USS consultation response

21 May 2021

This response has been agreed by the College’s Senior Management Team and approved by way of Chair’s action by the College’s Finance and Resources Committee, a Committee of the College’s governing body.

(A) Covenant Support Measures

1. Would you be willing to support the alternative covenant support package which UUK has outlined in section 3 as the means to achieve a solution which might be acceptable in the round (see also question 15)?

We remain of the view, as previously argued by UUK, that the employer covenant as a whole is strong and that the assessment of the covenant as “tending to strong” by USS is unduly influenced by the decision of Trinity Cambridge to leave the Scheme. The settlement of s.75 debt by Trinity presumably did not leave the Scheme in a materially weaker position.

Scheme exit is not a realistic prospect for many employers and is an extremely unlikely course of action for Goldsmiths, so UUK’s proposal to offer up a longer moratorium on exits is appropriate and resonates with our repeated call for stakeholders to take a long term view of the Scheme.

Our concern regarding debt monitoring metrics is that a number of institutions will be seeking new loan facilities to help them manage their way through the current difficult economic circumstances. Continued reductions in Teaching Grant, uncertainty over student numbers and pandemic-related working capital constraints are financial issues that the sector needs support to work through and it is in the long term interests of the Trustee (and of the employer covenant) to ensure that its actions do not limit the ability of institutions to do this.

We will accept the debt monitoring regime, acknowledging that we are likely to be impacted by it, but it needs to be operated pragmatically and in a climate of cooperation and support.

2. If the USS Trustee is not willing to accept UUK’s alternative proposal (should there be employer support for it), would you be willing to support the USS Trustee’s scenario 3 covenant support package to obtain a ‘strong’
covenant rating? If not, why is this and what level of covenant support would you be willing to provide?

We refer to the answer in Q1 above. Given that we share the widely held view that the covenant remains strong without the need for additional covenant support, it is difficult to offer a view on what level of covenant support we would be willing to provide.

As we have stated in Q1 we are prepared to support the UUK proposal and this is as far as we would be prepared to go on covenant support.

As we have stated to the Trustee directly, we believe that the approach adopted by the USS is too cautious and takes too short term a view. The USS answers the charge with a level of technical detail which, while entirely necessary and appropriate, is nevertheless insufficient if not viewed pragmatically alongside the bigger picture which recognises that: (i) employers have always stood behind the Scheme (bar one solitary exit of an employer who was required to pay a substantial s75 debt); and (ii) the long term prospects for UK Higher Education, both in terms of UK demographic change and international attractiveness, remain exceedingly strong.

3. Are there areas of the covenant support measures which cause you particular concern, or which you would wish to see modified? Please provide details.

The challenge of the debt monitoring and pari passu requirements will largely rest on how they are operated in practice. As expressed in Q1, the proposed regime needs to be operated pragmatically and in a climate of cooperation and support.

4. Are there other areas of covenant support you would wish to consider such as contingent contributions or asset pledges?

We note that when contingent contributions were discussed previously, it was suggested they might be in the region of 1-2%. If this remains the employers’ overall appetite, then they are clearly a drop in the ocean given the proposed increases in contributions that the Trustee considers necessary. We therefore see little merit in supporting this approach.

We also note the previous discussion of, and consultation on, contingent funding structures. As was noted at the time, a solution resulting in reduced pension contributions but which is accompanied by similar contributions to another vehicle isn’t much of a solution. This “give with one hand and take with the other” approach has little obvious to commend it.
(B) Contributions

5. Do you agree that the current levels of employer contribution (21.1% of salary) and member contribution (9.6%) are the maximum sustainable – and should be the foundation for any solution?

It is our firmly held view as an employer that, in the current economic circumstances, the current level of contributions is the maximum sustainable. The current level of contributions represents a sizeable existing commitment for both employers and employees.

