UCEA response to the Public Service Pensions: Consultation on the discount rate methodology

Background

The Universities and Colleges Employers Association (UCEA) represents 173 Higher Education Institutions (universities and colleges) across the UK. As a membership organisation our mission is to represent, negotiate for, and promote the interests of UK Higher Education Institutions (HEIs) as employers. To do this effectively we aim to anticipate the challenges of changing times, working jointly with key sector groups. A key policy area on which we support our employers is pensions. UCEA represents Higher Education (HE) on both the LGPS and Teachers' Pension Scheme (TPS) Advisory Boards. This includes over 100 "post 92" modern universities and HE colleges with around 40,000 active members (6%) in the TPS and around 30 university medical schools in the NHSPS.

The increase in pension contributions following the 2016 valuations was unprecedented, unpredicted and unwelcome by HEIs. The difficulty that the HE sector had in funding this significant amount from existing budgets where substantial income streams are fixed should not be underestimated. This was compounded by the fact that there was no additional funding made available to help HEIs as there was for schools and colleges. A further increase in the employer contributions rates would be much more difficult for our member HEIs to absorb, especially given the continuing impact of the Covid-19 pandemic.

A significant proportion of the increase in the cost of the public service schemes was due to the change in the SCAPE discount rate applied by HM Treasury as the result of an unexpected in-cycle review. This meant it announcement on the discount rate were very close to the implementation date of the outcome of the 2016 valuation. In as much as the quantum of the increase in the cost of the public schemes as a result of the change to the SCAPE discount rate was unwelcome, it was the lack of notice that put extreme pressure on our employers as they had little time to prepare and budget for the higher than anticipated increase in contributions. It also meant it had not been included in HE sector expenditure forecasts or strategic plans (often over 3 and 5 years) provided to the HE regulator or government in relation to university spending. In addition, the short notice meant that it was not possible for government to find additional funding for HE employers in TPS -as it did for schools and colleges - to fund the entire increase in theiremployer contributions. In addition, university hospitals in the NHSPS received only partial additional funding towards the increases in their contributions rates. So HE employers were hit significantly harder than others in the public service schemes.

Finally we would like to confirm our support for the response made on behalf of the TPS SAB alongside our own HE sector specific response.

UCEA response

Question 1: Do you agree that these are the correct objectives for the SCAPE discount rate? If not, please explain why and specify any alternative objectives that you think should be included.

We agree that these objectives seem reasonable and confirm that HE employers in the public service schemes would welcome long term stability in the employer contribution rate. This would allow them to budget with more certainty and ensure that forecasts of university expenditure provided to the HE regulator and government will be more accurate, therefore allowing better consideration of the sector's funding needs.

Question 2: Do you agree that these are the most appropriate methodologies that should be considered? If not, please specify any alternative methodologies that should be considered and how they would fit with the Government's proposed objectives.

Yes.

Question 3: What are the advantages and disadvantages of a SCAPE discount rate methodology based on expected long-term GDP? If this methodology is adopted, should any of the modifications (allowing for short-term GDP projections, allowing for actual experience) be considered?

Our major concern with this method is the volatility in the long-term GDP measure, which is in part driven by the uncertainty in the output from existing GDP models. This can be demonstrated by considering range of potential outcomes in the output from the models used.

Question 4: What are the advantages and disadvantages of a SCAPE discount rate methodology based on the STPR? If this methodology was adopted, should any modifications (allowing for the public service pension context or allowing for long-term uncertainties) be considered?

Employers would welcome the long-term certainty in costs that this method would provide.

In relation to the "catastrophic risk" element, we can see that there are possible catastrophic events that could affect public service pension schemes, or indeed HE employers, as well as the public sector as a whole. For example, risks that could affect the global economy and therefore drive significant reductions in investment returns, or that affect population and therefore impact on membership numbers and contribution receipts, which could all impact heavily on the affordability of unfunded pension schemes from a taxpayer perspective.

Question 5: Which SCAPE discount rate methodology do you recommend, and why?

We support the return to the STPR methodology. While retaining the link to long-term GDP may be beneficial in the short term leading to a reduction in employer costs, we believe our employers are in favour of greater stability and certainty of costs over the longer term.

Question 6: Are there any equalities impacts of changes to the SCAPE discount rate methodology that the Government should consider?

As mentioned in paragraph 2.17 of the consultation document, there are a number of indirect impacts of excessive volatility in the discount rate which can lead to difficulties in the management of employer expenditure. This is due to the significant impact that the SCAPE discount rate has on the total cost of the pension scheme. In businesses that are knowledge based where the main cost is staff (in excess of 60% of university expenditure goes on staff costs) unforeseen increases in cash expenditure with little notice can often only be managed in the short term through reducing staff costs in other areas. This has already been demonstrated by at least one HEI following the 2019 TPS contribution increases. In many cases immediate cost reductions have focussed on reductions in support services i.e. not those provided by the academics that participate in TPS or NHSPS, which not only leads to concerns of unfairness, but it also means that the focus of cost reduction will fall on lower paid roles often women and part timers.

Question 7: Do you agree with the proposal for reviews of the SCAPE discount rate to be aligned with the scheme valuation cycle?

We strongly agree with the proposal to align the reviews with the valuations.

However, we note that if the STPR is the chosen basis, the likelihood of needing an in-cycle review is significantly reduced. We would recommend removing this facility as this would give employers greater certainty about the timing of future changes and improve planning and budgeting.

If the in-cycle review is retained there needs to be a limit set on how close to the implementation date a change can be made. Employers need to be able to budget appropriately and cannot do this if costs can increase significantly at the last minute. It should also be noted that for academic employers their financial year does not align with 1 April pension scheme year. For HE the financial year usually starts on 1 August so any contribution changes need to be announced at least a year in advance of August i.e. 18 months before the April implementation date, so that the amount can be included in budgets for the relevant academic year (in the case of the 2020 valuation this means September 2022 for the 2023/24 academic year). In addition, most universities plan expenditure on a longer basis such as 3 to 5 years, or longer for capital projects, so significant short term increases in their outgoings can be extremely difficult to absorb and will not have been able to be included in assessments of the HE sector's funding undertaken by the HE regulator or government. Therefore the timing of any future changes to the SCAPE discount rate is vital.

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