DEFEND USS PENSIONS

EXECUTIVE SUMMARY

Currently, there is a consultation of UCU members in pre-92 universities on their willingness to take industrial action to stop the destruction of the USS pension scheme.

UCU Left members and members of the UCU Joint Negotiating Committee for USS Carlo Morelli and Marion Hersh make the case for voting YES for action to defend pensions.

The threat

USS is consulting with employers and has suggested closing the Defined Benefits (DB) pension scheme and replacing it by a fully Defined Contributions (DC) scheme or significantly reducing the threshold e.g. to £15,000, with pension on salaries above that in the DC scheme.

This would be a real disaster for all USS members. The USS DB scheme guarantees you a good pension (though it has declined in value since 2011) and certainty as to how much you are going to get.

A DC scheme would have both uncertainty and a much smaller pension. You know what you will pay (defined contribution), but not what your pension will be.

Closing or reducing the DB scheme would also threaten the pension you have already accrued and the future pensions of existing pensioners. This is because the funds in the DB and DC schemes are separate.

Closing the scheme or significantly reducing the salary for which DB pension is received would reduce the income to the DB scheme. Currently income is much greater and would continue to be so without any changes.

But ending new contributions would create a point at which income and pensions to be paid out will just balance.

Below this point assets will need to be sold off and at some point the combination of asset sales and DB income (if any) will not cover the existing pensions. If the DB scheme were kept open assets would not need to be sold and this problem would not arise.

Consultative e-ballot

We would suggest that the threat to our pensions is qualitatively different to previous threats to pay and pensions.

We consider we are not exaggerating when we state that unless we take action we could face USS pensions being reduced to a fraction of their current value and even the end of the pension scheme.

By voting for industrial action we can halt the attack on our pensions.

Our pensions are our deferred pay not a play thing to be destroyed by government policy, USS and employers.

Linking this with students' campaign to end student debt means that together we can work to halt the marketisation of HE and for a free quality system for all.

If you haven't received your e-ballot request a new one: tinyurl.com/ucu17x

Why there is no need to reduce benefits or Increase contributions – Summary

The proposals for reductions in benefits are based on the idea that the current valuation of USS is going to give a large deficit. However,

- First Actuarial, a respected firm of actuaries that advises UCU thinks that the valuation should be based on cash flow. This would give a surplus.
- The valuation approach used ignores the fact that USS is a collective scheme for a whole sector and not exposed to the risk arising from single employer based schemes. It has assets of over £60 billion, almost TWICE the value of HE (expenditure £33 billion).
- A lot of incorrect assumptions are used. For instance, the key valuation of self-sufficiency required in the scheme is based on Gilts, a type of investment with low and volatile interest rates.

  Over two thirds of USS investments are in assets with higher returns than Gilts. USS should use the real evidence not a 'reference' set of evidence. Similarly, the inflation updating used for the liabilities such as salaries is CPI + 2% while that for assets is only CPI +0.9%. USS introduces layers of prudence which are designed to create a deficit.

WHY THERE IS NO NEED TO REDUCE BENEFITS OR INCREASE CONTRIBUTIONS

What is at stake?

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.

That is almost twice the total size of the whole of the UK Higher Education sector with its £33b expenditure in 2015-16.

Almost 400,000 past and present staff in our universities are reliant upon USS for their pensions.

Future staff too will be discouraged from entering into a career in universities if their potential pension in retirement cannot be guaranteed.

Therefore what happens in USS is of utmost importance to us all, whether or not you are about to retire, are mid-career or have just entered into your career in a university.

Unfortunately, our pensions are being placed at risk by a process of dishonesty and theft. These may seem strong words but they describe what is happening to our pensions and explain why taking industrial action now to defend our pensions is so important.

USS can safely provide a decent pension for all. However, what is at stake is not only what remains of our Defined Benefit (DB) scheme but the viability of the scheme in total.

Pension theft

The USS pension scheme is a strong and growing scheme. In every way we examine the real data for USS income and expenditure the same picture applies;

1. The scheme has consistently been in surplus over the years after paying out pensions and costs of running the scheme. In 2014 the scheme had an actual surplus of £3.5b. Today the equivalent figure is £8.3b.

2. The scheme continues to grow with contributions from existing members exceeding those of outgoings from current pension payments. In 2016 this amounted to £284m. The picture of a positive cash flow is expected to be the case under the current scheme for the foreseeable future.

3. The performance of the investments in stocks and shares has been consistently stronger than gilts 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'.