Although financial circumstances dictate that it cannot change our institutional view, we do acknowledge that, of those employees who responded to our survey, 31.6% were prepared to pay more in contributions, although just under one fifth considered them to be too expensive already. 50% responded that they should stay at 9.6%.

a. If not, please state the level of employer contribution you would be willing to pay to USS following the 2020 valuation.

We acknowledge that a reduction in contributions would not be appropriate in light of the current challenges the Scheme is facing. We therefore support the current level of contributions and believe that all stakeholders must work in good faith to maximise pension benefits within the constraints provided by these contributions.

b. We would welcome any commentary on the reasons for your views.

The current economic climate has been extremely challenging for Goldsmiths, with the College in a deficit position, due in part to the previous increase in USS contributions and greatly exacerbated by the costs of the pandemic and associated reductions in international student revenues. The College’s governing body must have the financial sustainability of the institution at the forefront of its mind and it cannot, therefore, countenance further increases in pension contributions when they are already so generously funded.

c. We would also welcome employer views on the level of member contribution.

We acknowledge the sector-wide issues of non-participation in the Scheme, although note that Goldsmiths appears less affected by them, with opt-out rates comparatively low. However, that is not to say that further increases in employee contributions wouldn’t have a future negative effect on participation.

As noted above, of those employees who responded to our survey, 31.6% were prepared to pay more contributions, although just under one fifth considered them to be too expensive already. 50% responded that they should stay at 9.6%. “Free text” comments to the survey suggested a risk of opt-out for some if employee contributions were to increase.
In addition, of those respondents who had chosen not to participate in the Scheme, all cited cost as the reason.

(C) Benefits

6. Do you support the broad principle of seeking to retain the hybrid benefit structure?

In an age when many defined benefit schemes have closed, we believe that the ability to offer a generous pension with an element of defined benefits is an extremely attractive proposition and a great strength of the sector. We therefore support the retention of the hybrid benefit structure.

Our survey of Scheme members demonstrated opposition to moving future benefit accrual solely to a defined contribution basis, with 63.2% of respondents registering their disagreement.

7. Looking at the illustrative hybrid benefits which UUK has put forward, would you consider this an acceptable outcome in terms of benefits at this valuation – based on the positions on covenant support and contributions laid out?

We have answered this question assuming that it refers to the alternative position that UUK has put forward and not UUK’s re-articulation of the three scenarios produced by USS.

The principal merits of the UUK proposal are that:

- It retains the hybrid structure and keeps the door open to improving the defined benefit position if circumstances should improve significantly. Closing the defined benefit section, which seems an inevitable consequence of USS’s three scenarios, would almost certainly mean that it remained closed for good as experience suggests these decisions are rarely, if ever, reversed.

- Contributions are kept at their current level. While these are high, they stand a better chance of being sustainable as employers (and employees) have begun to digest them and incorporate them into their financial planning over the past two years.

The downside, of course, is that pension benefits are cut. We believe that if this solution is to be adopted, it has to be seen as an answer to the problems of the Scheme as they currently stand. If circumstances improve, the door must be kept open to a degree of future reversal – there cannot be a one-way street of incremental benefit cuts.
We included the UUK proposal in our employee consultation and note that there is strong opposition to it (72.4% disagreed) among respondents. However, it remains at the limit of affordability for the College, so we would therefore reluctantly consider the UUK alternative proposal to be an acceptable outcome.

8. If the illustrated hybrid would not be acceptable, what alternative benefit arrangements would you wish to provide (and please indicate alternative positions on covenant and contributions as appropriate)? (For example, if the USS Trustee does not ultimately amend its assumptions, would you wish to offer a hybrid solution as set out in the USS Trustee’s illustrations or would you prefer to move to a different offering, such as DC provision?)

If aggregate contributions remain at 30.7%, then none of the USS’s three scenarios offer a value for money pension proposition. In all cases, the defined benefits offered are either non-existent or meaningless (only Scenario 3 might be considered “semi-viable”, and that is an extremely charitable use of the phrase).

