USSEmployers

# RESPONSE FORM

A consultation by Universities UK with employers on the indicative outcomes of the valuation

**CLOSING DATE: 24 MAY 2021**

**REPLY TO: PENSIONS@UNIVERSITIESUK.AC.UK**

## **MAKING YOUR RESPONSE** TO THE CONSULTATION

We welcome responses to this consultation from each and every one of the scheme's participating employers.

We are keen to have the widest possible range of views and perspectives ahead of the next steps of the 2020 valuation.

Through this consultation we are formally seeking views and direction from employers on some key questions, particularly on:

- Covenant support measures
- Contributions
- Future benefit structures
- Addressing the high opt-out rate and flexibilities
- Governance
- UUK's Alternative Approach

This template form is optional and can be used for the response from your institution,you may also want to feedback this information another way.

With these views, UUK can then progress the negotiations with the University andCollege Union (UCU) within the Joint Negotiating Committee (JNC).

**Please send the response from your institution to pensions@universitiesuk.ac.uk by 5pm Monday 24 May 2021.**

## COVENANT SUPPORT MEASURES

1. Would you be willing to support the alternative covenant support package which UUK has outlined in section 4, as the means to achieve a solution which might be acceptable in the round (see also question 15)?

**SUMMARY POSITION**

**Before responding to the specific questions, we would like to provide some context for the views we express. In previous consultation responses over the last two years, we argued that committing to a 31st March 2020 valuation as part of finalising the 2018 valuation was unlikely to be in the best interests of members and the USS scheme. Given the economic and circumstances with the COVID pandemic, we are surprised the Trustee has persisted with the 2020 valuation. We are disappointed the Trustee has decided to press ahead with a non-statutory valuation in these circumstances. It has caused unnecessary stress and worry for our members and staff at a time when they have been going above and beyond to deliver outstanding education to our students and world leading research throughout the pandemic. The Trustee's actions risk further unnecessary disruption to UK Higher Education and may ultimately weaken the collective employer covenant.**

**In summary, we would like to convey the following key points:**

**1). Governance reform is required to actively address the perception amongst employers and members that the Trustee is out of touch and not taking a pro-active approach in finding solutions to the current challenges the scheme faces.**

**2). The valuation should be performed as at 31 March 2021. This date represents a more representative point for a scheme valuation. If the USS Trustee is unwilling to abandon the 2020 valuation then it is essential that any changes (other than the implementation of an employer covenant support package) are held over until a 2021 valuation is completed.**

**3). We are prepared to pay a total contribution rate of 34.7% (employer 23.7%; member 11%) in line with the 2018 valuation Schedule of Contributions. It would appear very challenging to maintain a scheme with a meaningful level of future defined benefits without this level of contribution. We believe that only minimal, if any, change to future benefits should be required at this contribution level on the assumption that a reasonable employer covenant support package is provided alongside a 2021 valuation.**

**4). 75% of our eligible USS members have expressed a preference for a DC only option to be explored.**

**5). The Trustee should obtain an independent review of performance of themselves and the USS Executive Team. The latest deficit positions could have been mitigated to some extent had an appropriate level of liability hedging been implemented. We have consistently raised this point over the last couple of years.**

In answer to this specific question: yes, we are willing to support alternative covenant support packages outlined in section 4.

## COVENANT SUPPORT MEASURES

2. If the USS Trustee is not willing to accept UUK's alternative proposal (should there be employer support for it), would you be willing to support the USS Trustee's scenario 3 covenant support package to obtain a 'strong' covenant rating? If not, why is this and what level of covenant support would you be willing to provide?

Yes, if this was absolutely necessary to maintain an affordable hybrid scheme for future generations with a meaningful level of defined benefit. We propose that the longer moratorium period incorporated within the UUK covenant support proposal (20 years) be incorporated into the USS Trustee's Scenario 3 proposal on the condition that USS adopts reasonable valuation assumptions. We are offering this position in order to maintain an affordable hybrid scheme with a meaningful level of defined benefit. Our expectation is that the USS Trustee should be able to incorporate post valuation experience and actuarial assumptions that maintain the existing benefit structure with future total contributions in the mid 30's (in line with the long-term contribution rates arising from the latest

2018 valuation) with this enhanced level of employer covenant support for staffs' pensions.

