DEFENDING PENSIONS: A FIGHT FOR ALL OUR FUTURES

Megan Povey, University of Leeds

25 July 2018
Defending Pensions: A Fight for All Our Futures
Megan Povey, University of Leeds

This is a USSbrief, published on 25 July 2018, that belongs to the OpenUPP (Open USS Pension Panel) series. It was originally written in late November 2017, and was submitted to the UCU-UUK JEP (Joint Expert Panel) on 18 June 2018 by the author.

Introduction

Pensions are our deferred wages—generally hard earned, saved and paid back in retirement. Until recently pension savings were invested in future wealth creation—stocks and shares called equities. Historically, by far the best return on savings has been achieved through investment in equities and risk associated with individual investments was collectively shared between our employers, active members of pension schemes and pensioners. A wide range of pension schemes shared this characteristic and in one form or other, collectively defined the benefit to the pensioner in return for contributions throughout a working life by both worker and employer. Contributions were linked to wage rates and benefits to average wages.

Following a series of pension scheme collapses due to company failures, the Pensions Regulator (tPR) was established by Parliament in 2004, together with a fund (the Pension Protection Fund, PPF) to which every pension scheme contributes, designed to bail out failed pension schemes. One duty of tPR is to reduce the risk of situations arising that may lead to claims for compensation from the PPF.

Our pensions are being placed at risk by a process of dishonesty and theft. This was conducted by a poisonous combination of hard-nosed employers, a zombie government bent on making Margaret Thatcher’s infamous statement that “there is no such thing as society” a reality, together with City financiers, tPR and pension scheme managers who are looking for new opportunities in a ‘liberalised’ pensions market.

The threat can only be understood as part of the neoliberal (market economics and privatisation) discourse which has dominated UK politics since Thatcher and until Jeremy Corbyn became leader of the Labour Party. The success of Corbyn in the 2017 election has destroyed the Tory government’s ability to drive through their privatisation agenda. Corbyn’s popularity is built upon a widespread belief that austerity has gone too far together with a desire to revert privatised public sectors for the benefit of their users, not for those who make a profit from them.

The above may seem like strong words but they describe what is happening to our pensions and explain why taking industrial action to defend all our pension schemes is so important. Our pension scheme in Higher Education—the Universities Superannuation
Scheme (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.

USS is one of the biggest pension schemes in Europe. Twice in the last 6 years USS members have seen the value of our pensions cut while we pay more. It doesn’t have to be like this: our colleagues in post-92 universities are doing much better.

Things have been made worse by the new breed of university managers viewing ‘their’ institution as a business on the road to privatisation; where any potential pension liability on the balance sheet could deter private investors. The collective point of view of our employers is given by Universities UK (UUK).

The most determined industrial action will be necessary to defend our pension. We are not on our own. The Communications Workers Union (CWU) is running a brilliant campaign to defend their pension and there are many other DB and similar schemes under threat. If we build the maximum unity with other trade unions, with our students and with parents; together with a campaign which engages all our members, we can win.

We will need to campaign at several levels, with industrial action and a spirited defence of DB pensions in the form of a political campaign seeking to turn the tide back, including winning a future Labour government to the defence of the collective provision of pensions. **How to do this is the subject of this pamphlet.**

**What is the Universities Superannuation Scheme (USS)?**

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 £60bn ([USS Annual Report and Accounts, 2017](https://www.universitiesuk.info)). That is almost twice the total size of the whole of the UK Higher Education sector with its £33bn expenditure in 2015–16 ([HESA](https://www.hesa.ac.uk)). The collective DB scheme that USS is today was established in 1971 in a joint initiative between the predecessor union to the UCU, the Association of University Teachers (AUT), so unusually for a pension scheme, university staff are represented on the scheme board. However, the origins of the scheme stretch back to 1911 when representatives of university teachers urged employers to establish a scheme like an already existing scheme for school teachers. Now, almost 400,000 past and present staff in our universities are reliant upon USS for their pensions. **Therefore, what happens in USS is of utmost importance to us all, whether you are about to retire, are mid-career, have just entered your career in a university, or have not yet started a career in higher education, perhaps on a casual contract and yet to gain your first post.**
Pension theft

Pensions are not a present from our employers. They are deferred pay. Cutting our pensions not only means a penurious old age but also a pay cut now. The USS pension scheme is a strong and growing scheme. In every way that we examine the real data for USS income and expenditure the same picture applies.

The employers’ proposals: cut the pension

The employers propose an end to the DB pension scheme and its replacement with a Defined Contribution (DC) scheme. Under DC, you know what you pay, you just don’t know what you will get—all the risk is transferred to individuals—the members of the pension scheme. In DB, you know what you will get and what you will pay—risk is shared between scheme members.

