Model Responses for Members to the Consultation Run by USS

Please individualise your response by drawing on your own experiences and by editing what is below.

1. Normal pension age of 65

The Normal Pension Age (NPA) is the earliest age at which a member has the right to draw a pension from the scheme without actuarial reduction (unless incapacitated). At present this is age 60. The proposal is that the NPA would be 65 for new entrants to the scheme from 1 April 2011 and for future service from that date of existing members not already 55 years of age. The employers estimate that this would produce an initial saving to USS equivalent to a contribution rate of 1.3% of salary. But the USS actuary has estimated that increased longevity requires only an increase of 1% in the contribution rate from April 2011, and both UCU and the employers want an increase of that magnitude. Thus there is no financial need for this change. I consider altering the NPA for existing members to be an unacceptable change of conditions of service.

I believe that a NPA of 65 for new entrants is an acceptable way of addressing the long-term longevity problem. This would make a saving for USS equivalent to contribution rate of 0.3% of salary immediately, 0.6% after five years and eventually rising to 1.3%.

The employers also propose that future NPA increases would be linked to increases to the State Pension Age. The Government already plans to raise this in steps to age 68. Again, I consider that doing this to people who are then members of USS is an unacceptable change of conditions of service. If someone wishes to retire early at, say, age 60, they would suffer an actuarial reduction on that part of their pension earned after the change to USS, but, in addition, every time the NPA increases the size of actuarial reduction goes up. As the actuarial reduction is approximately 4% for every year early, someone retiring early at 60 would lose about one third of the relevant part of their pension, once the NPA has reached 68. At present they would have no reduction. With this increase in NPA few people could afford to leave early, and the voluntary shedding of staff will be more difficult and costly for the employer.

2. Actuarially reduced early retirement benefits

At present members can draw a pension without actuarial reduction from age 60. Most of my comments have already been made under the NPA of 65. The exemption for existing members over the age of 55 should be extended to all existing members.

There is a proposal to actuarially reduce the benefits paid to people made redundant. This has nothing to do with the sustainability or affordability of USS as it is cost neutral to USS. If someone is made redundant there is a charge to the employer for the early payment of a non-reduced pension. The proposal would make the individual responsible for this charge or otherwise accept an actuarially reduced pension. With the increased NPA the reduction would be substantial and the person made redundant would get a pension which is a tiny fraction of what they would get at present. The purpose of this proposal is to make redundancies cheaper for employers, and that is no business of the USS Trustees. I reject this proposal.

3. Flexible retirement arrangements

I welcome this because many people want this option and because it will help USS deal with increased life expectancy.

“On flexible retirement, benefits are to be payable to a member without actuarial reduction only from the member’s NPA, but for a member who aged 60 or over, the member’s employer may consent to his or her benefits in respect of service prior to 1 April 2011 being paid without actuarial reduction.” I believe that this consent must be compulsory.

4. Contributions and cost sharing arrangements

The employers claim that USS is in danger of becoming unaffordable. They pay 16% of salaries, but have paid 18.55% in the past. More recently and locally, QUB pays a 19% contribution to the Retirement Benefits Plan (RBP) for non-USS staff and has made additional payments. Because of their desire to sort the RBP problem out within 10 years, QUB has increased their employer's contribution to 24.2%. This was paid in a lump sum to cover 2008-11. So 16% for USS is clearly affordable by Queen's and the national UCU proposals would not require any increase in the foreseeable future. The employers also mention cuts in the funding of HE. The funding position and the outcome of the Browne proposals are yet to be resolved. Changes to USS along the lines proposed by UCU are adequate to keep a 16% contribution rate into the foreseeable future. The draconian proposals made by the employer are way over the top of what is needed for the long-term stability of USS. That is why they must be modified as a result of this consultation process.

In the employers' "A specification of proposals to change USS June 2010" Annex D they wrote "In the long term it is possible that the employers' proposed changes will produce savings that will enable the employers' contribution rate to be reduced to a more realistic level during the extended period when university finances are likely be severely constrained. It is impossible to indicate what the likely long-term employer contribution rate might be although we believe that ideally it should be closer to 10% …" And in Annex F they estimate the long-term effect of their complete CARE package as "7.3% saving compared to current final salary scheme." Thus the employers long term aim is cost cutting and their statement on page 7 of their glossy is a complete misrepresentation.

I support the proposal that future cost increases and decreases (above the base level of a total of 23.5%) would be shared between employees and employers in the ratio 35:65, with the proviso that the employee base level may not be 7.5%, but tiered. I am hesitant about this being only the default position if the JNC fails to agree on specific cost sharing arrangements given the recent behaviour of the Chair of the JNC. I object to the proposal that for any decrease in total contribution below the base level the employees' contribution rate cannot fall below 7.5% (or 6.5% for CARE), so that the employer gets all of the saving. I believe that the 35:65 share should also apply to decreases below the base level. Rather than a decrease in contributions I would prefer that the Trustees use any surplus funds to alleviate the inflation cap if that proposal is not dropped or to improve other benefits.

