UCEA response to the Public Service Pensions: cost control mechanism consultation

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. It also meant it had not been included in HE sector expenditure forecasts and strategic plans (often over 3 and 5 years) provided to the HE regulator or government in relation to university spending. Should a further increase in employer contributions be forthcoming following the 2020 valuations the impact would be much greater and would have a detrimental impact on both HE staff and students, especially given the ongoing Covid-19 pandemic.

Our employers believe that monitoring and managing the cost of the public service pension schemes continues to be vital but are supportive of the current review of the mechanism, given the unexpected result of the 2016 valuation.

UCEA Response

Question 1: Do you agree that a reformed scheme only design would achieve the right balance of risk between scheme members and the Exchequer (and by extension the taxpayer), and would create a more stable mechanism?

Our greatest concern with the proposal is stated clearly in the consultation document itself; "it would further reduce the strength of the cost control", and we would remind HM Treasury that the majority of the cost increase following the 2016 valuation (60%) came from the legacy final salary schemes. While overall it appears likely that a reformed CARE scheme only design will create a more stable mechanism and does seem fairer to members as benefit changes can only be applied to CARE service, it will remove a significant proportion of overall cost from the cost control mechanism. This is especially true as the McCloud remedy proposes that all affected members be moved back into the legacy final salary scheme for the relevant service. This will remove a lot of the cost benefit that was expected following the move to CARE in 2015 and, in our view, makes it more important that there is an economic check which includes <u>total cost</u>, as discussed below.

In addition, the consultation document states that this is "placing all the risks of past service costs (both reformed scheme and legacy scheme) onto the Exchequer". Here we would comment that the Exchequer is not the employer in these cases and not all participating employers are publicly funded, such as those in the HE sector. Managing the cost to the Exchequer and ultimately the taxpayer, does not take into account the fact that the short-term impact of any increase in cost is felt directly by the employers. The SCAPE consultation itself includes the statement: “A change to employer contribution rates as a result of changes to the SCAPE discount rate does not have a direct impact on the cost of unfunded public service schemes to the taxpayer”. This highlights how the employers are caught in the middle as the cost management process is focussed on managing long-term costs at the expense of the shortterm impact on employers. In the HE sector this has been exacerbated by the lack of additional funding for HEIs that participate in the TPS employers and only partial funding for medical schools in the NHSPS to cover the increase in employer contributions following the 2016 valuations. Therefore, we believe an element of risk is missing. We would wish the direct risk to the employers in terms of the contribution rate to be considered and options for managing the total cost to employers to be put forward.

Question 2: Do you agree with the Government’s intention to widen the corridor? If not, why not?

Broadly yes, but we agree with GAD’s comment made at a recent webinar on the subject that this is a “quick and dirty” approach to resolving the problem. While it makes a breach of the cost cap less likely it does not resolve the fundamental issue of cost and it does not mean that a breach will not happen i.e. a breach “within the next ten years” could still happen next year. In addition, we have to support the concern raised by other stakeholders that increasing the corridor means the magnitude of any change, should the aim be to bring the cost back to target, will be much more significant. We would support an approach that gives each SAB the ability to recommend ways to manage the costs within the 3% cap and collar, as is used by the LGPS SAB.

Question 3: Do you think that a corridor size of +/-3% of pensionable pay is appropriate? If not, why not?

If this is the approach to be taken a 3% corridor seems reasonable. An even wider cap and collar would exacerbate the issue of large-scale changes being required to bring the cost back to the target cost, as mentioned previously.

Question 4: Do you agree with the proposal to introduce an economic check?

We are supportive of the introduction of an economic check and the need to prevent “perverse” outcomes in future. However, we also feel strongly that this needs to consider the <u>total cost</u> of the pension schemes not only, ultimately, to the Exchequer but also to the employers in the short term, especially as the main driver of cost at the last valuation was through the legacy schemes. If the intention is to manage the <u>actual</u> cost of providing a pension, as stated in 1.4, we believe this has to include the cost of both past and future service across both current and legacy schemes.

We also feel that it would be helpful if there was a requirement to consider the impact on the public service pension schemes of decisions taken in related areas of government policy, for example, when decisions are taken regarding public sector pay increases or workforce changes. This could assist with setting more appropriate actuarial assumptions at the time of the valuation and therefore for the outcome to be less unexpected. These issues could be discussed with the respective SABs. For example, if there had been more consideration of the impact of long term pay restraint on public service scheme costs, then the outcome of the 2016 valuations could have been anticipated and better managed.

Question 5: Do you think that the SCAPE discount rate, as it currently stands, is an appropriate economic measure for the cost control mechanism?

It could still be possible to use the SCAPE discount rate, as linked to GDP, as the basis for an economic check but, once again, this is focussed on the ultimate cost to the Exchequer, not the employers.

It would seem reasonable for an affordability check to be undertaken that looks at the position of the different groups of participating employers, for example, in the HE sector affordability would be affected by any government decision on fee levels or student numbers, as this would be expected to impact on the income of HEIs A better understanding of employer affordability would reduce the likelihood of government subsidies being required to fund contribution increases in future years.

Question 6: If the SCAPE methodology changes, and the Government considers that the SCAPE discount rate is therefore not an appropriate measure for the cost control mechanism, then do you think that a measure of expected long-term GDP should be used instead? If not, please set out any alternative measures that may be appropriate in this scenario. Please consider in the context of the separate review of the SCAPE methodology currently being undertaken by HM Treasury.

The affordability of the Exchequer would still ultimately be based on income from taxpayers. Therefore, we could see an argument for using a measure still linked to long term GDP for the affordability check, even if the SCAPE discount rate is based on the STPR (which is our preference). However, we would still press for a more immediate check of employer affordability as outlined above.

We were concerned to see that the last adjustment made to the SCAPE rate as part of an in-cycle review was made during a period of great uncertainty in long term GDP projections, as demonstrated by the wide range of possible outcomes posited by the OBR. We feel that if a GDP related figure is used it needs to have a greater level of confidence.

Question 7: Do you envisage any equalities impacts from the proposals to reform the cost control mechanism that the Government should take account of?

Should the <u>total cost</u> of the public service pension schemes not be adequately controlled into the future and no additional funding be made available to HE employers, we can envision our employers needing to make further changes to their business models and the services they provide in order to fund additional pension costs. In organisations that are knowledge based, where the main cost is staff (in excess on 60% of HEIs annual expenditure goes on staff costs) this will inevitably mean staff cuts. 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. Such indirect impacts are mentioned in paragraph 2.17 of the consultation on the SCAPE discount rate.

Emelda Nicholroy

Head of Pensions Policy

13 August 2021