Consultations

USS Trustees: An integrated approach to scheme funding

UUK: USS Funding and benefits

Response by University of Oxford

Thank you for the opportunity to comment on both these documents. In our response we set out a number of areas where we have concerns or questions, but we have also tried to suggest constructive alternatives to both process and proposals. We do accept the serious situation of the scheme, and we are committed to working constructively with all relevant parties to find the most equitable and stable solution we can for our staff. We hope that our response can help with finding that best solution, and we would of course be very happy to discuss it further.

This response reflects the views of a working party specially set up by University Council to reply to you. There has been no opportunity for Council to express its views, but we have had the benefit of a limited amount of feedback from some active members in the scheme. Though there was limited college representation on our working party, this response should please be read as coming from the University: we cannot speak for individual Colleges who are independent employers. Given that so many of our academic staff hold dual University and College contracts, we would have liked to have been able to consult formally with the Colleges, but that has not been possible over the summer. We shall share this response with both Council and Colleges, and subject to their permission, with our staff and unions, and we are likely to receive further feedback when we do so.

Our comments are based on the information we currently have. Before we take a considered view, we would need to review more information and to consult on this with our professional advisers and our scheme members. We have set out below a number of areas where we should like to see more information.

Summary

i. We have considerable concerns about the timetable and process of this consultation, and we very seriously advise UUK and USS to reconsider the speed of these discussions. We are concerned that some good options may not have been fully considered and others may yet emerge from consultation. Much more data and information are needed if we are to build trust and have a constructive dialogue with our staff and our Union representatives.

ii. We agree that prudence and reduction of risk in the scheme are essential. We shall need to convince our staff that this valuation and associated benefit changes truly reflect the long-term financial situation of the scheme. We would therefore be grateful for more information on valuation assumptions, especially the potential for gilt-yield reversion, and on alternative valuation approaches.

iii. We support in principle the idea of the guiding principles and technical tests of the sort proposed to manage risk in the scheme. We feel that it is premature to give these specific tests our endorsement until we see how they would work in practice to eliminate proposals that might be put forward. In particular, we need to understand how sensitive the tests are to the values built into them (e.g the affordability limits).

iv. We should like to understand better what alternatives UUK has considered and the reasons why they were not taken further. Before we can support any one proposal for reform, we

contribution at the same level, and preserve the best possible benefits for Oxford staff without subsidising the scheme as a whole while the deficit is being paid down.

The context of the present consultation

Our response is based on the following understanding of the context of the consultation.

The USS will produce the triennial scheme valuation in November, and it is bound to show a substantial and increased deficit. The Trustees are responsible for deciding on the investment policy and the acceptable levels of risk; and the employers are responsible for considering how much they will pay in contributions and any consequential changes to benefits. The USS Trustees have made some suggestions about benefit design because of the unusually difficult position that the scheme is in. There is a limited time for the Trustees and the Pensions Regulator to agree how the deficit should be tackled. This valuation exercise must be repeated every three years, and so there is a wish to find a stable solution that will not need further radical amendments at future valuations.

We understand that the Trustees are convinced of the need to reduce the overall risk borne by the scheme and that they are minded to reduce the investment risk in the scheme over 20 years by rebalancing the investment policy away from equities and towards gilts. This new investment policy is forecast to produce lower returns, and so the liabilities must also be reduced or the cost of contributions will be raised unacceptably.

Employers currently pay 16% on salary for USS benefits: in the final salary section, around 12% is paid towards future accrual of benefits, and the remaining 4% is used to reduce the deficit over an agreed period (currently 10 years, but probably to rise to 15). Based on a survey carried out by UUK last year, it appears that many employers are unwilling to pay more than 18% in total (possibly rising for short periods in extreme conditions to 21%). This is partly because all employers will, from 2016, have to pay around another 2.5% on salaries in increased National Insurance when contracting out from the State Pension Scheme ends. UUK and the Trustees are therefore proposing that the scheme liabilities should be limited by capping the salary to which defined benefits apply. This in itself reduces the risk in the scheme, and so a smaller change to the investment policy is needed, which in turn keeps contributions lower.

Not all employers stated that they were unwilling to pay above 18%. After this current exercise has taken place, we understand that USS intends to carry out a second review, of mutuality and of the scope for greater flexibility for employers. We note this could bring possibilities for some tailoring of the scheme for individual universities.

