UCU DISPUTE LETTER DATED 7 JUNE 2019

FURTHER RESPONSE POINTS FOR USS EMPLOYERS

Background

- Employers fully recognise the importance of providing a secure, retirement income for staff. The hybrid nature of USS enables this, but like other schemes that offer defined benefits it has faced funding challenges. The legal requirements on USS require a balanced funding solution for members and employers, that must be acceptable to the USS Trustee and The Pensions Regulator.

- Employers have pushed the USS Trustee to accept the Joint Expert Panel (JEP's) recommendations. Although the Trustee has conveyed its reasons for not doing so in full, its proposed Option 3 – with an aggregate contribution rate of 30.7% of salary – is 'largely in line' with what the JEP recommended.[1] When compared to the 35.6% of salary required under the 2017 valuation, it is evidence of the positive impact the JEP has had so far.

- Employers are working with UCU and USS on JEP 2, and will seek a commitment from the Trustee to engage with its next recommendations in the hope of finding a long-term solution in the interest of employers and members.

The emerging employer position on Option 3

- Employers consider, indicatively at this stage, that Option 3 represents the best available option for the conclusion of the 2018 valuation. The contribution rates that would apply under Option 3 are 21.1% of salary for employers and 9.6% of salary for members. Importantly, there would be no changes at all in the level of benefits.

- These rates should be considered against the higher increases that would be due in October 2019 and April 2020 under the 2017 valuation. Unless an alternative conclusion is reached, employers are legally required to implement these contributions, meaning that the employer contribution will rise to 22.5% of salary from 1 October 2019, and the member contribution will rise to 10.4% of salary.

- Employers hope that Option 3 can form the basis for the conclusion of the 2018 valuation, as it provides specifically for a valuation as at 31 March 2020 – which will allow the JEP's phase 2 report to be published and for its recommendations to be taken into account.

1. *Completion of 31 March 2018 Actuarial Valuation*, Aon (2019), p. 1

- The two other options proposed by the Trustee received little or no support from employers, with employers instead wishing to focus at this stage on a conclusion to the valuation in line with Option 3.

- Although indicatively supported, employer contributions of 21.1% of salary is beyond the levels considered sustainable in the long term given competing priorities. Contributions at this level could only potentially be acceptable to employers on the condition that there is an early opportunity for stakeholders to address issues relating to the longer-term sustainability of the scheme following the JEP phase 2 report, and through the outcome of the 2020 valuation. Paying contributions over the short term at this level is the commitment employers are prepared to make in this valuation cycle to maintain the current level of pension benefits for their staff.

- Employers have confirmed they are willing to further explore Option 3, but need fuller details, including on the assumptions that would underpin the approach, and also the nature (and detail) of the requirements sought by the Trustee relating to covenant.

- Employers are mindful that Option 3 provides for lower contributions for this valuation period, and from 1 October 2021 the overall contribution will rise from 30.7% of salary to 34.7% of salary. This emphasises the need for discussions regarding the longer-term sustainability of USS, which will be enabled by the JEP's phase 2 recommendations.

The impact of Option 3 on members and employers

If the 2018 valuation is concluded under Option 3, the 2017 valuation increases will be superseded. This means that:

- *The average scheme member will pay £362 less in contributions per year for the same level of benefits if Option 3 is implemented instead of the planned 1 October 2019 increases, and £815 less per year than the planned 1 April 2020 increases.*

  Contributions of 9.6% of salary would supersede the 10.4% due at 1 October 2019, and 11.4% due at April 2020.

- *Employers will be committing to pay an extra £250 million per annum into the scheme (a 3.1% of salary increase in the employer contribution).*

  This is equivalent to approximately 5,500 average-full time roles[2], and compares to the c. £500 million extra employers would collectively need to pay per year as of April 2020 under the 2017 valuation increases.

- *Every extra 1% of salary employers pay into USS costs c. £80 million.*

  This is equivalent to 1,760 average full-time roles.

2. The average salary of a USS member as at 31 March 2017 was £42,659, which updated by an increase of 3% per annum equates to £45,256 as at 31 March 2019 – this was used in the calculation of the salary for an 'average full-time role'.

Why employers cannot meet the demands made in UCU's letter

- If employers were to reject all the options proposed by the USS Trustee, there would be delays to the completion of the 2018 valuation. As a result, the October and April increases under the 2017 valuation would be virtually guaranteed due to time pressures.

- In the absence of a decision on the 2018 valuation outcome, it is likely that the USS Trustee will conclude the valuation in a manner that it deems appropriate, which could be in line with Option 1 – contributions of an aggregate of 33.7% of salary with increases split 35:65 between members and employers. This would result in rates of 10.7% of salary for members, and 23% for employers. This risks derailing the progress the JEP has made so far, and its planning regarding JEP phase 2.

- The Pensions Regulator (TPR) has made it clear that it would have concerns and likely questions regarding a outcome in line with Option 3 which provides for contributions of 30.7% of salary – and while the USS Trustee has yet to respond to the TPR letter – it is clear that Option 3 would lie at (or perhaps beyond, based on TPR's initial comments) the very limit of acceptability. It is therefore completely unrealistic to expect the USS Trustee to contemplate going further and submitting a valuation that delivers combined contributions of 26% with no changes to benefits.

- It is also completely unrealistic to expect employers to 'commit to uphold the level of contributions no higher than 26%'. As the 2017 valuation has been filed with the Regulator, refusing to pay additional contributions would be unlawful and would provoke legal action, and indeed more broadly the power to decide the contribution rate within USS rests with the USS Trustee, subject to consultation. In short, there would be no legal basis upon which employers could make such a commitment.

- The default position in the agreed scheme rules in the absence of an alternative decision is to share contribution increases 35:65 between members and employers, and this is both reasonable and justifiable (see below). Contribution rates are set in the 2017 valuation schedule of contributions and cannot now be altered.

It is unreasonable to expect employers to pay the full cost of any additional contributions increases

- The 35:65 cost sharing formula was decided on by the Joint Negotiating Committee in 2011 and is embedded in the scheme as the default basis on which increased costs should be shared.

- The JEP's first report recommendations – supported by UCU – were designed around any increases being shared 35:65 between members and employers. Scheme members should note that the JEP based their recommended solution on estimates of USS' numbers, suggesting it was just one example of 'a number of different paths the Trustee could take to reduce the contribution rate to below 30%'.[3]

- Employers are already saying they would commit a further £250 million per annum over the next two years to maintain the current level of benefits while the JEP 2 completes it work and allows stakeholder to jointly address the future of the scheme. For many employers this level of contribution is already beyond what is considered sustainable, and to expect employers to pay the employee share too is simply not realistic.

3. *Report of the Joint Expert Panel* (2018), p. 63

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