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FE & HE Digest

Winter 2022

Latest news from the Further and Higher education sectors

Now, for tomorrow

Welcome to the Winter Edition of FE/HE Digest.

This update comes at a time of great uncertainty and shifts in the political landscape. Undoubtedly many Institutions will be in the midst of some interesting discussions over defined benefit pension schemes as well as dealing with rocketing energy costs and a difficult environment for recruitment and retention of staff.

We also eagerly await the outcome of the Office for National Statistics (ONS) review of the classification of FE Colleges, more details inside. In this edition we have set out a number of articles which we hope will be of interest.

If you do have any questions on any matter raised in this edition please do get in contact with one of the team.

Best Wishes,
Further & Higher Education sector teams

Defined Benefit Pension - LGPS

The Local Government Pension Scheme (LGPS) is a defined benefit pension scheme which sits on the balance sheet of most education institutions. This year there has been lots of discussion on this topic as there have been some gargantuan movements in actuarial assumptions and as a result some institutions have seen a swing from a liability position to that of an asset. Others are seeing big reductions in liabilities and are concerned that this position might be reversed in the future leading to further volatility.

We have been talking to a number of our clients about these issues and have noted the following:

1. Discount rates have increased substantially from c1.6% to c3.5% as a result the present value of the liabilities of the scheme have been reduced significantly
2. Bond yields are high which has caused the rise in discount rate
3. Inflationary increases (largely to pension payments) have not yet been experienced within the scheme
4. Salary increases have not been as high as the inflation rate, keeping future liabilities down

However, there is a growing feeling that these large reductions in liabilities are not going to last too long. Indeed there is a growing expectation that the Pension Increase Order (PI Order) that is due to take effect in March 2023 will include a large % increase which would increase pension liabilities considerably. The expected % of this PI Order will vary from scheme to scheme as there are a number of factors at play – including which reference date the scheme uses to calculate infliation – typically this is September each year but it could (in theory be changed); also some schemes will have caps on them limiting the increase. A number of actuaries are allowing institutions to include the projected/estimated 2023 PI order into their 2022 calculations which may have the effect of reducing future volatility.

Secondly some institutions might be in the 'fortunate' position of having an asset in the scheme. The next question that proceeds is whether to recognise that asset or not. FRS102 states that If the present value of the defined benefit obligation at the reporting date is less than the fair value of the plan assets at that date, the plan has a surplus. An entity shall recognise the plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or refunds from the plan.

So there are a number of questions that arise from this:

1. How likely is it for the contribution rates to be reduced in the future when we know that inflation is currently high?
2. If the scheme has been in surplus for a number of years are there likely to be any reductions in the primary or secondary rates going forward?
3. What would happen if the institution exited the scheme – would a repayment be due – i.e. what is the valuation of the scheme based on a cessation basis?

The broad definitions of the primary and secondary contributions to LGPS. The primary contribution is the cost of accrual of the extra year of service for an individual employee – being a % of their salary. The secondary rate is the amount required over an agreed period to collect any deficit. This period is usually 20 years, but the actuary looks at risk, the potential for the Institution to be in it for the longrun – and looks at the average time to payment broken down into 5 year bands and discount rates set appropriately.

At this point those in an asset position will be needing to understand what their levels of primary and secondary contributions will be going forward. These are due to be published in the triennial valuation reports which are due out before the end of the year.

There are many issues surrounding this topic and undoubtedly there will be a lot of questions from Finance and Audit committees. Some of these questions will undoubtedly focus on the real world implications as to whether there are any practical implications that arise from this position. Guidance in this area is always going to be specific to the scheme and the institutions own position but its safe to say we have interesting times ahead so it is always worthwhile checking in with a specialist in order to understand your options.

Holiday Entitlement and Holiday Pay

The Supreme Court case of Harpur Trust v Brazel (2022) has recently clarified the law in relation to pro-rated holiday entitlement, and the impacts for employers could be significant.

The case was about a Part-Year worker who had a continuing contract but did not work every week of the year. The decision affects Part-Year workers, Zero-Hour workers, Seasonal workers and potentially Annualised Hours and Casual workers; it does not affect part-time workers who are contracted to work every week.

The Supreme Court judgement is that anyone on a Part Year, Casual, Zero-Hours or Annualised Hours continuing contract who does not work every week in a year is entitled to 5.6 weeks' holiday, not a pro-rated entitlement.

This means that employers will no longer be able to pay holiday to such workers at the 12.07% rate. Holiday pay will also need to be paid at the 52-week average.

How has this happened?

The Working Time Directive contained the 'conformity principle' meaning that anyone working less than full time, be that hours per week or weeks per year, would have a pro-rated entitlement. When the Directive was enacted in the UK as the Working Time Regulations, this was not included. Therefore, the Regulations state that all workers are entitled to 5.6 weeks' leave per year. The Working Time Directive does not prevent a more generous provision being made by domestic law. The UK could have amended the domestic legislation but chose not to.

