UNIVERSITIES UK CONSULTATION ON POTENTIAL MODIFICATIONS TO THE PROPOSED USS CHANGES FOLLOWING THE FORMAL CONSULTATION WITH AFFECTED EMPLOYEES AND REPRESENTATIVE BODIES

1. The changes to future benefits that have been under consultation would enable member and employer contributions to remain at their 9.8% and 21.4% levels respectively (and would avoid the unaffordable contributions associated with the USS Trustee's fall-back position). These contribution levels are important, as maintaining the 9.8% level will help to mitigate the risk of members choosing to opt-out of the scheme, even though future benefits will change. For employer contributions, we know from feedback that the 21.4% level is at, or close to, the edge of affordability. These factors have been important in considering any proposed modifications; there will invariably be a cost associated with any beneficial change to the proposals and contributions are already at, or very near to, the upper threshold.

2. Over 4,500 individual responses to the consultation from affected employees were received by the USS Trustee. Some of the main points arising out of these responses were as follows:

    a. The proposal that has drawn the greatest comment and concern is the 2.5% cap on inflationary increases for entitlements which build up from April 2022 (and to future indexation of the salary threshold). The proposal to reduce the accrual rate for defined benefits (DB) is next in terms of negative sentiment.

    b. Views on the member contribution rate are mixed; many affected employees feel 9.8% of salary is at or near the limit of affordability. However, some individuals have responded to the fall-back question to say that they would prefer to leave benefits unchanged (with some doing so on the basis that they would pay the fall-back contributions in full, but others for a limited period only).

    c. Responses indicate that members would find it useful to see greater flexibility or optionality within the scheme to build their pension around life events, different careers, financial capability etc., with support for members to enable them to make good decisions.

THE PROPOSAL TO INTRODUCE A LOWER CAP ON INFLATIONARY INCREASES – TRANSITION OPTION

3. The planned cap on inflationary increases of 2.5% is the proposed change which has elicited the strongest reaction and challenge. Introducing this new cap, replacing the existing cap provisions which start to activate once CPI exceeds 5%, is of course hugely important in securing the necessary reductions in the value of the future benefit package – enabling member and employer contributions to remain at their current level. However, it appears a very substantial concern of those being consulted that this change is being introduced especially at a time when inflation, as measured by CPI, is at relatively high levels. In the space of one year the level of CPI has increased from 0.6% (for the 12 months to December 2020), to 5.4% (for the year to December 2021). Whilst Government's target for inflation over the long-term remains at 2%, the Bank of England has stated that CPI inflation is expected to remain around 5% through the majority of the winter period, and peak at around 6% in April 2022. These are undeniable short-term inflationary pressures.

4. Universities UK (UUK) has approached the USS Trustee, without prejudice, to explore the feasible options should employers be minded to make a modification to the proposal relating to an inflationary cap in the light of the consultation responses. Specifically, we have explored the feasibility of a transitional measure, which will act as a bridge between the current benefit arrangements and the full activation of the proposed benefit package. This transition might be appropriate given the short-term inflationary pressures described in paragraph (3) above, and also looking forward to the exploration – and, we hope, potentially the future implementation – of new scheme designs which involve conditional elements of benefits (for example benefit indexation) which would allow improved inflationary increases to be applied as and when anticipated investment returns are realised (and which we expect should allow us to review the inflation cap at some point in the future).

5. The option we have considered is summarised below, and is set out in more definitive terms in the accompanying explanatory note from the USS Trustee. It is important to emphasise that the proposed modification is transitional in nature, and is therefore short term, leaving the planned changes to have their effect once the transition is complete.

For the period from April 2022, the proposed changes will be implemented as set out in the consultation with affected employees and their representatives, except that the specific proposal relating to the planned 2.5% inflationary cap shall operate subject to a cap transition. This cap transition facility shall mean that for the specific increases which are to be awarded in April 2023, April 2024 and April 2025, the 2.5% inflationary cap shall not apply* and it shall be temporarily overridden by the existing cap provisions[1] – and this shall have effect to specific tranches of benefits and entitlements as normally applies under the USS rules.