4. 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.'

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. In order to justify this theft requires a level of dishonesty in the reporting on the scheme.

Pension dishonesty and Gilts+

The sensationalist popular reporting on the scheme's finances and the narrative created by both the USS and government is directed at undermining the scheme through the dishonest creation of a notional deficit.

Our employers are also allowing this narrative to go unchallenged, despite the fact that it is detrimental to their long-term interests.

Our employers aim to cap short-term pension costs, and potentially even hope to benefit from a return of the surplus through pension contribution holidays. The changes however will in fact increase their costs, as we show below, by turning a notional deficit into a real deficit.

The aim of destroying collective pension provision has been a goal of government for a number of years.

The reason for this is that it moves the risk involved in long-term investment away from employers and government collectively and onto individuals without power to influence the outcome.

This 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 are assumed to be the safest of assets to purchase as governments are not supposed to default on their debt.

However, they provide much lower returns than assets such as stocks and shares. USS has over two thirds of its investments in stocks and shares.

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 £19b by July 2017.

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 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 the use of Test 1, one of three tests used in scheme management and valuation.

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 (DB) 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 Gilts+ 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 of its pension liabilities with immediate effect, in effect assuming that the entire UK HE system could go out of business, this is 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 as USS state 'in extremis'. Yet why would a scheme that seeks to match current contributions and income from assets 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 money now in order to gain a higher return when we do not need the money only to draw on it later on when we want a secure income. We accept lower returns when we have an immediate need to access our savings.

To make investments now with lower

returns necessitates we have to make much higher levels of savings for the same pensions later on 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 akin to putting your money under the mattress for each individual.

Yet 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 retire is not dependent upon the returns we get when our savings are moved into lower risk assets.

Indeed government was forced to recognise this unfairness when it abolished the legislation imposing the requirement that those with individual pensions were forced to take out an annuity upon retirement.

Collective schemes with positive cash flows as USS was shown to have 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.

Risk

The undermining of the USS scheme would introduce real risks to everyone's pensions. The government through the Pensions Regulator, USS and the employers suggest they are responding to the Test 1 induced deficit by reducing the risk of self-sufficiency not being achievable.

For them the risk is the gap between the scheme's valuation and self-sufficiency. In order 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.

The DC pension is an entirely individual pension in which the member bears all of the risk, yet they have no direct say in the running of the USS.

USS retains control over day to day investment decisions and the returns members gain from their years of contributions. They are 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.

Reducing or abolishing the Defined Benefit (DB) part of our pensions introduces a much greater risk to the scheme and that is the creation of a negative cash flow.

If contributions into the DB part of the scheme are 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 into a real outcome with the impact that it is universities themselves not USS who now have to finance the deficit.

In addition, while employers would bear the majority of these additional payments the risk-sharing arrangements imposed on members since 2014 would mean that they too would incur higher contributions.

Employers and employees share risk on a 2:1 basis. A major concern is that USS is at the limits of its affordability for members and an increase in contributions with no increase in benefits may lead to a rapid fall in the number of members who retain their membership of the scheme. The DC scheme itself could then be undermined by reductions in numbers of members in the scheme.

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.

Future benefits

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 have become the most recent incarnation of this risk.

Low gilt yields derived from Quantitative Easing are suggested to be the cause of lower yields across all types of assets, gilts and equities.

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.

Indeed, we believe returning to a Final Salary scheme is the most stable scheme providing long-term protection for members' pensions.

UCU needs members to take action

UCU is now alerting members' to the changes being debated by USS. It is at present uncertain exactly what changes might be finalised but the direction of travel is clear in the consultations USS have undertaken with employers.

USS is seeking to cut benefits in the DB scheme and possibly abolish completely the DB part of the scheme leaving members with only a DC pension.

At the same time employers are seeking to place a maximum cap on their contributions and abandon any responsibility for a deficit that their and USS's decision may create.

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.

We urge you to vote YES in the e-consultation currently under way. If you have not received an email allowing you to vote it may have been moved to your spam folder. A replacement vote can be provided by using the following link; tinyurl.com/ucu17x

Other sources

We urge you to read these blogs and letters questioning the media doom-mongers.

- medium.com/@mikeotsuka
- blogs.warwick.ac.uk/dennisleech/monthly/0817/
- timeshighereducation.com/opinion/letters-charybdis-centre-uss
- uculeft.org/2017/07/uss-pensions-lies-damned-lies-and-valuations/