Independent schools briefing, August 2024
ISPS 2023 valuation results

In this briefing we discuss the indicative results of the 2023 valuation of the Independent Schools' Pension Scheme (ISPS).

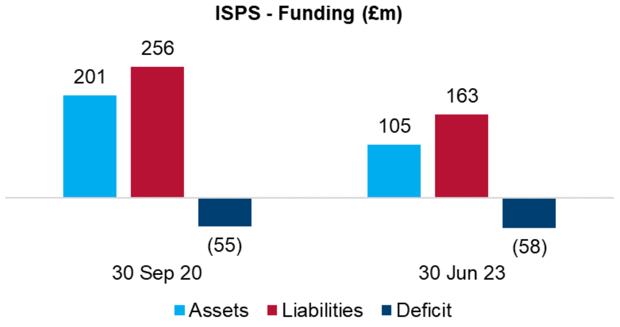
The headline results, described as ***"extremely concerning"*** by the ISPS Employer Committee (EC), are:

- The funding level has ***deteriorated significantly*** since the previous valuation, mainly due to the investment strategy performance
- The Trustee is considering a threefold increase in deficit contributions, maintaining the recovery plan end date of June 2032.

Indicative results

While the valuation results are not yet available, the EC has provided an updated position as at 30 June 2024 (i.e. three months before the valuation date).

This is shown below, alongside the results of the 2020 valuation:



As you can see, the significant fall in funding liabilities has been more than offset by a larger reduction in the value of the assets.

The result is that the deficit has increased, despite employers paying nearly £8m in deficit contributions since the last valuation.

The final valuation results will differ from those shown below.

The estimated position at 30 June 2024 is based on the principles used for the 2020 valuation. At the very least, these will need to be updated to allow for more recent information (for example, on life expectancy changes). However, it's unlikely that these changes will reduce the deficit materially.

What does this mean for shortfall contributions?

It's almost certain that the 2023 valuation will result in increased shortfall contributions. These are likely to be effective from September 2025. At this stage, the size of the contribution increase remains up in the air, and will be very sensitive to the final agreed funding shortfall and the length of the revised recovery plan.

The initial proposal from the Trustee to the EC would see overall contributions almost triple (**from £2.7m pa to £8m pa**).

A potential threefold increase in contributions seems inconsistent with the relatively small increase in the funding shortfall (based on the 30 June 2024 position).

There are two main reasons for this larger than expected increase:

1. The current recovery plan allowed for post-valuation events. As a result, the agreed contributions were those needed to remove a shortfall of c£37m (rather than the £55m at the valuation date).

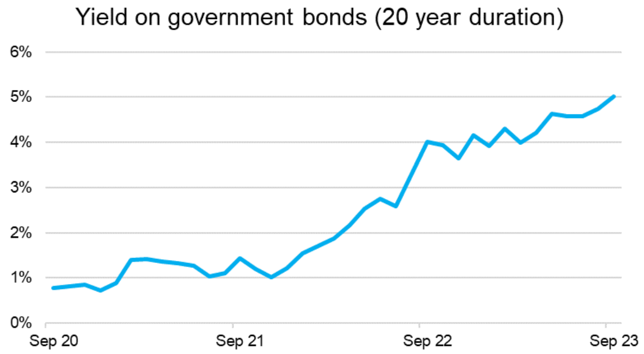
2. The Trustee's proposal maintains the recovery plan end date of 2032. This means the increased shortfall is to be removed over a much shorter period than was the case in 2020.

Why has this happened?

Pension scheme funding is complex, with many moving parts, but the update from the EC earlier in the year suggested that the primary reason for the worsening position was the execution and performance of the Scheme's investment strategy.

In particular, ISPS uses liability driven investment (LDI) funds. LDI is designed to 'hedge' changes in the value of liabilities caused by changes in interest rates and inflation.

We've seen significant increases in long-term interest rates since the 2020 valuation – as shown by the change in the yield on long-term government bonds/gilts, below – particularly the unprecedented spike in late 2022.



The speed and size of the increase over this period caused problems with LDI funds for many UK schemes. Assets held by ISPS fell in value more than liabilities over that period, contributing to the increased funding shortfall we now see.

What about future service contributions?

As the saying goes, every cloud has a (relatively thin) silver lining.

For those schools that still provide future pension benefits through ISPS, the cost of providing those new benefits is expected to fall significantly, potentially by up to 50%.

While this is unlikely to offset the impact of increases in deficit contributions, it is some good news for those employers that have not closed to future accrual.

> Schools that provide members with future Defined Benefit (DB) accrual will need to consider how to share any reduction in contributions with staff.

What can schools do about this?

Ultimately, the collective nature of ISPS means you are tied to the position as agreed between the Trustees and the EC if you wish to remain in ISPS.

Employers do have the option of paying their 'debt' and walking away from any future obligation to ISPS, but this comes at a heavy price.

Another, less travelled, road would be a transfer of your share of assets and liabilities away from ISPS into another arrangement. This is called a bulk transfer. For example, the Girls' Day School Trust completed a bulk transfer from ISPS in 2012.

However, there are significant costs involved in a bulk transfer, and the underlying shortfall will still need to be made good, so this is unlikely to be a solution for many schools.

> As part of the 2023 valuation, you should receive an updated estimate of your employer debt.
>
> If you have not previously considered the pros and cons of paying your employer debt, now is the ideal time to do so. If you have, you should consider how the analysis may change when it allows for the revised deficit contributions.

In summary

An increase in ISPS contribution requirements could hardly come at a worse time for independent schools.

Employer contributions to the Teachers' Pension Scheme increased by 5% of salaries earlier this year. Independent schools are already dealing with the implications of VAT on school fees from 1 January 2025. They're also continuing to absorb significant increases in almost all other costs. Another material increase in pension costs is most unwelcome.

The proposed implementation date of September 2025 does at least give schools some time to consider the impact of any increase on budgets and consider the options available.

For those schools still offering staff future DB accrual in ISPS, some thought will also be needed as to how any reduction in the cost of future benefits should be implemented and shared with staff.

Get in touch

First Actuarial is a leading adviser to independent schools. Find out more about our services for independent schools.

To discuss any of the areas explored in this briefing, contact our specialist team for independent schools.