Independent schools briefing, Quarter 1 2022

Independent Schools' Pension Scheme (ISPS) valuation results

The ISPS is a pension scheme originally set up for support staff and run by TPT Retirement Solutions. It has Defined Benefit (DB) and Defined Contribution (DC) sections. This briefing considers the latest valuation results of the DB section.

The results of the 2020 valuation, which were released earlier this year, are not good news for either employers or employees.

The funding level worsened to 78% in 2020 (from 80% in 2017) and the funding deficit increased to £55.2m in 2020 (from £38.2m in 2017).

Significantly, the funding rate for future benefits also increased sharply, in common with many other schemes with 2020 valuations.

This briefing looks at the background to the results, the impact on schools and the options available.

Why has the deficit increased?

Allowing for three years' worth of interest, expected asset returns, contributions paid and benefit accrual, the 2020 deficit was expected to be around £33.3m.

However, the new deficit is £55.2m – i.e. a worsening of around £21.9m, the key elements of which are:

- **Loss of £43.5m** from updating the 2017 funding strategy to account for 2020 market conditions. The ISPS valuation is heavily linked to gilt yields (yields on government bonds). When gilt yields decrease, the value placed on pension liabilities increases – and that's what we've seen.
- **Gain of £39.1m** from the outperformance of investment returns which will be, in part, linked to changes in gilt yields (see above).
- **Loss of £7.0m** due to the reform of the Retail Prices Index (RPI). This is the 2030 change which will bring RPI in line with CPIH (Consumer Prices Index including some housing costs).
- **Loss of £9.7m** as the valuation has built in greater allowance to enable the Trustee to make improvements to the rates at which members can exchange pension for cash.

What does this mean for deficit payments?

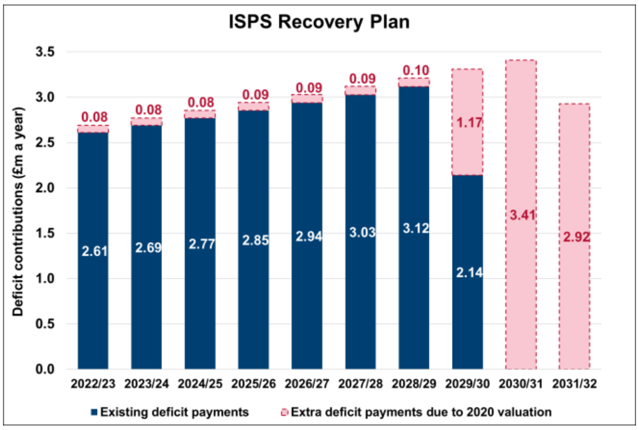
To clear the deficit, there will be a combination of higher contributions and an extension to the length of the recovery plan.

Investment returns continued to be strong after the valuation date. The resulting funding improvement is allowed for in the recovery plan, to keep contributions more affordable for schools.

Total contributions will increase from £2.61m pa to £2.69m pa from 1 September 2022 (an average increase of 3%), with individual employers seeing higher or lower increases depending on how their liability share has changed since 2017. Schools that have remained open to accrual since 2017 are likely to see higher increases.

The existing recovery plan was scheduled to end on 30 April 2030, but this has been extended by over two years to 30 June 2032.

The existing recovery plan and extra deficit payments (worth over £8m) resulting from the 2020 valuation are shown below:



What about the cost of future benefits?

Future service contributions will rise by over 50% from September 2022, again mainly due to the fall in gilt yields, but changes to other assumptions have also contributed.

DB section of ISPS	Current cost (% of salary)	Cost from Sep 2022 (% of salary)	*Increase (as % of current cost)*	*Increase (as % of salary)*
1/60th Final salary	30.5%	**48.6%**	*59%*	*+18.1%*
1/80th Final salary	23.1%	**36.6%**	*58%*	*+13.5%*
1/80th CARE	23.0%	**35.8%**	*56%*	*+12.8%*
1/120th CARE	15.6%	**24.1%**	*54%*	*+8.5%*

What is the impact on my school?

Your school should consider how the change in deficit contributions and (where relevant) future service costs fit into business plans. Some schools will see larger increases than others depending on how their liability share has changed.

What options do we have?

Schools should look at the options for managing future service costs, such as moving to a less expensive section, closure of DB sections and/or sharing costs with staff. Affordability appeals exist for employers that can't afford higher deficit contributions.

When can any changes be implemented?

TPT has confirmed it needs to be notified of changes to DB sections and/or member contribution rates by 31 May 2022, for these to take effect from 1 September 2022. Such changes may trigger a statutory consultation process with affected staff.

Where TPT does not receive confirmation of any changes, the default position is that the current DB sections offered will continue and the school will pick up the full cost increase for future benefits.

Schools can make changes at different points of the year as long as they provide at least three months' notice to TPT. For example:

Timeframe	Task
Well before 31 July 2022	Consultation with affected staff and decision-making by the Governing Body.
By 31 July 2022	Confirm changes to TPT.
1 November 2023	Changes take effect.

We have already closed to future DB pension build-up – is there anything we can do?

Schools may have already closed DB sections to pension build-up, using the DC section for future savings. However, there are still areas to consider:

Understand the results: Governing Bodies should ensure that they understand the valuation results and the reasons for the change in position. Risk registers may need to be updated accordingly.

Consider liability management: The allocation of deficit contributions by liability share means that liability management exercises – such as early retirement exercises, commutation of small pensions and transfer value exercises – can help reduce your share of total deficit contributions at future valuations and improve your annual accounting position. Different liability management exercises will be appropriate for different member profiles, and a cost/benefit analysis of all options is essential.

Bulk transfer to another scheme: If a school has critical mass of pension liabilities, then a bulk transfer to an existing or new scheme can give the school more say in the funding and investment strategy. Girls' Day School Trust and Manchester Grammar School have both completed bulk transfers recently.

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.

To discuss this briefing, get in touch or visit us at stand 131 of the ISBA conference on 17–18 May.

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

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