Strategic enquiry into the pension arrangements for the higher education sector

A report prepared by Hewitt for Universities UK
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Foreword

This report represents the first published output of the strategic enquiry into the pensions arrangements of the higher education sector. The enquiry was initiated by Universities UK (in association with GuildHE and the Universities and Colleges Employers Association (UCEA)) and managed by a group chaired by Dr Geoffrey Copland, formerly vice-chancellor of the University of Westminster. Responsibility for taking it forward now rests with the Employers Pensions Forum, which Universities UK and UCEA have recently created to discuss sector pensions issues.

Following the completion of the survey of institutions’ views on pensions and the publication of this report, the Forum will be considering possible future scenarios for the development of sector pensions provision. These will take account of the survey results and the areas where there is support for change that have been identified in the report.

We intend to issue a further consultation paper identifying the main options (and assessing their feasibility) in due course with the aim of assessing the potential for sector agreement on a way forward. Based on the outcome of this consultation, the Forum will prepare an implementation plan that will identify the actions needed to secure the agreed pensions changes.

Professor Bill Wakeham
Chair, Employers Pensions Forum

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Introduction

Universities UK in association with the Universities and Colleges Employers Association (UCEA) and GuildHE (with financial support from the Higher Education Funding Council for England and the Scottish Funding Council) has sponsored this strategic enquiry into the pension arrangements of the higher education sector. This review took place against a background of unprecedented change in pensions in both the private and public sector.

The review sought the views of higher education institutions on the current system of pension provision and how, if at all, they would like to see changes made.

Terms of Reference
The terms of reference for the whole project are to develop a comprehensive pensions strategy for the higher education sector covering the next ten years and beyond. The project should identify options for the development of sustainable and affordable pensions provision that the sector will need to make if it is to continue to recruit and retain high quality staff at all levels. The review should take into account the potentially diverse requirements of academic, academic-related and support staff and the parallel development of new pay and reward policies by higher education institutions.

The project is set in the context of the government’s ongoing pensions reform programme and the impact on the sector of legislation already introduced to improve the security of members’ benefits, which has imposed considerable additional financial burdens.

The project should identify the actions that will be needed to develop options going forward, including the appropriate structure for gaining consensus and authoritative decision making and the practical mechanisms for cost-effective long term management.
Principles
Universities UK, in conjunction with UCEA and Guild HE, has developed a set of principles to shape the current enquiry:

- **Sustainability** – future pension provision must be robust to cope with further periods of great change in the sector and society generally.
- **Affordability** – the cost of pensions payable from a set age is rising inexorably as people live longer. Higher education is not immune from this – some of the smaller local schemes for support staff are particularly affected.
- **Flexibility** – the differing needs of institutions in recruiting both academic and non-academic staff at all ages must be provided for. This must translate into real and cost effective choices for member institutions.
- **Relevance to the future of higher education** – the solution must exhibit a good fit with future strategic developments in higher education.
- **Effective governance** – a process for representation and accountability within a legal framework is essential, to create unity of purpose and compatibility.
- **Consensus** – the strategy must gain broad acceptance within the sector, from employers, employees and their representatives. It must also be acceptable to external stakeholders.

Adviser
The first phase of the overall project was to carry out a consultation exercise amongst the higher education institutions. Following a tender process, this phase was awarded to Hewitt Associates, a top three benefits consultancy in the UK and the largest global provider of complete human resource solutions. Hewitt is a market leader in pensions advice with a reputation for clear communication and genuine consultancy. It combines the businesses of Hewitt Associates and the former UK Partnership of Bacon & Woodrow (originally formed in 1924). The lead consultants from Hewitt involved in the project were Kevin Wesbroom, Richard Mulcahy and Amanda Turner – experienced pensions professionals with long seated deep knowledge of UK pensions.

Consultation process
The process agreed for the first phase of this project was as follows:

- the selection of the advisers, after establishment of the terms of reference and the principles behind the project.
- development of a test phase of consultation questions. These were tested on a trial group of twelve institutions. In addition structured interviews were held with each of these institutions in order to verify that the correct issues were being addressed and that the context was clearly understood.
- following this test phase, a consultation pack and survey questionnaire were sent to all higher education institutions.
- this report sets out the results of the survey. The new UUK/UCEA Employers Pensions Forum is considering the results and developing a series of proposals as possible routes ahead. These will be discussed with the sector later in the year.

Background
Some background information on pension provision in the higher education sector is set out in Appendix A. Appendix B contains a basic briefing on the cost of pension provision, whilst Appendix C summarizes some of the changes implemented recently to pensions in the public and private sector. Appendix D contains a more detailed statistical analysis of the survey responses. Appendix E is a pensions jargon glossary.
The Pension survey

A key part of the first phase of this review was the survey of pension views amongst the higher education institutions. The survey took the form of a series of twenty questions on pensions – expressed as a point and counterpoint or contrary position. Institutions were invited to indicate where – on a scale of 1 to 10 – their viewpoint lay, between the point and counterpoint. The survey was available for completion on a secure website and the results were collated and analysed by Hewitt.

A total of 163 invitations to participate in the survey were issued and 87 responses were received. This was a response rate of 53% which ensured that a good cross-section of institutions was represented, thus enabling an analysis of responses to be undertaken in a variety of ways – for example by geography or by type of institution. We comment below on the differences in responses between these groups, where relevant. The responses received, analysed by groupings, are summarised below.

<table>
<thead>
<tr>
<th>Grouping</th>
<th>Questionnaires sent</th>
<th>Responses received</th>
<th>Response rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russell Group</td>
<td>20</td>
<td>19</td>
<td>95%</td>
</tr>
<tr>
<td>Campaigning for Mainsteam Universities (CMU)</td>
<td>29</td>
<td>14</td>
<td>48%</td>
</tr>
<tr>
<td>1994 Group</td>
<td>19</td>
<td>12</td>
<td>63%</td>
</tr>
<tr>
<td>University Alliance</td>
<td>23</td>
<td>15</td>
<td>65%</td>
</tr>
<tr>
<td>Non-aligned</td>
<td>37</td>
<td>19</td>
<td>51%</td>
</tr>
<tr>
<td>Guild HE</td>
<td>35</td>
<td>8</td>
<td>23%</td>
</tr>
</tbody>
</table>

Analysis of results

In the following pages we set out the twenty questions included in the survey and show the full range of responses received. We have also quoted two statistics in relation to each of the responses:

- the average response received (statistically the mean of the responses). The point position covers answers with a value of 1 to 5, whereas the counterpoint side of the scale has values from 6 to 10.

- the polarisation of responses. This is a statistical measure developed by Hewitt with the aim of identifying the extent to which there is commonality of views or a strong divergence of views. This statistic operates on a scale from 0 to 100%. A score of 0% would mean that all survey respondents ticked exactly the same box. A score of 100% would mean maximum polarisation – imagine that half of the responses gave a response of 1, but the other half gave a response of 10. A divided response like this would give the greatest challenge to reaching a consensus on the way forward for the higher education sector.

Statistical analysis

The responses to the twenty questions are set out below, together with the statistical values above. We have also quoted some specific comments offered by respondents to the questions, illustrated in italics. Appendix D sets out some further analysis of the responses.
Under the ‘point’ position, the pensions offered by all institutions in the higher education sector would be the same – for example final salary schemes paying a pension from age 65.

Under the ‘counterpoint’ the type of pension provision offered by each institution could vary, according to what it felt was relevant to its specific circumstances. So this might include a particular institution deciding that they wished to offer say a stakeholder pension, or a career average pension or a choice of pensions. Under the ‘point’ position this would not be allowed and there would be uniformity of provision across the sector.

