



## SUBMISSION TO THE JOINT EXPERT PANEL

June 2019

### Call for evidence:

1. Developing an approach to future valuations that is clear (and clearly understood by stakeholders) and which can deliver both a sustainable scheme and a shared set of principles.
2. An exploration of different paths to the valuation of technical provisions and other aspects of the valuation methodology, including Test 1.
3. Considering questions of risk sharing, including adopting a different approach to contributions (which could, in turn address issues of intergenerational fairness and equality); examining further the question of mutuality and the question of employer appetite for risk; and the potential for risk sharing.

### Our response:

We would like the USS to adopt a valuation methodology and process that are simple, transparent, timely and efficient. Before responding to the latest call for evidence we would like to thank the members of the JEP for their efforts to improve the USS and find a long-term solution for the scheme. We are concerned that the USS Trustee rejected most of the recommendations made by the panel for the 2018 valuation other than updating the valuation for the latest available data, which would be customary at any valuation. This is despite both stakeholders (UUK and UCU) instructing the Trustee to implement the JEP recommendations in full. Furthermore, the actuarial advisors of both UUK and UCU (Aon and First Actuarial) have confirmed that the JEP's Phase 1 recommendations are appropriate within the range of assumptions that are applied for a scheme with an equivalent covenant. To date the USS Trustee has provided little evidence justifying or explaining their response. We are extremely concerned that the next valuation exercise will also end with a sub-optimal process and outcome. In future, we expect the USS Trustee to implement the recommendations of the Joint Expert Panel if they are supported by both stakeholders and are within the range of assumptions adopted by private defined benefit schemes with a strong or tending to strong covenant.

1. **The next USS valuation:** The 2018 valuation process has been poorly managed and we are concerned that another valuation as at March 2020 gives insufficient time for USS and the sector to consider the outcome of your first two phases of work. We ask that the Joint Expert Panel recommends an explicit and detailed timetable for the next valuation. Ideally, we suggest that another valuation is not undertaken until 2021 to allow a proper discussion between the USS Trustee, employers and members about the methodology for the next valuation.

2. **Employer consultation timelines:** Employer consultation timelines continue to be very tight for the 2018 valuation as they were with the 2017 valuation. We are concerned that Boards, in particular, do not have time to properly consider and debate very important issues relating to their people and the organisation's financial sustainability. Actuarial advice is of good quality but is often being provided quite late in the day. We ask the that JEP considers some minimum standards for effective employer consultation.
3. **Historical reforms:** Consideration of the future sustainability of the scheme needs to reflect the substantial reforms that have been made in recent years. The scheme no longer has a final salary accrual structure and the linkage between final salary benefits earned to the date of the reforms and a member's salary at retirement has been removed. They represent substantial changes that were accepted by members and employers and which significantly reduce the risk of future defined benefit accrual with a career average revalued earnings structure linked to a limited level of earnings. We are concerned that these facts and associated implications have been forgotten, or are being deliberately ignored, by some participants in the Higher Education sector. Funding the past service deficit, which largely relates to final salary accrual up to 2016, and the cost of future accrual should be considered as two separate matters to safeguard equity between generations.
4. **Hedging and control of inflation and interest rate risks:** We strongly urge the JEP to make recommendations to USS regarding the hedging of an appropriate level of liabilities to inflation and interest rate risks. Effective hedging is one way that the funding risk relating to the past service deficit can be reduced if it can be implemented in a cost effective manner. This would give both the USS Trustee and employers greater future cost certainty and reduce the risk to future funding of new benefit accrual and education and research. Asset de-risking .
5. **Asset de-risking:** De-risking scheme assets, for example from equities to bonds, potentially has significant implications for both cost and risk. Future valuation proposals should provide information about the impact of proposed changes in asset allocations on both costs and risk profile. This should be considered alongside liability hedging options to achieve an optimal balance between cost and risk.
6. **Survey of employers' attitude to risk:** The JEP phase 1 recommended that the employers' willingness and ability to bare risk was reassessed. However, to our knowledge the Trustee has not done this. Therefore, the USS and UUK should review employers' attitude to risk and the level of support that they are willing and able to provide to USS going forward. UUK's current mandate from employers, which is relied up by USS for its decision-making purposes, is almost two years' old and must be updated. We suggest that the JEP supports UUK to undertake a new process in advance of the completion of the second phase of the JEP's work.

