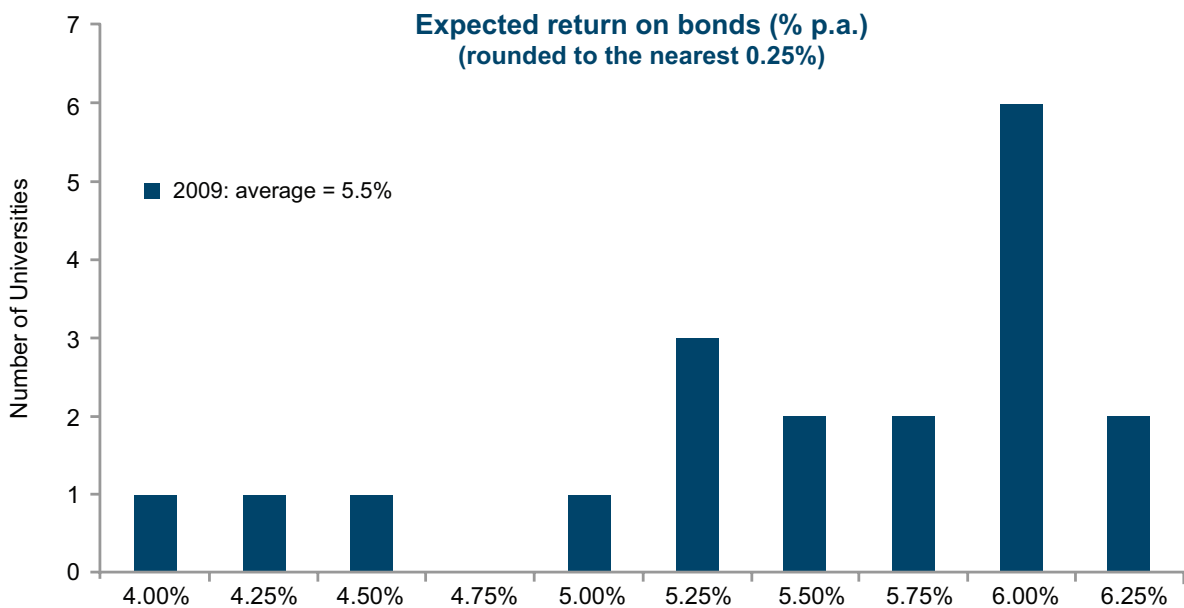
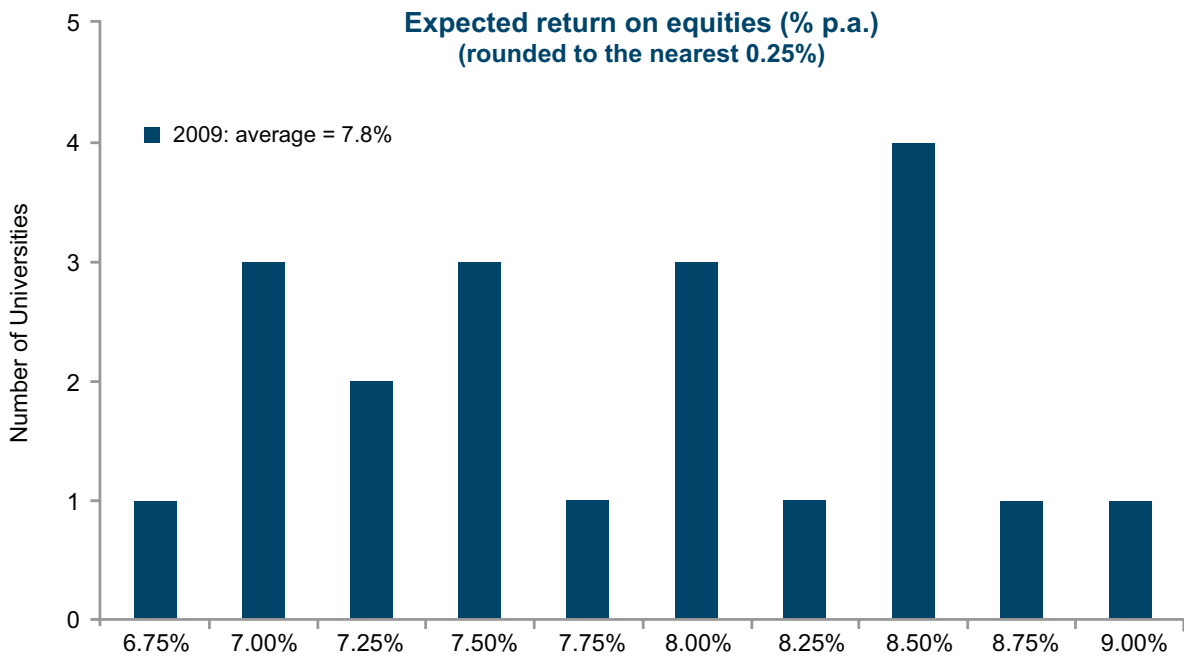
We have shown below the life expectancy assumptions for a man aged 65 at the year end and also indicated the life expectancies implied by some of the mortality tables that were used.