### Table 1: Uniformity of the sector

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>All institutions in the higher education sector should have the same pension arrangement</td>
<td>All institutions in the higher education sector need not have the same pension arrangement</td>
</tr>
<tr>
<td>15 8 12 7 8 3 11 8 3 12</td>
<td></td>
</tr>
<tr>
<td>Average response: 5.1</td>
<td>Polarisation of responses: 58%</td>
</tr>
</tbody>
</table>

**Comments**

There is more support for a commonality of pension provision, than a diversity of pension benefits. The Russell Group is more likely to be represented amongst those responses that favour having a wider choice of pension benefits to suit the circumstances of the individual organisation. Some organisations felt that the commonality of provision should be restricted to academic staff.

“Score 1 for academic and senior support staff, 8 for other”

“the higher education sector should retain the same pension arrangements with regard to the USS scheme. However we would wish to retain flexibility to be able to offer a different pension option to the more junior members of staff”

“Pensions are a long term 40 year contract and must be recognised as such at the sector level. They are not suitable for individual institutional variation according to their relatively short term affordability criteria”

### Table 2: Individual choice?

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employers should have a menu of pension options to offer their staff</td>
<td>Employers should be free to offer what pensions they want</td>
</tr>
<tr>
<td>10 10 17 9 8 4 5 8 9 7</td>
<td></td>
</tr>
<tr>
<td>Average response: 5.0</td>
<td>Polarisation of responses: 52%</td>
</tr>
</tbody>
</table>

**Comments**

There was quite a divergent range of views as to whether individuals should have a choice of pension benefits. Although the ‘average’ response leans towards offering a choice, several institutions (particularly amongst the University Alliance and those that are non-aligned) indicated that they would not favour this. Informal conversations with some respondents suggest that some of the possible downsides of offering choice would be the degree to which members would understand or appreciate the choices, the difficulties of dealing with individuals who make the ‘wrong’ choice, and the burden of additional administration.

“A competitive packaged menu of employee salary and benefits is important in competitive employment markets”

“Some limited option flexibility may be desirable”
Under the point position there would be a limited range of pension options available across the sector. So this limited menu might include:

- 1/60th final salary from age 60
- 1/50th CARE (career average revalued earnings) from age 65
- 6% defined contribution plan

and so forth. One could envisage a choice of up to a dozen ‘approved’ types of plan design. Each institution could then decide which options from the menu to offer to its staff. The counterpoint says that there is no material advantage in restricting choice in this fashion, and that individual institutions should be able to design whatever types of plan they feel they need.

**Table:**

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employers should have a menu of pension options to offer their staff</td>
<td>Employers should be free to offer what pensions they want</td>
</tr>
<tr>
<td>18 13 15 15 9 1 6 1 1 8</td>
<td></td>
</tr>
</tbody>
</table>

**Average response:** 3.9 **Polarisation of responses:** 43%

**Comments**

There was widespread support for an “industry sponsored” range of options for members (as opposed to a choice being offered on an individual basis by each institution). The 1994 Group, Universities Alliance and those that are not aligned, were particularly in favour of choice at a sector wide level.

“There is a need for greater choice and flexibility but this could not be unlimited at national level”

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This question looks at whether institutions should be prepared to adopt a common approach or whether they should be able to adjust the pension packages (subject to employment and pensions law requirements) to suit their specific funding circumstances.

Under the ‘point’ position all institutions would have the same pension cost, for example expressed as a percentage of payroll. (To the extent that institutions’ staff structure, age profile etc. differs, the ‘point’ position would imply some degree of cross subsidy between institutions.)

Under the ‘counterpoint’ institutions would be able to adjust the type of packages or methods of funding which suits them most. This would imply attribution of actual costs to each institution, i.e. no cross subsidy. The ‘counterpoint’ would have greater clarity of individual accountability but might result in higher costs.

**Table:**

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is more important that all institutions have the same cost</td>
<td>The level of the pension cost for each institution is most important</td>
</tr>
<tr>
<td>15 6 6 3 9 6 6 5 11 18</td>
<td></td>
</tr>
</tbody>
</table>

**Average response:** 5.9 **Polarisation of responses:** 68%

**Comments**

This was the survey question that drew the greatest divergence of opinion from respondents. There were some strong groupings both for and against the proposition of having a uniform approach. The University Alliance and Guild HE were most strongly in favour of a uniform approach, whereas the Russell Group and CMU were most strongly in favour of an individual approach determined by each institution. The issue of cross subsidies between potentially competing institutions lies at the heart of those responses leaning towards the counterpoint position.

“The level of pension cost is very important to each institution, but at the same time employer contributions to the USS scheme should be maintained at the same percentage of pensionable earnings”

“In a developing differentiated and competitive market in higher education, there will be differences in what is affordable, and there are no benefits to standardisation”
Questions 5: Central or local negotiation?

Under the ‘point’ position the higher education sector would negotiate with central government and with the trade unions/staff side as a single group in respect of any pension changes. This could mean that compromises will be necessary that may not suit individual institutions in order to get to an agreed position.

Under the ‘counterpoint’ it will be left to each individual institution to decide and negotiate on any pension changes. This will lead to a lack of uniformity in the system but may lead individual institutions to have greater control over their pension cost.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>The higher education sector should negotiate on pension issues as a single group</td>
<td>Each institution to negotiate pension provision at a local level</td>
</tr>
<tr>
<td>28 18 15 1 6 9 2 3 1 4</td>
<td></td>
</tr>
</tbody>
</table>

Average response: 3.3  Polarisation of responses: 40%

Comments

It can be seen that there was a strong preference for centralised higher education negotiations with central government agencies and with the trade unions for example. This was the case even where an individual institution might disagree with the negotiated outcome – the general view was that there was more to be gained from central deals that might not be “perfect” rather than each organisation having to devote time and energy to negotiate on its own. A number of Russell Group institutions expressed strongly the opposite preference of negotiating on a local basis.

“Common negotiation has advantages, but there would have to be acceptable mechanisms for obtaining institutional views”

“Barring national negotiation for academics, negotiation should be local”

Question 6: Economies of scale

The ‘point’ position says that the sector should look to exploit its collective buying power and should pursue the greatest administrative economies of scale in offering pensions benefits. The logical conclusion of the ‘point’ argument would be a single central point of provision of all benefits for the sector.

The ‘counterpoint’ says that individual institutions should be free to pursue their own policies of providing benefits, if they feel this delivers greater overall cost control. The administrative economies could relate to the terms on which any new arrangements are provided or how the existing schemes are funded.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>The sector should work together for administrative economies of scale</td>
<td>Institutions are in competition and there is no place for co-operation</td>
</tr>
<tr>
<td>42 16 16 3 3 5 1 0 0 4</td>
<td></td>
</tr>
</tbody>
</table>

Average response: 2.3  Polarisation of responses: 18%

Comments

There was a very strong consensus that the sector should exploit its buying power and should look for economies of scale in the operation of its pension arrangements. There is no doubt that many higher education institutions have faced significant increases in the operating costs of their own in-house schemes (Self Administered Trusts) in recent years, as a result of legislative, accounting, funding and governance changes in the market place. Across the sector it has been estimated (Michael Bourn, Twenty questions about pension provision in higher education, BUFDPG, 2006 ) that there could be overall savings on administrative overheads of between £30-£40 million a year in respect of institutions’ own schemes and their membership of the Local Government Pension Scheme. Many institutions indicated that they would be prepared to sacrifice some local autonomy in return for a general reduction in the level of overheads associated with pensions.