7. **Employer reliance:** If Test 1 or similar is retained for the next valuation, it would be beneficial for UUK to consider with employers the level of reliance that USS places on the employer covenant (Test 1). The current headroom is assumed to be an increase in contribution levels by 7% for a period of 20 years if additional contributions are required to fund future pension payments. The strong track record of our institution and the long-term nature of our activities means that we are prepared to extend the period from 20 years to 30 years. Our growth plans would also indicate that the current assumption of CPI for the annual increase in the scheme's pensionable payroll is too low. CPI +2% would be more appropriate. We do not consider that there is scope to amend the additional contribution level of 7% without causing medium term damage to the institution through the diversion of resources away from research and teaching activities in a manner that would likely affect jobs and cause harm to the long term strength of the institution. Our willingness though to extend materially the period over which the USS Trustee could seek additional contributions and an uplift in the growth assumption will significantly increase the level of reliance that the USS Trustee can take and will in turn provide greater capacity to provide meaningful defined benefits. We would appreciate modelling and forecasts of how these changes affect contribution rates and scheme funding outlook.
8. **Improve the valuation methodology:** The current valuation methodology is too complex and poorly aligned with the risks the scheme faces. We are particularly interested in the risk of two events: 1) the risk that the scheme defaults on its obligations; and 2) the risk that the scheme has insufficient assets to cover its accrued liabilities and requires additional funding from employers. These risks could be estimated and forecast over time under a range of plausible assumptions (i.e. stress tested). We would like to know how the probability of scheme default evolves over time with different scenarios, funding and investment strategies. For example, if contingent contributions were introduced (i.e. as in the USS's recent option 2), how does the risk of USS default change over time? Similarly, if we delay or cancel the shift from equities into bonds, how does the risk of scheme default change over time? The current tests are only weakly related to the risks we are concerned with and may be misleading.
9. **Strengthening the covenant:** The mutual structure of the scheme leverages the combined strength of the sector. The rules around employer's exit from the scheme should be clarified to ensure the employer covenant is maintained. However, the USS should consider the covenant strength of individual employers and seek to move those employers with weaker covenants into a defined contribution only section of the scheme. This would typically be those admitted bodies with no or few net assets. There is a precedent for this within the Social Housing Pension Scheme, which is the multi-employer scheme for the affordable housing sector.
10. **Provide accessible and relevant information:** Considerable work was undertaken by all parties in the months leading up to the valuation and a wealth of information exists. However, much of this information was not pulled together in a coherent manner to enable members and employers to understand the likely valuation position, choices and consequences. Pensions are an extremely complex subject and more could be done in the future to raise awareness of issues at an earlier date and provide more accessible information to enable members and employers to express preferences on a better-informed basis. For example, the initial valuation results and an accessible description of the planned assumptions could be published along with the default implication on contribution levels and/or benefits for staff members and employers.

11. **Retendering for the scheme actuary:** Many people have raised concerns with a number of aspects of the 2017 and 2018 valuations. This may have affected members' confidence in the administration of the scheme and the USS Trustee. The scheme actuary has signed off these valuations and provided advice to the Trustee. Retendering for the scheme actuary may help increase confidence in future valuations. We appreciate that a tendering exercise and potential replacement is not practical at the current point in time, but should be undertaken prior to the commencement of the next valuation
12. **Data availability:** The USS must make sufficient data available to evaluate the valuation. This should include sufficient information to model and forecast the impact of changes to key variables on the scheme funding position. USS will not rebuild trust with significant sections of its membership unless it does this.