**Universities Superannuation Scheme**
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# Trustee proposal to finalise the 31 March 2017 valuation

**Introduction**

The USS Trustee has announced that it is carrying out a new valuation at 31 March 2018. This new valuation will address the recommendations of the Joint Expert Panel, and the consultation is expected to commence in a matter of weeks. In the meantime, the Trustee wishes to consult with UUK on finalising the 31 March 2017 valuation.

In our view:

- Calling a 2018 valuation is a reasonable approach to consider the JEP recommendations.
- We agree that the 2017 valuation must be finalised.
- The Trustee is proposing to complete the 2017 valuation on the Rule 76 approach adopted when consulting with members and their representatives.
- Some may question the merits of supporting what is effectively a "backstop" position with the 2017 valuation, with materially higher contributions than recommended by the JEP, that would apply from 1 October 2019 if the 2018 valuation is not resolved satisfactorily by then. This could create uncertainty for employers and members, and there may be accounting consequence for reasons we explain if the 2018 valuation is not agreed promptly.
- Further information will likely be available on the 2018 valuation ahead of the 11 January closing of this consultation, which may give employers more comfort in the proposed approach.

In this note we set our views in more detail, and we explain an alternative approach.

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**A new valuation – 31 March 2018**

The JEP believed that its Phase 1 recommendations could be applied to the 2017 valuation: *"The Panel does not underestimate the practicalities of concluding an actuarial valuation so long after the valuation date. Nonetheless the Panel believes it would be in the public interest if all the stakeholders, including TPR, could find way forward to implementing our recommendations within the 2017 valuation."*

The Trustee proposes a different approach – i.e. to finalise the 2017 based on the Rule 76 consultation – with a fresh valuation at March 2018 used to consider the JEP recommendations.




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We have expressed to the Trustee the indicative support of employers for the adoption of the JEP recommendations, but nevertheless recognise that the Trustee's approach – with both a 2017 and a 2018 valuation – is a practical way to consider Phase 1 of the JEP recommendations. The Scheme Actuary can take on board more recent information for the calculation, and a new valuation may help to reset discussions. However, employers and members should be comfortable that a two-valuation approach would leave them in no worse a position as had the JEP recommendations been adopted for the 2017 valuation. The stakeholders will also need to decide how to interpret the JEP recommendations for a 2018 valuation.

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## 2017 valuation – what's being consulted on?

Unfortunately, the 2017 valuation cannot simply be set aside. It still needs to be completed, and the statutory deadline of 30 June 2018 (15 months after the valuation date) has already passed.

The Trustee proposes to finalise the valuation and submit this to TPR in February 2019, a timeline we understand the Trustee has agreed with TPR. The Trustee proposes to finalise the valuation under the Rule 76 contribution proposal, on which it has consulted already (through employers) with affected employees and their representatives. To do this, the Trustee is formally consulting with UUK on the remaining valuation documents – the Schedule of Contributions and the Recovery Plan – which together set out the contributions to be paid by employers and members. We set out our drafting comments on these documents in the Appendix.

The headline contributions being proposed are summarised below:

| Period | Proposed employer contribution | Proposed member contribution | Proposed total |
|---|---|---|---|
| Date of signing to 31 March 2019 | **18%** | 8% | 26% |
| 1 April 2019 to 30 September 2019 | **19.5%** | 8.8% | 28.3% |
| 1 October 2019 to 31 March 2020 | **22.5%** | 10.4% | 32.9% |
| 1 April 2020 to 31 March 2034 | **24.9%** | 11.7% | 36.6% |

The rationale for the proposed contributions is we understand as follows.

**1 April 2019 increase.** The Trustee aims to collect the cost of future service benefits (minus the 1% DC employer match) under the Rule 76 approach over the year beginning 1 April 2019, with no allowance for deficit contributions. This would require total contributions of 30.6% of pay over the year, but the Trustee is phasing this in over two 6-month periods. From 1 April 2019 the proposal is for a total cost of 28.3%.