5. Caps on pension increases and on revaluation of deferred benefits

The proposal is that the part of a pension earned by service after 31 March 2011 is not inflation proofed if CPI exceeds 5%. This breaks the link to 'official pensions'. This cap is not a proposal of the Government for state and 'official pensions', nor has Hutton proposed it for public sector pensions. It also calls into question whether USS can properly be called a defined benefit scheme.

There have been extensive periods in the past when inflation exceeded 5% and if this proposal had been in force then pensions would have been substantially reduced in purchasing power. See the calculations of Cooper and Cowley. It is claimed that it is necessary to address the inflationary risk, yet USS survived substantial periods of high inflation in the late 1970's and 1980's without capping. While equities may not increase in value in line in with inflation in the very short run, they are generally regarded as an excellent hedge in the long-run. In addition any extended period of inflation is likely to be accompanied by increased earning of Gilts. In the long run USS income as well as outgoings can be expected to increase in line with inflation.

The proposal shifts any inflationary risk from the employers to the individual. What Hutton says about the Government is equally true of the employers and USS: "… this ignores the ability of Government as a large employer to pool and manage certain types of risk better than individuals." A pension fund can take a long-term view and ride out periods of high inflation yet, under this proposal, the individual would be hit immediately. This proposed capping must be dropped.

It is proposed that the rate of revaluation of deferred benefits for future service after 31 March 2011 would be by CPI subject to a maximum of 2.5% a year. At present they are revalued by RPI. The switch away from RPI was not forced by the Government nor is it a proposal by Hutton. What I said above about the capping of pension increases applies even more so to this proposal. As Cooper and Cowley have shown, this can result in a very substantial erosion of the eventual pension. Using a 21-year run of recent inflation produces an erosion of 25%, while using a period of high inflation they estimate an erosion of 77%. I regard this as only a little short of legalised theft from deferred pensioners and believe that this proposal must be dropped.

6. New CARE-like benefits for new entrants

I am not opposed to a CARE scheme *per se*, but I strongly object to the miserly one proposed. A pension would accumulate at a rate of 1/80 of Career Averaged Revalued Earnings per year worked and there would be a lump sum of 3/80 of CARE. By using the same fractions as in the final salary scheme, the employers ensure that the benefits are always less than in the present USS scheme. This is because average earnings will always be below final salary because of movement up scales and promotions. Even the most favourable estimates of the proposals give a reduction of about a third compared to the present USS, and Cooper & Cowley have examples with a cut of about a half. This CARE proposal is greatly inferior to the present USS and the slight difference in employee contribution rate (6.5% instead of 7.5%) does little to compensate for this. Overall the costs must be much lower, and the scheme could be proposed only in order to save the employers money. It will be very damaging to universities and I oppose it.

A pension scheme using 1/80 per annum for the pension and with 3/80 for the lump sum is cost equivalent to a pension scheme without a lump sum using 1/68 per annum. The most recent Civil Service (Nuvos) pension scheme is a CARE scheme using a fraction of 1/43. So on identical earnings, a Civil Service pension would be more than half as much again as that paid under the employers' proposals for USS. (And the employee contribution rate is only 3.5%.) So the employers' proposals are disastrously uncompetitive. Universities will be harmed because of difficulties in recruiting staff. USS will be harmed because staff will decline to enter it and USS will quickly become a mature scheme and require a more rapid switch to less volatile but poorly yielding investments.

In a CARE scheme the contributions to date are annually revalued scheme by a factor related to prices or national or occupational earnings. I could find acceptable a scheme for new entrants that revalued by RPI and used a suitable fraction such as 1/50. But the proposal does not even use CPI but a capped version of it. In periods when CPI is over 5% this will further erode the accumulated pot. Thus the value of the final pot and the benefits derived from it will be further diminished. The proposed CARE-like scheme is far worse than any CARE scheme in the public sector and is not acceptable, especially the capping of the revaluation.

What I said about the capping of inflation proofing of pensions earlier applies equally to pensions from the CARE section.

Universities like to employ staff who have experience of working abroad and to employ experienced Research Assistants and Fellows. Yet if these people have a gap of six months or more in their employment in a USS institution they will have to join the inferior CARE pension scheme. Moreover the benefits earned from their previous USS service will be updated by only the smaller of CPI or 2.5%, which will quickly whittle away their value in periods of moderate or high inflation. Such gaps are common for fixed-term staff and women with family responsibilities. The vast majority of those who return to USS service after a gap do so within 18 months and I believe that the gap criterion should be changed to this.

7. Other

The scale of the employers' proposed changes is completely unnecessary and changes similar to those proposed by national UCU (which were actuarially evaluated) are all that are required.

