USSEmployers

Q&As for the latest on the USS 2020 valuation & JNC decision

November 2021

This Q&A is intended to help employers answer questions that they receive about latest developments 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.

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1. At the JNC did UCU table their own proposal for changing the scheme?

We have not received an alternative formal proposal from UCU for decision by the JNC. The JNC decision on the UUK proposal was passed by the casting vote of the JNC Chair, after UCU decided not to table their own formal proposal. We repeatedly said to UCU during the JNC process that UUK would be willing to put any UCU suggestions to employers to seek their views and that offer still stands. Up until this point, UUK has not been allowed to even discuss the union's suggestions for benefit reform publicly – indeed it remains unclear if the UCU suggestions have the support of its members. The upcoming member consultation on the UUK package is important and open – and could lead to these proposals being amended. Employers will still consider alternative benefit structures and formulations, provided they are viable, affordable and implementable.

2. Why did employers not agree to a further one-month extension of the JNC discussions as proposed by the UCU?

UCU did not ask for a one-month delay to the JNC timetable as they claim. Over the last 18 months of discussions, the USS Trustee has made it clear throughout that without a solution to the 2020 valuation emerging from the JNC both employers and members would be forced to pay much higher contributions than at present from October 2021. The JNC has already formally had four and a half months to discuss the valuation outcome (already extended by 6 weeks) in addition to the time prior to that. Given the lack of a UCU formal proposal to the JNC it was not apparent that any further time would be productive and a further month of JNC deliberations would almost certainly have led to the imposition of these higher costs by the USS Trustee – starting with member rates rising to 11% from October 2021, with employer rates due to increase too if decisions were further delayed. This would damage the student experience and cost jobs, as employers would be forced to move money from other budgets to pay more into pensions, and priced even more members out of the scheme leaving them without pension savings.

3. What do you say about the UUK proposal leaving staff 'one third worse off'?

For a university staff member earning under the salary threshold of £40,000 per annum, the UUK proposal would lead to a headline reduction of about 12% in future pension benefits (benefits earned prior to any change are secure and unaffected), assuming inflation remains below 2.5%. Members earning over the salary threshold would also receive a generous (by market standards) 20% DC contribution above the threshold. Under the USS Trustee's scenarios, members would be paying between 13.6% and 18.6% of salary (compared with 9.6% now) – this would leave all members much worse off in terms of take-home pay, and many members would be priced out of the scheme. The UUK proposal also contains a commitment to quickly developing flexible and lower cost options for members, but we are yet to determine the detail of these – and indeed we hope to work with UCU to shape options that best meet the needs of members.

4. Did UUK withdraw employer covenant support when UCU suggested scheme reform?

UUK did not withdraw employer covenant support. UUK is simply not in a position to grant employer covenant support unconditionally without consulting and gaining the support of employers, especially if any proposed reform comes at a higher cost. To enable an outcome to the 2020 valuation to be reached, employers have offered considerable additional covenant support – worth an extra £1.3 billion a year.

This covenant support has been pledged as part of the UUK package of measures including maintaining contribution at or close to current rates, retaining a good portion of guaranteed benefits, exploring conditional indexation, a review of USS governance and progressing a lower cost option. We consistently made it very clear to UCU over the course of this year that if they had an alternative proposal to bring forward, which they have had many months to develop, we could ask employers whether the same level of covenant support would be available for it. As it transpired, UCU didn't put forward a formal proposal – nor did they allow UUK to take any form of proposal to employers for consideration.

5. What do you think about claims that UUK's proposal for changing the scheme poses a 'serious risk' to members' pensions?

The UUK proposal provides a viable and implementable solution to the 2020 valuation, which retains a significant element of defined benefit within the future pensions earned by members at close to current contribution levels. The UUK proposal also commits employers to even stronger levels of support for the scheme, which further protects the valuable benefits which have already been built-up by members. The UUK package of reforms also includes a commitment to explore what might be better long-term pension designs such as Conditional Indexation (which can provide increased benefits when investment returns do well, as we expect they will do in the longer-term), the development of a lower-cost option for members to help address the opt-out rate, and to immediately begin work on a governance review of USS. The UUK proposal is an alternative to the USS Trustee's proposed unaffordable contribution rates for scheme members and employers, which would have caused considerable angst for members. Damage to the student experience and job losses would have followed had universities had to move money from teaching and research budgets to pay even higher pension costs.

