Independent schools briefing, Quarter 2 2021

Schools and their wider Defined Benefit pension exposure

If we've learned one thing from advising this sector, it's that schools (including independent schools and academies) are now offering a diverse range of Defined Benefit (DB) pensions to their teaching and non-teaching staff.

In this briefing we summarise those various DB arrangements and provide further information for those who wish to see the details behind the overview.

In the next quarter, we will produce a similar note covering the range of Defined Contribution (DC) pension schemes that we now see schools offering.

	Teachers' Pension Scheme (TPS)	Local Government Pension Scheme (LGPS)	School's own trust-based scheme	Independent Schools' Pension Scheme (ISPS)	Growth Plan
Type of scheme	Unfunded public services scheme	Funded public services scheme	Occupational single employer trust-based funded scheme	Occupational multi-employer trust-based scheme	Occupational multi-employer trust-based scheme: Series 1 to 3 are DB, Series 4 is DC
Open/Closed	Open	Either, often no choice	School can normally decide	School can decide	DB closed (DC open)
Funding	Notional	Each fund decides	School and trustees agree	Trustee decides	Trustee decides
Exit costs	None (at the moment)	Yes, can be triggered inadvertently	Yes, but unlikely to be triggered	Yes, can be deferred by having DC members	Yes, can be deferred by having DC members
Control	None	Very little, assets usually 'on risk'	With the trustees, normally need only consult the school	Very little, assets held are fairly cautious	Very little, assets held are fairly cautious
Pension cost accounting	DC	Normally DB	DB	DB	Depends on section
Key issues	McCloud, potential for redundancy and ill-health costs	McCloud, potential for redundancy and ill-health costs	Long-term funding target, the trust deed & rules	Long-term funding target; last man standing; exit debt	Long-term funding target; last man standing; exit debt

Teachers' Pension Scheme (TPS)

Type of scheme: Unfunded public services state pension scheme. Only teaching staff are eligible to become members – so a number of schools will have another pension arrangement for non-teaching staff. The benefits payable and the underlying rules of its operation are all set out in legislation and regulations. It provides a DB pension at retirement for teachers who reach retirement age. It also pays pensions to a 'spouse' and lump-sum payments on death in service, among a number of other benefits (including retirement on the grounds of ill health and on redundancy).

Open/Closed: The context here is whether the scheme is open or closed to new members. The TPS is open to any eligible teacher. We are currently waiting for legislation that will introduce the concept of 'mixed economy' for independent schools (i.e. existing teaching staff would be able to remain in the TPS, but new hires would not have to join the TPS).

Funding: The TPS is a 'pay as you go' state scheme (i.e. contributions paid in by current teachers are used to pay benefits to retired teachers). However, a valuation of the liabilities is carried out, and an assessed surplus/deficit is reviewed at each valuation. The last valuation reported a shortfall of £22bn, and an element of the school's contribution rate reflects a contribution to meet that deficit. The next valuation date is 31 March 2020, and the next contribution revision for schools is expected in April 2024.

Exit costs: None at the moment, but the question is whether this might be introduced if the funding position continues to show such a material shortfall.

Control: There are no investments to manage, and no pace of funding to consider. However, the £22bn shortfall is in part being met from higher school contributions. Benefits and member contributions are set out in regulations. Schools therefore have no control over any aspect of the cost they are asked to pay after each valuation.

Pension cost accounting: Schools only have to account for contributions paid; there is no balance sheet asset or liability.

Key issues: McCloud Remedy – All benefits accrued since 1 April 2015 are to be reviewed, and those 2015 changes will be reintroduced for all members from 1 April 2022 (see our Q1 2021 briefing for more details). Redundancy and retirements on the grounds of ill health can result in strain payments.

Local Government Pension Scheme (LGPS)

Type of scheme: Funded public services state scheme for local government employees, but can also be made available for employers taking over local government services. Benefits and rules are set out in legislation and regulations. Different regulations and therefore benefits apply in Scotland compared to England and Wales. It pays DB pensions and has a similar past history to the TPS. There are about 100 separate LGPS funds; each is run by a local authority.