“One pension scheme across the entire sector could lead to significant cost savings”

“This is not a universal condition but we should do so where it is sensible”

“Many universities run their own schemes for support staff. This is wasteful in terms of administrative cost. It would be helpful to combine these schemes into one”
Question 7: Cross-subsidies

The ‘point’ position recognises that there are cross-subsidies between different institutions but that these cross-subsidies are acceptable. The ‘counterpoint’ suggests that there should be no cross subsidies. Cross-subsidies arise from a variety of sources.

So for example under the Universities Superannuation Scheme (USS) an institution which regularly gives higher pay rises than the average, or which allows greater numbers of its members to retire on enhanced terms after the age of 60 will be a ‘winner’, given that a common contribution rate is paid by all employees. Under the ‘counterpoint’ there will be a need to isolate the actuarial cost to the scheme of each institution’s pension provision – which in an extreme case would mean separate funding arrangements. Intermediate positions might seek to identify the biggest or most variable cross-subsidies in a centralised scheme and to charge participating Employers accordingly.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>The current level of subsidies between institutions is acceptable</td>
<td>9 7 7 4 14 12 6 13 4 11</td>
</tr>
<tr>
<td>No cross-subsidies are acceptable</td>
<td></td>
</tr>
</tbody>
</table>

Average response: 5.7  Polarisation of responses: 48%

Comments

A wide range of responses was elicited here, with no strong degree of consensus. There were “clumps” of responses at either end of the spectrum, as well as two groupings with intermediate views. There are a number of related themes around the question of cross-subsidies that will need to be addressed in any eventual solution.

“No increase in the level of subsidy would be acceptable”

“In an ideal world, no cross-subsidies are acceptable. We are not in an ideal world”

Question 8: Treating staff equally

The ‘point’ position says that the same broad value of pension arrangements should be offered to all employees. This is not the case at present and a number of institutions offer different arrangements to their non-academic staff from those offered to academic staff participating in USS.

The ‘counterpoint’ position says that this differential position is acceptable. Having the same pension system does not necessary mean that the same pension would be provided to all. For example it could be possible to offer a range of choices for employees but the level of choice could differ between academic and non-academic staff. This question seeks to answer the question as to whether you believe that any such differentials are valid. One reason why different choice or different pension provision might be made is because the requirements for and sources of different types of employee varies.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
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</thead>
<tbody>
<tr>
<td>In each institution [or in all institutions, depending on the answer to Q1], the pension arrangements on offer to all grades/types of staff should be the same or at least of broadly equal value</td>
<td>26 13 14 3 3 2 3 11 0 12</td>
</tr>
<tr>
<td>In each institution [or in all institutions, depending on the answer to Q1], the pension arrangements on offer to all grades/types of staff need not be the same</td>
<td></td>
</tr>
</tbody>
</table>

Average response: 4.2  Polarisation of responses: 66%
Comments
The majority view favoured broad maintenance of the current system which, by and large, offers the same type of benefits to all staff. There are a small number of institutions that at present offer very different benefits to different staff categories – such as a defined contribution plan for non-academic staff – but there was not widespread support for this approach. There was however a sizable minority – drawn largely from the CMU and Russell groupings – which feels that they should have the opportunity to offer a significant level of pensions choice to their staff.

“It would be helpful for a merged institution like [xx] if there could be a bulk transfer of TPS staff to USS”

“Each scheme should have the same benefits for all members of that scheme, but each scheme may have different benefits”

Question 9: Targeting
All pension schemes distribute the available spend in a variety of ways; some members of the scheme will “cost” more than other members, even though the employer may pay a uniform contribution rate for all.

The current system could be characterised as benefiting longer serving employees, those who gain higher than average pay rises (but also short-service staff joining late in career), and those who retire early. (Note: under a defined benefit scheme a member who chooses to join late in career incurs a higher cost to the scheme per quantum of pension benefit than an earlier joiner, due to the shorter investment period.)

Under the ‘counterpoint’ position, pension benefit should be distributed more uniformly. The ultimate reflection of this would be in a defined contribution scheme where everybody receives benefits equal, for example, to 10 per cent of pay. A corollary of this system is that the eventual pension will be proportionately less for people with the characteristics noted above! Other pension types will distribute resources in a less extreme fashion but all designs will favour some groups of individuals.

<table>
<thead>
<tr>
<th>The point</th>
<th>11</th>
<th>5</th>
<th>14</th>
<th>12</th>
<th>23</th>
<th>5</th>
<th>6</th>
<th>5</th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pensions should continue to be targeted as at present</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The counterpoint</td>
<td>Pensions should be more uniformly distributed than at present</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Average response: 4.4 Polarisation of responses: 29%

Comments
There was significant support for a greater element of redistribution in the pension package than that implied in the current arrangements (which favours male, longer stayers with above average pay rises). However there was not the same degree of support for a uniform defined contribution system that would distribute resources far more evenly, with a number of institutions arguing that the targeting under the current system was broadly acceptable. The distribution, or redistribution, of pension spend is closely tied with the answer to Question 14 about risk sharing.

“This issue really relates to our preference between a defined benefit arrangement and a defined contribution arrangement. Defined benefits are our preferred option”
Question 10: Pensions or not?

Under the ‘point’ position an institution is saying that it favours providing a package of pension benefits broadly at the current level of cost to the institution.

Under the ‘counterpoint’ the institution would want to have the ability to offer lower pension benefits for example but to compensate employees elsewhere in their reward package (or conceivably vice versa). In an extreme case an institution might decide that it does not want to provide pensions to some or all of its employees but would prefer to pay them a higher cash sum (having due regard to the pay spine where relevant).

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>We support the idea of providing pensions at broadly the current level</td>
<td>We want greater flexibility in setting our overall reward package including pensions</td>
</tr>
</tbody>
</table>

Average response: 4.7  Polarisation of responses: 55%

Comments

Institutions were generally comfortable with the current role and level that pensions played within the overall reward package. However a number of institutions (15 from Russell Group and CMU members) wanted a more liberal regime under which pensions would be capable of being “de-emphasised” in favour of other aspects of pay and benefits.

“There is a need for flexibility in the way remuneration is viewed”

“In our view the present arrangements are unaffordable and unsustainable and cost savings too large and unpredictable for any sensible long term planning of pensions costs”

“Pension provision is an important part of the overall reward package”

“It is essential that the pension provision is considered as part of the remuneration package”

Question 11: Pensions paternalism

Under the ‘point’ position the institutions are taking a degree of responsibility for ensuring sensible pension provision for their employees. If an employee chooses to reject the provision offered then no cash alternative would be available.

Under the ‘counterpoint’ position, employees would be given a choice as to whether to take the pension provision or receive a realistic cash alternative. This might suit individuals who did not need or do not want pension provision for whatever reason – because they have their own arrangements that are more than substantial, or even at the other end of the scale because they believe that additional saving for retirement would be offset by means tested benefits. Under the ‘counterpoint’ individuals could make this choice but under the ‘point’ position this is made for them by the employer.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>We want to encourage employees to save for pension; cash should not be given to employees who opt out</td>
<td>Employees should have the choice between more pay or pension</td>
</tr>
</tbody>
</table>

Average response: 4.1  Polarisation of responses: 49%

Comments

By and large the higher education sector tends towards a paternalistic approach of providing pensions for all staff, and encouraging employees to save for their pensions. Nevertheless there was a sizeable minority – again drawn from the Russell Group and CMU – which favoured the idea of giving individuals some element of individual choice of taking pensions in lieu of cash. There are some high profile cases in the private sector of employees who have gone down this route.