6. Will UUK's proposal for changing the scheme lead to a 35% reduction in benefits as claimed by UCU?

It's not true that staff in the scheme are facing a cut in their pension of 35% – the impact will be a reduction of between 7% and 15% on future benefits for most, and without change staff could ultimately face a cut in their take home pay of approximately £1,600 a year in increased contributions for those earning around £40,000. Pensions built up to date are secure and won't be changed.

7. How have employers moved during discussions over the valuation?

Employers have gone the extra mile to protect the scheme and secured much lower costs through their additional covenant support. Without such additional commitments from employers, valued by the USS Trustee at £1.3 billion per year, scheme members and employers would be looking at overall salary contribution rates 80% higher at 56%, instead of around 31%, and the closure of the defined benefits part of the scheme. This level of covenant support will be forthcoming despite it hampering the ability of many institutions to borrow money, invest and improve their services to students and staff. Throughout this valuation, UUK has repeatedly made the case to the USS Trustee and The Pensions Regulator to take a less cautious approach to the valuation, which has led to the USS Trustee modifying its approach to the valuation and lowering costs in the scheme.

Following positive dialogue with UCU during the course of the JNC discussions, UUK negotiators also made a late modification to the employers' proposal to include an enhancement to the benefits provided to staff who leave the scheme with less than two years' service.

8. Why can't UUK and UCU agree on a way forward for the 2020 valuation?

There have been countless meetings over the last 18 months between USS, UCU and UUK to discuss the valuation. Employers are keen to continue this positive dialogue over the coming weeks, not only with the union, but also the wider membership and their representatives through the forthcoming minimum 60-day member consultation on the proposals passed by the JNC.

9. What will be the impact on employers of providing the proposed covenant support?

By making even firmer commitments to USS on covenant support, employers are taking on considerable additional costs and risk so they can offer members the best possible level of benefits at current contribution rates, or as close to them as possible. This backing from employers is unprecedented among UK pension schemes, with the USS Trustee valuing their additional covenant support at around £1.3 billion per year. These measures could limit employers' ability to borrow money in the future and/or lead to higher borrowing costs, and be a barrier to improving courses, facilities, and services to students and staff. It will likely be the financially weaker employers that will be most severely impacted, since they rely on secured borrowing the most, and this could feed immediately through to cost-cutting. But nevertheless, providing this extra covenant support has been necessary in order to continue to provide attractive future benefits which contain elements of both Defined Benefit and Defined Contribution pension saving.

10. What sort of governance reform do employers want to see?

Employers believe that aspects of the governance of the scheme continue to hinder rather than help the scheme to meet its objectives and to serve the interests of scheme members and sponsoring employers. The scheme's governance remains largely the same as when it was created in 1974 and employers have commented that a governance review is necessary to ensure the objectives of the scheme and those involved with it are reviewed and that it continues to meet employers' expectations; trust and confidence in the valuation process have been strained in recent years. UUK believes a governance review, carried out with independent expertise, is long overdue and wants to work with employers, the UCU and the USS Trustee to take this forward as soon as possible.

11. Now the USS Trustee has accepted the JNC's decision, will the USS Trustee implement its plans for contributions increases in October 2021 and April 2022?

No. On 3 September 2021 the USS Trustee agreed to take forward the Joint Negotiating Committee's recommendations for concluding the 2020 valuation, saving university employers and hundreds of thousands of scheme members from escalating contributions from October – for employers, from 21.1% of salary to 23.7%, while members would have seen their payments rise from 9.6% of salary, to 11%. But with the USS Trustee board's approval of the JNC's decision to modify benefits, and agreement to proceed with a dual schedule of contributions, new rates of 21.4% for employers and 9.8% for members will apply instead.

