

22 September 2014

Mr A Bruce
UUK
pensions@universitiesuk.ac.uk

Dear Mr Bruce,

USS is a critical part of the remuneration package for our academics, and the proposed changes are significant. Brasenose College therefore wishes to respond directly to the USS consultation, although we recognise that the University of Oxford will also be submitting a response.

Due to the timing of this consultation the College has had only limited ability to discuss and explain the proposals with Fellows and other employees affected by the proposals. Despite the poor timing, the consultation has predictably raised a number of concerns among Fellows, and is highly likely to influence job decision of academics considering a career at Oxford, or those considering job offers elsewhere. Comments received in the College have focussed on disappointment over how the scheme has been run, the detrimental impact on future pension and some expressions of lack of confidence in the management of the scheme going forward. It has also been suggested that the most effective communication has been from the Union. The College would find it helpful to have more support from USS and UUK with materials to communicate the issues and proposals clearly to members (some of the slides at the webinar on 8 September are helpful in this regard).

1. Durability: Managing the deficit and limiting contributions

The College recognises that the USS scheme needs to change. Specifically the College recognises that:

- 1) the USS scheme is in deficit, and a plan needs to be in place to reduce this deficit over time, although the rate and method of change are questioned below.
- 2) across the sector employer contributions need to be limited and the earlier consultation has set this limit at 16-18%. The College is prepared to take some risk that contributions might exceed the 18% hurdle, but recognises that this is not the case for the sector as a whole.
- 3) the ratio of changes in contribution rates between employer and employee needs to be maintained at two-thirds/one-third.

2. Timing of decisions and tests

The College believes strongly that the current economic environment, with Quantative Easing and negative real interest rates, is unusual. In particular interest rates are likely to rise in the next few years. This means that not only is this a poor time to consider de-risking of the investment approach, but also that the tests used to assess the scheme are potentially too short term. The calculations of liabilities are dependent on gilt rates, which will rise over time, reducing the deficit. The tests about the stability of contributions consider the risk of employer contributions exceeding 18% or 21% hurdles over three years – but three years is too short a time scale, given the unusual economic environment with negative real interest rates.

The College would like to see a more modest change in benefit package at this time, perhaps with CRB introduced for all, with strong arguments from USS to the Pensions Regulator that USS is sufficiently robust to be able to assess the situation again in three years, when a CRB scheme may be affordable, and that the maintenance of a DB scheme (albeit CRB not Final Salary) should not at this point lead to increases in pressure to “de-risk”.

3. De-risking

The College appreciates and supports the need to put the scheme on a more stable financial footing, with plans to reduce the deficit in the long run, but the College does not support proposed “de-risking”. Although “de-risking” reduces the risks that employer contributions will not rise above a set level (16% - 18%) at any point, it also virtually guarantees that contributions will be higher for any level of benefits offered over the life of the scheme.

The College notes the estimates from USS that the proposed de-risking will result in an increase of £4bn in the deficit and a rise in contributions of 3% for employees and 6% for employers.

We understand that the Trustees are concerned to meet the demands of both employers and the Pensions Regulator to reduce the risk of contributions exceeding certain levels, but we encourage the Trustees to maintain as much risk in the investment portfolio as possible.

A move to increase gilts in the portfolio is highly likely to lower investment returns and so increase the risk of deficit or higher contributions. In the long run equities have historically outperformed bonds; this is reflected in the College’s own investment policy as the College endowment has a very low allocation to fixed interest assets. The College recognises that a pension scheme is not a perpetual endowment fund, but the timescales of a well-supported pension scheme such as USS are long enough for a weighty allocation to gilts or other fixed income products to be detrimental to the investment performance of the fund, and so likely to increase the deficit over time. The College is willing and able to accept some potential risk of increased contributions in future in return for a more balanced and sensible investment approach now.

Furthermore, at this point in the economic cycle, any move into gilts is likely to be even more problematic, as gilt yields are so low there must be a real prospect for significant capital losses, so depressing the investment returns and worsening the scheme’s deficit further.

4. Changes in benefit structure

4.1 CRB for all?

The defined benefit scheme is highly valued by our academics and other staff. The College accepts that the Final Salary scheme is not affordable and some change in benefits is necessary. A CRB scheme for all would be the next best option. Although currently looking unaffordable, the College would like to understand whether a CRB Scheme might be affordable in more normal economic environments, and in particular understand the increase in interest rates likely to be required before the 2017 valuation to bring a full CRB scheme into balance.

4.2 Hybrid scheme, with salary threshold

If the Trustees and Regulator deem a CRB scheme as unaffordable now, and are not willing or able to adjust the modelling to take a longer perspective, and so more changes need to be made now, then the proposed hybrid scheme has some merits. However, the College has a particular concern for the impact of USS on the recruitment and retention of senior staff, particularly

senior academics upon whom the international reputation of Oxford depends. The majority of senior academics in the College are paid a salary of about £60,000 to £65,000.

At first glance the loss of DB pension to the top third of these academic salaries is problematic, but the analysis provided at the webinar on 8th September suggests that the higher expected returns from DC elements of pension should provide similar benefits for most of these employees than a full CRB pension. The most notable exceptions are those that are close to retirement. If some mitigation can be provided to those employees, then the outcomes would be more acceptable.

The College recognises that the introduction of some DC elements will reduce the requirement for de-risking, which is helpful, although should be used in addition to (and not instead of) the introduction of an investment strategy which is long-term and maximises the use of risk assets, as proposed above.

The College would also like to understand what other options have been considered by USS for combining DB and DC, and in particular if other structures may achieve similar reductions in risk and deficit in way that shares the benefits of a DB scheme more evenly across the majority of academics.

4.3 AVCs above the salary threshold

Above the salary threshold, the employer contributions fall to 12% in the models circulated. The College is willing to maintain higher contributions for the pensions relating to higher salaries. This could be particularly relevant for AVCs for employees who wish to purchase additional DC benefits.

Some of our College members have expressed an interest in purchasing more DB benefits instead of DC benefits. A better understanding of the way these might be provided would be useful, including likely investment profiles (gilt-heavy?) and prospective returns.

4.4 Impacts on different employees

The College is concerned about the potential impact on different sections of the College's workforce. We would like to understand how the scheme will affect women, part-time workers, those who take career breaks, joint appointments and those approaching retirements age who may be incentivised to retire early.

Yours sincerely,



Philip Parker
Bursar

Cc
Stephen Goss, University of Oxford
John Church, EBC
David Locke, Conference of Colleges Secretariat