

Foreword from the Joint Review Group

We are pleased to convey the text of a speech by the chairman of the Joint Review Group, Sir Andrew Cubie which was delivered to the USS institutions' meeting at the end of November 2009, and separately to representatives from UUK and UCU. We commend this speech to you as identifying the issues that face the scheme, and as a description of the ongoing progress of the negotiating group.

Signed: The USS Joint Review Group

The JRG chairman's speech to the USS institutions' meeting held on 24 November 2009, and also to separate meetings of selected UCU and EPF audiences

Thank you very much for inviting me here today to speak to you ... it is a pleasure for me to address this gathering of representatives from USS. I give this presentation in my role as the chairman of the Joint Review Group, which is, as you will know, the working group of the Joint Negotiating Committee (the JNC) that is charged by all key interest groups with finding ways to address the formidable funding challenges facing USS.

Let me begin by saying something about the JNC, as I am aware that its role has attracted significant attention in the last 12 months or so. I think it is accurate to say that the nature of the JNC's work has changed in recent times. For many years the benefit changes that were considered by the JNC emerged as improvements rather than reductions (or alternatively as changes to comply with legislation), but the JNC – and indeed the scheme overall, faces quite different challenges at this time.

The scheme is, of course, run by the trustee board. It manages the scheme's assets and provides the administration under which the terms of the trust, guided by the scheme rules, are delivered. However, the scheme rules also state that issues relating to making *changes* to the terms of the trust – ie changes to the contributions or benefits of the scheme – must be decided by a separate body, namely the JNC. In terms of the constitution of the USS, the JNC has in terms of its constitution from the outset had an equal balance of employer and union representatives. Today, it is made up of five members nominated by UCU (to represent scheme members) and five members nominated by UUK (to represent the employers). I fulfil the role of independent chairman.

It is right and proper that at this stage I make it clear – as no doubt a question might otherwise arise – that the rules do indeed state that I have a casting vote on any decisions that face the JNC. It is certainly my unwavering intention to secure an agreed settlement on any future changes to the scheme, and both sides have confirmed to me that they are committed to achieving this. However, in the event that this ultimately proves impossible and the opportunities for agreement have been entirely exhausted, then all I will say, to be quite open about the issue with everyone – and I say this without a wish that it carries any sense of threat or warning, is that the use of the casting vote provision by me is not off-limits. That is why there is an independent chair. I would emphasise that, from where I stand, I see two sides that are hugely committed to finding a solution to the challenges that face USS, and I am grateful to both sides in UCU and the Employers Pensions Forum (and indeed to the USS board and the executive) for the time, effort and resources that they have put into seeking to find a negotiated solution.

What I have just said sets the context for my report to you this morning. The main purpose of today is, however, to speak about the progress that has been made by the group, and for me to mention what I believe lies ahead.

Firstly, I should give some further context for the creation, approximately 12 months ago, of the Joint Review Group. Back in 2006 the trustee company put forward a number of proposals for changes to the scheme which it thought were advisable in the light of growing funding pressures, but at the time it was not possible for these changes to be agreed. However, a process had been started and in the intervening period there has been continuing (and indeed growing) concern about the costs of the scheme. The concerns have certainly not been unfounded, as we have recently seen the employer contribution rise from 14% to 16%. There were, and still are - and to a degree there always will be - a number of uncertainties about the future funding of the scheme, and these were revealed in even starker relief in the 2008 scheme valuation. These are not unique issues for USS – these are challenges that most defined benefit schemes have had to wrestle with during this period – but as a result it became necessary in USS to assemble a group representing the scheme’s stakeholders, to try to find a way forward.

So, what are the risks that face the scheme, and the changes under consideration? Whilst I must preserve, at their behest, the confidentiality within which the group wishes to continue its detailed discussions, this briefing will, I hope, be helpful. Such sensitive negotiations cannot proceed in the public gaze – I can, however, say that the following are the major areas under our consideration:

Let me begin with:-

Longevity – it does not need me to explain that the effect of people living longer is having an impact upon the cost of pensions, and this is significant in relation to USS. Costs will continue to increase unless changes are made. Both sides are agreed on this, and discussions are ongoing to agree the way in which this challenge should be addressed. Various mechanisms are available, such as later retirement ages for payment of benefits, and higher contributions by members. The group is well aware of approaches that have been adopted by other schemes – and indeed by the government in relation to state pension ages – and I hope that the details of the measures that USS will adopt can be agreed by the group over the next few months.

Salary increase risk – this is a particular risk within final salary pension schemes, as salary increases towards the end of a career uplift the whole of a member’s past service in the scheme (and large increases therefore have a significant effect on the value of past service benefits). The group has carried out a very detailed analysis on salary increases in the last few years, to see from where the salary increases have emerged (for example at which salary level) and how these costs might be controlled. As a consequence I can say that a career average benefit structure is being looked at, but it is just one option. I would not want anyone to think that a career average outcome is inevitable, but it is under active consideration – although you will be aware that such arrangements come in very different forms in terms of their key parameters.

A career average structure means that benefits accrue on a year-by-year basis - rather than being entirely subject to an individual's final salary - and generally have a redistributive effect in that they work optimally for those who have salary increases that are generally at or around the level of inflation. They mitigate the sometimes anomalous - and also expensive, in terms of scheme funding - outcomes that can emerge in final salary schemes where a person, with a long period of scheme membership, has significant pay increases in the years near retirement. As always, much depends on the specific detail of any CARE proposal, for example the benefit accrual fraction (the current benefit accrual within USS's final salary arrangements is of course a 1/80th pension and a 3/80ths lump sum). Another key factor is the method by which the year-on-year benefits that are earned are revalued through to retirement. However, the benefit outcomes for some members can be as good if not better under a CARE benefit approach - depending on the other key features of course. This issue as to which benefit outcomes are produced, given the different career patterns that occur within the sector, is due to be considered by the group in the coming weeks. Understanding the actual benefit outcomes under any CARE formula is hugely important of course, and the group intends to give this its full consideration.

