

## CONSULTATION ON RECOVERY PLAN AND SCHEDULE OF CONTRIBUTIONS RELATING TO THE 2017 ACTUARIAL VALUATION

## UNIVERSITIES UK RESPONSE

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## Introduction

On 5 December 2018 the USS Trustee wrote to Universities UK (UUK) with a draft Recovery Plan and Schedule of Contributions as part of concluding the 2017 valuation, and in doing so commenced a consultation with employers.

By the time the consultation closed on Friday 11 January 2019, UUK had received 59 responses from USS institutions, representing approximately 79% of the USS active membership.

The responses have been compiled into what UUK believes is the collective view of scheme employers, which proceeds in eight specific areas:

1. The context within which the consultation was undertaken
2. The influence of movements in markets after the valuation date
3. Sustainability of the contributions proposed by the USS Trustee under Rule 76
4. Deficit recovery contributions
5. A limitation on the planned contributions, and an interim schedule of contributions
6. Accounting for pension costs
7. Draft Schedule of Contributions
8. Draft Recovery Plan

### 1. The context within which the consultation was undertaken

UUK recognises that these matters relate specifically to the 2017 actuarial valuation of USS. There have, of course, been a number of subsequent developments, not least the (welcome) decision from the USS Trustee to undertake a further actuarial valuation as at 31 March 2018, in order to be able to take into account the recommendations put forward by the Joint Expert Panel (JEP). Employers have expressed their conditional support for the JEP's recommendations.

UUK supports progressing the 2018 valuation in the hope that it can facilitate an agreed position in line with that proposed by the JEP. There are, however, matters relating to the USS Trustee's proposals for the 2017 valuation on which employers have expressed strong views. These are presented below, so that they can be given full consideration by the USS Trustee in the spirit of the genuine consultation which has been undertaken. Employers are acutely aware that the proposed contribution levels from the 2017 valuation will - absent acceptance by the USS Trustee of an interim schedule of contributions - prevail unless, and until, superseded by agreed outcomes from the 2018 valuation.

## 2. The influence of movements in markets after the valuation date

The USS Trustee has expressed concern around recent market movements, for example in the period from October to December 2018, and UUK understands that this was an influence in the proposals put forward, notably for deficit recovery contributions (DRCs) which are discussed below. A number of employers have commented that while market movements cannot be ignored, they would hope that fluctuations in the funding level after the valuation date are not given too much weight by the Trustee given the enduring nature of the scheme, and of the strong covenant provided to the scheme by employers. In its letter the USS Trustee confirmed it would again review the proposals relating to the Recovery Plan following the close of the consultation, and employers hope this might be an opportunity for this longer-term context to be given appropriate weight over what has been seen by way of recent volatility.

## 3. Sustainability of the contributions proposed by the USS Trustee under Rule 76

In their responses, employers made clear their concerns regarding the sustainability of the proposed contributions for employers and members. The contribution levels proposed from October 2019 onwards would, if implemented, have very significant implications for institutions, with the potential to undermine the long-term financial viability of some employers, and otherwise are likely to result in the scaling back of investment plans, pressures on staffing and adverse impacts upon students.

Many employers also made specific comments about the affordability of the scheme for members at the proposed contribution levels, with potentially very damaging effects on participation levels and on the overall confidence of employees in their workplace pension scheme. Many of these concerns have been expressed to the USS Trustee before, and UUK hopes that members of the Trustee board will take them into account when reviewing the comments that follow on DRCs, and more generally as they finalise the required contributions.

## 4. Deficit recovery contributions

A commonly held view among employers is that the USS Trustee has not provided a clear justification for its decision to propose DRCs of 6% of salary. Employers are not clear how the figure of 6% of salary has been arrived at, and ask the USS Trustee to once again consider the following factors:

1. that asset outperformance in the Recovery Plan was used in the recovery plan which emerged from the 2014 valuation, but not in this valuation
2. the comments from the Joint Expert Panel that it saw no substantive reason why DRCs should be increased from their current level
3. the scale of the declared deficit compared with that seen at the 2014 valuation does not support the proposed DRCs (an increase from £5.3 billion to £7.5 billion, but with a virtual threefold increase in DRCs)
4. the continued strong and enduring nature of the covenant, and the further

endorsement of this standing from the USS Trustee's covenant advisers (for example on the issue of covenant horizon)

These concerns regarding the proposed level of DRCs have been expressed to UUK with considerable strength of feeling, well above that on any of the other issues, and UUK believes it important that this is understood by the members of the Trustee board.

