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RESPONSE FROM UNIVERSITIES UK TO ITS CONSULTATION WITH USS EMPLOYERS ON THE RECOMMENDATIONS IN THE JOINT EXPERT PANEL'S SECOND REPORT

28 April 2020

INTRODUCTION

The Joint Expert Panel (JEP) published its second report in December 2019 on the valuation of USS and on related matters of valuation methodology, governance and process. On 23 January 2020 UUK commenced a first phase of consultation with USS employers to invite their views on the JEP's recommendations.

A total of 68 institutions responded to this first consultation, which together employ approximately 83% of the active membership of USS. We are grateful to so many employers for taking the time to respond, and for providing such useful comments and views. The following sets out further details regarding the responses to each of UUK's consultation questions.

SECTION ONE: SCHEME PURPOSE STATEMENT AND VALUATION PRINCIPLES

Q1: WHAT ARE YOUR VIEWS ON THE INTRODUCTION OF A SCHEME PURPOSE STATEMENT, AND DO YOU AGREE THAT SUCH A STATEMENT CAN BE USEFUL?

65 out of 66 responding employers (98.4%) support the proposal to introduce a scheme purpose statement. These employers represent 82.7% of the total active membership, and 99.7% of responding active membership.

Some respondents (19) suggested amending the purpose statement to specifically include "long-term sustainability" and "affordability" as key components. A small number of employers wished to emphasise the role of trust, and of the need for a shared understanding amongst the stakeholders.

RESPONSE AND NEXT STEPS:

The Tripartite Group, established following the publication of the JEP2 report, issued a proposed scheme purpose statement of "To provide a financially secure future and retirement for scheme members and their families, and support the long-term needs of the HE sector." We believe that this is a helpful statement, and encapsulates the vast majority of the content proposed by employers. The issue of sustainability is one that the Tripartite Group has now considered more substantively, and has produced a definition which incorporates affordability.¹

¹ <https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/A-definition-of-sustainability.pdf>

Q2: DO YOU BELIEVE IT HELPFUL TO SET OUT VALUATION PRINCIPLES, AND WHAT ARE YOUR VIEWS ON THE PRINCIPLES AS PROPOSED BY THE JEP?

Q3: DO YOU HAVE ANY FURTHER COMMENTS ON VALUATION PRINCIPLES OR THE JEP2 REPORT'S SECTION 6?

A total of 65 out of 66 responding employers (98.4%) expressed support for the development of valuation principles, and indeed for the specific principles proposed by the JEP in its second report (representing 81.9% of the total active membership and 98.6% of responding active membership).

A large proportion of respondents mentioned the importance of embedding “long-term sustainability” of the scheme in the principles. Respondents also mentioned the following in relation to Q3:

- stressed the importance of a clear methodology for the valuation;
- mentioned that the principles are very “high level” and that more details are needed on how they would work in practice;
- said that the role of the JNC should be explained in greater detail
- mentioned that this process of specifying the principles in further detail may lead to uncovering further work and thus to longer timescales, and
- thought it might be helpful to share and agree on the principles with the Pensions Regulator.

RESPONSE AND NEXT STEPS:

The proposed valuation principles published by the Tripartite Group appear reasonable to employers, but it is clear that the issue of sustainability is at the forefront of employers’ minds. The issue of sustainability is one that the Tripartite Group has now considered more substantively, and has produced a definition which incorporates affordability.² Many of the other points raised by employers will be picked up in other workstreams, for example better clarity regarding the JNC’s role.

² <https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/A-definition-of-sustainability.pdf>

SECTION TWO: VALUATION GOVERNANCE

Q4: DO YOU BELIEVE THAT THE SCOPE OF THE AREAS OF GOVERNANCE CONSIDERED HAS BEEN APPROPRIATE, AND IF NOT WHICH ADDITIONAL AREAS DO YOU BELIEVE WOULD BE HELPFUL TO BE REVIEWED?

A total of 53 out of 62 employer respondents (corresponding to 85.4% of respondents, 73.8% of the total active membership, 86.3% of the active responding membership) stated that the scope of the areas of governance considered was fully appropriate. Nine respondents had more nuanced views, challenging some of the areas of scope, or emphasising others; many of these views focused on the USS trustee and issues of its accountability, and the appointment of its directors.

Q5: WHAT ARE YOUR VIEWS ON THE SPECIFIC RECOMMENDATIONS AS THEY APPLY TO THE TRUSTEE BOARD, TO THE JNC, TO UUK AND TO UCU?

The near totality of respondents was highly supportive of the specific recommendations. Although some respondents added further areas for considerations, all the current proposals were positively welcomed by nearly all respondents.

With regard to the lines of responsibility between the trustee and the JNC, and their individual effectiveness, it is clear that some employers believe that the JNC is currently not fully functioning and that it needs to receive greater support in order to better perform its role. The issue of JNC funding is recognised as difficult; while some respondents welcomed an increase of funding for the JNC, others noted that raising additional funds could be a concern.

To echo earlier comments, some respondents mentioned that the role of JNC is currently quite confusing and should be clarified for all stakeholders.

