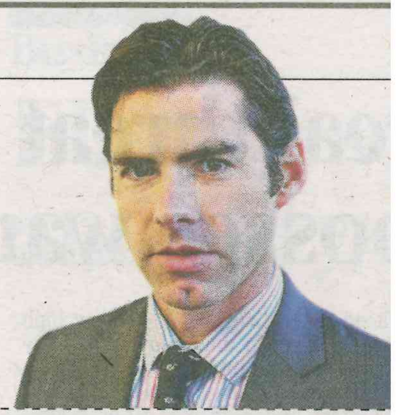
Philip Aldrick



Universities' pension scheme could be their most rigorous examination

Philip Aldrick is Economics Editor of The Times

"Pension schemes are back in the news, and not for the right reasons. Sir Philip Green, the Topshop tycoon, has left BHS with a whopping £571 million deficit to plug. Tata Steel's shortfall is £485 million. Thousands of honest workers face the prospect of losing part of their entitlements as the two crippled businesses threaten to break cast-iron promises.

It doesn't stop there. The combined deficit of schemes backed by the industry-funded Pension Protection Fund is £302 billion and experts reckon it won't be long before others are scooped up by the lifeboat as sponsor companies hit the rocks. Questions are already being asked about Premier Foods, the maker of Mr Kipling and Bisto, a £320 million company with a £395 million deficit whose American suitor mysteriously walked away this month.

None of them, though, comes close to the black hole in the pension scheme of that most venerable of British institutions, our universities. Since 1975, the pension benefits of Britain's higher education establishments have been pooled together under the Universities Superannuation Scheme. With £49 billion of assets, it is the largest scheme in the country. It also happens to have the largest deficit, £10.5 billion last year on a "self-sufficiency" basis.

Stewardship of the promises made to workers depends on two things: the management of the scheme and the strength of the institution backing them. Universities are unique in that they have a policy lifeline through the government's control of tuition fees. Raising fees from £9,000 a year would

be politically fraught, however, which makes careful management even more important.

The bad news is that the USS is rapidly destabilising. There is no immediate risk, but, like a long-term illness, it needs remedial action. The USS started grappling with the problem in 2014, when its "technical" deficit was £5.3 billion and the scheme's liabilities, the value of pension promises in today's money, were 89 per cent funded. An agreement was struck with the Pensions Regulator to bridge the gap over 17 years, twice the average, by increasing contributions and trimming generous final-salary benefits.

A year later, though, the scheme was £8.2 billion in the red and only 86 per cent funded. Barnett Waddingham, an actuary, reckons that the shortfall is now £11 billion. Next year, when the USS must update its recovery plan, Barnett Waddingham has warned that, all else being equal, universities will have to increase their contributions from 18 per cent of salaries to 27 per cent.

The sums involved are so huge that pensions are becoming a deadweight. In 2012, university contributions to the USS were £950 million. Last year, they were £1.14 billion, a 20 per cent increase over a period of 6 per cent inflation. If Barnett Waddingham is right, universities could soon be asked for another £600 million a year.

To put that in context, universities' annual income is about £33 billion. Almost half comes from tuition fees, £15 billion, of which the fastest-growing part is non-EU students, who pay more than £4 billion a year and are a cash cow that universities want to milk. Unfortunately, government migration targets are proving a thorn in their side.

Worse, the USS has an inherently unstable structure. If one university goes bust, its liabilities are simply covered by the rest. This "last man standing" approach means that top universities could end up in an unsustainable position should some of the 370 institutions in the USS fall by the wayside. No pensions lifeboat is big enough to rescue the USS.

The strength of union representation also makes the USS hard to reform, although ground was given in the recent renegotiation, which saw everyone moved from a final-salary to a career-average scheme capped at £55,000.

Universities' social contract with staff has always been that low pay comes with decent benefits. The problem is the social contract with students, who are loaded with debt in part to pay for pensions they will never be offered. If the scheme sinks deeper into the red, calls will come for higher fees.

The big hope is that interest rates rise, which, through complicated mathematics, will reduce the liabilities. If that's the plan, however, it would make Sir Philip look as clean as a whistle.

Universities, we'd like to think, measure themselves by a higher standard."

The true costs of Brexit ... what on earth are they?

This week saw the first effort by Eurosceptics to make the economic case for Brexit. The self-funded eight-strong group were a rather sad sight as they lined up against the mighty resources of the International Monetary Fund, OECD, [..]0, Treasury and Bank of England.

"The overwhelming majority are of the view that the economic costs are very high," Lord Stern of Brentford and the London School of Economics said this week.

Yes, the Brexit paper had holes. It assumed that leaving the EU would be as easy as returning home from a Mediterranean beach break. It forecast inflation to "get back on track" yet consumer prices to be lower. Interest rates would rise with seemingly no impact on growth. Trade lost with Europe would just pop up elsewhere.

But the one thing it proved comprehensively was that different assumptions yield different answers. The Treasury's 6.2 per cent hit from Brexit became a 4 per cent gain. What Lord Stern omitted to say about the "overwhelming majority" was that they used similar inputs. So it was hardly surprising that they got similar outputs. Consensus doesn't make you right, but it does allow you to be smug.