In addition, the employers intend to cap their contribution to the scheme, transfer all ‘de-risking’ costs to members and cut employer contributions from 18% to 12% for future pensions. This will rob us of our pensions in future when everyone is being told they need to save more for pensions—our employers are doing the opposite. Since employers are the final resort to funding the deficit, their short-term aim of capping contribution costs will generate a high cost of a realised deficit payment.

Moving everyone to DC will destroy the link between past and future staff, break the important link that ensures the scheme continues to grow with positive cash flows, risks destroying future pensions and undermines past pension accrual by creating the very deficit they seek to avoid.

It gets worse—USS seeks to benefit from employers’ desire to remove pension risk from their balance sheets by stealing the surpluses in the scheme which should go to the members as pensions, retaining them for their own advantage. Why have a managed fund and pay expensive investment managers, when USS intend to move to a passive fund investing mainly in bonds which are the worst performing investments needing no investment management at all?

We face a perfect storm of privatising interests, circling our scheme like vultures.

It is not for nothing that the UCU calls the employers’ proposals an existential risk to our pensions.

The scheme has consistently been in surplus over the years after paying out pensions and costs of running the scheme.
Ending DB pensions may lead to the destruction of the pension scheme

Reducing or abolishing the 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 would 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 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, DB 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. We need to return to the social democratic ideal of pay-as-you go social security. As mentioned before, university managers only look at immediate profits not long-term role.
of universities. We demand the return of universities to the control and accountability of the public sector.

De-risking: how to destroy a pension scheme

The undermining of the USS scheme would introduce real risks to everyone’s pensions. The government (through tPR), USS, and the employers suggest that they are responding to the Test 1 induced deficit (See appendix for the technical details) by reducing the risk of self-sufficiency not being achievable. Test 1 is how the move from collective DB to DC becomes justified and arises from new accounting principles consequent on EU membership (called FRS102) inspired by the view that the world is a casino in which organisations compete for capital and profit, the risk of failure requiring management. This logic generates irrational views of the risks faced by any organisation, regardless of private or public, collective or individual. On this view, the risk is the gap between the scheme’s valuation and self-sufficiency. To reduce this gap, reductions in benefits are being sought by reducing or abolishing the DB part of the USS scheme. This would leave members of the scheme almost wholly reliant upon the DC part of their pension contributions. The DC pension is an entirely individual pension in which the member bears all the risk, yet we have no direct say in the running of the USS. USS retains control over 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.

If new entrants are only getting 12% contributions from employers and 6% is going into a scheme they receive nothing from, with ‘pension freedom’ they may opt out of the scheme all together. This could produce a spiralling deficit leading to the end of the scheme. Employers would love that as they could save 12% of pay but the DB fund would collapse if that occurred.

Does this mean an end to retirement altogether?

USS and our employers are being ‘reckless’ and acting ‘criminally’. The advantage of collapsing the scheme and members opting out with no pension provision for employers is that it ends retirement. In an industry with an ageing workforce and declining real pay means that staff shortages can be solved by stopping retirement all together.

Employers are building discrimination into pensions—intergenerational solidarity

Currently USS and the employers have a legal obligation to provide benefits promised to existing pensioners. Under DB, this obligation is underpinned by what is called the
‘intergenerational solidarity’, active members of the pension scheme provide the pension for retired members in return for a pension promise when they retire. This pledge can be seen more broadly in terms of investment of savings in future wealth creation through stocks and shares, creating the future income needed to support the pensioners of the future.

DC pensions betray this pledge—however, since it is a legal obligation on them, the employer’s proposals imply a transfer of active member savings to subsidise the old DB promise.

The Final Salary DB was much more egalitarian than Career Average DB introduced in 2014 which itself is much more egalitarian than DC. We call for the return to DB and even better to Final Salary pensions. This will require a long term political campaign in the labour movement, for a return to the previous social democratic consensus and an end to the neoliberal establishment view previously shared by almost all political parties.

Under-represented groups in HE, including women and BAME staff, whose career tracks usually mean lower salaries will suffer the most from this subsidy of the old DB promise. **Therefore, it is essential that we fight for the defence of a DB scheme and eventually the abolition of the DC scheme altogether—it is the only way to a fair pension scheme.**

**UCU needs members to act**

UCU is now balloting for strike action in defence of the current USS scheme [ed. note: the author wrote this text in November 2017]. 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 and UUK are seeking to close the DB scheme leaving members with only a DC pension.

