Defending pensions – a fight for all our futures

Introduction

Our pensions are being put at risk by a process of dishonesty and theft. This is being conducted by a poisonous combination of hard-nosed employers, a zombie government bent on realising Margaret Thatcher's infamous statement that "there is no such thing as society", together with City Financiers, the Pensions Regulator (tPR http://www.thepensionsregulator.gov.uk/) and Pension Scheme managers, looking for new opportunities in a 'liberalised' pensions market.

The above may seem strong but, as outlined below, it summarises the various forces combining to attack our pensions and highlights why taking industrial action to defend all our pension schemes is so important. Our pension scheme in Higher Education – the Universities Superannuation Scheme (USS) – is one of the biggest and richest pension schemes in Europe and can safely provide a decent pension for all. However, the recklessness of those involved means that what is now at stake is not only what remains of the collective Defined Benefit (DB) part of our scheme, but the viability of the total scheme.

Twice in the last 6 years USS members have seen the value of our pensions cut while we pay more. It doesn't have to be like this: our colleagues in post-92 universities are doing much better.

The threat can be understood as rooted in the neo-liberal agenda (market economics and privatisation), which has dominated UK politics since Thatcher. But, this agenda is weakening. The success of Corbyn in the 2017 election has undermined the Tory government's ability to drive through privatisation. Corbyn's popularity is built upon a widespread belief that austerity has gone too far together with a desire to return privatised public sectors back to the benefit of their users. As such, the window for the Government to push through destructive changes to our and other workers' pensions is closing. In November 2017 the senior Department for Work and Pensions official responsible for pensions, Charlotte Clark, stated: '*this is probably our last chance to make changes to the DB (Defined Benefit) pensions sector*', an acknowledgement of the growing resistance attacks on our pensions.

Things have been made worse by the new breed of University Administrator viewing 'their' institution as a business on the road to privatisation; where any potential pension liability on the balance sheet could deter private investors or bank borrowing. The collective point of view of our employers is given by Universities UK (UUK).UUK's approach has been to minimise the 'risk' to their individual institution's balance sheet at the cost of maximising the risk to members of the pension scheme that they will be left with insufficient pension to be able to retire. This is summed up by UUK's stated desire to 'review the entire concept of retirement'.

The most determined and well-coordinated industrial action will be necessary to defend our pensions. We are not on our own. The Communications Workers Union is running a brilliant campaign to defend their pensions and there are many other similar collective Defined Benefit schemes under threat. If we maximise unity with other trade unions; stand alongside our students and their parents; and build a campaign which engages all our members, we can win.

That means that we will need to campaign at several levels, not solely with industrial action, but also by mounting a spirited defence of Defined Benefit pensions in the form of a political campaign. This can turn the tide back, and win a future Labour government to the defence of the collective provision of pensions. **How to mount these different campaigns is the subject of this pamphlet.**

What is the Universities Superannuation Scheme (USS)?

Pensions are our deferred wages – generally hard earned, saved and paid back in retirement. Until recently pension savings were invested in future wealth creation – stocks and shares. Historically, by far the best return on savings has been achieved through these investments and the additional risk associated was minimised through the creation of a collective scheme linking employers, active non-retired members and pensioners in a process of intergenerational savings. A wide range of pension schemes shared this characteristic and in one form or other, collectively defined the benefit to the pensioner in return for contributions throughout their working life by both worker and employer. Contributions were linked to wage rates and benefits to average wages.

USS, the pension scheme for all academic and academic related staff in pre-92 Universities is one of the largest pension schemes in Europe, with assets of over £60b (USS Annual Report and Accounts, 2017, https://www.uss.co.uk/how-uss-is-run/running-uss/annual-reports-and-accounts). That is almost twice the total £33b annual expenditure of the whole of the UK Higher Education sector in 2015-16 (HESA, http://www.universitiesuk.ac.uk/facts-and-stats/Pages/higher-education-data.aspx). The collective Defined Benefit (DB) scheme that USS is today was established in 1971 in a joint initiative between the predecessor union to the UCU, the Association of University Teachers (AUT), so unusually for a pension scheme, university staff are represented on the scheme board. However, the origins of the scheme stretch back to 1911 when representatives of university teachers urged employers to establish a scheme like an already existing scheme for school teachers. Now, almost 400,000 past and present staff in our universities are reliant upon USS for their pensions. **Therefore, what happens in USS is of utmost importance to us all, whether you are about to retire, are mid-career, have just entered your career in a university, or have not yet started a career in higher education, perhaps on a casual contract and yet to gain your first post**.

