Universities UK

Dame Kate Barker
Chair - USS Trustee
USS Limited
Royal Liver Building
Liverpool
L3 1PY
Sent by email

9 March 2021

Dear Dame Kate

Request for a review of the illustrated outcomes for the 2020 actuarial valuation of USS

Thank you for sharing the materials for the 31 March 2020 actuarial valuation. We are currently working through them in detail and, in this letter, share the first reactions from employers following significant feedback we have received in recent days. We have also enclosed some initial questions in the Appendix.

Let us start by saying that we fully recognise the challenges involved with the 31 March 2020 actuarial valuation. While the scheme may have a reasonable funding position on a “best estimate” basis, we understand that the USS Trustee must adopt a prudent approach by law. Employers recognise that the level of prudence (and hence the size of a deficit) is the decision of the USS Trustee. It is clear that, on the basis of the USS Trustee’s update report and from the Rule 76.1 report itself, reform would be needed to achieve affordable and sustainable contribution levels for scheme members and employers – based on results at 31 March 2020.

Employers are not arguing that the scheme’s status quo can be maintained. We want to work collaboratively with you to consider a revised approach and assumptions that bring the headline costs down and ensure that reform is proportionate, justified, and in the best interests of the scheme members. However, we have not received strong or clear justification for the very high pricing decisions – and, as such, employers are very concerned that the scheme is facing an unnecessary and unjustified level of reform.

Chief Executive
Alistair Jarvis

Universities UK
Woburn House
20 Tavistock Square
London
WC1H 9HQ

telephone
+44 (0)20 7419 4111

twitter
@ universitiesuk

email
info@ universitiesuk.ac.uk

website
www.universitiesuk.ac.uk

The USS is a unique scheme. It is open, supported in a mutual structure by approximately 340 employers, and enjoys a long-term investment strategy that has historically focused on growth assets. As an open scheme with a long-term investment strategy, we know that the funding position can vary materially from one valuation to the next, and the 31 March 2020 valuation comes at an obviously difficult time. In these circumstances, it is important to employers and employees alike that the valuation approach is not an overreaction to a unique set of circumstances.

When considering how much prudence to layer on top of the best estimate position, there is clearly a range of reasonable views that the USS Trustee could adopt. However, there is concern that the position the USS Trustee's has adopted takes very little account of UUK's technical provisions consultation response, and appears to be largely unaffected by the evidence presented in the Valuation Methodology Discussion Forum and the views of UUK and UCU representatives who attended that forum. In consequence, the very high prices for current benefits put forward by the USS Trustee are unaffordable for employers and will risk pricing even more staff out of the scheme, particularly those at early stages of their career, thereby increasing even further the current intergenerational unfairness evident within the scheme. It also undervalues the collective and enduring financial strength of the participating employers.

It was helpful to receive the USS Trustee's high-level illustrations of the benefits that could be provided for current contributions under each of the three scenarios. However, in each case we are concerned that the resulting relatively modest benefits for all the options would fail a 'value for money' test for many employees - leading to even higher opt-outs and the penalisation of younger colleagues, in particular.

We are seeking a review by the USS Trustee of the illustrative outcomes it has presented.

We understand the nature of the legal powers which exist and believe that a request for a review is appropriate before the crucial next steps are progressed on the valuation. Employers need a sound platform for the decisions to be made over the coming period, especially on the basis of the changes needed for the scheme to be affordable and sustainable to all stakeholders, while ensuring that the reform is proportionate and based on a reasonable assessment of the covenant strength. During the review which we ask that you undertake, which we hope and expect could take place ahead of our consultation with employers later this month, we would welcome continued engagement with the USS Trustee, and would wish to offer our constructive support and input – and that of our advisers.

We are also concerned with the USS Trustee's positioning that the valuation outcome is entirely down to the employers. Fundamentally, it is down to the USS Trustee's own decision-making about the price of benefits, and the value it proposes to attribute to additional covenant supporting measures. There is a clear implication that all employers need to do is to provide further covenant support, and that if employers do not provide this then employees need only blame employers.

This is unreasonable on two accounts. Firstly, employers are concerned that the latest approach does not fully take account of the strength of the package of covenant supporting measures put forward collectively on behalf of the 340 employers.

Secondly, in practice there is no clear justification for why the covenant requests have such a material impact on the contributions requested, and the scenarios seem staged to drive employers to provide even more additional support.

We find this pitting of stakeholders against each other to be unhelpful and opportunistic given market conditions at 31 March 2020. Also, many of the covenant support asks would ultimately impact on employees as well as employers (through pay, staff recruitment, funding for research etc.) – and indeed on students, their university experience and the ability to provide the support they need – so, based on a full understanding of the sector, the position is clearly more nuanced than presented.

The Pensions Regulator (TPR)

From the outside looking in, some of the decision-making and process from the USS Trustee looks odd to employers, including the extent of the influence of TPR in this valuation compared with previous valuations. The potential contribution levels being discussed in detail before Christmas were very different from those published following the period of intensive USS Trustee discussions with TPR. These perceptions erode trust in the process and make agreement across the stakeholders harder to achieve. It would be beneficial if the USS Trustee could provide further comfort on the process followed, for stakeholders to have confidence in the results.

We would be keen to discuss with you the impact if guaranteed defined benefit (DB) accrual were to be reduced, whilst maintaining the hybrid structure. It is our understanding that if the amount of DB risk building up over time were reduced, and hence less reliance on covenant (all else being equal) particularly over longer periods, this could suggest an alternative path where the level of prudence is adjusted to reflect the benefit change which would be implemented, making the costs more affordable to employers and members. We understand that the principle of such an approach would be supported by TPR. With some relaxation of assumptions, a solution would be more achievable that allows for current contributions and a continued hybrid benefit structure, supported by a package of additional covenant support, that would be both affordable and meaningful.