## COVENANT SUPPORT MEASURES

### 3. Are there areas of the covenant support measures which cause you particular concern, or which you would wish to see modified? Please provide details.

We are pleased that the USS Trustee is proposing to accept security granted over assets that have been directly funded by debt and/or grants without requiring a pari passu security position for the USS scheme in many scenarios as these assets are covenant enhancing (furthering our academic mission and strengthening future cash flows). However, there are some types of arrangement that must be carved out of metric E without requiring pre-clearance from USS to enable employers to operate their organisations. The current proposed approach is unduly bureaucratic and does not represent good value for money for contributions to be expended on them. We propose that a direct carve out without pre-clearance is provided for:

1). Quasi-security (where there is not a direct charge in favour of a lender over an asset, but they are in a better position to recover their losses upon an insolvency than other unsecured creditors by virtue of the control they have over an asset) provisions are unduly bureaucratic as they relate to the lease back of assets. By their nature these arrangements relate to assets that would otherwise not exist and would appear to fall into the category of covenant enhancing assets that USS signal they would typically approve. (See section 4.14 of document C2: https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/USS%20Document%20C2%20Debt%20Monitoring%20Framework%20March2021.pdf)

2). Any security or quasi-security arrangements relating to asset grant funding agreements should also automatically be excluded. These assets are covenant enhancing and would not exist without the grant that is being secured against the assets. Obtaining pre-clearance for such arrangements could require very regular engagement. (see section 4.4c in document C2)

## COVENANT SUPPORT MEASURES

### 4. Are there other areas of covenant support you would wish to consider such as contingent contributions or asset pledges?

We do not consider that asset pledges are a feasible option. The majority of the borrowing undertaken by USS employers is on an unsecured basis. A contingent asset arrangement is likely to require the consent of borrowers, private placement investors and bond holders. The probability of getting all of those creditors to agree is remote.

Contingent contributions remain unattractive from the last time this was considered as part of the 2018 valuation response. They make it really challenging for institutions to plan and effectively deploy their resources to achieve their academic mission without holding back resources just in case additional contributions are called by USS. However, we would be willing to consider them if they enabled a meaningful level of defined benefit to be earned in the future if the collective employer group are not prepared to pay more than the current contribution level of 20.7%. We would be prepared to accept contingent contributions up to 23.7% to align with the long term contracted employer contribution rate currently in place.

## CONTRIBUTIONS

5. Do you agree that the current levels of employer contribution (21.1% of salary) and member contribution (9.6%) are the maximum sustainable – and should be the foundation for any solution?

a. If not, please state the level of employer contribution you would be willing to pay to USS following the 2020 valuation.

b. We would welcome any commentary on the reasons for your views.

c. We would also welcome employer views on the level of member contribution.

No – current contribution levels are not at the maximum sustainable. The long-term outcome of the 2018 valuation should be the foundation for any solution (34.7%). Staff members have previously been consulted in relation to the associated member rate of 11% and the rates are contractually committed in the current Schedule of Contributions.

a. We would be willing to pay contributions in line with the outcome of the 2018 valuation (total contributions of 34.7: employer 23.7%; member 11%).

b. We note that USS employers' reluctance to pay the long-term contribution rate agreed as part of the 2018 USS valuation is undermining the scheme covenant. Employers have known for at least eighteen months that this higher level of contributions will become due from October 2021. There has been a reasonable time period for employers to adjust their institutional plans to meet this contractual obligation. An alternative benefit structure should be considered for employers who are not willing to pay to maintain a hybrid scheme with a meaningful level of future defined benefit accrual.

c. A member contribution rate of 11% is not out of step with comparable schemes. A flexible DC option should be considered to provide an option for staff who are unable to afford current/future contribution rates to participate in the hybrid scheme.

## BENEFITS

6. Do you support the broad principle of seeking to retain the hybrid benefit structure?

Yes. Our staff want a meaningful level of defined benefit pension provision to give them greater certainty over their income in retirement. We are prepared to support this on the basis that salaries for staff are generally not as high as they may earn elsewhere. A meaningful element of defined benefit pension helps to compensate for this and is a key tool to attract the best staff.