Pension Theft

Pensions are not a present from our employers. They are part of our contractual pay. Cutting our pensions not only means a penurious old age but also a pay cut now. The USS pension scheme is a strong and growing scheme. Not only does it have large assets but its' income exceeds its expenditure and will do so for decades to come. In every way that we examine the real data for USS income and expenditure the same picture applies.

Government plays an important role in this theft through their creation of a so called 'independent' regulator, the Pensions Regulator (tPR). Following a series of pension scheme collapses due to company failures, tPR was established by Parliament in 2004, together with a fund (the Pension Protection Fund, PPF) to which every pension scheme contributes, designed to bail out failed pension schemes. One duty of tPR is ostensibly to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund (PPF). In reality however their approach is to end collective provision of pension schemes and enforce a transition to individual provision of pension schemes. Risk of pension default is not reduced but instead passed onto the individual and away from employers or government. This unambiguously places tPR on the side of the banks and the City of London pensions industry and in opposition to the interests of thousands of pensioners.

The employers' proposals – cut the pension

The employers propose an end to the collective Defined Benefit (DB) pension scheme and its replacement with an individual Defined Contribution (DC) scheme. Under DB, you know what you will get and what you will pay – risk is shared between scheme members and employers. Under DC, you know what you pay, you just don't know what you will get – all the risk is transferred to individuals as members of the pension scheme. This makes a DC scheme both expensive, costs of running the scheme are not minimised and collectively shared, but even more dangerously an individual's pension is at risk of wild variation in asset prices immediately prior to retirement. The only solution to this for the individual DC member is that they themselves de-risk their own pension with the result that they have lower returns and a still lower pension.

In addition to moving to a full DC scheme, the employers also intend to cut their contributions to the scheme. Rather than promise a minimum level of contribution to our pensions they will transfer all 'de-risking' costs to members and cut employer contributions to 12.45% for future pensions. This will rob us of our pensions in the DC scheme. When everyone is being told they need to save more for pensions - our employers are doing the opposite.

Moving everyone to DC will destroy the link between past and future staff, break the important link that ensures the DB scheme remains open to new entrants and therefore continues to grow with positive cash flows, risks destroying future pensions and has the opposite effect of 'de-risking' by creating the very deficit they seek to avoid.

If income from earnings from the assets in the DB part of the scheme is less than the pension payments then the DB assets will have to be sold to raise income to pay for the liabilities. The DC scheme is separate from the DB scheme and liabilities in one scheme cannot be paid for by assets in the other scheme. Therefore, for the DB scheme to have negative cash flow would begin to create a real rather than a notional deficit. If that were to occur then the call on additional contributions from employers that they seek to avoid would be inevitable. So, undermining DB makes the artificial risk from Test 1's self-sufficiency goal (see Appendix) into a real outcome with the impact that it is universities themselves not USS who would have to finance the deficit. Employers' short-term aim of capping contribution costs can generate a high cost of a realised deficit payment they have aimed to avoid. At the valuation date of March 2017 USS estimated the Self-Sufficiency deficit amounted to £23b. This would come from university budgets if made real and potentially bankrupt many universities.

Of course employers are aware of this threat so their proposal is not to technically close the DB scheme but instead to stop members making contributions once their salary rises above £0 (yes that is not a typo!). Under a £0 cap on contributions but with a DB scheme which is still technically 'open' the deficit created by a negative cash flow would instead be funded by the cost sharing and contributions from both members and employers. These Deficit Recovery Contributions would come out of our employers contributions to our future pension accrual. So instead of employer contributions helping us to build up our future pension we are now paying a second time for the pension we had already built up. USS have stated these Deficit Recovery Contributions should be as high as 6% leaving less than 10% of employer contributions for building up our future pension entitlement. This is despite the fact that USS themselves accept the scheme is actually in surplus.

It is not for nothing that the UCU calls the employers' proposals an existential risk to our pensions.

Instead of welcoming the fact that the scheme has consistently been in surplus over the years after paying out pensions and costs of running the scheme, is therefore growing and will continue to do so for the foreseeable future our employers, government and USS itself are undermining the future viability of the scheme.

We face a perfect storm of privatising interests, circling our scheme like vultures.

Ending DB pensions may lead to the destruction of the pension scheme and the end of retirement.