I turn now to:-

Flexible retirement – both sides agree that it is important to implement new arrangements for flexible retirement. Such new arrangements will be necessary in terms of future workforce management by employers within the workplace, and also so that employees can have an opportunity to step their way into retirement rather than approach what can be seen as a cliff edge. This can be an important factor in addressing the longevity pressure, as it will arguably encourage employees to work longer and draw a proportion of their retirement benefits later than they otherwise might have – albeit working fewer hours or in a position of lesser responsibility – where that fits in with the employer’s workforce planning.

The next area of discussion relates to:-

Cost-sharing – it has been agreed that some form of “new deal” is needed in the way that pension costs are shared, and in particular in relation to future cost increases. This is a bold statement. The group seeks to strike a balance to ensure that on the one hand any cost increases are justified, whilst on the other hand making sure that members are given the full picture and are not denied the opportunity of paying more, if that might mean they could retain high quality pension arrangements.

Finally, I would like to mention that investment risk is a major issue for the group to consider. The trustee company is currently carrying out its own deliberations over investment strategy for the future, and at this point we anticipate that there will be a renewed dialogue between the trustee company and the JRG stakeholders about the level of risk that is appropriate in the investment strategy, and the consequences of any change to the cost of scheme benefits. This is a complex area, but it is clear that a move to de-risk the investment strategy – to avoid harmful fluctuations in the funding level of the scheme – does have an effect on funding assumptions and therefore ultimately upon the cost of scheme benefits. I anticipate that there will be discussions taking place in the near future in the Investment Committee and at

the Board about the link between a shift in strategy and the cost of pension benefits. Clearly this is something that the group wishes to take into account before deciding any outcome.

Turning now to our timetable, the working group was established approximately 12 months ago, and has met on 11 occasions. Now, that sounds like a lot of meetings, and indeed it has seemed so, but an enormous amount of ground has been covered in the period. Any outcomes of this process will have impact over decades so we must reach secure conclusions. Much of the time has been spent on analysis of the challenges facing the scheme, which has involved considerable input from the USS scheme actuary. It has been important for both sides not only to identify the nature of the challenges facing the scheme, but also to see sound data that helps to assess quantum. For example, many will recognise that the scheme faces challenges from longevity, but perhaps what is more important is being able to understand the scale of the problem. It is odd to regard a greater average life expectation as a problem, but in the circumstances of USS, it most certainly is! The other task is to understand how one issue interlocks with another, and the working group has spent some time understanding this better over the last few months.

Whilst I do consider that building the foundations in terms of expert knowledge and understanding has been important - and I have been content for this to take place in the time that has been available - it is clear that the group is moving into a new phase where the focus will be on decisions and outputs. In September of this year the group agreed a timetable which involved agreement of principles by the end of October, agreement of the detail of any changes by April 2010, with implementation targeted to begin in October 2010.

The group has met the first leg of this important timetable, by agreeing the principles that will govern the future discussions. These points have been labelled as “principles”, but they could also be described as a list of the inescapable risks that are faced by the scheme. They include some of the things of which I have already spoken – and these risks have been accepted as such by both UCU and the EPF – together with statements about how those risks might be addressed. This is hugely important – firstly, because I emphasise that this demonstrates agreement between both sides as to the nature of the risks that face the scheme, and, secondly, because it provides the bedrock upon which decisions about the future will be made.

So, we have taken some important steps in terms of making progress, and I acknowledge the distance that both sides have come in the discussions to reach our current position. I am most grateful to Terry McKnight and his colleagues on the UCU side, and to Keith Burnett and his colleagues on the employers’ side, for their joint commitment to the process. I am also grateful to the USS trustee board, for its patience in the light of its concerns over scheme costs and risks, and also in terms of the support and assistance that it has provided to the group over the last 12 months.

I realise that there are some who would want changes to happen now, and to them the process I have described will seem to be creating inexorable delays in reaching inevitable decisions about the scheme. For others, the idea of *any* scheme change will be anathema and any proposition for amendments to benefits or contributions would be unacceptable. Personally speaking, I do not believe that either of those extremes are views held within the Joint Review Group - instead, I believe

that we have a group that is facing up to the challenges both fairly and realistically, and is approaching its task in a measured way without undue haste and yet also without unnecessary delay. That is surely what you would expect from a group that is charged with deciding changes which affect the second largest private sector pension scheme in the UK. If we fail in our task the consequences will be significant for individuals, institutions and the standing of the sector. In addition, if we fail, Government of whichever colour in 2010 may well intrude into our discussions.

In closing, I am acutely aware that USS has a long and successful history, and is a scheme that is hugely valued by institutions and members alike. Collaboration amongst universities to sponsor and support USS is one of the sector's major achievements (if not the major one in shared activity). I know that the benefits of USS are regarded as a 'jewel in the crown' for UCU and its scheme members. I cannot in consequence believe that anyone would want deliberately to put the sustainability of USS at risk.

Therein lie some of our formidable challenges, but let me be clear that these challenges are foremost in the minds of the group, and we look forward to continuing our work, tackling these issues and concluding with an agreed outcome by spring of next year. I certainly look forward to the task, as do my UCU and EPF colleagues on the JRG – and I hope to make further announcements over the coming months about the progress that has been made, to scheme stakeholders and to scheme members.

I hope that you have found my report to be interesting and informative.