If in the future, the investment returns are better than expected, we understand that the Trustees would not wish to improve the DB section of the scheme, but might agree to improve the DC section.

We have the following comments on the proposals, each referring to a section of our Summary:

1. The timetable and process proposed by UUK/USS

The present consultation seeks comments from employers by 22 September 2014 for consideration at USS board meetings in October and November, alongside the final valuation. We understand that staff would then be formally consulted on final proposals in January 2015 as part of the statutory consultation process.

We recognise that the Pensions Regulator will have expectations of the timetable, and also that action to address the deficit must be taken in good time to secure the scheme against further deterioration. However, we believe that the current timetable and consultation process is unwise.

effect. The way in which they constrain options depends on the values used for parameters such as affordable contribution rates and the acceptable risks of certain rates being exceeded.

Setting these values has to be a matter of judgment for the USS Trustees, and guidance has reasonably been taken from UUK's survey of employers. However, we understand that that survey produced a range of values, and we have no sense of the sensitivity of the tests to the precise values that have been chosen. We also do not yet understand the sensitivity of the tests to the details of the various benefits options which might come under consideration.

Before accepting the principles as stated, we should like to see examples of the outcome of their application to a range of benefits options that have been tested. In particular, we wish to understand how changes in the values used in the tests might affect the outcome for any given option, and, conversely, by how much it is necessary to change the contributions and benefits in any particular option to reverse the outcome of applying a standardised test.

Our concern is that we would not wish the principles and tests to be used inflexibly to rule out options which, with some acceptable changes either to the tests or the options, might provide valid solutions as alternatives to the proposals currently put forward. We therefore think it is premature to give the tests our endorsement at this stage.

4. The selection of the proposal under consideration

We should like to understand better what alternatives UUK has considered and the reasons why they were not taken further. Before we can support any one proposal for reform, we would need to see the alternative solutions that were considered, including the approaches proposed by the UCU, and understand the views of UUK and the USS Trustees on these alternatives.

It would be a tremendous help to see some of the alternative options that have been considered, costed so as to make them potentially acceptable to the Trustees and illustrated to show the implications for a typical member. Consideration has already been given to what employers can afford both routinely and in the extreme, but we are now being offered just one hybrid scheme - might there be alternatives which employees would see as attractive and for which they would be willing to pay higher contributions?

We note that there is no proposal for complete closure of the DB section. It is possible that such a closure would change the Trustees' view on the scale of the de-risking required, and open the possibility for a much more generously funded and ambitious DC scheme. Although we do not expect this option to be acceptable to our staff, we should like to see some modelling of what could be achieved, for the purposes of comparison.

5. Closure of the Final Salary (*FS*) Section

The core of the present proposals is to close the FS section completely, breaking the link of past service to final salary, and to provide a hybrid scheme, partly DB and partly DC, for all members.

The link of all past service to the final salary has undoubtedly resulted in some very generous benefits for those who receive significant promotion at the end of their career, and this has been exacerbated by the salary inflation that has been seen at the top end of the pay scale in the past decade. The cost of providing this benefit to everyone is well above what staff have paid to secure these benefits; and we accept that all the reasonable estimates that we have seen establish that the cost of continuing with the present system unchanged is prohibitive.

We are however concerned that there is a large group of staff who are not expecting significant pay rises, and who nonetheless value the certainty of DB benefits linked to their normal salary progression in their career. It seems excessive to break the link entirely. We should like to see consideration of them that the extent of the DB element would not be eroded by inflation. We note that this was not the case in the examples given in the UUK webinar.

7. Length of service: potential for a nursery scheme

Protection of lower-paid staff is an important aim. However, there seems to be limited benefit in offering a DB scheme to staff who are more likely to leave USS and become deferred pensioners: these staff might derive more benefit from having a DC pot which could more readily be transferred to their new employment.

We believe that fixed-term contract research staff and junior administrators may on average be more likely to leave the HE sector than permanent academic staff. Our own data show a significant difference in length of service at Oxford between these staff groups and staff paid above £40k.

We should therefore like to see the USS national data on the (median and mode) average length of service in USS of leavers, deferred pensioners and retired staff, split by different salary bands. We are aware that other staff may also have short periods of USS service, for instance if they are senior academic staff recruited from overseas who then return to their previous jurisdiction.