Objectively, defined contributions might represent a better value for money option in this situation, freeing employees to take their own decisions on investments and pensions strategy. They may well do a better job than the Trustee in providing themselves with an acceptable level of pension provision at an affordable cost.

However, this presupposes that the Trustee’s analysis is accepted. Stepping back, given long term economic trends (e.g. the recent era of low interest rates may well be an aberration, even if this isn’t the current view of bond markets), the fundamental strength and sound prospects of the higher education sector, and the demonstrable support to the Scheme given by employers over the past 46 years, it seems beyond belief that the USS would suggest that under Scenarios 1 and 2, with aggregate contributions at a sizeable 30.7%, no meaningful future defined benefit pension accrual is possible.

No amount of number-crunching can mitigate the fact that a large degree of subjective decision-making regarding the employer covenant, future interest rates and investment returns has resulted in these scenarios producing such a negative result.

9. Would you wish to explore conditional indexation or other conditional benefit models as a possible solution (likely longer-term, beyond the 2020 valuation)?

We welcome measures that bring additional flexibility to the Scheme, especially in respect of the ability to recognise upside risk in situations where circumstances improve. We would welcome a proposal from the Trustee.
(D) Flexibilities and options

10. Would you like to see flexibilities implemented for members to move away from the current uniformity of the USS structure, and if so which flexibilities do you think are particularly important?

Our own data suggests that take-up of USS membership is high for eligible employees, although there is some variation across grades (e.g. 10.4% opt-out at Grade 6 and 0% opt-out at Grade 10).

However, that still leaves some employees without an employer pension, so we would welcome greater flexibility. We are concerned about the complexity of a tiered structure in the event that the defined benefit salary cap is reduced to £40,000, but would support the options of: (i) lower contributions for lower (but at least some) pension benefits; and (ii) an optional lower cost defined contribution scheme.

Respondents to our employee survey were supportive of greater flexibility (59.2% agreed), including options which promise lower contributions in return for lower benefits.

11. Would you support the creation of a lower cost saving option for members and which of the parameters described in this paper are most important / or would need modification?

(If yes, we would welcome employer views on the options to achieve this (potentially informed via engagement with eligible USS employees).)

We would be supportive and welcome firm proposals.

As noted above, respondents to our employee survey were supportive of greater flexibility (59.2% agreed), including options which promise lower contributions in return for lower benefits.

12. Would you support the creation of an option for members to switch (from the hybrid structure) to wholly DC pension saving?

(We invite employer views on whether the same deficit recovery contribution should be made for members choosing any new flexible DC alternative option, and what levels of member and employer contributions devoted to DC pensions saving should apply).

As a general point of principle we are supportive of greater flexibility and acknowledge that membership of a lower cost defined contribution scheme might be attractive for some eligible members (notwithstanding the significant support for defined benefit pensions among current members).
However, should the hybrid scheme contributions end up at the levels suggested by USS’s three scenarios (i.e. with current benefits maintained), the risk of members transferring in volume to a lower cost defined contribution scheme might be quite high. UUK is right to point out the unintended consequences this might have for the funding of the existing scheme, making an already difficult position far worse.

We assume this option entails defined contribution membership for all future accrual, with existing defined benefits accrued to date protected for transferring members. We further assume that deficit recovery contributions would continue to apply for transferring members, but not to new members of the defined contribution scheme who will have had no prior stake in the defined benefit section of the Scheme.

It is hard for us to comment on what level of deficit recovery contributions should be adopted, and we would welcome further guidance on this point. However, surely there would have to be a dual approach for those transferring and those who are new to the Scheme, given that the former group will benefit from past accrual under the defined benefit element of the scheme and the latter group will not.

For future service, the aggregate pension contributions should be set above the levels common in the private sector. Many private sector employers offer other benefits as part of their reward packages, with pensions representing only one aspect. Absent such reward packages in the HEI sector, the pension offer has a greater significance. However, the amount should not be higher than the current aggregate contribution levels of 30.7% less the current deficit recovery element. We would need to undertake a more detailed employee consultation on whether contributions were fixed or on a sliding scale, ideally with worked-through options to present to staff.