In calling on the USS Trustee to review its approach, we also ask that there is a focus on identifying and defining benefit packages (with corresponding assumption choices) that could lead to the current contribution rate being maintained. We would also need to look at different approaches to contributions, as part of a move away from a one-size-fits-all approach, to address the high opt-out rate by junior staff in the lower paygrades, and the intergenerational unfairness this is causing. We would request that the USS Trustee works constructively with UUK and UCU to determine the optimal options which could be achieved.

We would be pleased to discuss this with you and ask that our letter is shared with all members of the USS Trustee Board.

Yours sincerely,

Professor Julia Buckingham CBE
President, Universities UK

Alistair Jarvis
Chief Executive, Universities UK

Professor Adam Tickell
Chair of the Employers Pensions Forum

Cc: Mike Birch, Director of Supervision, The Pensions Regulator

Appendix – Further details

Comments on the Three Scenarios

With Scenario 1:

- Under your high-level illustrations, Scenario 1 would lead (as you indicate) to the end of the hybrid benefit design with members effectively receiving a Defined Contribution (DC) benefit of 11.5% of salary but paying 9.6% of the costs – leading to a mass exodus of members, and the effective end of the USS. The approach represents a material over-reaction to the departure of Trinity College, Cambridge, when there is no evidence other employers wish to depart. The USS Trustee has placed considerable, and we believe wholly disproportionate, weight on this one employer leaving the scheme. Even without covenant enhancing measures we consider that the strength of the sector, as it impacts the covenant of the scheme, continues to be undervalued.

- We note that Mike Birch's letter of 26 February states that they view Scenario 1 as "compliant", with Scenarios 2 and 3 stated to be at the "limit of compliance with legislation". Historically TPR has stated that USS valuation outcomes are at the limit of compliance, so it is revealing that this comment does not apply to Scenario 1. The scenario seems designed to make additional covenant support unavoidable, but we do not believe that the USS Trustee's underlying assumptions are appropriate.

With Scenarios 2 and 3, these are difficult to judge against an overly prudent baseline of Scenario 1, but we are very surprised at the low value ascribed to the UUK package compared with the USS preference. While it is helpful to see high level illustrations of the benefits possible, the degree of prudence adopted by the USS Trustee means that the benefits do not appear credible as a hybrid design for affordable contributions. As with higher member contributions, the level of benefit reform illustrated would likely lead to a much higher opt-out rate - damaging the scheme, denying members a good value pension, and increasing intergenerational unfairness.

Initial questions

We are reviewing the detailed materials, as will the employers, but from our first review we would welcome your responses to the following questions:

(a) Please explain how the updates of the funding positions at 30 June, 30 September and 31 December 2020 have been carried out (approach used to derive assumptions, assumptions, and results). Given the material movements over 2021 to date, please supply an updated funding position e.g. at 28 February 2021. Can the Trustee give the stakeholders assurance that if the funding position improves then it will be open-minded about this?

(b) TPR has provided quite specific guidance on individual valuation parameters. Has TPR provided to the Trustee any evidence for why its views are on the cusp of legal compliance as is claimed? Employers would like to see the evidence to support this legal position.

(c) Can the USS Trustee explain why it has not completed the consultations required by law before issuing an actuarial report under sub-rule 76.1, particularly given the material nature of the recovery plan contributions for this valuation? If it believes it is justified in publishing the report before consultation has taken place, how does it intend to preserve the genuineness of the subsequent consultations?

(d) Why has the USS Trustee seemingly paid very little regard to the detailed responses of employers to the technical provisions consultation? There is, understandably, great concern amongst employers that their views have been dismissed – particularly given the USS Trustee's positioning that the valuation outcome is so largely down to the employers.

(e) If the issue of covenant has emerged as a central point of challenge in the latest discussions between the USS Trustee and TPR, why has the USS Trustee not considered it helpful to speak with UUK on behalf of the scheme sponsors, given the deep knowledge and understanding of university finance which exists within the employer group? Employers can provide significant assistance to the USS Trustee in making the case to TPR for a strong covenant.

(f) There is a worrying concern regarding the exit of one strong employer from USS. We noted the statement from the USS Trustee in December 2020 in which the rationale for the arrangements is largely based upon this one event … "*Assumptions of employers' mutual support and enduring commitment to the Scheme had been constants in the approach to all previous valuations. Prior to Trinity College Cambridge's decision to exit the Scheme, they were taken as read. We now need to evidence them and make them tangible.*" Does the Trustee, with its understanding of the sector, still believe this statement to be true? This unique event seems to be having a disproportionate impact on the USS Trustee's assumptions, with a financial difference in contribution rates of 14.1% of salary, or approximately £1.1bn per annum of contributions, based upon the figures presented.

(g) Bearing in mind that an employer that chooses to exit from USS must pay a section 75 debt (or insurance buy-out debt), can the USS Trustee (i) confirm if it believes it is the case that the insurance buy-out level of funding is insufficient for USS's employers – and indeed does it believe that The Pensions Regulator holds this view too, as appears the case from its backing of the USS Trustee position, and (ii) in what circumstances could an employer be required to make contributions higher than the insurance buy-out amount? The high section 75 debt obligations already in place are a strong measure to prevent employer exit, and in any event provide for the full insurance cost of an employer's liabilities to be secured.