

Submission to Joint Expert Panel on USS:

## European Pension Regulation: The ending of retirement and the political economy of USS

Dr. Carlo Morelli

Senior Lecturer Economics and UCU JNC negotiator,

University of Dundee, Dundee,

Email: [c.j.morelli@dundee.ac.uk](mailto:c.j.morelli@dundee.ac.uk)

### European Union and the end of Defined Benefit pension provision.

The European Union, through the European Commission (COM), has created a framework to ensure the harmonising of retirement across the EU involving a levelling down of pension provision to deal with the low replacement rates of the working population. Rather than facilitate immigration into the EU the worsening of pension provision is explicitly identified as the means to address stagnating labour supplies in European economies. This has led to support for the raising the retirement age across the single market, restricting access to early retirement, supporting longer working lives and forcing women to work longer as a means to close the pension gap between men and women (COM, 2012, pp. 8-13). As the 2012 White Paper on pension reform *An Agenda for Adequate, Safe and Sustainable Pensions* concluded:

*'We need a more European approach to tackling challenges to pension systems, in line with successive conclusions of the European Council which have called for closer economic policy co-ordination. It is now time to act and to implement in a decisive manner the actions put forward in this White Paper.'* (COM, 2012, p. 15).

As part of these changes to retirement a single market for Private Pension Plans (PPP) has been a stated goal in which pension provision can be made portable as labour moves across national boundaries. The development of a European market for non-guaranteed Defined Contribution (DC) pensions has therefore been progressed through the regulatory body the European Insurance and Occupation Pension Authority (EIOPA). The ending of guaranteed Defined Benefit (DB) pensions is an explicit requirement for this approach. Rather than encouraging guaranteed pensions as a means to secure a retirement free from poverty DB, guaranteed pensions, are in this view seen as an impediment to this new market for pensions. As made evident in the EIOPA 2013 report *Towards an EU single market for personal pensions An EIOPA Preliminary Report to COM*, on potential changes the 'main rationale' for launching the initiative on personal pensions included the need to 'adapt the regulatory framework to the general shift towards individual responsibility for securing retirement income (DB to DC)'. (para 3, p.4). However, one of the main limitations was the continuation of guaranteed pensions. Thus: 'Most stakeholders do not think that it is feasible to create a **cross border framework for PPPs with guarantees** (2013, para 205, p. 42 original emphasis). Differences in tax legislation and contract law

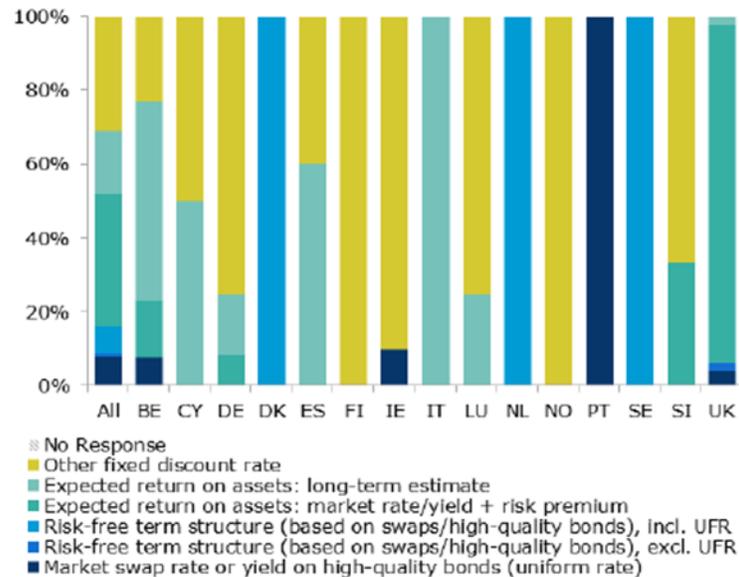
across EU states involve higher costs, and hence lower profits, for pension companies engaging in insurance type guaranteed pension transfers and therefore make capital transfers a less desirable activity. As EIOPA note it is 'costly for insurance companies and might in consequence hinder them from offering their products on a cross border basis' (2013, para 16, p.33). In contrast however, for non-guaranteed DC pension provision EIOPA concluded that 'EIOPA believes a strong case is made for a future Directive that would establish a single market for PPPs inter alia through the alignment across the EU of PPP holder protection measures.' (2013, para 221, p.45). For pension companies non-guaranteed, individual pension savings allow for capital transfers, across national boundaries between organisations, due to the lack of future risk to those institutions receiving the capital transfer. It also facilitates increases in profits for transfers through additional commissions and charges. In the single market for pensions under construction non-guaranteed pensions result in investment risk, higher charges and longevity risk all being borne by the individual not the pension company.