In relation to the USS trustee, there was strong agreement from employers that trust is a key issue and that trust in the trustee board has been shaken in recent times, due in part at least to the board directors being perceived as remote and their messages being mediated by the USS executive.

On the future role of UUK, many employers commented on the potential simplicity and alignment (with issues of pensions and pay as part of total reward) of transferring responsibility to UCEA. That said, employers also commented in their responses that UUK's work on pensions has been effective, and that they welcomed a review which was broad in nature given the complexities of the role.

With regard to UCU's role as the member representative body, employers supported a review of the role recognising the considerable proportion of scheme members who currently are not members of UCU (either by choice, or because they are not eligible to be so) and who therefore have no means of representation. Some respondents noted that additional resources might be required as well as careful consideration of how this could be achieved (for example focus groups, surveys etc.).

Some employer respondents noted that there needs to be a clear resolution process for when the JNC cannot reach a mutually acceptable agreement. That said, there are questions about the current JNC Chair's casting vote option, with most respondents seeking a review of this particular decision-making mechanism. Generally speaking, respondents did not believe that the option raised by the JEP that independent mediation be introduced would be acceptable, not least that it would be likely to prolong decision-making.

On the issue of a valuation sub-committee, there was strong agreement that the establishment of such a sub-committee - with strong links to the JNC - would improve the valuation process. Respondents emphasised the importance of establishing a clear valuation methodology in relatively swift timeframes.

Q6: DO YOU HAVE ANY ADDITIONAL COMMENTS ON VALUATION GOVERNANCE OR THE JEP2 REPORT'S SECTION 7

Respondents emphasised that the relationship between the USS trustee board, UUK and UCU needed to improve, and that better scheme communication - issued on a joint and collective basis - was a key part in achieving this. This included improved transparency, for example by making datasets available to model potential outcomes for the scheme.

More generally, employers expressed a strong focus on the need to deliver change swiftly, overcoming disputes, to ensure the long-term sustainability of the scheme.

RESPONSE AND NEXT STEPS:

A JNC effectiveness group (JNCEG) has been created by UUK and UCU following initial discussions on these issues within the Tripartite Group. The JNCEG, attended also by members of the USS executive, will consider the issues raised by employers in their responses - and recommendations from the JNCEG will be considered by the Tripartite Group, and reported more widely as quickly as possible.

SECTION THREE: ALTERNATIVE PATHS TO THE VALUATION

This section was split into four separate questions, and the summary responses of employers are set out below.

Q7: WHAT ARE YOUR VIEWS ON THE OUTLOOK FOR THE SCHEME BEING THAT IT IS AN ONGOING SCHEME, AND ALSO THE VARIOUS REFERENCES BY THE JEP TO IT STAYING OPEN?

Out of 62 respondents to this question, 51 employers expressed clear support for the scheme remaining open. These represent 82% of respondents, 70.4% of the overall active membership and 85% of the responding membership.

A total of 11 respondents stated that they supported exploring different options (which included additional flexibility for members, support for smaller participating employers etc.) or that [two employers] they were not in favour of the scheme remaining open; the shared concern among all these respondents was that keeping the scheme open may not be compatible with its long-term financial sustainability.

Q8: IN RELATION TO RISK APPETITE, WHAT WOULD EMPLOYERS FIND HELPFUL IN ORDER FOR THEM TO BETTER UNDERSTAND THE RISK AND REWARD TRADE-OFFS IN USS?

Most respondents stated that they would welcome further analysis on the level of risk, and that this should be presented clearly and concisely. The responses highlighted a widely felt need to understand more about short- and long-term risks, and the trade-offs between taking different positions on risk.

Most respondents supported the JEP's recommendation that members and their representatives should have input into discussions on how much risk is taken and how risk is shared. A small proportion of employers were significantly risk averse. Overall, respondents focused on the importance of communicating around risks effectively and transparently.

Responses to these questions also included mention of:

- the need for training / education on risk appetite and risk evaluation;
- analysis of both short and long-term risk and their consequences;
- quantitative estimates of the probability of scheme default and the probability of further increases in deficit recovery contributions and future service rate under different funding strategies;

- analyses of different reward options;
- benchmarking with risk in other schemes, and
- including demographic factors in risk calculations.

Q9: DO YOU AGREE THAT THE JEP'S PROPOSALS REGARDING A DUAL DISCOUNT RATE APPROACH WARRANTS FURTHER ANALYSIS AND EXAMINATION?

Q10: DO YOU HAVE ANY ADDITIONAL COMMENTS ON POTENTIAL APPROACHES TO THE 2020 AND FUTURE VALUATIONS OR THE JEP2 REPORT'S SECTION 8?

The near totality of respondents to the question (98.4% of respondents; 97.2% of responding active membership; 80.6% of total active membership) supported the exploration of a dual discount rate approach.

