FINANCIALISATION IMPOSES CONSTRAINTS ON THE USS JOINT EXPERT PANEL BUT A UCU SUCCESS IS STILL POSSIBLE

Paul Bridgen, University of Southampton

30 August 2018
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This is a USSbrief that belongs to the OpenUPP (Open USS Pension Panel) series.

The problematisation of the USS’s valuation approach, as institutionalised by the establishment of the Joint Expert Panel (JEP), was a major UCU achievement in its pension dispute with Universities UK (UUK). Few other disputes about defined benefit (DB) pensions—and there have been lots in UK and elsewhere over the last two decades—have had such a success. Most have ended with the curtailing of DB provision in the face of the implacable insistence from scheme sponsors and trustees that valuations, based on similar principles to those used for USS, show schemes are unsustainable. The UCU’s industrial action managed both to postpone (hopefully for good) the further curtailing of DB provision and raise serious doubts about the assumptions underpinning the whole pension valuation process.

Yet, this brief argues that in fulfilling its remit to review the 2017 USS valuation and agree key principles of future ones, the JEP’s options are potentially limited; that financialising processes affecting UK pension and higher education policy over the last two decades impose significant constraints on available solutions. Certainly, a JEP proposal is possible that achieves the fundamental objective of the UCU dispute (i.e. the maintenance of a DB pension), but, if agreed, this will likely be based on a finessed approach that maintains USS in its existing regulatory framework. Those hoping for a more fundamental reform are likely to be disappointed—unless the members of the JEP can find a way to challenge some of those wider constraints. It is with these latter views that I start.

The UCU’s success in achieving the establishment of the JEP was in no small part the product of a wide-ranging and skilful critique of the USS’s approach undertaken by a range of UCU academics, as detailed in blogs and in USSbriefs before, during and after the dispute (e.g. by Leech USSbriefs7, Academics for Pensions Justice USSbriefs26, Murray USSbriefs17, and Otsuka USSbriefs30, USSbriefs39). Many of these contributions wanted the USS to break free from the regulatory constraints under which it operates as a free-standing, private scheme—those related to its regulation by the Pensions Regulator (tPR). John Murray, for example argued that USS should be ‘allowed to derogate from the real or implied rules of pensions legislation’; that USS should be treated as a special case among such schemes (USSbriefs17). Dennis Leech, on the other hand, called for a ‘cash-
flow’ approach to USS valuation. This approach, not generally accepted by tPR, values schemes on a year-on-year basis and shows projected surpluses for USS so long as it remains open (USSbriefs7; see also Salt and Benstead, 2017).

It is certainly possible that the three UCU representatives (Catherine Donnelly, Saul Jacka, and Deborah Mabbett) have raised such options in discussions with the three UUK representatives and the Chair, Jo Segars, Chief Executive of the Pensions and Lifetime Savings Association. We will find out when the JEP reports in September 2018.

However, the weeks since the setting up of the JEP have given cause for doubt that any fundamental change to the USS valuation approach will be conceded. The USS Executive has robustly defended its valuation with CEO Bill Galvin insisting, in an email dated 18 April 2018, it ‘cannot and will not resile from the outcome’. Scheme participants have instead been encouraged to accept that ‘challenging’ circumstances necessitate contribution and benefit changes.

The USS Executive adopts this position confident that, while its approach is questioned by its UCU critics, it is broadly consistent with the expectations of other audiences to which a final settlement will need to be broadly acceptable e.g. tPR, the House of Commons Work and Pensions Committee, HM Treasury, financial institutions holding university bonds, etc. It is in these locations that financialisation processes have exerted the greatest influence; financialisation being understood here as structural transformations to the logic of contemporary capitalist economies and democratic politics resulting from the increased power of global finance (van der Zwan, 2014).

Such processes explain the epistemic shift during this time in pension valuation methodologies, and why these approaches are now hegemonic in political and regulatory circles throughout the industrialised world. They are also implicated in the recent significant shift in university financing, which has made some university executives increasingly nervous about perceptions of risk related to the USS pension scheme.

On pension valuation methods, global financial and accounting elites have pushed these since the late-1990s away from the more flexible approaches traditionally favoured by actuaries, towards ‘objective’, market-based methods (see for example Véron, 2007). The international financial community, particularly the International Accountancy Standards Board (IASB), had for long criticised the former approach on the basis it was deficient in providing transparent and
comparable information for ‘the world’s capital markets … to make economic decisions’ (quoted in Veron, 2007: 15, 26; see also Ponds and van Riel, 2007). It pressed for an internationally enforced market or ‘fair’ valuation, based on current asset values and bond yields. This took the form of International Accounting Standard IAS 19, which also stipulated that the balance between assets and liabilities must appear on the sponsoring company’s balance sheet(s) (Yermo, 2003). Victory was secured at a global level. In the EU, for example, IASB standards were generally accepted by the European Council and Parliament in 2002 to be fully incorporated in the consolidated financial statements of all European publicly-listed companies by the beginning of 2005 (Veron, 2007: 16). These developments have been an important reason why DB pensions have come under severe pressure in all settings in which they operate. In the Netherlands, for example, the home to the biggest occupational pension sector in terms of fund size (OECD, 2017), they helped instigate a sector-wide shift from final to average salary provision between 2001 and 2005 (Bridgen and Meyer, 2009). IAS19 was labelled a ‘DB killer’ by Dutch pension experts (Wheelan, 2003) and the pressures on its system continues to this day (De Deken, 2018).