This evolving European framework for pension provision has therefore been a significant factor in the reinforcing of the drive towards the replacement of DB pensions with DC pensions. The DC pension market is a market where high commissions and profits can be created, at the expense of the individual seeking a secure future pension. In the UK this process has been underway for more than two decades and has been developed through the creation of artificial deficits. A key component in this process of constructing deficits has been through the choice of discount rates. In the UK particularly, conservative discount rates have been chosen to value long term pension sustainability as a means to motivate the change from DB to DC.

### **Discount rates**

European Union regulations require pension schemes to undertake valuations with a long term horizon to assess their funding position. This includes ensuring remedial action is in place to resolve any funding shortfalls. However, the exact form which this valuation takes and specifically the choice of discount rate is nationally determined. As a result a range of methodologies for setting the discount rate is evident. The UK can be identified as an outlier in approach taken to discount rate determination for its pension scheme valuations, across the European Union, whose effect is to exaggerate the extent to which a notional deficit of liabilities over assets may exist. The UK has a strong bias towards valuations based upon risk free forms of asset (see figure 3.4 below).

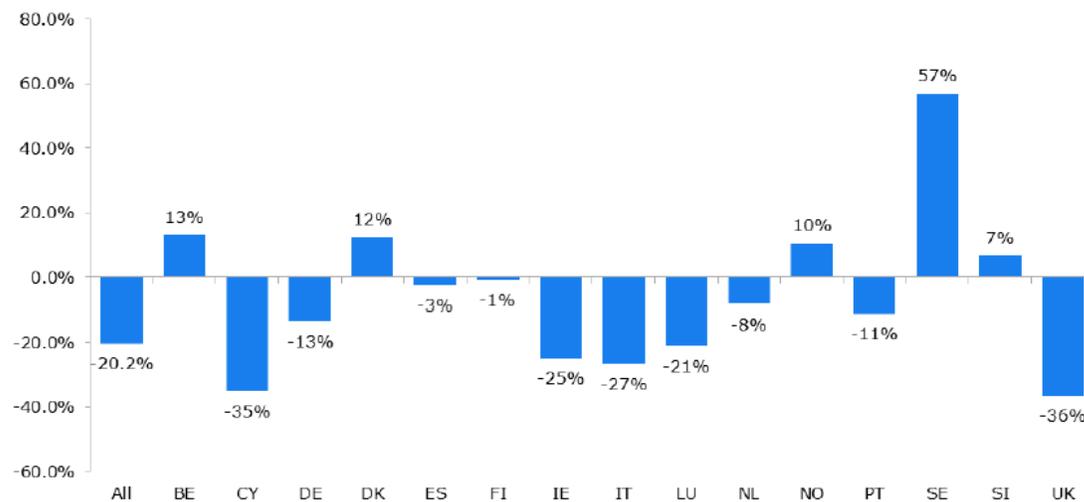
*Figure 3.4: Type of discount rate used to establish technical provisions by country, % respondents*



Source: European Insurance and Occupation Pension Authority (2017). *Stress Test Report 2017*, EIOPA-Bos-17/370, 13 December 2017 Frankfurt, Germany: EIOPA. Figure 3.4. available at <https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Occupational-Pensions-Stress-Test-2017-.aspx>

Decision on the discount rate is then the main driver of any surplus/deficits of assets over liabilities. Note again the UK with one of the highest deficits of assets to liabilities has amongst the most conservative discount rate in the EU (see figure 3.15 below). As EIOPA, note ‘this is mainly caused’ (2017, p. 27) by changes in the discount rate and resulted in the UK having the third lowest number of open DB schemes in the EU, behind Italy and Ireland (2017, Figure 3.19, para 99, p. 29).