“A more flexible benefits system has attractions and provided it is made clear to employees what they may be giving up, they should be expected to take responsibility for their own financial affairs”

“The presence of a standard pension arrangement may not be suitable for all staff within an institution and staff should therefore have some choice as to the shape of the remuneration package”

“Many competitors for labour already offer this flexibility and employees find it very attractive at various points in their careers”
The ‘point’ position says that an institution can broadly survive with the current level of pension costs. The ‘counterpoint’ says that pension costs are acceptable providing that there are no increases beyond the current level.

It should be noted that costs can be high because of the continuing scale of benefits or because of the need to finance past service shortfalls. This question looked at the combined effect of these two features as they impact on the amounts paid by institutions.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>We are comfortable with the current level of pension costs</td>
<td>Current pension costs are too high</td>
</tr>
<tr>
<td>7</td>
<td>5</td>
</tr>
</tbody>
</table>

Average response: 5.8  Polarisation of responses: 39%

**Comments**

There was a wide spread of opinion as to whether current employer costs were too high. An average response sat fairly and squarely between the point and counterpoint positions but this does not reflect the diversity of the views expressed. Responses were split fairly evenly around this central outcome – about half arguing that they were comfortable with current cost, but half arguing costs were too high. The 1994 Group in particular was generally more comfortable with current levels of pension costs whereas CMU regarded them as too high.

“Costs in total i.e. employers and employees, are too high for sustainability and there needs to be some re-balancing toward employees. Some reduction in benefits is inevitable to contain costs”

“While current costs are ‘affordable’, they are high and must be controlled and not allowed to drift upwards”

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**Question 13: Member contributions**

Under the ‘point’ position member contributions towards the cost of benefits would remain fixed at broadly their current levels – for example 6.35 per cent of pay for members of USS. The ‘counterpoint’ position argues that if the cost of benefits increases for example as a result of greater longevity – then member contributions should be increased accordingly.

These increases could be expressed as a constant fraction of the total additional cost: for example a third of the increase could be paid by members and two thirds by institutions or they could be simply adjusted in some ad hoc fashion from time to time. The ‘counterpoint’ may also include a view that members should pay more to keep the current arrangements.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Members’ contributions should remain fixed at current levels</td>
<td>Members’ contributions should vary to reflect the true cost of their benefits</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

Average response: 7.4  Polarisation of responses: 30%

**Comments**

There is a general feeling that members are getting a very good deal from the pension provided in the higher education sector and that an increase in member contributions would be reasonable. Increases have been common in private sector pension schemes. Increases in member contributions are one way in which extra costs could be met – another is by way of a different scheme design as in Question 14 below.

“Employees should participate more fully in decisions about the costs of their pension schemes, and share cost burdens”

“More sharing of risks and costs with members”
Under the current system, all of the inherent risks associated with pension provision fall to the institutions (unless rises in the members’ contribution rate were to be negotiated with the staff side). So if for example investment returns prove to be less favourable than expected this will be reflected in a deficit which will require increased funding from the institutions. Similarly if actuarial predictions of pensioners’ survival rates are exceeded, the employers will have to increase their funding.

The ‘point’ position says that institutions accept this position. The ‘counterpoint’ says that employees should bear all of the consequences of unpredicted future events. The purest form of this would be a defined contribution arrangement under which the amount of the member’s pension depends on investment returns and annuity rates and the level of pay rises experienced and dates of contributions (reflecting salary history) made by the member and employer.

It should be noted that these are the two extremes and that other pension arrangements are becoming more widespread which share or divide the risks more evenly between institutions and employees.

### Question 14: Risk sharing

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>We want the Institution to bear all the risk</td>
<td>1 4 4 7 59 10 2 0 0 0</td>
</tr>
<tr>
<td>We want the employees to bear all the risk</td>
<td>We want the employees to bear all the risk</td>
</tr>
</tbody>
</table>

Average response: 4.8  Polarisation of responses: 6%

**Comments**

This was the most startling response amongst all of the twenty questions. Responses exhibited the highest degree of commonality – and argued that institutions wanted a balance of risk sharing in pensions, rather than the current system under which the employer takes all the risk. This would represent a significant move in the design and/or funding of the pensions offered in the higher education sector.

“Employees should be expected to share the risk of increasing costs arising out of future benefit improvements or higher mortality rates”

“The (pensions) regulator is taking a particular view on prudence that means risk has to be better managed and this will inevitably lead to a sharing of risk in the longer term rather than the employer always bearing the risk. This is particularly the case for those operating local schemes”

“We believe that, in due course, we would like to see pension benefits linked to lifetime earnings not final salary”

### Question 15: The degree of change

The point position argues that the current arrangements are broadly satisfactory, and that only relatively minor ‘tweaks’ are needed to benefits or the financing and governance arrangements. The counterpoint argues that more fundamental changes are needed to the style, structure, costs and financing of pensions in the higher education sector.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>We believe that the current arrangements are broadly acceptable</td>
<td>6 11 12 9 15 11 12 4 3 4</td>
</tr>
<tr>
<td>We believe that radical changes are needed</td>
<td>We believe that radical changes are needed</td>
</tr>
</tbody>
</table>

Average response: 4.9  Polarisation of responses: 34%

**Comments**

All shades and degrees of radicalism were exhibited in the responses! The overall consensus is that some change is needed, but this should be evolutionary rather than revolutionary. CMU members were most in favour of radical change whilst the University Alliance was more comfortable with the current arrangement.

“The current arrangements are broadly acceptable and fundamental changes are not required”

“The sector may need to consider fundamental change before long”

“Neither radical change nor tweaks on an ill informed basis will benefit the sector”

“The survey while interesting, is at best ten years too late to shape provision/strategy across the sector”
Question 16: Staff understanding

The ‘point’ position says that staff have a good understanding of the way the current schemes operate and the level of pension benefits they might expect. The ‘counterpoint’ says that staff have a poor understanding of current schemes and cannot readily plan for their retirement. The understanding of the schemes can also relate (for example) to the implications of transfers or changes of status or changes in hours such as phasing of hours closer to retirement.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff have a good understanding of the current schemes</td>
<td>Staff do not have a good understanding of the current schemes</td>
</tr>
<tr>
<td>1 9 13 9 17 2 11 10 8 6</td>
<td>9 11 10 8 6</td>
</tr>
</tbody>
</table>

Average response: 5.6  Polarisation of responses: 38%

Comments

There seemed to be quite a split of opinion on the extent to which staff understood their pension entitlements. The two strands could be characterised as:

- “pensions is just all too complicated” – one could argue that this has been a traditional answer to pensions!
- “people now value a final salary pension” – all of the attention focused in the media about the pensions crisis has served to emphasise to people that they have a good deal if they are still in a final salary scheme (even if they do not understand it!)

“Experience within [the institution] is that staff only really take the time to understand pensions when they have to, because they are considering their financial position in retirement, or when they are encouraged to by direct communication from the employer”

“The details of the current scheme are too complex for anyone other than a pensions expert to understand them”

Question 17: Staff appreciation

The ‘point’ position here says that staff have a good appreciation of the financial value of pension benefits. They recognise how much it costs their employer to provide the benefits they receive, and would be prepared to reflect this in negotiations about pay and conditions, for example.

The ‘counterpoint’ says that staff have a poor appreciation of the economic value of their pension benefits. They would not accept a lower pay offer, for example, to reflect an increase in the cost of employer pension provision.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff appreciate the financial value of the pension benefits provided</td>
<td>Staff do not appreciate the value of the pension benefits</td>
</tr>
<tr>
<td>2 11 13 6 12 5 10 14 7 7</td>
<td>2 11 13 5 10 14 7 7</td>
</tr>
</tbody>
</table>

Average response: 5.7  Polarisation of responses: 42%

Comments

Although there is again a fair degree of divergence in the responses, the balance is moving more towards a lack of appreciation by staff. Understanding pensions is one thing, but appreciating the true value of the benefit is another! Getting people to trade against the value of their pension entitlements would be an even more difficult step. Even the well informed individuals would probably assume that the average contribution paid by the employer is the value – for them – of their own pension benefit.