Reducing or abolishing the collective DB part of our pensions not only introduces a great risk to the DB scheme through the creation of a negative cash flow and a deficit but also threatens the future of the individual DC scheme itself.

The outcome of self-sufficiency and Test 1 increases the chances of transforming USS from a pension scheme with healthy real surpluses and a notional deficit into a scheme with a real deficit and a notional self-sufficiency based upon delivering inadequate future pensions.

A major concern is that reductions in employer contributions into DC may lead to a rapid fall in the number of members who retain their membership of the scheme if USS is at the limits of its affordability for members and increases in deficit contributions from which new members of USS gain no benefit take place.

It gets worse - USS seeks to benefit from employers' desire to remove pension risk from their balance sheets by stealing the surpluses in the scheme which should go to the members as pensions, retaining them for their own advantage. Why have a managed fund and pay expensive investment managers when USS intend to move to a passive fund investing mainly in bonds which are the worst performing investments needing no investment management at all?

USS and our employers are being reckless. The collapsing of the scheme and members opting out with no or only limited pension provision could mean the end of any hopes of future retirement.

The employers are building discrimination into pensions – intergenerational solidarity

Currently USS and the employers still have a legal obligation to provide benefits promised to existing pensioners. Under DB, this obligation is underpinned by what is called intergenerational solidarity. Savings now from active members of the pension scheme provide the pension for retired members in return for a pension promise when the active member retires. This pledge can be seen more broadly in terms of investment of savings in wealth creation through stocks and shares today creating the employment and income needed to support the pensioners of tomorrow. DC pensions betray this pledge

We call for the return to DB and even better to Final Salary pensions. This will require a long term political campaign in the Labour Movement, for a return to the previous Social Democratic consensus and an end to the neo-liberal establishment view previously shared by all political parties.

Under-represented groups in HE, such as women and BAME staff, whose career pathways usually mean lower salaries and slower promotion will suffer the most from the ending of the old DB promise. Women and BAME staff will on average have the lowest DB benefit built up before it ends. **Therefore, it is essential that we fight for the defence of a DB scheme and eventually the abolition of the DC scheme altogether – it is the only way to a fair pension scheme.**

Future Benefits: how to destroy a pension scheme

Changes to the scheme are continually justified in terms of risk and costs, despite the logic above being repeatedly explained to USS and employers. Future costs of benefits rather than past costs of benefits has become the most recent incarnation of this risk. Low gilt yields (supposedly more secure government and company bonds which amount to loans) derived from Quantitative Easing are suggested to be the cause of lower yields across all types of assets, gilts and equities (another name for stocks and shares). Yet even if these returns were to be lower over the long run it is still the case that increasing the reliance upon gilts, either in the scheme's valuation or by moving investments from equities to gilts as is suggested by USS's de-risking strategy will continue to make the costs of future benefits higher than would otherwise be the case.

USS needs to remain an open, defined benefit based pension scheme in which collective provision of pensions are at the centre of its approach. We need to return to the Social Democratic ideal of a collective provision of social security. As mentioned before, university administrators only look at immediate profits not the long-term role of universities. We demand the return of universities to the control and accountability of the public sector.

The undermining of the USS scheme would introduce real risks to everyone's pensions. The government through the Pensions Regulator (tPR), USS and the employers suggest they are responding to the Test 1 induced deficit (See appendix for the technical details) by reducing the risk of self-sufficiency not being achievable. Test 1 is how the move from collective DB to individual DC becomes justified and arises from new accounting principles consequent on EU membership (called FS102, http://www.icaew.com/en/technical/financial-reporting/new-uk-gaap/frs-102-the-financial-reporting-standard) inspired by the view that the world is a casino in which organisations compete for capital and profit, the risk of failure requires management. This logic generates irrational views of the risks faced by any organisation, regardless of private or public, collective or individual. On this view, the risk is the gap between the scheme's valuation and self-sufficiency. To reduce this gap reductions in benefits are being sought by reducing or abolishing the defined benefit part of the USS scheme. This would leave members of the scheme almost wholly reliant upon the Defined Contribution (DC) part of their pension contributions. Members are then completely dependent upon how USS determines its return on investments. Although UCU has members on the Board of Trustees and the Joint Negotiating Committee, these bodies have little day-to-day control over the growing empire USS is building.

The university as a provider of public goods through free education.

