USSEmployers

Q&As on UUK's consultation on the 2020 valuation

April 2021

This Q&A is intended to help employers answer questions that they receive about Universities UK's (UUK) consultation on the 2020 USS valuation. If there are any other matters or questions that you would like answered or further information, please email pensions@universitiesuk.ac.uk.

21. Is it likely that many more scheme members may turn their backs on the scheme at the prospect of even higher contribution levels?
22. What do you say about claims that a pessimistic view of investment returns by USS is unduly affecting the valuation?
23. Do you agree that the current USS scheme promotes inequality between different generations of staff?
24. How will UUK assess and weight the responses to this consultation?
25. What are the next steps with the valuation?

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1. Why is UUK consulting on changing the scheme when it has expressed concern at the figures put forward by the USS Trustee?

Universities UK (UUK) continues to press USS and The Pensions Regulator on the assumptions made on the 2020 valuation so far – we believe the USS Trustee has room for manoeuvre to lower its pricing to minimise the extent of the changes needed to the scheme. We also raised a series of specific questions on which we will need convincing responses. The USS Trustee has responded to our request in a letter dated 29 March 2021, which is still being considered, and constructive discussions continue. While these discussions continue, UUK is proposing an alternative path for the valuation in this consultation which would reduce the headline costs put forward by USS and give scheme members the best possible level of benefits for more affordable contributions. The way forward that we are consulting on requires the USS Trustee to review and revise their assumptions to a fairer position as employers have requested.

2. Do employers have confidence in the USS Trustee?

We appreciate this is a complex area, that the USS Trustee has difficult decisions to take and often comes under competing pressure from scheme members, the University and College Union (UCU), individual employers, UUK, and The Pensions Regulator. We should also recognise that the USS Trustee board includes seven directors (out of 12 directors overall) appointed by the stakeholder bodies (four by UUK, and three by UCU). We continue to question and challenge the USS Trustee's current interpretation of specific technical matters related to covenant strength and pricing, and not the suitability of individual trustees. The feedback we are receiving from employers is that certain aspects of the scheme governance are unhelpful, in terms of the USS Trustee and stakeholders being able to jointly discuss potential scheme solutions following a valuation, and also on the overall balance of powers within the scheme and the process of consultation. As part of this consultation, we are therefore asking employers whether they would support a review of the USS governance arrangements.

3. Do employers have the ability to change the governance of USS?

Any changes to scheme governance would need to be very carefully considered, not least to ensure consistency with UK pensions law; there is no unilateral power for the employers to change the governance of USS. It is expected that any review of USS governance would be a collaborative project, involving stakeholder bodies and of course the USS Trustee itself. Any governance review would also require input from independent experts, including legal advice.

4. Why did the USS Trustee not delay the valuation as the timing of March 2020 coincided with a particularly difficult economic climate?

The USS Trustee promised to be flexible with the valuation timeline to reflect on developments in the financial markets and the university sector but that 'proceeding with the valuation was the best way (of) responding to the current circumstances and the adverse funding position as it allows for a full review of the issues'. Now the USS Trustee is carrying out the valuation, the longer-term view of investment returns and specific developments since March 2020, including the substantial recovery in asset values, need to be fully factored-in to the final valuation outcome. Before the valuation is completed employers expect the USS Trustee to factor in any market improvements post-valuation date.

5. Are you calling for a delay to the scheduled October 2021 contribution increases?

Given the delay in receiving the USS Trustee's pricing decisions, it is now a very challenging timeline. If if all those involved work together it should be possible to find a solution before October. This might provide the USS Trustee with good reason to consider a revised schedule of contributions to allow the remaining formalities of the valuation to be concluded (such as the recovery plan consultation) and which would remove the need for the contribution increases already scheduled for October 2021. If a solution isn't found by then, or if sufficient progress isn't made, there is not just the prospect of the October 2021 increases (from the 2020 valuation) but also the USS Trustee could impose the even higher levels of contributions set out in its update report (USS Trustee's update report, 3/3/21).

6. Has the USS Trustee changed the methodology used for this valuation?

Since the start of 2020, representatives from USS, the UCU, and employers have been working closely together to update the approach to the valuation. This led to the development of high-level shared valuation principles and, for example, the replacement of the 'Test 1' measure of risk appetite from the valuation methodology – a real bone of contention in previous valuations – and also with a Dual Discount Rate, both of which have been welcomed by both UCU and employers.

7. Will you ask the Joint Expert Panel (JEP) to look at the issues of disagreement?

We have no plans to do so. The Joint Expert Panel concluded its helpful work in late 2019. The views set out by the JEP in its reports continue to be helpful in informing the ongoing debate about the financial sustainability of the USS pension scheme, however the panel's views are advisory and independent to the formal valuation process. The USS Trustee has the legal responsibility for the valuation and protecting the financial stability of the scheme.