However the material in Appendix C illustrates that the average here can be a very misleading indication of the “true” underlying cost.

“Staff understanding varies and hence so does their appreciation of the benefits. The older the person the greater their understanding is”

“(XX) has undertaken a major communication exercise with its support staff regarding the in-house pension scheme and they have a far better appreciation of their position than do academic staff”
There is a growing recognition that there is a significant cost to early retirement that needs to be met either by additional contributions or benefit reduction. The ‘point’ position says that each institution should pay its own direct costs of early retirement – by way of special contributions at the point the member retires or by a higher long term funding rate.

The ‘counterpoint’ position says that institutions should share the cost of early retirements as part of an overall sector wide funding arrangement. This would lead to cross-subsidies and “winners and losers” in terms of institutions having more or less early retirements. Intermediate solutions are possible, such as the changes recently introduced by USS where costs over a certain age (60) are shared but those under this age are allocated to the specific institution.

**The point** | **The counterpoint**
--- | ---
The cost of early retirement should be met by each institution | The costs of early retirement should be shared across the sector

Average response: 2.9 Polarisation of Responses: 40%

**Comments**
There is strong support for greater accountability and responsibility for the costs of early retirement. The principle of solidarity across the sector comes under strain when institutions are presented with the true cost of allowing individuals to retire early on enhanced packages. The USS solution goes some way to addressing the principle of cost allocation in relation to early retirement and it has widespread support. Indeed, given the strength of support for the ‘point’ view it could be argued that there would be support for even more separation of costs.

“This decision has already been taken for staff retiring under 60; it should be extended up to normal retirement age with appropriate notice”

“First point is that early retirement should be cost neutral – i.e. benefits are actuarially reduced. Each institution should then have the facility to augment benefits to the extent that it can afford to do so”

---

The ‘point’ position says that pensions should be structured around the employment models that have been traditional in the higher education sector. It could be argued that the current, predominantly final salary, pension schemes were designed to meet a particular employment model which could be characterised as being long serving with relatively regular pay reviews.

The ‘counterpoint’ position says that this employment model is no longer as relevant as it was in the past and that pensions should reflect the greater diversity of employment models that now exist.

**The point** | **The counterpoint**
Pensions should be focussed on the traditional employment models in the sector | Pensions should reflect the diversity of employment models within the sector

Average response: 5.8 Polarisation of responses: 41%

**Comments**
There is a feeling that the current model should be changing – but this would be more on a progressive or gradual basis rather than a ‘big bang’ overnight change. The Russell Group is most inclined to favour an approach that recognises greater diversity of employment models, whilst University Alliance prefers the current system.

“We are happy with the current situation, but anticipate that there will be a need for greater flexibility going forward”

“There is not a great diversity of employment models at present”
The ‘point’ position says that in looking at pension benefits or potential changes in benefits, the higher education sector should be looking to benchmark its provision against pensions provided in the public sector.

The ‘counterpoint’ says that increasingly higher education should look to the private sector to benchmark pension and other employee benefits. The difference between these two can be quite stark since pension benefits in the private sector have been substantially revised and changed over the last 5 – 10 years. It is now relatively uncommon in the private sector for a new employee to be offered final salary type pensions and alternative types of pension provision such as career average or defined contribution benefits are now the norm. To date the public sector has chosen predominantly defined benefits arrangements such as final salary or indexed career average benefits.

<table>
<thead>
<tr>
<th>The point</th>
<th>The counterpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension benefits should be comparable to</td>
<td>Pension benefits should be benchmarked against those</td>
</tr>
<tr>
<td>those provided in the public sector</td>
<td>in the private sector</td>
</tr>
<tr>
<td>12 11 21 11 17 7 2 3 0 1</td>
<td></td>
</tr>
</tbody>
</table>

Average response: 3.7  Polarisation of responses: 22%

Comments
The higher education sector sees itself looking towards the extended public sector, at least in terms of benchmarking its pension provision. Given the presence of large public sector type schemes such as the Local Government Pensions Scheme (LGPS) and the Teachers’ Pensions Scheme (TPS) in the sector this is perhaps not surprising.

“The nature of employment in the university sector is changing and consideration must be given to the shape of pension provision to ensure it is appropriate”

“We have a significant number of different labour markets in which we compete”

“The pension schemes we offer are viewed as a significant attraction to recruiting staff from outside of the public sector and a diminution of scheme benefits could have a highly detrimental impact on the recruitment of quality staff”
Conclusions and next stages

Areas of consensus
The survey has highlighted a number of areas where there is a high degree of consensus amongst the higher education institutions:

- There should be a greater degree of cost and risk sharing between member and employer. There are a number of ways in which this could be implemented as discussed further below.
- The sector should work together for cost efficiencies in the delivery of pensions. The extent to which this desire for economies of scale comes into conflict with an institution’s desire for control of its own costs has not been tested.
- There is widespread support for allocating the cost of early retirements to individual institutions, rather than this cost being shared across all participants. This has happened recently in the case of retirements under the age of 60 in USS, and there could be some ‘appetite’ for a broader development of this process.
- Members should be prepared to pay more towards the cost of their pension benefits.
- The sector would prefer to benchmark its provision more closely to the public sector than the private sector. This has to be tempered by the desire for some greater elements of diversity of employment patterns to be recognised.
- Pension and reward should reflect a changing workforce, rather than the current benefit arrangements which favour a specific career profile.

Hot spots
Equally there are some areas where opinions are more strongly polarised and which could give problems in arriving at solutions. Several areas of disagreement focus around the role of pensions in the employment package. A number of institutions favour having a more liberal system under which there would be greater elements of pension choice for individuals and their employing institution. This could include offering cash in lieu of pension altogether, or targeting certain groups of employees very specifically with different pension packages. Others favour the maintenance of the current, more traditional, paternalistic role under which a common system of pensions is applied to all staff in all institutions. These organisations are uncomfortable at the idea of potentially treating different groups of staff very differently as far as pensions are concerned.

There is also a tension between different groups on the extent to which they would prefer to ‘sink or swim’ on a common basis in response to rising costs, or whether they can develop their own cost containment strategies. There are also differences around some of the financing aspects of pensions with a number of institutions indicating they are ‘feeling the pinch’ in terms of increasing pension costs.

Possible solutions
Whilst it is still too early to consider actual solutions there are some areas which look worthy of further consideration. We can consider these under three broad headings:

- Delivery vehicle
- Benefit design options
- Risk Sharing
**Delivery vehicle**
Is it possible to move to a single higher education pension platform? Or perhaps more realistically can we reduce the number of schemes that are used in order to take advantage of greater economies of scale? Whilst this could be a laudable objective there are many “political” questions to be addressed – such as “which scheme or schemes should we be migrating towards?” What would be the effect on the funding of existing schemes? The financing and governance structures are radically different between the types of provision prevalent in the sector at present and it would be an uphill battle to make major changes. Providing governance and cost allocations issues are addressed it would be possible to envisage a progressive policy under which a more uniform delivery system is implemented:

- All new entrants to the sector after a given date are entered into the chosen pension plan (or plans)
- Future benefits for existing members are progressively provided through the new plan
- A strategy is developed for migrating across past benefits, including benefits for deferred members and pensioners.