It is important to place the destruction of collective provision of pensions within a wider context of the continuing marketisation and privatisation taking place in UK Higher Education. The introduction of student fees and the rise of high levels of student debt encouraged universities to act like private businesses. Universities have sought to maximise their income by targeting tuition fees while lowering the costs of university provision. Staff costs have fallen consistently as a proportion of total income while capital expenditure has risen. The biggest and fastest growing university will be the one that succeeds in this environment. Not only have universities acted as private companies but the Tory government's Higher Education and Research Act in 2016 laid the basis for private providers to enter the higher education market and accelerate tendencies to privatisation within the sector. Together student fees and debt, marketization and privatisation have together undermined the central idea of universities providing a public good in which society collectively benefits from increased levels of educations. The undermining of collective pensions are part of this very same process leading to individuals having to act only in their self-interest.

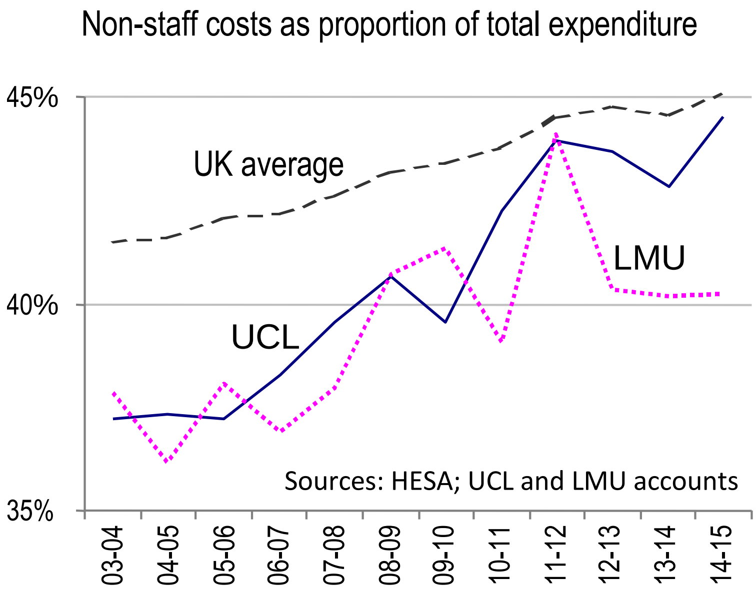
We need to return to a university sector providing free public goods in an environment in which universities are publicly funded and publically accountable.

Student debt and cuts in staff pensions are two sides of the same marketisation coin

So-called 'non-staff costs' (primarily buildings) have increased steadily as a proportion of expenditure over the last ten years. The trend for the booming pre-92 University College London (a USS institution) is similar to the post-92 London Metropolitan University, which has lurched from crisis to crisis over the same period. (Source: Holmwood *et al*. (2016: 11), *In Defence of Public Higher Education*. HE Convention.) Holmwood *et al.* comment:

> UK-average data from the Higher Education Statistics Agency shows an 8.7% growth from 41.5% of expenditure in 2004 to over 45% in 2015. UCL grew its non-staff budget by almost 20% over this period. Whereas LMU's ratio is more volatile, the upward trend is similar. Students and taxpayers might be forgiven for asking what their fees are supporting – the money is not being spent on employing teaching staff.

The graph below shows where university income is actually spent.