At the same time employers are seeking to place a maximum upon 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. This should be part of a longer term political strategy to restore social democratic politics—we need to argue that Labour under Corbyn adopts a position of collective provision of DB pensions, the public university and academic freedom. Unity with other trade unions in the defence of pensions will help with this. A trade union conference in 2018 on pensions can help with this. We need a members’ campaign of writing to Labour MPs.
We can win. The government is weak and university leaders are under attack for their profligacy. In UCU’s September 2017 consultative ballot over changes to USS, 86.6% of members who voted said they would be prepared to take industrial action to defend USS pension benefits [ed. note: in UCU’s January 2018 USS ballot, the turnout averaged more than 58%, with 88% voting for strike action and 93% for action short of a strike].

Appendix: technical details

**USS is a very healthy pension scheme**

In 2014 the scheme had an actual surplus of £3.5bn ([USS Annual Report 2017, p.104](https://example.com)). Today the equivalent figure is £8.3bn ([USS, 2017 Actuarial Valuation, Table 8](https://example.com)).

![Summary Fund Account](https://example.com)

**Figure 1**: Over the past year, fund assets have grown by over £10bn while contributions exceed benefits paid. Source: USS Annual Report and Accounts 2017 and Dennis Leech, University of Warwick.

The scheme continues to grow with contributions from existing members exceeding those of outgoings from current pension payments. In 2016 this amounted to £284m ([USS Annual Report 2017, p.64](https://example.com)). The picture of a positive cash flow is expected to be the case under the current scheme for the foreseeable future.
Figure 2: Even if we assume that there is no income from assets, the fund is predicted to continue grow very significantly. Source: First Actuarial Report for UCU, Progressing the Valuation of the USS, 15 September 2017.

When asset growth is factored in, fund growth is even more impressive since the performance of the investments in stocks and shares has been consistently stronger than gilts over the long run. USS states that ‘over the last five years the scheme assets have returned 12.0% per year, and outperforming gilts liability proxy by 2% per year’ (USS Annual Report 2017, p.44).

Figure 3: A prudent assessment of fund asset growth suggests a growth rate well above that of inflation. Note the depressing effect of gilts where returns are negative when inflation is accounted for. tPR’s insistence on a de-risking strategy of increasing the proportion of gilts is damaging to the fund.
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. To justify this theft requires a level of dishonesty in the reporting on the scheme.

What is de-risking? Pension dishonesty and Gilts+

The sensationalist popular reporting on the scheme’s finances and the narrative created by both the USS and government are directed at undermining the scheme through the dishonest creation of a notional deficit. Our employers are also allowing this narrative to go unchallenged, even though it is detrimental to their long-term interests.

The aim of destroying collective pension provision has been a goal of government for many 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 by USS. 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 uses 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.
How to turn a surplus of £10bn into a deficit of £18bn

By using a Gilts+ estimate of the scheme’s value USS can create the reported deficit totalling £23bn at March 2017. Gilts+ however fluctuates massively. While a deficit of £23bn was estimated in March 2017, it had fallen to £18bn by July 2017. [ed. note: the deficit had fallen to around £8bn by July 2018.] 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 claims to have amended it by using a partial best estimate for future income. However, it is still embedded within the valuation methodology through its use of one of its key tests of the schemes management, Test 1.

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 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 its pension liabilities with immediate effect, in effect if the entire UK HE system goes out of business, 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. 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 them now, to gain a higher return when we do not need them, only to draw on them later when we want a secure income but lower return. To make those safer investments immediately necessitates we must make much higher levels of savings for the same pensions later 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 equivalent to putting your money under the mattress for each individual (see Derek Benstead’s comment and Mike Otsuka’s discussion).

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 take our pensions is not dependent upon the returns we get when our savings are moved into lower risk assets at a specific point in time, when an individual is approaching retirement and desires a secure income from the pension fund. Indeed, government was forced to recognise this 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 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.

Acknowledgements

Thanks to everyone who has contributed to the debate on the UCU activists’ email list. The discussion at the UCU Left Meeting on 18 November 2017 informed this pamphlet. Thanks to Dennis Leech for providing the figures and consistently providing a rational perspective on a constantly obfuscated and irrational viewpoint from UUK and USS. Thanks also to Carlo Morelli and Marion Hersh, two UCU negotiators on the Joint Negotiating Committee of the UCU and USS for technical support in the production of the pamphlet and for so effectively representing members in these complicated and difficult negotiations.

This is a USSbrief, published on 25 July 2018, that belongs to the OpenUPP (Open USS Pension Panel) series. It was originally written in late November 2017, and was submitted to the UCU-UUK JEP (Joint Expert Panel) on 18 June 2018 by the author. This USSbrief represents the views of the author only. The author believes all information to be reliable and accurate; if any errors are found please contact us so that we can correct them. We welcome discussion of the points raised and suggest that discussants use Twitter with the hashtags #USSbriefs37 and #OpenUPP2018; the author will try to respond as appropriate. This work is licensed under a Creative Commons Attribution-NonCommercial-NoDerivatives 4.0 International License.