What are the implications?

Part Year Zero Hours and Season workers continuing contracts should be amended to remove references to the 12.07% holiday entitlement or to the pro-rating of holiday entitlement. Existing staff on these contracts should be issued with an Amendment to Contract, and this should be done within one month.

Employees on Part-Time and Annualised Hours contracts should also be reviewed to highlight anyone who does not work every week.

Employees on these contracts will be entitled to 5.6 weeks' holiday per year from now on. Holiday pay will then be based on their average weekly pay over the previous 52 weeks, excluding any weeks which they did not work and taking into account the remuneration of earlier weeks to bring the total up the 52 weeks (if the worker has not worked for the employer for 52 weeks, then an average of the weeks worked should be used).

This should be implemented promptly to correctly pay workers holiday entitlement thus reducing the likelihood of claims for backdated holiday (there is a three-month time limit for such claims). Otherwise, employers could face costly Tribunal claims.

Casual worker contracts which provide for no continuity of service between assignments will not be affected as these are not continuing contracts. Employees on Fixed Term contracts will similarly be unaffected.

Should you need an assistance, MHA's HR Solutions team can review Contracts of Employment and advise on the correct calculation of holiday entitlement and pay going forward.

Change in Designation?

Following the introduction of the Education Act 2011, since 1 April 2012, Further Education Colleges (FECs), Sixth Form College Corporations (SFCCs), and institutions designated as being in the FE sector (Designated Institutions) (hereafter collectively referred to as "Colleges"), in England, have been classified to the non-profit institutions serving households (NPISH) sector (S.15) in the UK National Accounts.

Following the Skills for Jobs White Paper published in January 2021, the Office for National Statistics (ONS) has announced that it will carry out a review of the sector classification of FECs, SFCCs, and Designated Institutions, in England in the context of the latest international guidance.

If the ONS decide to reclassify Colleges as public sector bodies this could have a profound effect on the sector. This would include nationalising 3rd party debt, removing the ability for Colleges to borrow externally.

The outcome is expected at the end of November.

Is the Bishop of Oxford dead?

Introduction

Forgive this sensationalist title as no cleric has been harmed in the writing of this article. By the Bishop of Oxford we are referring to the common name given to the landmark legal case from 30 years ago, officially Harries v Church Commissioners for England in 1992, that has set the framework for charity investment since. The recent case this year of Butler-Sloss v the Charity Commission and HM Attorney General was taken up to confirm if those principles still applied, even though charity investment has changed significantly since.

The ruling and its implications

The charity concerned in this case has charitable objects for environmental protection and improvement and the relief of poverty. The case considered whether the charity could have an investment policy which excluded potential investments where the trustees considered they conflicted with those objects. Interestingly the Bishop of Oxford case suggested this scenario would be rare.

Whilst it is arguable that the Butler-Sloss case has not changed what are now widely held principles, the Charity Commission has welcomed the judgement as a helpful confirmation.

The principles in the judgement confirmed trustees responsibilities for charity investment are derived from their primary duty to further the purposes of the charity. This is normally achieved by maximising the financial returns on their investments following the statutory standard criteria of ensuring the suitability and diversification of investments.

Where investments potentially conflict with the charitable purposes, trustees can exercise discretion when to exclude those investments. In doing so trustees should balance the potential extent of that conflict with its potential financial effect.

Wider factors such as a negative impact on charity stakeholders can be considered. Typical examples of this include where holding certain investments would significantly harm fundraising prospects or be repugnant to charity beneficiaries. Decisions based on purely moral grounds must be taken very carefully, so personal views will often need to be set aside.

One of the barristers representing the Attorney General was at pains to emphasise that this case does not provide guidance on programme related sometimes known as social investments, nor mixed motive investments. The legal responsibilities for these are not seen as an exercise of investment powers. In these cases charities should refer to specific Charity Commission guidance and recent legislation.

The Charity Commission has been reviewing its guidance on charity investment, CC14, and it has stated this case has been helpful, so they will be issuing a revision in the coming months. In the meantime it would be appropriate for all institutions which have charity status and that are undertaking investment activities to review their formal policy on investment to ensure that the clarified principles are reflected.

Simply these are that trustees seek to act honestly and reasonably using appropriate skill and care, and to invest in a manner that is in the best interest of the charity and its purposes; and that where an investment may create a conflict, the trustees will use their best judgement to consider that against the potential financial detriment.

Conclusion

If the formal process set out in the Butler-Sloss case is followed in investment policies and practices, this suggests that trustees will have met their legal duties even if a third party may claim they would have come to a different conclusion based on the same circumstances.

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