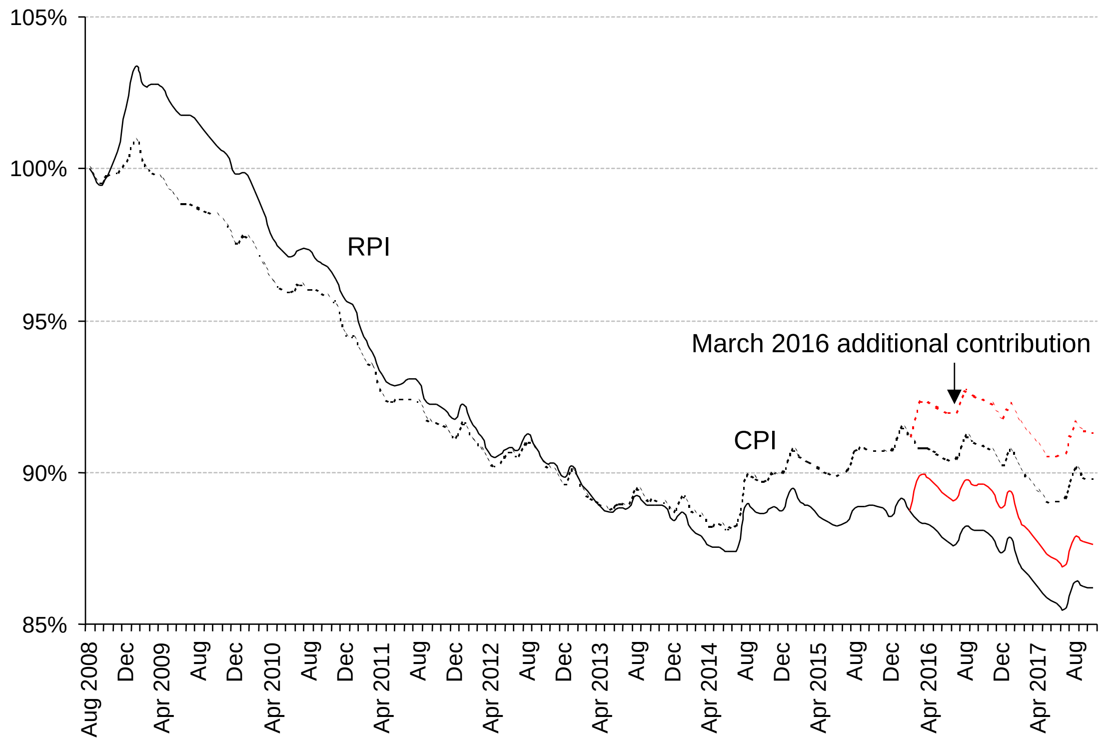


An increase in non-staff costs is of course a decline in staff costs, i.e. pay and pension contributions. Sector-wide, staff costs fell from 58.5% to 55% (a relative cut of 6%) over the period 2004-2015.

In 2011, undergraduate tuition fees were hiked from £3,000 to £9,000. After cuts in the block grant the income universities received per student increased from around £6,500 to £9,000 for Arts and Humanities subjects (figures for STEM and medicine are higher). UK HE institutions continued to pour ever greater sums into buildings t o take advantage of the new market for higher education as it emerged.

At the same time as student fees were rising and non-staff costs were rising real terms staffing costs were falling. August 2008 marked a turning point in staff salaries. The end of a three-year pay deal coincided with a crash on the stock markets and a run on the banks. The employers decided that they were not going to match pay rises to inflation, and so began a period of sharp decline in salaries. Since employer pension contributions are paid out as a percentage of salary costs, a decline in pay also meant a decline in pension contributions.

The graph below shows the real-terms value of salaries adjusted for the Retail Prices Index (RPI) and the Consumer Prices Index (CPI), with August 2008 = 100%. Unlike CPI, RPI includes housing costs. The crash of September 2008 led to house prices falling, sending RPI temporarily negative. (Sources: CPI 'D7BT' and RPI 'CHAW', National Statistics; pay increases, UCU website).



Before 31 March 2016, the employers contributed an additional 16% of salaries into USS, a figure that rose to 18% thereafter. For employers, this additional 2% contribution is equivalent to paying staff a 1.7% pay rise. As this graph shows, however, this increase is small compared to the decline in real-term value of salaries (including pension contributions) since 2008.

Even with the more generous 'CPI' measure, including the additional pension contributions, real-term expenditure per employee in October 2017 was 91.3% of the August 2008 figure. Against RPI that figure was 87.7%. The above shows that the employers can easily choose to pay more.

UCU needs members to act

UCU is now balloting for strike action in defence of the current USS scheme. It is at present uncertain exactly what changes might be finalised but the direction of travel is clear. In the consultations USS undertook with employers in September the majority of employers were willing to accept a level of risk that would have allowed the existing DB scheme to remain largely intact. However, after the consultation and under pressure from a minority of hawkish institutions, USS/UUK sought still more conservative valuation of the pension scheme in order to prevent the DB scheme from continuing. The manufactured deficit (see technical appendix) rose by 50% after the employers' consultation leading to the employers revealing their DC only pension proposals.

This dispute is not a repeat of 2014. The stakes are clear: acceptance of the current attack in any form would be catastrophic for USS. The entire UCU leadership, right and left, was united in

November in calling for the hardest-hitting action possible with the potential for sustained strike action in February, during the teaching term, and in the run up to NSS, when universities are especially vulnerable. This might then be followed, if necessary, by a marking boycott this spring/summer. The tasks facing all of us are stark: unless we organise and build the greatest possible Yes vote and turnout; unless we convince and organise members to take the action; and unless we carry it out, and at the same time start building for a second ballot over exam marking - unless we do all three - the employers will take our stable and secure pension scheme and smash it on the rocks of Defined Contributions.