This would represent a significant program of change, which would require backing from the highest levels of government.

**Benefit design options**
There is support for having some greater degree of flexibility than is possible in the current final salary structure. This support may have its origins in the need to share risk and/or cost more evenly between employer and employee, or it may be a desire to recognise the more variable and diverse employment patterns in the sector. Equally there is a desire to avoid having a ‘free for all’ with a multiplicity of arrangements. This suggests that some form of limited ‘menu’ of pension plan designs from which institutions and/or members can choose could be the way ahead.

**Risk sharing**
Further work is needed on risk sharing or cost sharing. The table below outlines two broad possibilities, measured against the criteria developed by Universities UK for this review:

- Cost sharing – under which the existing final salary design might be retained but there would be formal arrangement for sharing the overall cost of pensions, for example with a contribution of one third from members and two thirds from institutions.
- Redesign the scheme benefits so that, for example, they were based on career average rather than final salary.

<table>
<thead>
<tr>
<th>Affordability</th>
<th>Cost sharing – final salary</th>
<th>Change scheme design</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Affordable</strong></td>
<td>In theory yes. In practice not if member contributions rise too high. If benefits cost too much we need to address the benefit level</td>
<td>Cheaper starting point than final salary. Can accommodate increasing life expectancy. Does not deal with past service problem very well.</td>
</tr>
</tbody>
</table>
| **Sustainable** | Does not fit well with modern working practices:  
  - flexible working/down sizing.  
  - shorter term contracts.  
  - part timers. | More flexible. Future changes to pay don’t impact past benefits. |
| **Flexible** | Providing choice will give flexibility | |
| **Relevant** | Benefit levels remain towards public sector ‘camp’ | Greater equivalence of benefit levels between the public and private sectors |
| **Effective governance** | Cost sharing mechanisms often subjective. Cross-subsidies still exist | More transparent governance. Less cross-subsidies as salary growth not a factor |
| **Consensus** | Consensus for greater sharing of risk/cost | |

**Next Steps**
This report will be considered by the Universities UK/UCEA Employers Pension Forum which will develop proposals for the way forward. The Forum will consult the sector later in the year on possible ways forward. Given the potential impact of any changes this consultation will take on board conversations with Treasury and the existing pension providers on the prospects for change in pension provision.
Appendix A: 
Current pension provision

Participation
Higher education institutions participate in five main pension arrangements, namely: Universities Superannuation Scheme (USS), the Teachers Pension Scheme (TPS) (the Scottish Teachers Superannuation Scheme (STSS) in Scotland), Local Government Pension Scheme (LGPS), the Superannuation Arrangements for the University of London (SAUL) and the National Health Service Pension Scheme (NHSPS). In addition many pre-1992 institutions operate their own in-house arrangements (Self Administered Trusts (SATs)) for non-academic/lower pay spine staff.

Number of institutions participating in each external arrangement

Pensions by type of institution
The graph below illustrates how the split of different pension arrangements varies by type of institution.

Source: Michael Bourn, Twenty questions about pension provision in higher education, BUFDG, 2006
**Type of pension provision**
There are some strong similarities – and some noticeable differences – between the types of pension provision offered to higher education staff.

**Similarities**
- Final salary pension provision is almost universal across the higher education sector
- There are broadly similar overall level of benefits across schemes (either 1/60ths pension or 1/80ths pension PLUS 3/80ths cash for each year of service)

**Differences**
- Member contributions – varies from nil to 7 per cent of pay
- Retirement age – the age at which members can take pension in full ranges from 60 to 65
- Pension increases – varies between full and capped RPI increases
- Other – differences in terms for ill-health, early retirement benefits etc.

A handful of institutions are providing substantially different benefits for non-academic/low pay spine employees including defined contribution provision.

**Universities Superannuation Scheme (USS) – a summary of benefits**
- Final salary scheme (based on the highest average salary in last 3 years or highest revalued salary over any 3 consecutive years in last 13 years).
- Contribution rate (currently): employer 14 per cent, employee 6.35 per cent.
- Normal pension age is 65.
- Unreduced early retirement pension from age 60 at employer’s request funded by the scheme pooling of the costs.
- Pension 1/80ths of final salary for each year’s pensionable service plus lump sum (pension x 3).
- Death in service payment: salary x 3.
- Dependants’ benefits and ill health retirement pension: unreduced and where so decided enhanced with potential service to age 65.
### Governance issues

One of the issues in the higher education sector is the extent to which each institution is in control of its own pension provision and costs. To what extent can the institution influence the pension benefits it provides, or influence the cost – or apparent cost – of the various pension arrangements in which it participates? The table below looks, at a very high level, at the governance features of some of the current arrangements.

<table>
<thead>
<tr>
<th></th>
<th>Control</th>
<th>Mutuality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>USS</strong></td>
<td>Little influence for individual institutions. Elected representative body can influence significantly. Funded by scheme contributions. The only scheme available for all academics (and related staff) in participating Institutions. Optional for other staff as determined by the institution. Elected representative body can influence benefit changes but ‘complex’ governance framework. Established under a trust.</td>
<td>Full cross-subsidies – common contribution rates across all institutions (including the impact of early retirement) after age 60.</td>
</tr>
<tr>
<td><strong>LGPS</strong></td>
<td>No influence for individual employer. Higher education input to the scheme is through representation on the local administrating authority’s committees. At national level, UCEA is represented on relevant advisory groups. Funded by scheme contributions which depend on historic scheme experience and advice of actuary. Benefits set by government regulations. Institutions participate in over 50 financially independent regional LGPS schemes run by county/unitary councils.</td>
<td>Limited cross-subsidies – contribution rates broadly sets to reflect each employer’s experience (e.g. pay increases, retirements) and membership profile.</td>
</tr>
<tr>
<td><strong>TPS</strong></td>
<td>Not funded. Benefits paid directly by government, which sets the contribution rate and decides on benefits.</td>
<td>Cross-subsidies and subject to political influence. Government sets one contribution rate to apply to all.</td>
</tr>
<tr>
<td><strong>Saul</strong></td>
<td>Multi-employer, funded scheme, for colleges and others linked to the University of London.</td>
<td>Common employer contribution rates. (but early retirement actuarial costs are allocated to individual employers).</td>
</tr>
<tr>
<td><strong>NHS</strong></td>
<td>Not funded. Benefits paid directly by government, which decides on benefits and contributions.</td>
<td>Common employer contribution rates.</td>
</tr>
<tr>
<td><strong>Own ‘in-house’</strong></td>
<td>Individual institutions can influence decisions on benefits, on pace of funding and investment strategy. Need to work in partnership with scheme trustees who are generally a mixture of member and employer elected. Funded by contributions from employers and members, under a trust agreement. In theory each institution has control over benefits provided and eligibility. In practice most tend to ‘mirror’ USS provisions with minor ‘tweaks’.</td>
<td>No cross-subsidies – each institution bears cost of own scheme.</td>
</tr>
</tbody>
</table>
Appendix B:  
The Cost of pensions

Employer contribution rates
Employers in the higher education sector pay significantly different amounts to the current pensions arrangements as illustrated below.

Contribution rates across scheme types

![Contribution rates across scheme types](image)

Source: Michael Bourn, *Twenty questions about pension provision in higher education*, BUFDG, 2006

Pension costs
The key points about current employer contribution rates are as follows:

- Rates for USS, TPS, STSS and NHSPS all fall between 12.5 per cent and 15 per cent of pay.
- Additional contributions are typically being paid into local (SAT) schemes to fund deficits.
- Increases in rates are expected/being phased in across most schemes. There is increasing cost pressure across all schemes, but this is more immediate and apparent for in-house schemes (SAT). The balance of employer:employee contributions is moving out from its historic average of 2:1 to 2.5:1 or more.
- There are variable scheme funding levels. However using FRS 17 (the accounting measure) the combined pension deficit across the higher education sector is estimated around £5bn.