***This is further explained in the USS Trustee's explanatory note.**

6. There would be an additional cost associated with the introduction of a cap transition, as illustrated above. The USS Trustee's estimate of the total cost is an extra 0.3% of salary payable for the period from 1 April 2022 to 31 March 2024. We have given close consideration to this issue of meeting any additional cost, and whilst there are a number of important details and complexities, there are essentially two key points:

   a. If the cap transition were approved by the JNC, and the increase in associated costs were shared between members and employers in broadly the same proportions as apply under the scheme's cost-sharing provisions, the member contributions would rise by 0.1% of salary to 9.9%, and the employer contribution would rise by 0.2% of salary to 21.6%. One difficulty with this route is that even a 0.1% increase in the member contribution rate would be a 'listed change' under the regulations. Therefore, further consultation with affected employees and their representatives would be required – for a minimum of 60 days – affecting the commencement date of any such modification to the proposals (and questions, in this scenario, about what would happen in the meantime in terms of deciding on unmodified changes, or seeing the fall-back contributions implemented).

   b. Given that this would be a temporary, transitional measure – and given that additional cost, administration and potential delay would affect our other approaches – we have discussed with the USS Trustee the particular options available. In doing this, we have needed to fully take into account that employers (and many members) are at or near the very limit of affordability and indeed sustainability of their contribution levels. Therefore, we would like to propose to the USS Trustee a route where the 0.3% total cost would be met by an extra 0.2% contribution from employers, paid for two years, with the remaining 0.1% met through a modest extension to the recovery plan.

1 This means that increases shall be in line with increases in Official Pensions (in line with CPI) up to 5% per annum, with any increases in Official Pensions (in line with CPI) above 5% granted at one-half of the excess value, up to an overall upper limit on USS inflationary increases of 10% per annum.

7. If employers are supportive of the approach, and of the specific cost details described in 6(b) above, UUK will ask the USS Trustee to formally consider this proposal in order for it to confirm the pricing of the temporary cap transition to the JNC. Please note also that for the USS Trustee to consider this a reasonable basis upon which to proceed UUK would need to provide assurances to the Trustee that it would support a short consultation, formally with UUK, and through UUK with employers, on a revised schedule of contributions – and on a revised recovery plan if appropriate – incorporating the short-term cost provision (and these further short consultations would need to be concluded in March 2022 to allow for the implementation of the contribution and benefit changes from 1 April 2022).

8. To recap, the approach which we believe might be acceptable is for a temporary cap transition to be implemented as a modification to the proposed changes, with the cost of this transition met by an extra 0.2% contribution from employers payable from 1 April 2022 until 31 March 2024 (taking the employer contribution to 21.6% for this period, and then reverting to 21.4%), with the additional 0.1% cost of this modification met through a short extension to the recovery plan. Member contributions would remain at 9.8% of salary. This would all be subject to a short consultation on the schedule of contributions and recovery plan, and the final approval of the USS Trustee.

9. We believe that we should put this to approach to you for consideration. In particular, we would like to hear your views on the proposition that employers might be willing to pay an extra 0.2% of salary for a limited period, and accept a short extension to the recovery plan duration, to implement a temporary cap transition measure in the light of the consultation responses.

INVITATION TO EMPLOYERS TO EXPRESS THEIR VIEWS

10. We welcome comments and feedback from employers on the issues raised in this paper, and would like employers where possible to directly address the following specific question:

    Would you be supportive of a modification to the proposed changes to future benefits to introduce a temporary cap transition as briefly set out in paragraph five of this document (and explained in more detail in the USS explanatory note)?

11. We would be grateful to receive the responses of employers to this question ideally (even if in provisional terms) by Thursday 10 February at 5pm, with a final deadline of Monday 14 February 2022 at 5pm – to be sent to pensions@universitiesuk.ac.uk, so that the position can be taken into the concluding discussions in the JNC. If you would like any further information, please do not hesitate to contact the UUK pensions team at the email address above.

12. We extend our thanks once again to all employers for your continued attention to these issues, and to what we hope are the concluding phases of deciding on the responses to the 2020 valuation.