As would be expected in a country where the financial sector is so economically important and politically strong, the UK accepted largely uncritically these developments. The UK accountancy regulators (the Accounting Standards Board [ASB]) insisted on the introduction of its own ‘fair value’ standard (FRS 17) almost three years in advance of the EU’s recommended date (Bridgen and Meyer, 2009). The legislation on pension regulation since 1997 has reflected these developments, with The Pension Regulator basing its approach to regulatory oversight of valuation on such methods for most of this period (for details, see House of Commons Library, 2017). Political and policy discourse on pensions is thus dominated by references to ‘deficits’, not least under the influence of financial commentators, such as John Ralfe (see for example his ‘University pensions bet has failed. Who will pay?’) associated with the predominant knowledge community. This regulatory trajectory has been further reinforced by regular examples of governance malpractice by corporate pension scheme managers, the most recent involving the retailer BHS, which have led to political demands for regulation of schemes to be tightened (Work and Pensions Committee, 2017; DWP, 2018).

Finally, the impact of these processes on the USS scheme has been intensified by the financialisation of UK higher education. As other contributors to USSbriefs have highlighted (for example, Barnett USSbriefs16), these have involved universities turning to the capital markets in response to cuts in government finance, the
unreliability of fee income and a more competitive domestic and global environment (see Hale, 2018). A large number of universities have thus issued bonds to raise substantial amounts of money direct from financial institutions. Like all asset-holders, the holders of this debt expect to be able to judge investment risk, anticipating it will be expressed transparently using accepted accountancy standards. Pension risks are well-established in the financial community as a potential source of investment concern, with one leading wealth fund manager in 2016 describing large corporate pension fund deficits as the ‘unexploded bomb in investment portfolios’ (Caldwell, 2016). It is unsurprising therefore that worries about USS have arisen quickly. Thus, for example, the prospectus accompanying the most recent University of Cambridge £600 million bond issue detailed at length the particular risks USS posed to the institution (Hale, 2018). Such concerns are highly likely to have influenced some universities’ attitude to risk as part of the 2017 valuation (see Hakenbeck USSbriefs12 and Dolan USSbriefs13), and there is no reason to believe this general concern will have disappeared now, though the risk appetite of some universities has improved since September 2017, not least under the pressure of the UCU dispute.

None of the above means that the USS Executive had no flexibility in conducting its 2017 valuation. Scheme trustees undoubtedly have room for manoeuvre and the regulator has no direct power to insist on a particular approach. Indeed, if the USS Executive had used off the peg some of the standard ‘fair value’ valuation approaches (e.g. section 75, s179, FRS 102, etc.—for details see House of Commons Library, 2017), this would have resulted in a deficit much larger than the one finally identified in February (see Table 1; see also Miles USSbriefs36).

<table>
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<tr>
<th>Table 1: Possible USS ‘deficits’ 2017/18</th>
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<tr>
<td>Solvency, section 75</td>
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<tr>
<td>Deficit</td>
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<td>Funding level</td>
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Sources: USS Report and Accounts, USS Valuation 2017

However, the financialised context within which the USS scheme currently sits makes it less likely the JEP will recommend a valuation approach substantially out of line with current orthodoxies. Rather, some form of agreement seems likely that involves a less restrictive interpretation of the infamous Test One, based perhaps on the USS’s own offer to employers in February 2017. This suggested current pension arrangements could be retained by employers accepting slightly higher
levels of risk and an increase in the ‘assumed return on Test 1’s “self-sufficient” low-risk investment portfolio from gilts plus 0.50% to gilts plus 0.75%’ (Otsuka, 2017; see also Otsuka USSbriefs30). A similar proposal was acceptable to employers in 2014 (UUK, 2014), but was rejected in 2017. It should be possible based on such an approach to plausibly and acceptably flatten or eradicate the scheme deficit making unnecessary significant change to the scheme’s design.

While such an outcome would not constitute a heroic victory against the broader forces of financialisation, it would mean, as suggested above, that the most important original objectives of the UCU’s industrial action had successfully been achieved. A significant retreat would also have been forced on the more hard-line members of the UUK.

Vigilance would be needed to entrench this success, perhaps involving the permanent institution of the JEP or something similar into the governance structures of USS. If consensus on USS scheme management is a genuine goal of the post-strike negotiating process, for example, what is required is a much deeper, transparent and open-minded engagement with representatives of scheme members from the earliest stages of the triennial valuation process. The UCU membership is also now much better versed in the complex debates over pension valuations and is highly unlikely to accept as a straightforward matter of fact any future statement concerning a deficit in the USS scheme (see Wilkinson USSbriefs48). More generally, as Megan Povey suggests in USSbriefs37, UCU should press for wider union collaboration on the issues raised by the recent dispute. Defined benefit pensions have been in decline for more than two decades; it is well past the time when such action was required.

References


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