Building for the ballots and action plan will test all of our resolve, but the only way to convince doubters is collective. This brings us to a central truism of trade unions. Action that seems impossible alone becomes achievable when acting together. University lecturers, researchers and academic related staff are no different from other workers, but we are not very used to collective action! In every university we need to build a single issue campaign group - an 'action committee' - and recruit members to it systematically, running stalls, setting up email lists, and calling meetings. Use it to campaign for a Yes vote and then use it to organise the strikes.

Every member has a stake in this dispute. Our responsibility is to give them a network they can use to build the action we need in a fight they care about. This is a grass roots strategy to win, and it is what UCU Left is all about.

We believe that by voting for industrial action we can begin to halt the onslaught on our pensions. By linking our defence of pensions with the students' campaign to end student debt, we can together begin to halt the marketisation and individualisation of higher education. This should be part of a longer term political strategy to restore social democratic principles of pension provision. – we need to argue that Labour under Jeremy Corbyn adopts a position of collective provision of DB pensions, abolition of student fees, the defence of the public university and academic freedom. Unity with other trade unions in the defence of pensions and a trade union conference in 2018 on pensions can help with this. We need a members' campaign of writing to Labour MPs and a political campaign against the Tories austerity agenda.

We can win. The government is weak and university leaders are under attack for their profligacy. In UCU's recent consultative ballot over changes to USS, 86.6% of members who voted said they would be prepared to take industrial action to defend USS pension benefits.

Acknowledgements

Thanks to everyone who has contributed to the debate on the UCU Activists List. The discussion at the UCU Left Meeting on the 18th November 2017 informed this pamphlet. Thanks to Dennis Leech for providing the figures and consistently providing a rational perspective on a constantly obfuscated and irrational viewpoint from UUK and USS. Thanks also to Carlo Morelli and Marion Hersh, two UCU negotiators on the Joint Negotiating Committee of the USS and UCU for technical support in the production of the pamphlet and for representing members in these complicated and difficult negotiations.

Appendix – Technical Details

USS is a very healthy pension scheme

In 2014 the scheme had an actual surplus of £3.5b (https://www.uss.co.uk/how-uss-is-run/running-uss/annual-reports-and-accounts, USS Annual Report 2017, p.104). Today the equivalent figure is £8.3b (USS, 2017 Actuarial Valuation, available at https://www.sheffield.ac.uk/polopoly_fs/1.728969!/file/USSTechnicalprovisionsconsultationdocumentSept2017.pdf table 8).

Summary Fund Account

For the year-ended 31 March, in £billions	2017	2016
Contributions	2.1	1.9
Benefits paid	(1.8)	(1.9)
Net return on investments	10.0	0.7
Net increase in the fund	**10.3**	**0.7**

Figure 1 Over the past year, fund assets have grown by over £10b whilst contributions exceed benefits paid. Source: USS Annual Report and Accounts 2017 and Dennis Leech, Emeritus Professor of Economics, University of Warwick

The scheme continues to grow with contributions from existing members exceeding those of outgoings from current pension payments. In 2016 this amounted to £284m (https://www.uss.co.uk/how-uss-is-run/running-uss/annual-reports-and-accounts, USS Annual Report 2017, p.64). The picture of a positive cash flow is expected to be the case under the current scheme for the foreseeable future.