**1 October 2019 increase.** Under the Rule 76 approach, the contributions requested for the second 6-month period are 32.9% of pay (since (28.3+32.9)/2=30.6). The JEP report recommends that the steep contribution increase should be avoided; this is one of UUK's primary objectives.

**1 April 2020 increase.** The proposed annual rate from 2020 increases to 36.6% of pay. This corresponds to the proposed deficit contribution of 6%, on top of the future service cost of 30.6%.

The proposal is to address the deficit by contributions of 6% of pay over 14 years from 1 April 2020. Unlike the 2014 valuation, no allowance is made for expected asset outperformance (in excess of the prudent discount rate) to help address the deficit. The Trustee proposes to revisit the allowance for asset outperformance in January, potentially resulting in a slight reduction in proposed deficit contributions depending on market conditions in the New Year.

By law, the contributions set out in the Schedule of Contribution can either be based on either the position at the valuation date, or at the date of signing the schedule. The USS has used the valuation date approach in the past (which is more typical, and avoids the goalposts moving during discussions), and this is how the Scheme Actuary’s certificate is currently drafted. We are not convinced of the merits of changing the approach so that deficit contributions are based on conditions at the end of the valuation process, as this would mean that stakeholders would generally not have clarity on the costs until the last moment.

UUK, based on feedback from employers, had supported a deficit contribution figure of 2.1% of pay in its response to the September 2017 consultation by the Trustee. The JEP also arrived at 2.1% (as part of a 2017 valuation) based on the expected asset outperformance over the recovery period being shared as for the 2014 valuation. Given these two stakes in the ground, employers do not wish to move higher than 2.1% for the 2017 valuation.

If 2.1% were adopted, then the total contribution rate from April 2020 would be 32.7%, similar to the proposed Rule 76 rate from 1 October 2019. We believe 2.1% of pay would be credible because:

- The recovery plan assumptions need only be “appropriate” (unlike the Technical Provisions assumptions which must overall be “prudent”).
- For the 2014 valuation, the Trustee was comfortable sharing the estimated asset outperformance between the Scheme, and employers/employees.
- Adopting a similar approach for the 2017 valuation could lead to a deficit contribution of under 2.1% (as set out in Annex 10 of the JEP Report).

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**Backstop concerns**

Our main concern (at time of writing) is the merits of supporting a “backstop” position that ignores the JEP, along with the public perception issue of being seen to ignore the JEP (if the 2017 valuation is completed long before the 2018 valuation).

The 2017 valuation may be completed by February 2019. But the 2018 valuation is unlikely to be concluded before June 2019 – so members and employers would be exposed to a period of uncertainty about what contributions are payable from 1 October 2019. This may cause planning issues (and distress) to employers and members, as well as creating pressure to agree to a position for the 2018 valuation.

There may also be accounting consequences. The Trustee intends to provide further supporting information to employers on the accounting consequences of the 2017 valuation. If the 2018 valuation is not concluded before the next accounting year-end (i.e. 31 July 2019, for many), then employers may need to recognise a higher liability on their balance sheet based on the 2017 valuation if a new, replacement valuation has not been signed off.

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**Alternative approach – Interim schedule to implement April 2019 increase only**

We understand that the Trustee has advised TPR that it will finalise the 2017 valuation by February 2019. However, subject to notifying TPR and considering any feedback, the Trustee could delay the formal sign-off of the 2017 valuation until the 2018 valuation is agreed. Any contributions required as part of the “final” 2017 valuation would be immediately superseded by the results of 2018 valuation. This would be a better outcome for employers and members, but there are two practical issues with running the valuations in parallel:

1. The 2017 valuation timetable extends *even further* beyond the statutory deadline (of 30 June 2018).
2. The Trustee will not receive the first planned increase in contributions due from 1 April 2019.

In the cover letter, the Trustee identifies issue 1 as an important concern. While TPR could finalise the valuation itself, such a process is difficult practically (as well as politically), and may take years, so TPR may allow the parties a chance to conclude the 2018 valuation rather than seeking to use its powers. TPR may be persuaded to “act in the public interest” on this as guided by the JEP, and this could certainly be explored.