USS is not a public sector scheme since it has its own pension fund, but the benefits are similar to those in the public sector. It is not within the remit of the Hutton Public Service Commission. There are other Defined Benefits (DB) schemes in the private sector, but USS has special circumstances, which make it more robust. It is the second largest UK pension fund. It is a multi-employer scheme, where the employers are jointly and separately liable for the liabilities of the scheme on a 'last man standing' basis. It is reasonable to assume that the university sector as a whole will continue to exist. Thus USS can take a longer perspective than most other DB schemes and invest in risk-bearing assets, such as equities, that earn on average a higher return than that which would be available by investing in risk-free assets.

Initially the employers were very concerned that the Pensions Regulator would require them to submit a costly recovery plan should a deficit in USS funding be revealed. As explained below this possibility is now extremely remote. But even if it did happen, the recovery plan must take into consideration the specific circumstances of the scheme and would be spread over many years. Even before the changes listed below, the view of the Scheme Actuary was that there is likely to be sufficient flexibility within the scheme specific approach to avoid an unaffordable outcome.

The rapid increase in salaries that initially cause concern for USS have proved to be a one-off blip. The pay movements used in USS actuarial assumptions are in two parts. The first is a general annual increase assumed to be applied to the pay spine; this increase is 1% above RPI. In addition USS assume a set of annual increases to allow for movement up scales and promotions. In 2008 the general pay increase was just RPI and the 2009 general pay increase was 0.5% and the offer for 2010 is just 0.4%. Given the economic climate large general pay increases are unlikely in the next few years. (QUB is using 0.5% p.a. in its financial forecasts and is forecasting static average pay over all grades until 2013/14.) Yet the 2008 actuarial evaluation assumed future general pay increases of 4.3% per annum. Compounding the salary spine increases since the last actuarial valuation yields 5.95%, while the actuarial assumption was 13.46%. Since salaries are not going up as fast as assumed, neither are the pension liabilities.

Since the employers' proposals were formulated and costed there have been three major changes, which improve the financial health of USS.

Firstly, the stock market has improved and so has the yield of Gilts. The USS fund has grown by £8.28 billion to reach a fund total of £30.197 billion in the year up to March 2010 and the stock market has continued to go up. Not only is USS moving to investing more heavily in Gilts, but also the yield of Gilts is used in some of the financial tests applied to assess the financial health of USS.

Secondly, the abolition of the default retirement age will mean that some people will continue working longer, which is generally beneficial to the pension fund.

The third, and most important, change since the employers' proposals were costed is that USS has had to follow the Government and start using the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) as the measure of inflation proofing of pensions once they are in payment. But now the employers propose to cut the link with 'official pensions' and specify using CPI rather than the Pensions Increase Act for inflation proofing.

Historically, the annual increase in CPI has been about 0.68% less than that of RPI and Hutton assumes 0.75% long-term. (Currently the CPI annual increase is 3.1% while RPI is 4.6%.) It has been suggested that the composition of CPI may be changed to make it closer to RPI. This might scale back slightly the effects on USS described below. However, the Government's switch to CPI for official pensions was made in the context of cost saving, so even a modified CPI will be designed to save cost. The Office of Budget Responsibility has forecasted CPI and RPI for the next five years and the compound increase over that period is 11.8% for CPI and 18.4% for RPI.

The change to CPI means that pensions and other benefits will gradually decrease in value compared to what they would have been if RPI had continued to be been used. If this change had occurred 10 years ago, pensions would be 8% less by now. Cooper & Cowley estimate the decrease as 13% over 20 years, while Laith Khalaf estimates it as 25%. Any of these figures represent a very considerable saving for USS. It reduces the future liability of the pension fund for service to date by £2 billion (estimate by USS actuary) and, together with the continued rise in the stock market, means that USS is very unlikely to fail the tests applied by the Pension Protection Fund (PPF). (At 31 March 2010 USS was 112% funded on the PPF basis.)

The cut in liabilities due to the switch to CPI is about two thirds of the under-funding of USS on 31 March 2010 on the scheme-specific basis. So, together with the continued rise in the stock market, it is likely that the actuarial valuation on 31 March 2011 will show USS breaking-even or slightly in surplus on the scheme-specific basis. Thus there is no current financial crisis in USS and the possibility of the employers facing deficit contributions imposed by the Pensions Regulator is extremely remote.

The savings resulting from the switch to CPI also greatly reduce the liability of USS for future service. Estimates are that this will be equivalent to a contribution rate of about 2% of salary. The employers propose an increase in members' contributions of 1.15% and UCU proposed a tiered increase equivalent to about 1.2%. When the savings from the switch and the default retirement age are added to either of these proposals the income to USS will be more than enough to cover the problems associated with increased longevity, unexpectedly large salary increases, investment returns and volatility. So all the other proposed changes are unnecessary. However the introduction of staged flexible retirement is desirable.