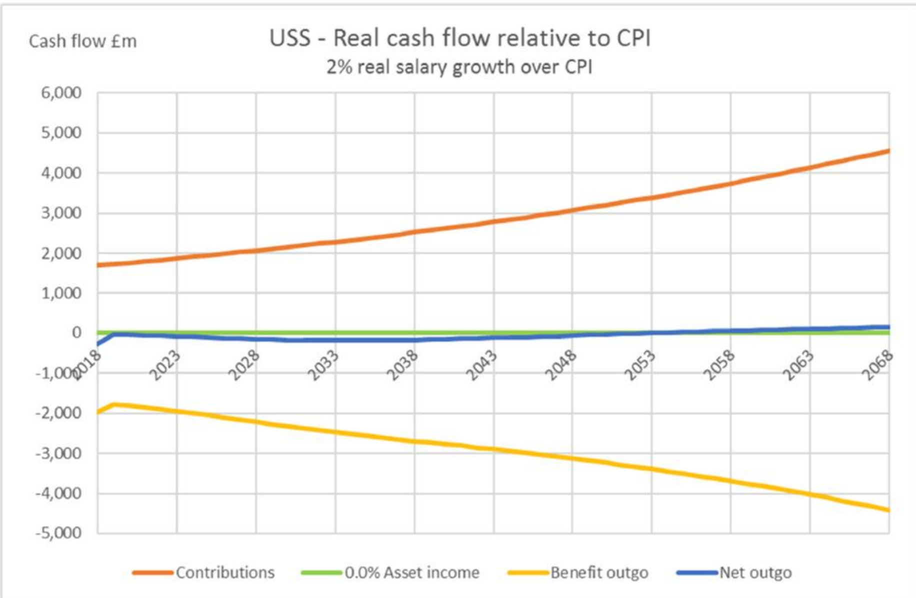


Figure 2 Even if we assume that there is no income from assets, the fund is predicted to continue grow very significantly. Source: First Actuarial Report for UCU Progressing the Valuation of the USS, 15 September 2017

When asset growth is factored in, fund growth is even more impressive since the performance of the investments in stocks and shares has been consistently stronger than gilts (http://www.which.co.uk/money/investing/how-investing-works/guides/asset-classes-explained/gilts-and-corporate-bonds-explained) over the long run. USS themselves state that 'Over the last five years the scheme assets have returned 12.0% per year, and outperforming gilts liability proxy by 2% per year', (https://www.uss.co.uk/how-uss-is-run/running-uss/annual-reports-and-accounts, USS Annual Report 2017, p.44).

When the returns on the scheme's assets and the pension liabilities are assessed within a framework of the best estimate, even with a measure of prudence to allow for error, it is the case that USS is capable of continuing to pay its pension liabilities. The main threat to this ability comes from the significantly lower returns investments in gilts would bring if de-risking were to take place.

Discount rate

We can then calculate prudent discount rates by combining the prudent returns per asset class with the asset allocations. The markets examined are UK and overseas equities, corporate bonds, gilts and property. A constant margin of 1% relative to best estimate has been taken at both dates on equities and property.

Prudent discount rate	31 Mar 2016 Allocation	31 Oct 2016 Prudent return	31 Mar 2014 Allocation	31 Mar 2014 Prudent return
UK equities	15.6%	7.2%	15.6%	6.9%
Overseas equities	46.9%	6.0%	31.2%	5.7%
Corporates	10.0%	2.8%	5.5%	4.4%
Gilts	20.0%	1.8%	21.7%	3.5%
Property	7.5%	6.2%	6.6%	7.2%
Alternatives	0.0%	4.6%	19.4%	5.3%
Whole portfolio	**100.0%**	**5.0%**	**100.0%**	**5.3%**

Figure 3 A prudent assessment of fund asset growth suggests a growth rate well above that of inflation. Note the depressing effect of gilts where returns are negative when inflation is accounted for. The pensions regulator's insistence on a de-risking strategy of increasing the proportion of gilts is damaging to the fund.

UCU's independent actuarial advisors First Actuarial statement on the scheme's viability concludes that:

> *'We conclude from the cash flow analysis later in this report, that the current contribution rate from the 2014 valuation remains a prudent contribution rate, given the current benefit design of the USS. In a scenario of "best estimate" pay rises, the benefits of the USS can very nearly be paid from contributions, without reliance on the assets. There is no need to change either the contribution rate or the benefits to have a prudent funding plan. The strong likelihood is that the USS can be invested to outperform the return required to safely deliver the benefits. Given time, the outperformance will increase the funding level to any desired target. Any formulation of the sign off of the valuation which maintains the current contribution rate and the current benefits is acceptable.'*

(Source: http://ucu.group.shef.ac.uk/wp-content/uploads/2017.09.15-progressing-the-valuation-1.pdf)

The changes being proposed would see the theft of these surpluses and earnings from our investments in members' pensions to USS itself and our employers. To justify this theft requires a level of dishonesty in the reporting on the scheme. USS are expected to act objectively yet they have continued to subjectively choose measures which seek to maximise a deficit whilst ignoring the evidence of a surplus.

What is de-risking - Pension Dishonesty and Gilts+

The sensationalist popular reporting on the scheme's finances and the narrative created by both the USS and government (See for example http://blogs.warwick.ac.uk/dennisleech/entry/uss_pensions_reply/) is directed at undermining the scheme through the dishonest creation of a notional deficit. Our employers are also allowing this narrative to go unchallenged, even though it is detrimental to their long-term interests.