Figure 3.15: Excess of assets over liabilities (excl. sponsor support, pension protection schemes and benefit reductions) in baseline scenario, % liabilities (excl. benefit reductions)



Note: Assets include all assets on the common balance sheet except sponsor support and pension protection schemes and liabilities include all liabilities, including conditional and discretionary benefits, except benefit reductions.

Source: European Insurance and Occupation Authority (2017). *Stress Test Report 2017*, EIOPA-Bos-17/370, 13 December 2017 Frankfurt, Germany: EIOPA. Figure 3.15. available at <https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Occupational-Pensions-Stress-Test-2017-.aspx>

## Summary

European Union regulation is a driving force for the closure of the DB schemes, not for financial reasons of sustainability or affordability but, for reasons of market accessibility by pension and insurance companies. European citizens' security in retirement is being sacrificed for the interests of a European wide insurance and pensions industry seeking to create an oligopolistic market structure and profit streams for the dominant firms that emerge. The UK, with a large private pensions plan industry, has been ahead of these developments leading the moves towards conservative discount rates, artificial deficits and closures of DB schemes.

## USS choice of discount rates

Submissions to the JEP by UCU, Dennis Leech and others have all indicated the means by which the USS scheme has chosen specific discount rates which are legitimately suggested to be overly prudent. Again they have repeatedly demonstrated the durability of the DB scheme when using cash flow in an open scheme as a measure of its sustainability. As a result it is not necessary for this submission to the JEP to repeat those assessments. Except to say USS's choice of assessment of Tests 1, 2 and 3, choice of negative real returns on investment and choice of valuing salary increases for liabilities at a higher level than salary increases for income (hence assets) into the scheme are all designed to present a picture of the long-term viability of the scheme in the worst possible light. These choices are, as described above,

being determined not by issues of sustainability but of the institutional interests of insurance and pension companies in maximising potential opportunities for profits in new market environments as they emerge in the future. USS itself is not a small pension provider and instead is one of the largest pension providers in the European Union. In acting to undermine its own DB scheme and replace it with a solely DC-based pension scheme it has an instrumental role in undermining guaranteed pension provision in the UK. As part of a wider European wide move to undermine retirement USS itself is well aware of the regulatory framework for European wide pension regulation. It is acting to facilitate the regulatory failure that will lead to impoverishment in retirement for pensioners generally and USS members specifically.

## **JEP**

The Joint Expert Panel is being asked to consider the 2017 USS valuation. However, its deliberations have much wider political consequences than simply that of one pension scheme. UCU member's industrial action was aimed not simply at the defence of their own pensions but also a wider political defence of the higher education sector against the process of marketisation. Now JEP has an opportunity to similarly defend not simply the existence of one DB pension scheme but also influence the political debate over the future of DB schemes for many millions of workers across the European Union. This requires JEP to be bold in its defence of the future of DB schemes but starts with a small step - challenging the valuation approach taken by USS. I would urge JEP to ensure it takes this step and clearly places itself in defence of European workers not of European bankers, insurance and pension scheme managers.

## **Bibliography:**

COM, (2012). *An Agenda for Adequate, Safe and Sustainable Pensions*, February Brussels, European Commission, 55 final. available at <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF>

European Insurance and Occupation Pension Authority, (2013). *Towards an EU single market for personal pensions An EIOPA Preliminary Report to COM*, Frankfurt, Germany. available at [https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029\\_Towards\\_an\\_EU\\_single\\_market\\_for\\_Personal\\_Pensions-An\\_EIOPA\\_Preliminary\\_Report\\_to\\_COM.pdf](https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029_Towards_an_EU_single_market_for_Personal_Pensions-An_EIOPA_Preliminary_Report_to_COM.pdf)

European Insurance and Occupation Pension Authority, (2017). *Stress Test Report 2017*, EIOPA-Bos-17/370, 13 December 2017 Frankfurt, Germany: EIOPA. Figure 3.4. available at <https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Occupational-Pensions-Stress-Test-2017-.aspx>