Furthermore, some universities are reporting that less well-paid members of staff are opting out of pensions because the individual contributions are too high, and that they see the punitive rate of DRCs as being an intergenerational wealth tax. UUK would be interested to see any evidence the USS Trustee may have in this regard.

## 5. A limitation on the planned contributions, and an interim schedule of contributions

It is clear from the responses received that employers welcome the 2018 actuarial valuation proposed by the USS Trustee as the means by which the recommendations put forward by the Joint Expert Panel can be taken into account; this remains the primary focus for employers.

Employers also note the importance of concluding the 2017 actuarial valuation, but highlight that it effectively creates a backstop position on the scheme's contribution requirements, which is adding to the current uncertainty for members and employers over what contribution levels will apply over the coming period. In addition, some employers have expressed concern that the completion of the 2017 valuation prior to the 2018 valuation may also raise concerns about whether the JEP recommendations will be taken into account.

There is some support among employers for the suggestion made by UUK's actuarial advisers, Aon, that an interim schedule of contributions should be implemented. This interim schedule would activate the increases due from April 2019, which would apply until the schedule of contributions arising from the 2018 actuarial valuation is implemented. Employers are committed to engaging seriously with the 2018 actuarial valuation, and in turn have expressed the view that agreement to an interim schedule would reflect goodwill on the part of the USS Trustee to achieving an outcome in line with that sought by the stakeholders. Agreeing to an interim schedule of contributions would help the USS Trustee to calm the sense of unease expressed to UUK by some employers that the 2017 valuation will serve to lock down a backstop level of contributions (at the unsustainable higher contribution levels which are proposed). We appreciate that The Pensions Regulator is working on the understanding that the 2017 valuation will be finalised in February, and UUK would be pleased to support the USS Trustee in any engagements with The Pensions Regulator on this topic.

## 6. Accounting for pension costs

Employers are grateful that the USS Trustee has confirmed it is keen to support employers on the implications for them, in accounting terms, of the potential outcomes relating to DRCs. UUK looks forward to seeing further information when it is available. The responses from employers expressed legitimate concerns regarding the potential change in the pensions liability which would need to be formally recognised, and its implications for banking

covenants and the general effect upon the financial stability which can be demonstrated by USS employers. UUK hopes that the USS Trustee understands how crucial this is for institutions, particularly given the criticality of the sign-off date for the 2018 valuation, and more generally the step of faith which employers must take to support the USS Trustee in concluding the 2017 valuation and in backing - on the USS Trustee's suggestion - a 2018 valuation as the route towards a solution which is in line with the recommendations put forward by the JEP.

## 7. Draft Schedule of Contributions

Employers note that in the section entitled 'Other employer contributions' a proposed change has been inserted which refers to employer contributions being those as set out in the USS Trust Deed and Rules, 'or, where not set out, as notified by the Trustee to the Employer.' This text does not appear in the current schedule of contributions. As far as UUK is aware this proposed change has not been explained in recent discussions or indeed in any supporting material, and appears to create a new power which would allow the USS Trustee simply to notify an employer that different contributions are needed (outwith the provisions of the schedule of contributions). We expect that this is not what the USS Trustee has intended, but UUK would welcome an explanation or clarification - and at this stage we should make clear that neither UUK nor employers generally could accept such a proposed change if its purpose was that set out above.

## 8. Draft Recovery Plan

There is a reference on page one of the recovery plan to the 'return on assets' assumption, which references the Statement of Funding Principles (SFP). The USS Trustee consulted on the SFP in September 2017, which set out an assumed 2.1% of salary deficit contribution (allowing for 50% asset outperformance in that recovery plan). UUK assumes that the USS Trustee will wish to update that earlier SFP as it relates to the 2017 valuation, as appropriate.



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