The aim of destroying collective pension provision has the support of some sections of the financial establishment who see an opportunity to charge large annual fees for managing individual Pension Accounts, in effect, privatising pensions' provision.

Accountancy regulation FRS102 has imposed a requirement to value pension income on a conservative basis but in the case of USS a still more conservative estimation of the future costs have been arbitrarily adopted. Instead of making use of the real returns of its investments and reducing these returns to allow for a level of prudence to achieve a 'Best Estimate' of expected returns USS use a damaging 'Gilts +' estimate. Gilts+ assumes the cost of future pensions based upon the notional investment required if all investment were made in government bonds. Government bonds provide much lower returns than assets such as stocks and shares and therefore greater amounts of gilts are required for any given future pension. USS currently has over two thirds of its investments in stocks and shares.

How to turn a surplus of £8b into a deficit of £23b

By using a Gilts+ estimate of the scheme's value USS can create the reported deficit totalling £23b at March 2017. Gilts + however fluctuates massively. While a deficit of £23b was estimated in March it had fallen to £18b by July 2017 (https://www.sheffield.ac.uk/polopoly_fs/1.728969!/file/USSTechnicalprovisionsconsultationdocumentSept2017.pdf ,page 10). To suggest a valuation can change by over 17% in just four months indicates that the Gilts + valuation methodology is a fundamentally volatile measure and indeed is completely incapable of providing an accurate objective measure of the scheme's value. UCU has been challenging the Gilts+ methodology for valuing the pension scheme since it was introduced as the justification for ending the final salary scheme in 2014. USS claim to have amended it by using a partial best estimate for future income. However, it is still embedded within the valuation methodology through its use of one of its key tests of the schemes management, Test 1.

Test 1

Test 1 is the latest incarnation of the Gilts+ approach to valuation of the scheme. It is Test 1 which is being utilised to end the defined benefit component of the pension scheme. Test 1 aims to measure how big a gap may exist between the current value of the scheme and that required to guarantee all future pension provision, referred to as 'self-sufficiency'. Yet it still uses the Gilt + approach and makes a fundamentally wrong assumption about what a pension scheme is for. USS seeks to measure how much it would cost to insure all its pension liabilities with immediate effect, in effect if the entire UK HE system goes out of business, probably less likely than the government going out of business! The logic of 'self-sufficiency' is designed to give a high level of confidence that no further additional costs would fall on employers or the scheme. Yet why would a scheme that seeks to match current contributions and income from assets with current pension payments seek to end this by purchasing an insurance policy?

USS treats the scheme as if it were a collection of individuals rather than a collective scheme in which reducing risk is a key advantage of collective provision. The reason we make individual contributions to a savings scheme is to be able to withdraw those savings at a future date. Therefore, we invest them now, to gain a higher return when we do not need them, only to draw on them later when we want a secure income but lower return. To make those safer investments immediately necessitates we must make much higher levels of savings for the same pensions later in our lives. A Gilts+ approach to self-sufficiency at a time when returns on Government gilts are negative, as they are currently due to quantitative easing, is equivalent to putting your money under the mattress for each individual (see http://wonkhe.com/blogs/would-a-shift-from-bonds-to-growth-assets-keep-the-uss-afloat/#comment-22629 and https://medium.com/@mikeotsuka/self-sufficiency-in-gilts-is-a-costly-means-rather-than-an-end-in-itself-f3d1fe8a3978).

In a collective scheme such as USS, we can pool the risk incurred in holding onto assets, getting higher returns for longer than an individual could. This also significantly reduces management costs. Collective schemes reduce our individual risk by ensuring that the pensions we receive when we decide to take our pensions is not dependent upon the returns we get when our savings are moved into lower risk assets at a specific point in time, when an individual is approaching retirement and desires a secure income from their pension fund. Indeed, government was forced to recognise this when it abolished the legislation imposing the requirement that those with individual pensions were forced to take out an annuity upon retirement (https://www.gov.uk/government/news/pension-changes-2015).

Collective schemes with positive cash flows as USS was shown above, do not need to move their assets into low yielding gilts at the expense of higher yielding investments. Instead they can continue holding onto higher yielding assets for as long as needed unless the contributions into the scheme are lower than the pension expenditure out of the scheme. Therefore**, retaining the positive cash flow and the open nature of the scheme are crucial for its continued success and the reduction of risk.**