12. Are employers supporting Conditional Indexation (CI) and how long before it can be implemented?

Employers are keen to develop a viable longer-term model such as Conditional Indexation (CI), which pegs a part of annual pension provision to the performance of scheme funds (and we believe over the long-term could deliver better outcomes in most scenarios). However, there are difficult legal and technical matters to overcome before something like CI could be implemented, which could take some time to resolve. UUK has proposed the establishment of a joint member/ UCU, employers, and USS working group to collaboratively design a CI or similar model for consultation. We are encouraged by some universities and their local UCU branches making joint statements on CI. If it is possible to jointly develop a model that is acceptable to all parties, employers would want to implement this as soon as practically possible.

13. What will be the impact of the UUK proposals on scheme member benefits?

Firstly, we reassure members that their pension benefits built up to date are unaffected and secure. This is a proposal to change the future benefits that are built-up, and a full consultation with members and their representatives will now follow the JNC decision with clear and detailed information on what this would mean in terms of future contribution costs and benefits to members. The impact of the UUK proposal and the risk of taking no action to resolve the scheme's financial challenges are clearly stated on the USS Employers website and published modelling gives examples of how benefits could change for people on different salary levels:

- USS Employers back changes to the pension scheme, 15 June 2021
- Employers respond to UCU's benefits modeller, 28 May 2021
- USS valuation: Aon comments on March 2021 materials, 9 April 2021

14. Do you believe that the 2020 valuation methodology is flawed and Universities UK (UUK) and the University and College Union (UCU) could have done more to stop this methodology being used?

Last year, UUK attended 11 Valuation Methodology Discussion Forum meetings alongside representatives of the University and College Union, and USS. This led to several changes in valuation methodology including the ending of the controversial Test 1 measure of risk appetite from the valuation methodology – a real bone of contention in previous valuations. While UUK believes that the USS Trustee is still taking an overly cautious approach to the valuation, The Pensions Regulator disagrees and believes a less prudent approach would not be compliant with pensions law. Employers and the union have repeatedly tried to change the views of The Pensions Regulator and the USS Trustee, but, ultimately, the USS Trustee has the power and legal responsibility to decide on the valuation methodology and it must do so within the bounds of UK pension law, regulation and guidance and under the supervision of The Pensions Regulator which itself has considerable powers.

15. Do you support moves to take legal action against the USS Trustee?

We understand the frustration and disappointment of scheme members and employers that the USS Trustee has priced current benefits so highly, and while we believe the USS Trustee could have taken a less cautious approach to this valuation, we don't consider there are legal grounds to challenge their decision making. We recognise that the USS Trustee has the considerable legal duty to protect the benefits that have already been earned so that they can be delivered perhaps many decades into the future regardless of future circumstances or scenarios; that is the expectation of members and employers and requires difficult judgements about prudence and caution. It must also decide on the contributions needed to build-up new benefits going forwards, and again that – once earned – they can be delivered when they become due. Any legal challenge would have to argue that the USS Trustee has acted unreasonably in protecting the valuable rights which have been, and which will in the future be, earned from the scheme.

16. What is happening with the difference between the USS Trustee's pricing of the UUK proposal, which is 0.5% higher than the current level of combined benefits?

Over the course of this valuation, the USS Trustee has been persuaded to adjust its assumptions to lower scheme costs, to offer the level of Defined Benefits for the additional covenant support proposed by UUK – at close to current contribution levels. This has reduced the headline costs, proposed by the USS Trustee, to give scheme members a better level of benefits which can be earned going forwards.

In communications to members, the USS Trustee has now confirmed that the 0.5% difference will be split according to the scheme's default 'cost-sharing' rule: 65:35 between employers and members, leading to rates of 21.4% for employers, and 9.8% for members.

17. Are employers willing to pay higher salary contributions than the current level of 21.4%?

There has been around a 50% rise in the rate of employer contributions into the scheme over the last twelve years (from 14% to 21.4% of salary). Only recently employers agreed to a considerable increase in contributions – an additional 3.1% (with the increase in contributions from 18% of salary) – and employers have agreed to continue at this higher rate again and offer significant additional covenant support to keep alive the Defined Benefits part of the scheme. Feedback from many employers and scheme members is that current contributions levels are at the limit of what they can afford, and 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 fees in England.

