USS 2020 valuation (technical provisions) consultation Q&A – September 2020

On 7 September 2020, the USS Trustee launched a first formal consultation on the 2020 valuation (technical provisions).

The following questions and answers address issues relating to the launch of this consultation. They are intended to be drawn from to assist with any enquiries received locally by employers.

They are not exhaustive. For further assistance in answering questions about the 2020 valuation process, please contact pensions@universitiesuk.ac.uk

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1. Why is a new valuation of USS needed?

A valuation is an assessment of the long-term financial condition of a pension scheme. When the 2018 valuation was concluded, the USS Trustee made a commitment to carry out another in 2020 so that higher levels of contributions timetabled for October 2021 could be superseded. The 2020 valuation process began in late 2019, and by law must be concluded by 30 June 2021.

2. Shouldn't the valuation be delayed because of Covid-19?

The USS Trustee is recognising the challenges presented by Covid-19 in the 2020 valuation process and has committed to be flexible with the valuation timeline.

While the valuation date is 31 March 2020, there will be 15 months for the Trustee and stakeholders to reflect on subsequent developments in financial markets and the university sector before the valuation has to be completed and submitted to The Pensions Regulator.

The Trustee believes that 'proceeding with the valuation is the best way [of] responding to the current circumstances and an adverse funding position as it allows for a full review of the issues.'

3. What are the proposed contribution rates for the 2020 valuation?

The USS Trustee has set out a wide range of illustrative total contribution rates – from 40.8% to 67.9% of payroll.

There are number of undecided factors that could affect the final figure, indeed even alter the range, including the continued impact of Covid-19 on the higher education sector, the Trustee's formal covenant assessment, and progress on implementing the covenant-supporting measures that the USS Trustee has asked employers to agree to. The details of the deficit recovery plan could also have a significant impact on the final figure.

4. Why are the potential contribution rates so high?

Challenging economic conditions and the prevailing regulatory environment has impacted all defined benefit schemes in recent years. From March, financial markets, low interest rates and the wider economy have deteriorated as a result of the Covid-19 pandemic, pushing the cost of the current level of USS benefits up still further.

Additionally, for this valuation USS has adjudged that it requires additional covenant support measures to retain the scheme's 'strong' covenant rating. As discussion on the detail of the covenant measures continue, USS has illustrated prices showing the impact of a downgrade in the covenant rating ('tending to strong'). Such a downgrade would in the Trustee's assessment raise the amount of contributions required as the Trustee does not consider it would have sufficient covenant support to back the financial risk that would need to be taken to secure a lower rate.

5. What is the 'covenant' and why is it weaker this time?

The employer covenant refers to the legal obligation and financial ability of the employers in USS to financially support the scheme. For the 2020 valuation, USS has provisionally assessed the covenant as 'tending to strong', instead of 'strong', as previously.

One of the USS Trustee's conditions for concluding the 2018 valuation with a 'strong' covenant (leading to a total contribution rate of 30.7% of salary) was for employers to agree in principle to a rule change that would prevent them from exiting the scheme without the Trustee's consent, and to agree that new secured debt they take on is treated equally to their USS obligations. USS say that without these measures in place, less risk must be built into the valuation assumptions, which means the required contributions need to be higher.

As of September 2020, the detailed terms of these significant covenant asks are still in discussion, so USS is currently progressing the valuation on the basis of a 'tending to strong' covenant, but this will be kept under review over the coming months

6. What is required for a 'strong' covenant?

USS are currently in the process of an additional review of the financial strength of the higher education sector, taking into account risks and opportunities (including those related to geopolitics, technological change, Covid-19 and government support).

In addition to the outcome of this review, USS have also confirmed that a 'strong' covenant is reliant on the successful implementation of a debt monitoring framework and rule change regarding employers' ability to exit the scheme without the consent of the USS Trustee, as well as agreement that any new debt they take on will be treated equally to their USS obligations.

7. Why have employers not yet agreed to the covenant supporting measures?

Universities UK (UUK) has not yet consulted with the scheme employers over the rule change on potential employer exits from the scheme, because further information is needed from the USS Trustee on the finer details of how exactly it would work. For example, in what circumstances would the Trustee prevent an employer from withdrawing from the scheme and ask for more funds than their Section 75 debt (an amount equal to the departing employer's share of the shortfall).

UUK has consulted with employers on the Trustee's proposed measures relating to secured debt. Concerns were raised over some of the Trustee's proposed metrics and the fact that a one-size-fits-all approach would not be appropriate across the body of diverse employers sponsoring USS. The Trustee is looking again at its proposals.

8. Will employers and members have to pay much higher contributions?

Employers are now being consulted over the proposed assumptions and methodology for the 2020 valuation, and the USS Trustee is continuing to progress work on its latest covenant assessment. The final required contribution rate cannot be confirmed until this work is complete.

Once the rate is confirmed, the University and College Union (UCU), representing members of staff in the scheme, and Universities UK (UUK), representing employers, will meet through the Joint Negotiating Committee (JNC) to decide how to meet the challenges posed by the valuation.

9. Can employers afford to pay much higher levels of contributions?

Over the coming months, UUK will be engaging with employers on their levels of affordability for USS contributions. When UUK last consulted employers on contributions levels in early 2020 a significant majority said that they were currently at the limits of affordability.

The serious financial implications of the pandemic have been felt across higher education through lost accommodation, catering and conference income, institutions spending more to support their students' digital learning, and the possibility of a significant fall in income from international students.

Universities must act collectively and responsibly to promote sector-wide financial stability in these challenging times and are already doing what they can to reduce costs through recruitment freezes, pay restraint, controls on spending, and taking other difficult decisions.

10. Will employers propose to close the defined benefit section of the scheme?

Employers recognise the importance staff place on a defined benefit part of the scheme and would like to keep a hybrid scheme operating, where this is financially viable and provides value for money.

UUK has not yet consulted employers on any changes to benefits. It would be premature to do this when there remains uncertainty about the valuation figures. These need to be confirmed by Trustee, following the current technical provisions consultation and other decisions which need to be made on covenant issues and the recovery plan.

We want to continue a positive dialogue with UCU and USS throughout this valuation, and to work with members and employers to secure an attractive and sustainable scheme.

11. What has changed in the valuation methodology?

During a series of talks, USS, UUK and UCU agreed to a set of shared valuation principles, which have informed a new methodology for the 2020 valuation, in line with what the Joint Expert Panel (JEP) recommended.

The 'Test 1' measure of risk appetite which UCU has long campaigned against has been removed, and the Trustee is proposing the implementation of a Dual Discount Rate, which was suggested by the JEP.

Employers are now being consulted formally over the proposed new valuation methodology.

12. What was the outcome of the tripartite talks between USS, UUK, and UCU?

Since the start of the year a tripartite group from UCU, USS and UUK have agreed a series of changes to the scheme's governance, transparency, ways of working, and the 2020 valuation methodology. This follows the publication of the second report of the Joint Expert Panel – an independent expert group set up jointly by UCU and UUK.

You can read updates from this group on our USS Employers website: https://www.ussemployers.org.uk/

13. What will happen next?

Employers are now being consulted on the proposed valuation methodology and technical provisions – the first formal consultation on the 2020 valuation with consultations on the Schedule of Contributions, Recovery Plan, and Statement of Funding principles to follow. This first consultation will run from 7 September until 30 October 2020, to give employers sufficient time to respond formally through their relevant decision-making bodies.

UUK will then collate all the feedback received and formally respond to the USS Trustee by 11 November.

An indicative timeline for the valuation can be found on the USS Employers website.