Our sampling of eligible USS members highlighted that if changes have to be made to the existing benefit package, then lowering the DC contribution level and the salary threshold would be the most acceptable options (greater than 50% support for both). Increasing the accrual rate or removing the lump sum payment upon retirement were considered unacceptable by most.

**BENEFITS**

7. Looking at the illustrative hybrid benefits which UUK has put forward, would you consider this an acceptable outcome in terms of benefits at this valuation – based on the positions on covenant support and contributions laid out?

The work undertaken by UUK is moving in the right direction. However, it does not represent an acceptable outcome. We believe that it is reasonable for the USS Trustee to adopt assumptions that could retain the existing benefit structure within the long-term contribution structure currently in place (34.7%). We are willing to honour the existing contracted Schedule of Contributions and put in place reasonable covenant support measures to enable the USS Trustee to adopt less prudent actuarial assumptions. Maintaining an affordable hybrid pension scheme with a meaningful defined benefit element is a crucial element of our employment package that is highly valued by colleagues.

**BENEFITS**

8. If the illustrated hybrid would not be acceptable, what alternative benefit arrangements would you wish to provide (and please indicate alternative positions on covenant and contributions as appropriate)?

*(For example, if the USS Trustee does not ultimately amend its assumptions, would you wish to offer a hybrid solution as set out in the USS Trustee's illustrations (p18 of the Update Report) or would you prefer to move to a different offering, such as DC provision?)*

We have consistently advocated in previous consultation responses over the last two years that an early valuation as part of the resolution to the 2018 valuation is not appropriate. Market conditions as of March 2020 were abnormal. USS is a long-term scheme and has an investment horizon of 30 years. We are at significant risk of altering the scheme off of the back of an exceptional event i.e. the Covid-19 pandemic. Whilst the pandemic is still ongoing in March 2021, market conditions have normalised to some extent since the onset of the pandemic, as its impact is better understood. Indeed, world equity markets are 40% higher today than they were at the proposed valuation date of March 2020. The 30-year Gilt Rate has also increased by 63%. Whereas, the yield Index Linked Gilts (ILG), a key benchmark used in the valuation methodology, has remained barely changed. Our strong preference is for the 2020 valuation to be halted and to submit a valuation as of March 2021 date as statutorily required. Furthermore, while we appreciate that the USS Trustee will take post valuation experience, (i.e. the £14bn increase in asset values) from March 2020 into account in the final valuation, this is not transparent to members. We do not see that it possible to discuss reform of the benefits and contribution rate to the scheme until the Trustee indicates how it will account for post valuation experience.

We believe that it is reasonable for the USS Trustee to adopt assumptions that could retain the existing benefit structure within the long-term contribution structure currently in place (34.7%). We are willing to honour the existing contracted Schedule of Contributions and put in place covenant support measures (USS Trustee's Scenario 3 modified to incorporate UUK's longer moratorium period on employer exits) to enable the USS Trustee to adopt the necessary actuarial assumptions to achieve a sufficiently valuable outcome for our staff.

## BENEFITS

9. Would you wish to explore conditional indexation or other conditional benefit models as a possible solution (likely longer-term, beyond the 2020 valuation)?

Yes. We are happy to consider conditional indexation and would welcome any modelling or evidence that can be provided.

## FLEXIBILITIES AND OPTIONS

10. Would you like to see flexibilities implemented for members to move away from the current uniformity of the USS structure, and if so, which flexibilities do you think are particularly important?

We recognise that the current one size fits all contribution and benefit rates do not work for all members. We are concerned about opt out rates and would be willing to consider flexibilities that would help address this. Our staff have told us that reducing the salary threshold for defined benefits is one of the more acceptable changes to manage contribution rates. 75% colleagues attending recent consultation events (12% eligible USS members) told us that they would like a DC option to be considered for members. We have not yet understood the reasons behind this response. However, it is reasonable to expect that contribution management is likely to be a key one.

## FLEXIBILITIES AND OPTIONS

11. Would you support the creation of a lower cost saving option for members and which of the parameters described in this paper are most important / or would need modification?