Costs of provision
It might be thought to be a simple matter to answer the question “how much does a pension cost”. The answer is far from simple. One of the key reasons for this is that the cost can be affected by how fast the investments that back the pensions promise grow – or are assumed to grow. The greater the growth in assets, then the lower the amount needed today to pay a future commitment such as a pension.

Economists might argue that the true economic cost of a pension should be assessed by using the returns on very low risk investments – i.e. assets such as long term government bonds. In practice, pension schemes invest in assets intended to give higher returns than this, but this carries with it greater risk. There are no assets backing the unfunded schemes, but a “notional” asset return or interest rate is often assumed.
Higher education pension costs

The interaction between anticipated future returns and pension cost in the higher education sector is illustrated vividly in the charts below. In each case we show the cost of providing a pension of 1/80th of final pay and 3/80th cash for males who will retire at age 65, based on a common benefit structure. The cost is expressed as a percentage of pay. Costs increase with age since there is less of a period for an older person to benefit from future investment returns.

The lines on the chart show the cost according to the following patterns of assumed rates of investment return (net of inflation):

- 3.5 per cent (e.g. the Teachers Pension Scheme)
- 2.5 per cent (e.g. a typical Local Government scheme)
- 1.75 per cent (e.g. the typical guidelines for private sector schemes)

We have also shown, for comparison, the “economic cost” of the benefits (based on an assumption of investment in government stocks, assumed to return 1.25% p.a. more than inflation).

Pension costs and assumed returns

Cost differences by member

Even if we put aside factors such as the investment return issue above, the cost of final salary benefits varies by an individual’s circumstances. This is illustrated by the chart below, which compares the average cost of benefits for three sample individuals with different career paths. Whilst institutions might pay a single, ‘standard’ contribution rate, these cross subsidies do exist due to different membership profiles etc.

- Member A receives ‘regular’ pay increases and remains in service to age 65.
- Member B receives modest pay rises and then leaves service (and the scheme) at age 40.
- Member C receives two significant promotions and then retires early on an undiscounted pension at age 60.

Cost of benefit accrual

Source: Hewitt Associates
Appendix C: Pension changes

A pensions crisis?
Many factors are contributing to the so-called ‘pensions crisis’ in the UK, chief among them being significant increases in life expectancy and falling real investment yields which increase the cost of purchasing annuities, and stock market falls eroding the value of the assets held to back the liabilities.

The combined impact has been to increase deficits in UK pension schemes substantially. The introduction of the Pensions Regulator in the UK, together with new funding legislation giving greater power to trustees of occupational schemes has added to the pressure.

It could be argued that some of these features are “real” whereas others represent a change in the accounting mechanisms for pensions.

Drivers of change
Increases in pension costs have been the key issue leading to wholesale changes in private sector pension arrangements in the UK. Cost increases can arise from a variety of factors, including:

- Lower interest rates and low investment returns.
- Pensioners living longer. It is an acknowledged fact that pensioners are now living longer than previous generations, and longer than most previous pension funding patterns assumed. What is less clear cut is just how fast or for how long the improvement in longevity will continue. See the chart below, taken from the Report of the Pensions Commission, which was chaired by Lord Turner.
- Tax burden – the removal of tax reclaim on UK dividend payments.
- Compliance costs and other administrative overheads, such as Pension Protection Fund levies.

The uncertainty of future longevity

Source: Hewitt Associates; based on a method due to the Turner report

Note: ‘Expected’ uses the mortality table PMA92B_MC for the appropriate birth year
**Private sector changes**

Changes to private sector arrangements have been substantial and include the following:

- Benefit changes, including closure to new entrants, changing to career average plans, cash balance plans or most typically to defined contribution plans, as well as removal of favourable early retirement terms or freezing of pensionable pay.
- Contribution changes, including increased member contributions, multiple benefit scales (e.g. a lower benefit scale for members who do not wish to increase their costs), formal cost sharing arrangements, ‘smart’ pensions (where NI is saved) or putting pensions into flexible benefits packages.
- Funding changes, most notably special (company) contributions, or higher deficit contributions, companies looking to borrow to fund deficits, or the use of contingent assets and parent company guarantees.
- Investment changes, which often mean more bonds and less equities, but can also include alternative assets, risk budgeting and liability driven investment.

**Public sector changes**

The public sector is not immune from these pressures. Reviews of public sector arrangements such as the Principal Civil Service Pension Scheme (PCSPS) and the Local Government Pensions Scheme (LGPS) have attracted a lot of press coverage. With many institutions in the higher education sector currently required to participate in industry-wide arrangements (such as LGPS and USS) will pension changes be forced on institutions for some, but not all, of their staff? Where does that leave institutions’ own schemes? Against this background, the higher education sector is changing, with perhaps a greater focus than ever before on its public/private status. A summary of some of the major changes to public sector schemes is set out below.

**Local Government Pension Scheme (LGPS)**

The main features are as follows:

- a final salary scheme with a pension age of 65 for existing and new members and an accrual rate of 1/60th with the option of taking up to 25 per cent of the pension fund as cash;
- phased retirement facility to draw pension while continuing in work;
- tiered employee contribution rates, depending on the member’s annual salary;
- a facility to purchase up to a maximum of £5,000 of additional annual pension;
- no earnings cap (this was removed with effect from 1 April 2006);
- ill health benefits related to capacity to work;
- the cost of future actuarial increases will be shared equally between employer and employee contribution rates.

**Teachers’ Pension Scheme (TPS)**

The new TPS is a final salary scheme, which was effective from 1 January 2007 and includes:

- the existing TPS continues for current members at 31 December 2006 with pension age 60 and an accrual rate of 1/80th with lump sum;
- a new TPS for new starters from January 2007, with a pension age of 65 and an accrual rate of 1/60th with the option of taking up to 25 per cent of the value of the pension as cash;
- phased retirement facility to draw pension while continuing in work;
- the employer contribution rate increases to 14.1 per cent and the employee contribution rate to 6.4 per cent;
- a facility to purchase up to a maximum £5,000 of additional annual pension;
- earnings cap remains at present but this is currently under review;
- two-tier ill-health pension related to capacity to work;
- the cost of future actuarial increases will be shared equally between employer and employee contribution rates with a maximum 14 per cent employer contribution rate from 2008.
National Health Service Pension Scheme (NHSPS)
Discussions between government and the unions are continuing after public consultation on proposed changes which will result in a final salary scheme with different benefits for existing and new employees from April 2008 as follows:

- existing scheme continues for current members with pension age 60 (in some cases 55) and an accrual rate of 1/80th with lump sum with a one-off choice to transfer to the new scheme;
- a new scheme for new staff with a pension age of 65 and an accrual rate of 1/60th with the option of up to 25 per cent of the value of the pension as cash;
- a facility to purchase up to a maximum £5,000 of additional annual pension;
- four-tier employee contribution rate related to pay: 5 per cent up to £15,107; 6.5 per cent £15,107–£60,880; 7.5 per cent £60,880 to £100,000; 8.5 per cent above £100,000;
- Employers will continue to contribute 14 per cent (2/3rds of the overall cost);
- practitioners (GPs and dentists) will have a career average (CARE) pension scheme with accrual rate of 1.4 per cent and a 4.2 per cent lump sum for existing members and 1.87 per cent, revalued by RPI plus 1.5%, for new members;
- earnings cap will be removed at April 2008.