Open/Closed: This depends on the 'admission agreement' the school entered into when it joined. It's possible to close an open agreement or cease accrual, but the consequences of doing so can outweigh the benefits. We suggest speaking to an expert before closing an agreement to new hires or ceasing benefit accrual for any LGPS members. Closing the admission agreement to all future accrual triggers 'cessation' and an exit cost. See below.

Funding: Each LGPS fund has a different approach for different types of employers, both for the cost of accrual and for meeting any deficit. The next valuation date is 31 March 2022; the next contribution revision is expected from 1 April 2024.

Exit costs: Yes, if there is a shortfall at the end of the admission agreement. The amount due therefore depends on a snapshot of the funding level at exit, and the default is for any amount due to be paid in full, immediately. Note that a credit could also arise. However, the liabilities on exit tend to be measured more prudently than for funding or accounting, so their size can come as a surprise. There are now options to avoid the one-off cost that could arise.

Control: Investments are largely 'on risk', and a share of deficit is allocated to each employer and their members. Contributions are adjusted to remedy any shortfall. Benefits and contributions are set out in regulations. Schools typically have no control over its costs once the admission agreement starts.

Pension cost accounting: In most cases, full DB accounting under the relevant accounting standard will apply. A P&L charge is assessed each year, which may not match the contributions paid, and there is a balance sheet asset and liability measured on an accounting basis, which adds volatility to the school's balance sheet.

Key issues: McCloud Remedy – All benefits since 1 April 2014 are to be reviewed, and those 2014 changes will be reintroduced for all members from 1 April 2022. Redundancy and retirements on the grounds of ill health can result in strain payments.

School's own trust-based scheme

Type of scheme: Occupational trust-based scheme, usually for the school's non-teaching staff only. Benefits, contributions and powers are set out in the trust deed and rules, although provisions are often overwritten by subsequent legislation. The precise provisions are therefore unique.

Open/Closed: This depends on the trust deed and rules, which can be relatively easy to change. Many are now closed. Generally speaking, fully closing to future accrual does not trigger an exit cost, but the wind-up (which has a specific legal meaning for occupational schemes) does.

Funding: The scheme is established under trust law, and so trustees run the scheme. They must follow The Pensions Regulator's guide to scheme funding. Valuations are carried out every three years (with valuation dates differing for every scheme). The school has to be consulted over funding and investment strategy, so there is some control over the contributions required from schools. Valuations need to be completed within 15 months of the effective date.

Exit costs: Yes, but only when the scheme is wound up if there is only one employer participating, with funding assessed on the basis of an insurance company buy-out (i.e. very prudent). This is monitored at actuarial valuations. If more than one employer is participating, the exit cost trigger is for an employer to have no active members.

Control: Depends on the scheme's trust deed and rules. In general, the trustees have most powers, but schools generally will have a say on investments, funding, benefits and contributions.

Pension cost accounting: DB accounting under the relevant accounting standard will apply. The P&L charge is assessed each year – this may not match the contributions paid, and there is a balance sheet asset and liability measured on an accounting basis, which will add volatility to the school's balance sheet.

Key issues: Long-term funding targets (LTFT) – All occupational schemes are expected, in the next year or so, to be subject to a new code of practice from The Pensions Regulator. The cornerstone is the LTFT, to guide schemes to a secure end. This is likely to raise costs for scheme sponsors.

Deed and rules – Can contain provisions that cause issues for schools.

Independent Schools' Pension Scheme (ISPS)

Type of scheme: Occupational multi-employer trust-based scheme run by TPT Retirement Solutions. Terms and conditions are set out in the trust deed and rules. There is both a DB and a DC section.

Open/Closed: Can be either. It's relatively easy to close to new joiners. Closing to all future accrual for DB members can give rise to an exit cost unless the employer has employees in the DC section.

Funding: The DB section follows the same Pensions Regulator's guide to funding as mentioned for a school's own trust-based scheme. Valuations are again carried out every three years, with a valuation being carried out as at 30 September 2020. Contributions are likely to change in Q1 2022. TPT asks schools that join the ISPS to waive some of their rights when it comes to the valuation process, and as a result have little influence on the outcome. The 2017 report reported a shortfall of £38.2m.

Exit costs: Yes, but only if no active member (DB or DC) or the scheme is wound up, with funding assessed on the basis of an insurance company buy-out (i.e. very prudent). This is monitored at actuarial valuations.