8. Do you think the JEP would find a scheme deficit?

The JEP's first report highlighted the scheme had a deficit and using the same approach with this valuation would also find a sizable scheme deficit. Our actuarial advice is that it should be possible to price current benefits in the mid-to-high 30s% of salary using the approach recommended by the JEP, which is around the level of contributions the USS Trustee initially suggested to us was feasible (before the strengthening of the USS Trustee's views, alongside The Pensions Regulator's interventions, earlier this year). We believe that the USS Trustee is currently undervaluing the collective and enduring financial strength of the 340 employers participating in the scheme, which includes some of the world's leading universities.

9. Why is the USS Trustee asking for extra covenant support measures?

At the close of the 2018 valuation, the USS Trustee raised concerns about Trinity College Cambridge's decision to buy-out of the scheme. For reasons that we do not yet understand, the USS Trustee has placed considerable weight on this one employer leaving the scheme although we know of no other employer looking to exit the scheme, and in practice, the vast majority of employers (and all of the largest universities) could not afford to buy-out of the scheme because the costs of exit are so high.

10. Why is the USS Trustee not satisfied with the alternative covenant support measures illustrated by UUK?

USS has not yet provided clear or strong justification for why it has placed such a poor value on the covenant support package previously illustrated by UUK. This was developed fully in-line with the requirements set out by the USS Trustee, drawing on expert actuarial advice, to safeguard against employer exits and rising debt levels (despite the belief that these risks are being disproportionately assessed) and should allow the 2020 valuation to be concluded on the basis of a strong covenant. We are now consulting with employers on going even further on covenant support including a 20-year moratorium on exits to demonstrate even further our wish to find a solution.

11. Why can't current benefits be offered for current contribution levels? Can we not just keep the status quo?

In the valuation the USS Trustee is assessing the scheme's assets and liabilities to ensure it has sufficient funds to pay promised benefits, and also that contributions into the scheme cover the cost of benefits that might be promised in future. This valuation has revealed a further worsening of the scheme's funding position – a sizeable deficit – which means additional contributions would be necessary to fund the benefits that have been accrued and to get the scheme funding back on track – this is the USS Trustee's primary duty under the law. The cost of future pension promises has also risen. The combination of these two elements means that current benefits cannot be met by current contributions within the regulations, which are in place to protect members. The fact that the scheme has a sizeable deficit is confirmed by the USS actuary, the actuaries working for employers and is a view supported by The Pensions Regulator.

12. Why can't employers just pay higher contributions to retain current benefits?

There has been a c50% rise in the rate of employer contributions into the scheme over the last decade (from 14% to 21.1% of salary). Recent feedback from many employers and scheme members is that current contributions levels are at the limit of what they can afford. For universities paying a higher rate would mean diverting money from other budgets, with consequences for jobs, teaching, and the student experience. Finances at many universities are already under considerable strain from the consequences of the Covid-19 pandemic, student funding levels have fallen in recent years when taking account of inflation, and there is ongoing uncertainty about future levels of tuition fee income in England. As part of this consultation, UUK is formally asking employers about the maximum affordable contribution rate.

13. Employers need to show higher education staff that their commitment to USS is serious by working with UCU and USS on covenant support measures, are they going to do so?

While we still have concerns over the justification and rationale for the covenant support measures demanded, the USS Trustee seems prepared to impose damaging contribution requirements despite their impact on members and employers if the covenant support measures are not forthcoming. In such circumstances, there appears little alternative but for employers to avert what would be lasting damage to the scheme by considering going even further than previously illustrated by UUK. In this consultation, we are therefore proposing that employers consider an even stronger package of covenant support measures including a 20-year moratorium on employer exits without the USS Trustee's consent. If this package of measures is acceptable to employers, there should be no reason why the 2020 valuation cannot be concluded on the basis of a strong covenant with resultant lowering of contribution requirements (and a reduction in the level of benefit reform required).

14. Could employers pledge contingent assets to support a stronger covenant?

We are asking employers again about covenant support options as part of this consultation. The USS is a multi-employer scheme with over 340 participating employers and where there is a full cross-subsidy among employers. Some employers might be able to pledge assets, but many have suggested they cannot –

either because they don't have assets to pledge or have financial or legal restrictions upon their assets so they cannot pledge them generally to the scheme. Pledging assets would also have knock-on effects; in a multi-employer scheme like USS (which is non-sectionalised) it is very challenging to ask some employers to pledge assets, for the benefit not just of themselves but of the other employers too, when others cannot. This would undermine the mutual nature of the scheme.

15. Doesn't UUK now need to step up the pressure on USS to change its approach?

UUK continues to apply significant pressure on USS in public and in regular meetings. Our recent request to the USS Trustee and The Pensions Regulator to review the approach to the valuation was published, asking them to revise their assumptions and seeking much clearer justification for the higher level of contributions proposed. This built on the evidence and arguments outlined in UUK's response to the USS Trustee's Technical Provisions consultation. We are still digesting the formal response from the USS Trustee dated 29 March 2021, however the most important thing is that constructive dialogue continues to try to reach an acceptable solution. UUK will consider all governance options to ensure that the USS Trustee applies fair assumptions to the valuation.