Issue 2 i.e. not increasing the contributions is also flagged as a concern in the Trustee letter, and we agree that any delay to the 1 April 2019 proposed increase would undermine the Trustee’s case to TPR that they are taking the assessed deficit seriously.

However, it is not necessary to finalise the 2017 valuation in order to implement a contribution increase. Instead, a new Interim Schedule of Contributions could be put in place ahead of completing the 2017 valuation that replaces the current contributions with those due from 1 April 2019 i.e. employers would pay 19.5% and members 8.8%. These contributions would apply until the 2018 valuation is agreed.

This may sound complicated, but Interim Schedules have been used in other cases where a valuation has run past its statutory deadline. In addition, the Schedule of Contributions prepared for the 2014 valuation is drafted flexibly to allow for Interim Schedules to be put in place: *“This schedule may be revised from time to time where revisions to it are determined by the Trustee after consultation with Universities UK (as the Employers’ representative for these purposes), and provided that the Scheme Actuary certifies any changes in the rates of contributions…”*

An Interim Schedule would give the Trustee and TPR the comfort that the contributions are being increased (to 19.5% / 8.8%) even if the 2017 valuation is held open while the 2018 valuation is concluded. It may also help avoid criticism that the Trustee is pressing ahead with finalising the valuation under Rule 76, despite the concerns expressed about the Trustee's valuation methodology under the Rule 76 consultation.

Finally, and crucially, agreeing an Interim Schedule would be consistent with the Trustee's position of a 2018 valuation being the most appropriate approach to consider the JEP's recommendations, and to the agreement of all parties to a resolution ahead of JEP Phase 2.

**Next steps**

Given that the 2017 valuation has already gone well past the statutory deadline, the Trustee is understandably keen to complete it. Some employers may be content for this to take place quickly, so that energies can be focused on the 2018 valuation, rather than waste time debating two actuarial valuations. Others may be concerned about the backstop, and may prefer for regulatory timetable to be stretched further (which could be achieved by an Interim Schedule, subject to feedback from TPR).

The Trustee will shortly begin a consultation on a 2018 valuation, and further information will likely be available before 11 January (the deadline for this consultation). If material progress has been made on the 2018 valuation – and this is available and known before 11 January 2019 – then finalising the 2017 valuation may be more palatable. We know that UUK is committed to ensuring that employers are kept informed regarding developments as quickly and fully as possible over the coming weeks.

# Appendix – Drafting comments on Schedule of Contributions and Recovery Plan

**Schedule of Contributions**

The Schedule of Contributions is the legal document that sets out the contributions due from employers and members.

We have only one substantive comment: In the section "Other Employer Contributions" some new wording has been added compared with the current schedule: *"or, where not set out, as notified by the Trustee to the Employer"*.

We are not sure what is intended here, but a broad interpretation would be that the Trustee simply needs to notify the employers that different contributions (from that specified in the schedule) are needed, and it does not need to consult on a new Schedule of Contributions. This is unlikely to be what the Trustee intended, though we would like to understand this better, or go back to the original wording. We suggest feeding this back as part of the formal consultation response.

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**Recovery Plan**

The Recovery Plan is the legal document that sets out how the "deficit" at the valuation date is corrected, and which covers a component part of the total contributions set out in the Schedule of Contributions.

We have one comment: There is a reference to the "return on assets" assumption, which references the Statement of Funding Principles. The Trustee consulted on the Statement of Funding Principles in September 2017 where a draft was provided. This set out an assumed 2.1% deficit contribution, on allowing for 50% asset outperformance in that recovery plan. We assume the Trustee will update the draft Statement of Funding Principles and consult with UUK in due course.

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**Compliance**

The advice in this report and the work relating to it complies with 'Technical Actuarial Standard 100: Principles for Technical Actuarial Work' ('TAS 100') and 'Technical Actuarial Standard 300: Pensions' ('TAS 300').

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