*(If yes, we would welcome employer views on the options to achieve this (potentially informed via engagement with eligible USS employees).*

We are very concerned to maintain an affordable hybrid pension scheme with a meaningful level of defined benefit. The first aspect that we suggest is explored is the implementation of tiering of contributions on a gradual basis to mitigate any 'cliff edges' in order to make the scheme more affordable to lower earners. We would be interested in seeing evidence and modelling of tiered contribution rates compared to other schemes (e.g. TPS).

We believe that a tiering of contributions at the top and bottom ends of the member earnings scale is more progressive and simpler than offering a lower cost savings option. The evidence provided in UUK's consultation paper suggests that lower cost savings options do not address drop out issues and are typically used for tax management purposes by higher earners.

There are other options that we would be happy to explore. Modelling and evidence on what members would receive in return would be helpful. Options include offering members slightly lower contributions if they opt for a less generous lump sum upon retirement and a basic ill health and death in service insurance arrangement is an option for us if tiering of contributions is insufficient. This would not undermine our institutional objective of assisting our staff to make adequate savings for their retirement.

Another flexibility that could be introduced is to give members the option to lower their DB cap and pay more into the DC scheme. This is particularly relevant for some overseas staff, who may only be with us for a few years and are more familiar with this type of pension scheme. Additionally, some may consider that DC is better value for money for them given the rising cost of defined benefits as this may be perceived as better value for money to some (see our response to Question 12 below). The Australian higher education pension scheme (UniSuper)

successfully offers staff a choice between a wholly DC scheme or a hybrid scheme.

## FLEXIBILITIES AND OPTIONS

12. Would you support the creation of an option for members to switch (from the hybrid structure) to wholly DC pension saving?

*(We invite employer views on whether the same deficit recovery contribution should be made for members choosing any new flexible DC alternative option, and what levels of member and employer contributions devoted to DC pensions saving should apply).*

We would support an **option** for members to reduce the portion of their salary they receive defined benefits for and receive DC benefits instead. This could involve options for lower member contributions. The defined benefit element is highly valued by many staff and our aim is to protect it. However, it is not attractive to all staff. Any voluntary move from DB to DC benefits should include a more favourable employer contribution below the DB salary threshold than above it to reflect the saving in relation to these staff not opting for defined benefits. UniSuper in Australia provides university staff with a hybrid pension scheme with the option of DC only.

## FLEXIBILITIES AND OPTIONS

13. Would you wish to explore options for employers so that they can offer some variations to the USS standard benefits in the future – and if so, what would those variations be?

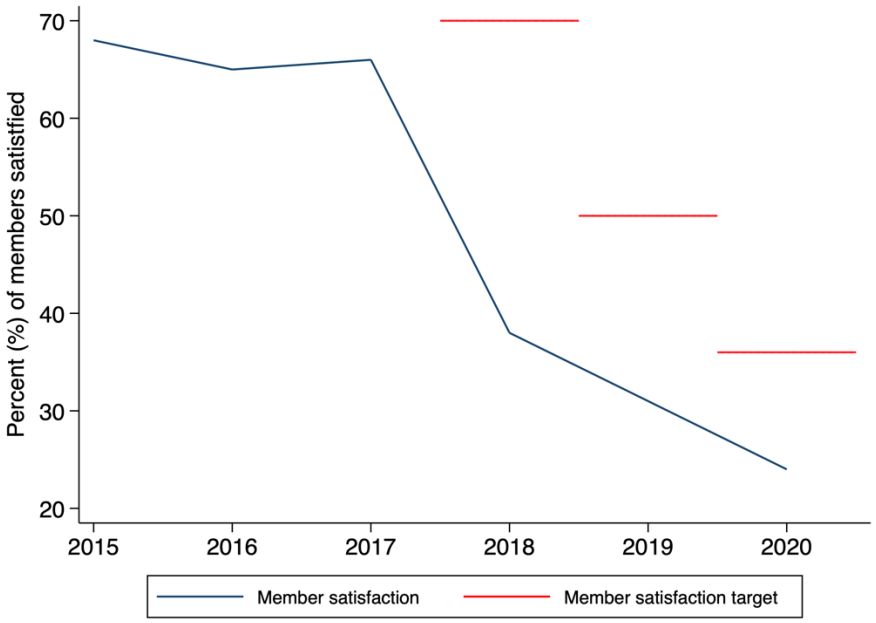
Not at the current time.