The wide range of life expectancy assumptions adopted by pension schemes generally can often be explained by differences in the underlying scheme membership. For example, different average income levels or occupations. However, given the profile of SATS members would be expected to be fairly similar from university to university the wide range highlighted below is perhaps surprising.



# Expected investment returns

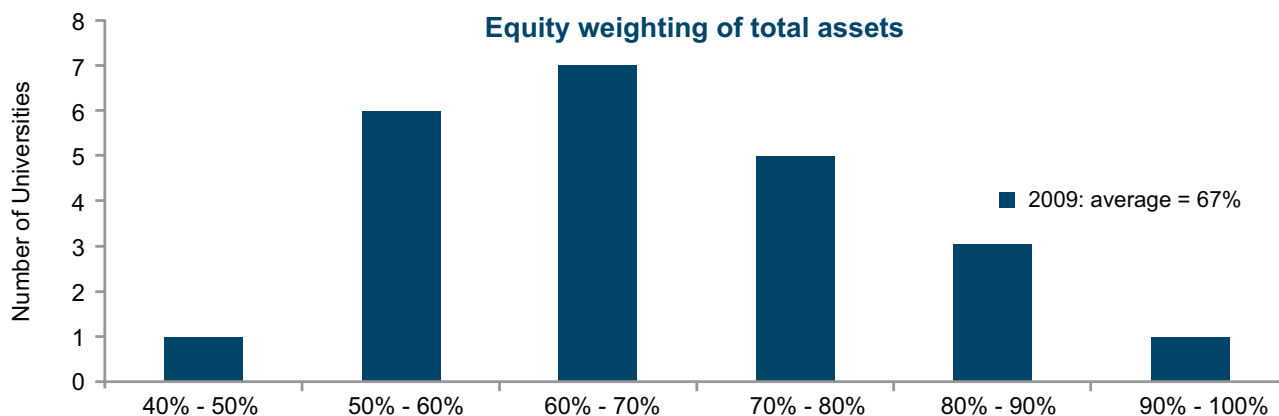
The expected returns on equities and bonds disclosed at 31 July 2009 are set out below.



The average expected equity return was 7.8% p.a., compared with the average yield on long-dated gilts of 4.5% p.a. thereby implying an average "Equity Risk Premium" of 3.3% p.a. (2005: 2.7%). The average expected bond return was 5.5% p.a., which is slightly more towards the yield on long-dated corporate bonds rather than long dated gilts at the year end.

## Asset allocation

The chart below shows the percentage of assets invested in equities for SATs in the 2009 survey.



The average equity weighting of 67% is slightly lower than the 2005 average of 71%. This could be due to lower equity values pulling the weighting down, the re-balancing of assets or the “de-risking” of schemes.

We hope that this analysis is helpful to universities in formulating their own assumptions under FRS17 for their respective SAT.

## For further information

Please contact your usual Barnett Waddingham consultant or email [CorporateConsulting@barnett-waddingham.co.uk](mailto:CorporateConsulting@barnett-waddingham.co.uk) to discuss any of these issues further.

You may also find our recent newsletter Current Issues in Financial Reporting for the quarter end 30 June 2010 useful when considering assumptions to use at 31 July 2010. This can be accessed on our website at the following address [www.barnett-waddingham.co.uk/publications/newsletters/current-issues-in-pensions-financial-reporting-30-june-2010](http://www.barnett-waddingham.co.uk/publications/newsletters/current-issues-in-pensions-financial-reporting-30-june-2010)

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