18. Why can universities in the Teachers' Pension Scheme (TPS) afford to pay in more than employers in USS?

They can't – they just don't have any choice, 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. There are fundamental differences in the rules, regulations and governance of the two schemes with TPS funded by government and USS not. 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.

19. Why are staff costs at a low of 52% of expenditure, yet employer income has risen by 38% in the last decade?

Direct comparisons of staff cost figures over recent years are generally not reliable due to changes to the accounting treatment of pensions from 2018–19 onwards. HESA figures that are adjusted for this change in methodology show that the average (median) institution in 2019–20 uses 54% of expenditure on staff costs, remaining in line with the previous four years (53-55%) and with employer income rises. The overall amount spent on staff increased by 5.5% for the median institution between 2018–19 and 2019–20.

20. Why are universities unable to pay more into pensions while their reserves have grown (£49 billion in 2017–18, more than triple the figure in 2009–10)?

A recent OfS report says that, excluding pension scheme accounting adjustments, surplus levels are actually falling. Accounting methodology for pension liabilities can distort changes in university surplus levels between years. Surpluses are not a reflection of the cash or day-to-day spending position of universities, nor do they mean that income was significantly higher than spending in 2019–20. Net liquidity, which accounts for existing liabilities and better reflects available funds, has also decreased across the sector. The USS deficit was halved (£7.5 billion, 2017 valuation, to £3.6 billion, 2018 valuation) which means that university accounts reflect the lower level of future commitments to pay down the deficit, and they will be updated further when the 2020 valuation is concluded.

21. With better levels of student recruitment than expected at the height of the pandemic, universities must be able to pay more into USS?

An increase in recruitment for domestic students does not mean universities have additional funds, as provision is delivered at a deficit. An OfS report finds that the unit of resource for home and EU students has been decreasing steadily since 2015–16. £9,250 in 2021–22 is equivalent to about £7,500 in 2012-13 terms. This means that, after adjusting for inflation, universities have 17% less resource per student fee now compared with when the £9,000 fee cap was first introduced.

Another recent OfS report shows that while there has been strong demand from UK students and overseas student recruitment held up well, albeit at lower levels than forecast before the pandemic, an overall fall in income in 2020–21 will adversely impact financial operating performance. Net operating cashflow, necessary to support longer term sustainability, fell from 8.4 per cent of total income in 2019–20 to 4.2 per cent in 2020–21, which the OfS acknowledges will not support sustainability in the longer term. It also points out that significant uncertainty remains for universities, particularly in relation to the financial consequences of restrictions on the movement of students, domestically and internationally.

22. Do employers favour scrapping the 2020 valuation in favour of one at March 2021?

The USS Trustee has stated that a 2021 valuation would make no material difference to the required contribution rate and while the deficit would be smaller due to recent market improvements, the cost of future service would in fact be higher. The Pensions Regulator has confirmed its support for this view (and note it is the USS Trustee that has the power to decide whether to carry out a valuation). Even if a 2021 valuation were contemplated – and we see no suggestion that it is – a 2020 valuation would still be required and be implemented. Without the UUK proposal, the 2020 valuation would require contributions to escalate from the current level of 30.7% of salary towards at least 42.1% and possibly as high as 56.2%.

23. Did employers previously budget for higher contributions from October 2021?

Some employers budgeted for higher contributions for a short period, but any further increase in contributions would need to be found in reserves or elsewhere in budgets. It is important to recognise that employers only agreed to the 2018 valuation outcome on the condition that more affordable rates would be achieved through the 2020 valuation, meaning these higher rates would not become payable.

24. Why does UUK claim that most scheme members face benefit cuts of between 10% and 18% when the consultation modeller gives different outcomes?

The modeller on the consultation website lets members adjust the figures to reflect different levels of inflation, salary increases, investment returns, and retirement age. Members can consider the changes through a variety of circumstances they think suitable or they can choose the default options. This gives a wide range of possible outcomes. This might show a small (say 1%) reduction in benefits overall for those closest to retirement, and around 25% for the member who is farthest away – a figure UCU has used. Typical member reductions to their USS benefits at retirement will be in the 10-18% range, as illustrated by examples provided by USS. We encourage all scheme members to consider their own circumstances when using the modeller and to respond to this important consultation.

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