Control: TPT typically requires employers to sign away most of their entitlements when it comes to scheme funding when they join. As a result, in general the TPT trustees have almost all the power over investments, funding and school contributions. An Employer Committee represents employers' interests to the trustee.

Pension cost accounting: DB accounting under the relevant accounting standard will apply. The P&L charge is assessed each year, which will not match the contributions paid, and there is a balance sheet asset/liability measured on an accounting basis, which will add volatility to the school's balance sheet.

Key issues: The LTFT will also apply to the ISPS – a possible outcome is a more prudent approach to funding, and this will be seen most likely at the next triennial valuation. Last man standing risk – this is a feature for multi-employer schemes such as the ISPS whereby any section 75 debt that is not recovered is shared across the other employers. In theory it all passes to the 'last man standing', and some employers want to remove such risks. 'Orphan liabilities' (i.e. liabilities with no participating employer supporting them) are currently relatively low in ISPS.

The Growth Plan

Type of scheme: Another occupational multi-employer trust-based scheme run by TPT Retirement Solutions. Terms and conditions are set out in the trust deed and rules. The Growth Plan has 4 'Series', and looks a lot like a DC scheme to employers, but Series 1, 2 and 3 are actually DB, which has given rise to some of the issues set out below. Section 4 is purely DC.

Open/Closed: Series 1, 2, and 3 are closed to future accrual of new benefits. Series 4 is open to new contributions.

Funding: Those Series deemed to be DB (largely due to investment guarantees) can give rise to a shortfall. Similar issues as described for ISPS apply, with valuations again carried out every three years. With a valuation being carried out as at 30 September 2020, deficit contributions could change in Q1 2022. The 2017 report reported a shortfall of £132m.

Exit costs: Yes, a section 75 debt can emerge for Series 1 to 3 if an employer no longer has any employees contributing to Series 4. Many employers therefore avoid the Section 75 debt by keeping an employee in Series 4, although some will pay the exit cost to remove the liability completely.

Control: Like ISPS, employers have very little control. There is an Employer Committee to represent employers' interests to the trustee.

Pension cost accounting: DB accounting under the relevant accounting standard will apply. The P&L charge is assessed each year, which will not match the contributions paid, and there is a balance sheet asset and liability measured on an accounting basis, which will add volatility to the school's balance sheet.

Key issues: Section 75 debt – The size of the liabilities tend to mean that section 75 shortfall is the main headache for employers. The LTFT will also apply, but will be less material due to prudence in the current funding target and investment strategy. Orphan liability and last man standing risk also apply, but across many more employers, as the Growth Plan is used by many of the TPT schemes, and so is not just used by independent schools (as ISPS is). Orphan liabilities make up nearly 50% of the Growth Plan.

In conclusion

In moving away from the TPS, schools need to consider the complexities and issues of other schemes.

Some schools will already have exposure to these other pension schemes, but may not be aware of accounting requirements, other liabilities that can arise, or that that they can influence the funding requirements.

An audit of your pension liabilities can help you to plan for the future, and mitigate risks that emerge.

We have advised schools on all the alternatives available, and we can help you understand your pension liabilities, and deal with any issues that these arrangements present.

How First Actuarial can help

First Actuarial is a nationwide firm of pensions actuaries and consultants. We help independent schools with all their pensions issues.

We offer a unique blend of public service pensions expertise, consultancy and communication skills. We are adept at running remote meetings, for both governors and teachers.

To discuss any of the areas explored in this briefing, contact your usual First Actuarial consultant or any of the lead consultants in our Education team:

Declan Keohane (Basingstoke)
E: declan.keohane@firstactuarial.co.uk
T: 01256 297 789

Dale Walmsley (Manchester)
E: dale.walmsley@firstactuarial.co.uk
T: 0161 348 7464

John Ingoe (Leeds)
E: john.ingoe@firstactuarial.co.uk
T: 0113 818 7365

Peter Norman (Peterborough)
E: peter.norman@firstactuarial.co.uk
T: 01733 447 681

Marcos Abreu (Tonbridge)
E: marcos.abreu@firstactuarial.co.uk
T: 01732 207 507

first actuarial