Principal Civil Service Pension Scheme (PCSPS)
Consulting for change. Proposals include CARE to replace final salaries, a higher level accrual rate for CARE than for final salary, and greater retirement flexibility. All options impact on future service benefits only – the final salary link continues for past service benefits.
Appendix D: Statistical analysis

Table 1: Overall Results

<table>
<thead>
<tr>
<th>Question</th>
<th>Number of replies</th>
<th>Average response</th>
<th>Standard deviation</th>
<th>Polarisation</th>
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<tbody>
<tr>
<td>Uniformity of the sector</td>
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<td>5.1</td>
<td>3.1</td>
<td>58%</td>
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<td>52%</td>
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<td>43%</td>
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<td>5.9</td>
<td>3.4</td>
<td>68%</td>
</tr>
<tr>
<td>Central or local negotiation</td>
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<td>3.3</td>
<td>2.6</td>
<td>40%</td>
</tr>
<tr>
<td>Economies of scale</td>
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<td>1.7</td>
<td>18%</td>
</tr>
<tr>
<td>Cross-subsidies</td>
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<td>2.8</td>
<td>48%</td>
</tr>
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<td>Treating staff equally</td>
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<td>3.3</td>
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</tr>
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<td>Pensions or not?</td>
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Table 2: Replies by group

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<th>1994 Group</th>
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<th>Guild HE</th>
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<td>3.3</td>
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<td>4.9</td>
<td>4.6</td>
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<td>3.4</td>
<td>3.1</td>
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<td>4.1</td>
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<td>3.9</td>
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### Table 3: Geographical split

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<th>Wales</th>
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<tr>
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<td>5.3</td>
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<td>Menu or a la carte</td>
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<td>3.9</td>
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<td>Cooperation or competition</td>
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<td>7.3</td>
<td>3.7</td>
</tr>
<tr>
<td>Central or local negotiation</td>
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<td>2.3</td>
</tr>
<tr>
<td>Economies of scale</td>
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<td>2.7</td>
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</tr>
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<td>Cross subsidies</td>
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<td>5.0</td>
</tr>
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<td>4.7</td>
</tr>
<tr>
<td>Targeting</td>
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<td>5.5</td>
<td>4.7</td>
</tr>
<tr>
<td>Pensions or not?</td>
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<td>3.3</td>
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<td>Pensions paternalism</td>
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<td>7.5</td>
<td>7.3</td>
</tr>
<tr>
<td>Risk sharing</td>
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<td>4.5</td>
<td>5.7</td>
</tr>
<tr>
<td>The degree of change</td>
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<td>5.3</td>
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<tr>
<td>Staff understanding</td>
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<td>6.0</td>
<td>4.3</td>
</tr>
<tr>
<td>Staff appreciation</td>
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<td>6.8</td>
<td>4.7</td>
</tr>
<tr>
<td>Cost of early retirement</td>
<td>2.3</td>
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<td>2.0</td>
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<tr>
<td>Traditional or new employment models</td>
<td>5.8</td>
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<td>5.7</td>
</tr>
<tr>
<td>Benchmarking</td>
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<td>3.7</td>
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</tbody>
</table>

* Includes Northern Ireland

### Table 4: Split by type

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<thead>
<tr>
<th>Question</th>
<th>Pre 92 institutions</th>
<th>Post 92 institutions</th>
<th>Higher education colleges</th>
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<tr>
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<td>4.3</td>
<td>5.6</td>
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<tr>
<td>Menu or a la carte</td>
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<td>3.7</td>
<td>4.3</td>
</tr>
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<td>Cooperation or competition</td>
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<td>4.9</td>
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<td>5.6</td>
</tr>
<tr>
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<td>4.0</td>
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<td>5.4</td>
</tr>
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<td>Pensions or not?</td>
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<td>5.5</td>
<td>4.3</td>
</tr>
<tr>
<td>Pensions paternalism</td>
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<td>5.6</td>
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<td>Member contributions</td>
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<td>6.6</td>
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<td>The degree of change</td>
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<td>5.2</td>
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<td>Staff understanding</td>
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<td>6.2</td>
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<td>Cost of early retirement</td>
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<td>Benchmarking</td>
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<td>3.3</td>
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</table>
Chart 1: Full Response
The full set of responses to the questions, analysed by group, are plotted below.

Chart 2: Distribution of Responses
The range of responses received can also be illustrated as below. Each coloured ‘block’ represents 10% of survey responses.
Chart 3: Analysis by Groups
The average of the responses when each of the groups is removed from the analysis in turn can be illustrated as below.

Chart 4: Polarisation of Responses
The polarisation of the responses when each of the groups is removed from the analysis in turn can be illustrated as below.
Appendix E: Pensions terminology

**Accrued pension**
The pension earned in a defined benefits pension scheme up to a particular point in time. Usually calculated by reference to a defined formula and based on service up to, and salary as at, the date in question.

**CARE**
Career average revalued earnings. Similar to career average pension scheme except the accrued pension in any particular year is then revalued from the year of accrual to retirement, death or leaving pensionable service using an appropriate index (usually linked to inflation).

**Career Average**
A type of defined benefit pension scheme in which the accrued pension is calculated for each year of pensionable service based on pensionable earnings in that year.

**Cash Balance**
A type of defined benefit pension scheme that maintains individual employee accounts like a defined contribution scheme. A percentage of salary is allocated to the account each year, and the account assets grow at a guaranteed rate to provide retirement benefits.

**Defined Benefits (DB)**
A type of pension scheme in which the scheme rules define the benefits to be paid on retirement, death or leaving pensionable service. The benefits are not directly related to contributions paid to the plan or investment returns on the contributions.

**Defined Contributions (DC)**
A type of pension scheme in which the benefits at retirement depend on the amount contributed to the plan and the investment returns on the contributions.

**Final pensionable salary**
The earnings on which the benefits are based in a final salary pension scheme. The scheme rules will describe the calculation of these earnings. The calculation may be based on pensionable salary in the year prior to retirement, death or leaving pensionable service, or it may be based on pensionable salary over several years prior to retirement, death or leaving pensionable service.

**Flexible benefits**
An arrangement where employees are able to choose how they receive their remuneration from their employer (usually with some restrictions). For example they may be able to elect to receive more holiday in return for reduced cash pay.

**LGPS**
Local Government Pension Scheme.

**Liability driven investment**
The term “liability driven investment” can be understood as simply matching assets to liabilities, but can be defined as any approach that uses a scheme’s liabilities as a starting point for setting investment strategy. The idea is to reduce risk by managing investments in a way that focuses on the liabilities, rather than a general investment index.

**Pension Protection Fund**
Pension Protection Fund – an umbrella scheme established by the government to pay compensation to members of eligible defined benefit pension schemes when the sponsoring employer becomes insolvent.

Continued over the page
The Pension Regulator
The regulator of work-based pension schemes in the UK. The objectives of the regulator are: to protect the benefits of members of work-based pension schemes; to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund; and to promote good administration of pension schemes.

Real returns
The actual return on an investment after removing the effects of inflation i.e. the return achieved above inflation.

SAUL
Superannuation Arrangements of the University of London

Smart Pensions
A pension scheme in which employees do not make any contributions to the pension scheme, but receive a salary reduced by an amount equivalent to their pension contributions, thereby reducing NI contributions payable (by both employee and employer).

STSS
Scottish Teachers’ Superannuation Scheme

TPS
Teachers’ Pension Scheme.

USS
Universities Superannuation Scheme

Further information

[If you have any questions about this Strategic Enquiry into pension arrangements for Universities UK please contact:]

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