We are not pensions experts, and we accept that there may be flaws in the approach outlined above. However, the core principle is sound: the existing Scheme should not be undermined, but there should be greater flexibility to encourage those who currently opt out to join.

13. Would you wish to explore options for employers so that they can offer some variations to the USS standard benefits in the future – and if so, what would those variations be?

We would be supportive in the interests of giving employees maximum choice and increasing take-up of USS membership. We would welcome more guidance on how this might work and the likely cost implications before concluding on variations.

(E) Governance

14. We would welcome views from employers in relation to the governance of the scheme and the valuation process (including views on the Joint Negotiating Committee). Specifically, would you support a post valuation
governance review, and what areas would you like to see covered in such a review?

We are very supportive of a full governance review and would expect that the following areas would be included alongside more standard governance considerations:

- How the USS communicates, particularly the clarity and transparency of its decision making. Pensions are clearly a very technical subject, but all stakeholders have an obligation to make their points in as simple terms as possible. This is so fundamental to securing employer and employee trust.

- The need for stakeholders to engage with the development of the Scheme on an ongoing basis, avoiding the “set piece conflicts” which engulf the sector during valuations. All key assumptions should be kept under constant discussion and review.

- The need for UUK to address how it develops alternative proposals. All too often, open questions are asked of employers (including in this consultation) which they are not necessarily in a position to answer given their lack of expertise. Worked through proposals, developed by representative experts across the sector, should be developed as standard, together with an evaluation of their pros and cons, and put to employers for consideration.

- The important role that a JEP-type structure can provide. There is a need for more independent analysis of, and commentary on, the positions put forward by USS, UUK and UCU. The JEP played an important role in building trust and confidence and, given the relative independence of its expert members, had an important role to play in the scrutiny of decision making. We would welcome the continuation of such a structure.

Respondents to our employee survey expressed some strong views on Scheme governance, in particular the composition of the Scheme’s Trustee Board, performance of the fund managers in light of the size of the deficit, and the pay and bonus structures for senior USS staff. We would support the inclusion of all of these matters in a review of governance.

(F) UUK alternative approach

15. As part of a solution to the 2020 USS valuation would you support the alternative covenant support package illustrated by UUK (headlines – moratorium of a minimum of 20-years with debt-monitoring and a paripassu arrangement for secured borrowing above c15% of gross/net assets), to provide a hybrid benefits package at current contribution rates in the order of (pension accrual of 1/85 of salary [plus 3 times lump sum] up to a salary threshold of £40,000 with the CPI indexation of benefits [for active, deferred
and pensioner members] capped at 2.5% per annum, and with DC above the salary threshold at an overall contribution of 20% of salary), together with a lower cost alternative to address the high opt-out rate, as well as a governance review of the scheme and valuation process?

We have provided the substance of our view in our answers to Q1 and Q7, so do not repeat our analysis here. However, we believe the following points are important:

- There should be a guarantee that if conditions improve materially, a reversal of benefit cuts will be consulted on.

- Should inflation consistently exceed 2.5%, the inflation cap should be reviewed. Higher than expected inflation may have consequences for a number of valuation assumptions and it would be appropriate to retain the option of lifting the cap.

- Pressure should remain to ensure that the Trustee does not indulge in excessive prudence and caution when finalising key assumptions, particularly the discount rate.

We support the proposal outlined, although we would continue to urge all parties to continue to work towards securing a better outcome within the constraints of the 30.7% aggregate contribution rate.

With this latter point in mind, we would support a full 31 March 2021 Scheme valuation so that the post-31/3/20 improvement in equity markets can be reflected in the valuation and the Trustee’s assertions around deteriorating future investment returns can be tested against current market conditions and expectations (e.g. in light of the United States’ economic stimulus package, the predicted post-pandemic bounce back in the UK economy etc.)