University of Cambridge

Response of the University's Pensions Working Group to the UUK/USS Consultation on USS

1. Introduction

1.1 This document forms the response from the Pensions Working Group, a sub-committee of the Finance Committee, to the USS document "An Integrated Approach to Scheme Funding" and to the UUK consultation on proposed changes to USS benefits. The Pensions Working Group is principally comprised of senior leaders and managers in the University. This response has not therefore been formally endorsed by the University's Council or the Regent House (the governing body of the University).

1.2 In preparing this response the Pensions Working Group has discussed the proposals with its Pensions Advisory Group, which comprises a cross-section of USS members and is chaired by the Pro-Vice Chancellor for Institutional Affairs, and with the Bursars of the Cambridge Colleges. At this stage, the response has not been circulated widely within the University or been the subject of discussions with staff representatives. However, the University notes that a full employee consultation will be carried out in the event that these or other proposed changes are agreed by the Joint Negotiating Committee. There will also be a Discussion of the Regent House on the future of USS on 28 October 2014.

Consultation period

1.3 The consultation covered the summer research period making it difficult for the University to consult widely with staff and with the senior leadership of the University. The Pensions Working Group would therefore like to express its concern that the timing of this consultation (July to September and even allowing for the one week's extension) was unhelpful in preparing a detailed response.

Employers

1.4 The University has consulted with the College Bursars and with Cambridge Assessment in preparing its response. Whilst the College Bursars will respond in their own right, the University would note that the Pensions Working Group, the College Bursars and Cambridge Assessment agree on the broad principles for change.

2. USS paper – an integrated approach to scheme funding

2.1 Although the general principles to be adopted by the Trustee appear to be reasonable, it is impossible without more detailed data — particularly in relation to investment risk and tail risk — to give a view on the validity of the conclusions of the USS Trustee. Based on the information provided our sense is that the assumptions made by the USS actuary may be overly prudent even allowing for the legal requirement for the funding assumptions to include some prudence.

2.2 Whilst the Pensions Working Group agrees with the concept of establishing tests, it is difficult to determine whether the three tests the Trustee proposes to use are appropriate without seeing more data, in particular relating to the size of the deficit and the speed of any planned de-risking. The Pensions Working Group notes that de-risking the investment strategy would (all other things being equal) lead to higher liabilities and future service costs and may involve increased allocation to gilts. Thus any de-risking should be very gradual and subject to regular review.

2.3 It is not clear whether USS had considered the UUK response to the previous consultation when preparing its document "An Integrated Approach to Scheme Funding", especially in relation to the visibility of the covenant and the speed at which de-risking should take place.

3. UUK paper – USS funding and benefits

3.1 On a general point it would have been helpful to include some worked examples in this consultation. These would have been particularly valuable in the EPF briefing note which was issued on 23 July 2014. We return to this point below. It would also have been helpful if UUK had included guidance, perhaps in the form of a series of consultation questions, on those particular areas where it needs a response.

3.2 The Pensions Working Group is broadly supportive of breaking the link to future salary increases for future service and for all future service benefits to be provided on a CRB basis with a couple of important caveats. The first relates to the updating of the 'deferred' final salary benefit and to the revaluation of CRB benefits accruing in respect of future service. It is not felt that revaluation in line with the change in the Consumer Prices Index (CPI) is adequate, particularly if as under the current arrangements this would be reduced/capped in the event of the CPI exceeding 5/10% in any year. It is not an unfair expectation of someone starting an academic career, who does not expect to receive substantial promotions, to have an expectation that at the end of their working life they will receive a pension which is around 50% of their salary at retirement. As in the long term salary inflation tends to exceed the CPI this would not be the case if past benefits were only increased in line with the CPI.

3.3 Subject to affordability, the Pensions Working Group would favour revaluation of accrued benefits at a rate above CPI, noting that a number of public sector schemes operate using revaluation in excess of the CPI. While it is accepted that a number of public sector schemes are unfunded and have taxpayer backing, others are funded.

3.4 The Pensions Advisory Group have suggested that revaluation should be by CPI+, say matching an index of average earnings or similar and that some sort of flexibility could be applied to the revaluation such that in the event of the CPI+ breaching a specified limit a full increase would not be given, but in future years when CPI+ is below the specified limit an above CPI+ increase could be awarded (provided that this was affordable) so that the cumulative uprating over a period of years matched the cumulative increase in CPI+. The Pensions Working Group also notes that a discretionary approach may be possible for example where salary linking on accrued benefits is guaranteed for 3 years but discretionary beyond that. The guarantee could be reviewed at each valuation and extended if the funding position was sufficiently strong.