16. Do the projected increases in the pricing of current benefits take account of any further decline in the drop-out rate?

We are not aware that the USS Trustee has factored-in an increase in the opt-out rate, at least at this stage, although they would undoubtedly keep this under review if indeed the higher contributions are implemented. The USS Trustee has revised downwards its assumptions for growth in the USS payroll (the total salaries of all active USS members), but states that this is based upon the USS Trustee having 'considered UUK's response and taken further advice from our covenant advisors PwC, other advisors, and the Scheme Actuary'. [p11 of the USS Trustee's update report, 3/3/21]

17. Do the latest figures from USS take account of the increased mortality rate since March last year causes by Covid-19?

The USS Trustee has undertaken a general update to the mortality assumption as a normal part of the valuation process, looking at longer-term (non-Covid) trends, and this has resulted in a slight easing of the overall mortality assumptions (which has led to a relatively small improvement in the funding position, and a lower cost of future service benefits). So that's good news from a funding perspective. However, the USS Trustee has also stated that it is too soon to form any views on the longer-term effect of the pandemic on mortality assumptions, stating 'Whilst high-level statistics indicate that there were more member deaths than usual in 2020, the number of excess deaths compared to recent years is around 200 and is, so far, not significant enough to materially impact the financial position of the Scheme'. [USS Trustee's update report, p9]

18. How will future contributions be split between employers and scheme members and agreed?

Regular discussions are taking place between USS, UCU, representing members of staff in the scheme, and UUK, representing all 340 employers. After the current consultation has closed, the University and College Union (UCU) and Universities UK (UUK) will meet through the Joint Negotiating Committee (JNC) to decide how to meet the challenges posed by the valuation including the future benefits offered by the scheme and the level of contributions made by employers and members. There are rules which apply in default to how any increases in costs shall be shared between members and employers, should the JNC not decide otherwise. You should note that pensions built up to date cannot be changed, it is only the future of the scheme which can change.

19. Why are universities in the Teachers' Pension Scheme (TPS) paying in more than employers in USS?

There are fundamental differences in the rules, regulations and governance of the two schemes with TPS funded by government (on what is referred to as a 'pay as you go' basis, albeit with notional valuations) and USS not. The government sets the contribution levels for TPS, and while universities lobbied strongly against the higher rates, they were imposed and universities, unlike schools, did not receive additional funding to meet the increased costs and have had to find the additional money from within existing budgets, which hasn't been easy and led to many making difficult decisions with some publicly linking the higher TPS costs to redundancy exercises.

20. Is there a risk of the USS scheme running out of money?

The USS Trustee is responsible for the financial viability of the scheme and making sure that the benefits promised to USS pensioners can be paid. The USS Trustee's decision making is overseen by The Pensions Regulator. We have no doubt that the USS Trustee is carrying out this duty effectively.

21. Is it likely that many more scheme members will turn their backs on the scheme at the prospect of even higher contribution levels?

Yes, this is possible. That is why in the coming months, the USS Trustee, UUK and UCU must collectively explore every possible avenue to tackle the deficit and consider ways of making the scheme more appealing and inclusive for the long run. UUK's consultation aims to stimulate debate on these issues and we would like the whole university community to engage with employers on the various options for change.

22. What do you say about claims that a pessimistic view of investment returns by the USS Trustee is unduly affecting the valuation?

As part of the valuation, the USS Trustee sets the level of investment returns it expects to receive in the future so that it can pay all of the members' benefits which have been earned. This involves trying to predict how financial markets might perform in the future, over time. Expected returns can be highly uncertain and, in general, historical returns are a very poor forecast of future returns. Of course, assessing future investment performance is only one part of the equation for a valuation, but it is an important one. By law, the USS Trustee must take a prudent approach to ensure that the scheme does not run out of money. In this blog, however, USS states that its modelling is currently 'somewhat more optimistic' than other professional forecasts on the extent to which future asset returns will outperform liabilities.

23. Do you agree that the current USS scheme promotes inequality between different generations of staff?

We agree there is some intergenerational unfairness within USS, as there is within most DB pension schemes. In USS a proportion of the payments made by employees and employers today and in the future go towards paying off the deficit and therefore to ensuring that the pensions promised in the past can be paid by the scheme. The high member contribution rate – 9.6% of salary – is pricing many early career staff out of the scheme and leaving them without pension provision. As part of this consultation, we outline possible options for changing the scheme to make it more inclusive.

24. How will UUK assess and weight the responses to this consultation?

UUK's consultation is with employers, however they are being urged to consult all eligible staff on the issues raised and factor in their views in the employer responses to UUK. UUK will then assess the consultation responses and look at the numbers of employers taking various positions and also weight this by the number of scheme members each employer has.

25. What are the next steps with the valuation?

UUK's consultation will close on 24 May and UUK will reflect the views expressed in the consultation and these will be taken forward at the Joint Negotiating Committee (JNC) so that it can decide, with representatives of UCU, how to meet the challenges posed by the valuation (and these decisions will include on the future benefits offered by the scheme and the level of contributions made by employers and members).