If it is true nationally that those scheme members who earn below £40k are more likely to leave USS within a short time, then we suggest this should be reflected in the scheme design.

We believe it is important to explore further at this stage the option of providing a good, highly portable DC nursery scheme for the first few years (say, five) of membership of the scheme. Although it adds complexity, it could both offer a more appropriate way of saving for a pension for those who are less likely to stay in the scheme, and allow for a smaller reduction to the benefits available to those who stay for the long-term. We would emphasize that any nursery scheme should be fairly funded by the employer.

The consultation suggests that if market conditions worsen, a response could be to lower the salary cap in future valuations. This could further concentrate DB benefits away from long-term academic staff and towards staff who potentially are more likely to leave the sector. A nursery scheme might help to avoid this effect.

We would like to see what difference it would make to the proposals that could be afforded if all members in their first five years of service were DC only. We would in particular like to understand whether pursuing a nursery DC scheme for the early years of membership might create the scope to raise the salary cap towards a £58k threshold.

8. Examples of typical effects on members

We have reviewed the worked examples given by UUK in their webinar. We note that they have been done on the basis that salaries inflate by RPI while the salary cap inflates by CPI, leading on average to a 0.8% erosion of the real value of the salary cap every year. We note above that we think it would be better to link the cap to a specific point on the national pay spine, avoiding this erosion.

The examples compare future accrual under the proposed hybrid scheme with present FS and CRB section benefits. These comparisons are misleading because they assume no promotion or incremental salary increases over time, which are particularly relevant to comparisons with the FS section. We feel that we should show our staff examples based on a realistic and typical career, including the kind of promotion that they might reasonably expect. We note that this would show a much greater reduction of benefits to the average academic member of staff than is shown in the UUK webinar examples.

As mentioned above, different universities are likely to have a different mix of staff between DC and DB under the present hybrid scheme proposals. It follows that if all employers pay the same contribution rate, there will be some cross-subsidy between parts of the scheme and between employers. We shall be concerned to ensure that any DC scheme is entirely free from any obligation to pay towards the deficit on the DB scheme. At Oxford we have a specific problem because many of our staff are jointly employed with Colleges and we shall want to understand how the contribution cost will be split fairly.

We suggest a separate "deficit contribution" should be levied on qualifying salaries, with the costs of future DB accrual and DC contributions shown separately.

11. Death in service and ill-health benefits for the DC portion of the scheme

The restriction of death in service to 3x the salary cap would represent a significant reduction in this protection for members, who currently receive 3x annual salary under both FSS and CRB sections. Similar concerns would apply to the restriction of ill-heath payments to the salary cap. We should like to understand more of what is proposed for the element of salary above the salary cap. We expect our staff to be concerned to retain these benefits, and we would like to see some modelling for the effects of doing so.

12. Ability for staff to pay more for improved benefits

We note that UUK advises that their main concern is to limit future DB accrual and so contain the growth of future DB liabilities, and therefore a number of options for increasing the DB contribution rate to provide enhanced benefits have been ruled out. We would like to revisit this decision because we think that such options could be very important for staff.

We expect there to be appetite for a core provision with some flexibility on both rates and accrual for those members who wanted to vary their investment in their pension at different life stages.

Apart from the ability to pay additional DC contributions into the new scheme, what options could come under consideration to allow those who wish to pay higher rates to secure higher benefits? Would USS consider including the option for individuals to pay higher contributions to change the accrual rate, increase their salary cap for CRB accrual, or (if necessary) preserve death in service and ill-health benefits at existing levels?

13. Ability for the employer to pay more for improved benefits

We note that under the present proposals it seems possible that our overall contribution costs might go down, because we have significant numbers of senior academic and research staff who will be above the proposed salary cap. This is neither desirable nor politically possible, and we would like to explore ways in which we can keep our overall institutional contribution steady and preserve better benefits for our own members, and pay our fair share towards reducing the deficit, without providing a subsidy to the scheme as a whole.

We note that other universities with significant numbers of senior academic staff may be in a similar position. After this current exercise has taken place, we understand that USS intends to carry out a second review, of mutuality and of the scope for greater flexibility for employers. We note this could bring possibilities for some tailoring of the scheme for individual universities. However, we would like to understand what might be possible earlier than this, as part of considering the current proposals.