3.5 The Pensions Working Group agrees that a structure embracing a DB scheme at lower income levels and a DC scheme above a salary threshold has attractions, and notes that this would assist those members who might otherwise be affected by the Annual and/or Lifetime Allowances, although, surprisingly, this is not mentioned in the consultation document. However, it is felt that the suggested threshold level of £40,000 is too low: if the cap were set at around this level the University might experience considerable difficulties in recruiting new staff, particularly senior academics coming from overseas and academic-related staff recruited from outside of the HE sector who currently enjoy benefits such as share options and bonuses which are not available in the HE sector and for whom the DB pension is seen to be a useful recruitment tool. Cambridge Assessment is a case in point. Its business is the setting of GCSEs and A levels both in the UK and overseas and it relies on being able to recruit staff from the teaching profession in a competitive market between examination boards for such staff. It is also felt that setting the threshold too low might discourage staff at a more junior level from applying for promotion. It could result in an exodus of the most talented researchers and teachers to overseas universities where pension provision is significantly better than the levels proposed (and in many cases already better than existing levels in USS). It is suggested that an appropriate level for any threshold might be the entry level of the professorial stipend as set by the national pay scales. This would also provide a simple and readily understandable method for increasing any threshold.

3.6 More generally, the Pensions Working Group notes that the proposed changes involve three main parameters:

- Indexation of accrued final salary benefits (CPI only proposed)
- Salary threshold (it has been suggested that a threshold of £40,000 would meet the trustee tests)
- DC contributions (12% employer contribution proposed)

There are of course other parameters (e.g. the indexation of the cap) but these are the principal ones. In the absence of sufficient information to comment in detail on the final design, the Pensions Working Group would suggest that, once the overall structure has been agreed, consideration be given to a regular review of these parameters by the trustee to enable the benefits to be adjusted to ensure that the scheme remains properly funded, but with the possibility of increasing benefits when circumstances allowed it.

3.7 The Pensions Working Group notes that during the consultation on the changes introduced in October 2011 a number of members indicated that they would be prepared to pay higher member contributions to USS to maintain benefits. Initial feedback suggests that there is still an appetite among some members to pay voluntary contributions at a higher level than the general rate of member contribution to retain the final salary link or similar. The University of Cambridge successfully introduced this type of arrangement in its Self-Administered Trust to allow existing members to retain the right to draw unreduced benefits from age 60. We also note that LGPS and NHS schemes have introduced tiered contribution rates. On balance the Pensions Working Group favours a simple structure in which members can make voluntary contributions to the DC component of the Scheme. However, the Pensions Working Group would welcome discussion about the viability of a facility that would allow members to target the original final salary benefit in a way that does not lead to excessive additional risk for the employers.

3.8 The Pensions Working Group does not believe that the case for a voluntary DC arrangement for earnings up to the DB/DC boundary is compelling. If this does attract wide support, it nonetheless feels that this should be a second order change that could be introduced at a future date. The Pensions Working Group and the College Bursars are concerned about the additional administrative complexity, both at institution level and for the USS Liverpool office, as a result of any changes and feel that this introduces additional complexity at a time when the Scheme will be undergoing major structural reform. There are also immediate concerns about how institutions could budget for pension costs if this proposal was introduced, particularly if it meant that USS moved away from using a blended employer contribution rate.

3.9 There should be no bar, except those prescribed in national legislation, to employees paying additional contributions to any DC arrangement. Were a DC arrangement to be introduced for higher earnings then there should be mandatory employee and employer contributions. However, it would be helpful if the level of the employer contribution could be flexible, depending on a number of factors including the level of any deficit recovery contributions. This would allow a university to set its budget for pension provision to a specified percentage of payroll and if the triennial valuation of USS resulted in the need to increase the level of deficit recovery contributions the level of contributions made to the DC arrangement of those earners above the threshold could be reduced to keep the overall pension costs within budget. It would of course be possible for a university to decide not to reduce its contribution or indeed to increase it if the level of deficit recovery contributions reduced. Such an arrangement may also result in additional flexibility in the benefit package universities could offer when recruiting senior staff.

3.10 The Pensions Working Group would expect death in service and ill health benefits to be broadly comparable to those currently offered by USS and these must be properly explained to members in any consultation.

3.11 The Pensions Working Group would have liked more information provided on the data used to formulate the proposals and information on other options which were considered and rejected. It would have been helpful to have had information on a range of costed options. This would have also helped to determine whether the proposed package would be sufficient to manage risk such that the scheme is both sustainable and provides an attractive package of benefits in the long term.

3.12 As already noted, the Pensions Working Group agrees that it is important that a future benefit package is flexible so that any de-risking can take place in a measured way without seriously impacting on future costs. However, this flexibility needs to work both ways so that in the event of the actuarial assumptions being unduly pessimistic there is flexibility to reduce contributions and/or improve benefits.

3.13 Finally, we note that USS was originally designed for careers spent entirely in the UK HE sector, but that USS now includes members with a highly diverse set of career pathways. It is important that USS provides schemes and worked examples appropriate for these diverse careers. It needs also to provide modellers which would allow institutions and individual members to understand the effect of changing assumptions, for instance a higher discount rate or the revaluation of past service benefits in line with different values of CPI + x.

The Pensions Working Group

Finance Committee

University of Cambridge