The responses from employers also mentioned the following points:

- the focus should be on providing value for money for members and employers;
- there is a clear need for long-term sustainability;
- liabilities should continue to be calculated on a self-sufficient basis, as a helpful reference point;
- it is important to understand how the requirements of the Pensions Regulator may affect outcomes of the valuation;
- a longer recovery plan should be considered for an open long-term scheme with the covenant characteristics of the USS employers;

RESPONSE AND NEXT STEPS:

Many of these points are being taken forward by the Valuation Methodology Working Group, and all of the above points will be brought to its attention. The VMDF is the joint UCU, USS and UUK group, and its work, including its statistical modelling and options analysis, will be taken forward by the USS trustee in its formal consultation on technical provisions and related issues (which is planned for June/July 2020, but subject to the USS trustee's evolving timeline).

SECTION FOUR: TAKING ACCOUNT OF THE NEEDS OF MEMBERS

(note that many employers linked their responses to the questions in this section four, considering that the issues are very much inter-linked)

Q11: ARE YOU CONCERNED WITH THE LEVEL OF OPTING-OUT OF USS, AND IF SO WHAT DO YOU BELIEVE THE PRINCIPAL REASONS FOR IT ARE?

A total of 54 respondents out of 64 (84% of respondents; 73.4% of the total active membership; 88.6% of the responding membership) were directly concerned about the member opting out levels. It is worth mentioning that even those respondents which were not directly concerned by the level of opting out could identify reasons behind the opting out that was taking place.

Employer respondents identified lack of affordability for both low- and high-earners as the chief reason for opting out. For the former, costs of housing (particularly in London) and greater financial burdens, such as repayment of student debt, were put forward as they key reasons for the scheme being increasingly unaffordable for lower-earning staff.

Other potential reasons mentioned for opting out include high earners and the impact of pensions tax, more generally a sense of diminishing value for money, and a lack of portability of the scheme for EU / overseas staff and staff on short-term contracts. Also mentioned, but less frequently, was a lack of understanding of the scheme structure and lack of trust in the USS trustee and as a scheme by members.

Q12: DO YOU SUPPORT THE RECOMMENDATION THAT FURTHER ANALYSIS IS UNDERTAKEN ON THE OPTION OF TIERED MEMBER CONTRIBUTIONS?

60 out of 64 respondents to this question (93.8% of respondents; 95.3% of active responding membership; 78.3% of active membership) supported the initial exploration of tiered member contribution options. In conjunction with this, employers would in parallel wish to investigate lower cost saving options, with both initiatives focussed on mid to low earners (see below).

Q13: DO YOU SUPPORT THE RECOMMENDATION THAT FURTHER ANALYSIS IS UNDERTAKEN ON FLEXIBLE OPTIONS FOR MEMBERS, FOR EXAMPLE LOWER COST SAVING OPTIONS?

62 out of 64 respondents to this question (96.9% of respondents; 82.1% of active membership; 100% of the responding membership) favoured the exploration of, and indeed many stated the need for, options in order to increase the flexibility within the scheme, and for example tackle the high rate of opting out. A 50:50 scheme, similar to that within the Local Government Pension Scheme, was an option mentioned by several respondents, as well as a DC only option.

Q14: DO YOU HAVE ANY ADDITIONAL COMMENTS ON THE NEEDS OF USS MEMBERS OR THE JEP2 REPORT'S SECTION 9?

In addition to the above points, respondents mentioned that options should be explored to reduce opting out from international staff. It was stressed that these flexibility options should progress relatively quickly and, if applicable, ideally alongside the timeframe for the 2020 valuation.

RESPONSE AND NEXT STEPS:

These were very helpful responses from employers, which provide backing for UUK to investigate these options, to discuss them with UCU, and to bring potential options back to employers for consideration. This work will be picked up by the UUK team and by the Employers Pensions Forum, in the first instance.

SECTION FIVE: MUTUALITY

Q15: DO YOU SUPPORT THE VIEW EXPRESSED BY THE JEP ON THE ISSUE OF MUTUALITY WITHIN USS?

Q16: DO YOU HAVE ANY ADDITIONAL COMMENTS ON MUTUALITY WITHIN THE SCHEME OR THE JEP2 REPORT'S SECTION 10?

There was no consensus view amongst employers on mutuality. Eight out of 61 respondents did not support mutuality or claimed to support it only as long as it did not endanger the sustainability of the scheme. On the other hand, those who supported mutuality tended to strongly endorse it, and to highlight the dangers of sectionalisation for the long-term sustainability of the scheme and noting that mutuality had allowed USS to better endure challenges over time. Institutions representing 66.4% of the total active membership supported mutuality, whilst institutions representing 16.6% of the total active membership had a more nuanced view on mutuality (but were not opposed to it).

RESPONSE AND NEXT STEPS:

The share of responses on the issue of mutuality will be considered by the Employers Pensions Forum, and this issue will then be taken forward by the UUK team as it develops overall options for consideration by employers.

SECTION SIX: ANY OTHER COMMENTS

Q17:

ARE THERE ANY OTHER ISSUES THAT YOU WOULD LIKE TO SEE CONSIDERED TO INFORM THE APPROACH TO THE 2020 AND FUTURE VALUATIONS?

There were no clear trends in the responses to this question. Some of the responses to this question included greater disclosure of investment performance data, increasing the focus on inter-generational fairness, placing a greater emphasis on a sustainable long-term future for USS, and on being more responsive and cutting the timescales within which decisions can be made.

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