## GOVERNANCE

14. We would welcome views from employers in relation to the governance of the scheme and the valuation process (including views on the Joint Negotiating Committee). Specifically, would you support a post valuation governance review, and what areas what you like to see covered in such a review?

The current governance of the USS is not working. Reform of the scheme's governance is essential to secure a sustainable future for the scheme. Member satisfaction is at an all-time low (see Figure 1 below). The significant challenges that the 2020 valuation is posing highlights the need to make changes this year. USS is a key element of the package UK HE offers its staff. Like every other aspect of the package we offer, it must be competitive to attract the best staff in a globally competitive market.

Figure 1: Member satisfaction and USS member satisfaction target over time




The USS Trustee needs to be much closer to members and have greater accountability for directly finding and implementing solutions to scheme challenges from a member perspective. Key governance changes that could assist with these objectives include changing the composition of the USS Trustee body to an independent chair with 50:50 employer nominated, and member nominated trustees. The independent trustees currently on the USS board do not have the same connection with the sector and its people as employer and member nominated trustees may. We note that a number of schemes that have not had the same difficulties as the USS have greater representation of employers and members at board level (e.g. RPS or SAUL). A more significant proportion of employer and member nominated trustees on the USS Board would enable change to other aspects of the USS governance, for example the Joint Negotiating Committee (JNC), that provide the USS Trustee with the ability to be more removed from their members. We consider that a significant refresh of the Trustee Board is required on the basis that the scheme deficit has risen so significantly. This could have been avoided to some extent. For example, we have consistently advocated for higher levels of interest rate hedging to be implemented by the Trustee.

We would also like the following matters to be taken forward to improve the governance of the valuation. We ask that the UUK and UCU representatives on the JNC should recommend changes to the scheme rules as recommended by the Joint Expert Panel second report:

1. set up a funding and valuation sub-committee of the Trustee to liaise with the JNC;
2. establish a joint forum between the Trustee and JNC to undertake joint modelling of the valuation assumptions; and
3. create a senior Steering Committee for the valuation comprising employer and member representatives.

Other changes that are needed, which were not recommended by the JEP:

4. undertake a 2021 valuation to restore trust.

5. publish full details of the valuation methodology to allow external stakeholders to reproduce and assess the Trustees' conclusions.

**UUK ALTERNATIVE APPROACH**

15. As part of a solution to the 2020 USS valuation would you support the alternative covenant support package illustrated by UUK *(headlines – moratorium of a minimum of 20-years with debt-monitoring and a pari-passu arrangement for secured borrowing above c15% of gross/net assets)*, to provide a hybrid benefits package at current contribution rates in the order of *(pension accrual of 1/85 of salary [plus 3 times lump sum] up to a salary threshold of £40,000 with the CPI indexation of benefits [for active, deferred and pensioner members] capped at 2.5% per annum, and with DC above the salary threshold at an overall contribution of 20% of salary),* together with a lower cost alternative to address the high opt-out rate, as well as a governance review of the scheme and valuation process?

UUK's proposal is a significant step in the right direction. However: (1) without substantial governance reform and changes to the scheme rules, we do not see how any such proposal would be sustainable in the long term and avoid disputes for future valuations. Governance reform should be a key objective as part of finalising the 2020 or 2021 valuations; (2) Our strong preference remains to seek an agreement with the USS Trustee to maintain the existing benefit structure for the contribution levels already established in the Schedule of Contributions. We believe that this is justifiable; alternatively (3) as a fallback we would be willing to consider alternative strategies for providing cost effect benefits to our staff, such as conditional indexation or alternative covenant support measures in preference to lowering the salary threshold.

---

**Please send your completed form to: pensions@universitiesuk.ac.uk by Monday 24 May 2021**

**Thank you for taking the time to respond to this consultation.**

---

**USSEmployers**

W www.ussemployers.org.uk

E pensions@universitiesuk.ac.ukT

@USSEmployers