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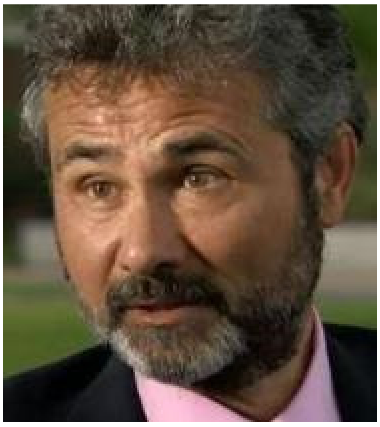


The Times Business Comment

August 17th 2017

"University pensions bet has failed.

Who will pay?"

https://www.thetimes.co.uk/edition/business/university-pensions-bet-has-failed-who-will-pay-h2x85skkq

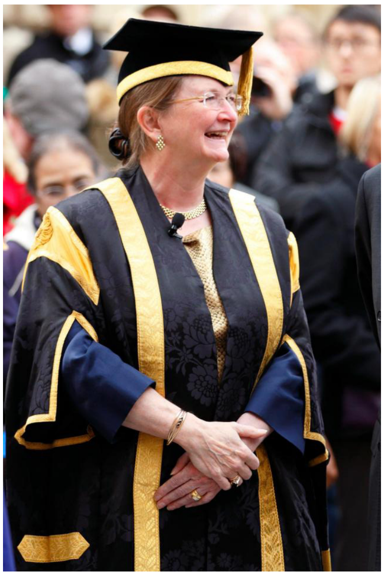
Universities have been in the headlines recently for all the wrong reasons: high student fees, high vice-chancellor salaries and now the record £17.5 billion deficit in the University Superannuation Scheme, the pension scheme for academics.

How much of a strain will pensions put on universities, which face an uncertain world after Brexit? USS is the UK's largest private sector pension scheme. In March it had 400,000 members, £60 billion of assets and £77.5 billion of liabilities on an FRS 102 basis, the accounting standard for all private sector schemes. Its £17.5 billion deficit is the largest ever for any scheme. It provides pensions for academic and senior staff at the 70 or so "old" universities, plus many smaller educational institutions. As a multi-employer structure, each institution is on the hook for all of USS's liabilities, the so-called "last man standing".

Academics at "new universities", the former polytechnics, are in the unfunded public sector Teachers Pension Scheme, not USS.

The 2014 actuarial valuation fixed USS's annual cash contributions for new pension promises at 23 per cent of salaries — 7.1 per cent for members and 15.9 per cent for universities. Universities are also paying 2.1 per cent of salaries over 17 years to clear the 2014 deficit. Cash contributions will be reviewed at the March 2017 valuation, which is now under way.

Because real long-term interest rates have fallen since 2014, the annual cost of new pension promises has risen from 23 per cent of salaries to about 33 per cent. The deficit has ballooned to £17.5 billion, requiring more than £1 billion a year in deficit contributions on the present timetable. Unless pension benefits are reduced or the deficit recovery period is extended, universities must more than double their annual contribution to about 40 per cent of salary.



The highest-paid vice-chancellor is ***Dame Glynis Breakwell***, of the University of Bath, on £450,000. She is also a USS trustee, where the average trustee fee is £47,000. Using Bath as an example, if its USS contribution increased to 40 per cent of salary, its entire 2016 operating surplus of £19 million would be wiped out.

Any reduction in pension benefits, or increase in member contributions, would be bitterly resented by its 200,000 active members and could prompt industrial action.

There is nothing more that USS can do to reduce the value of pensions already promised. It has already moved from annual pension increases based on the retail prices index to the lower consumer prices index, and from pensions based on final salary to career average. If USS doubled its present recovery period to 30 years, well beyond the Pensions Regulator's guidelines, it would require a deficit contribution of about 6 per cent of salaries, versus the existing 2.1 per cent, but this would still divert money from core teaching.

The real solution is for USS to close the defined-benefit pension and move to pure defined contribution, with, say, a 10 per cent university contribution, capping risk for universities and letting them use the cash saved to plug the deficit. This will happen sooner or later: companies are doing it wholesale, and many universities have already closed schemes for non-academic staff.

The root cause of USS's whopping deficit is the aggressive bet that it has taken over many years that equities will outperform boring bonds. This bet has not paid off, so the deficit has just got worse. By March this year USS had only 10 per cent of its assets in bonds to match its liabilities, even though pensions in payment are about 40 per cent of liabilities.

Under flawed accounting standards, universities do not report their full share of USS's costs, assets, liabilities or deficit in their own balance sheets, which would show their huge USS risks on a scale that they would not dream of running directly.

Many commentators say that students should not worry about £50,000 of accumulated debt, as any debt not repaid after 30 years is written off. However, when it becomes clear that many people are not repaying after 30 years the government may well just change the rules. Who knows, people could still be paying off their student loans from their state pensions.