USSEmployers

THE USS 2020 VALUATION

A consultation by Universities UK with employers on the indicative outcomes of the valuation

USS EMPLOYERS RESPONSE

August 2021

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INTRODUCTION

On 3 March 2021 the USS Trustee presented an Update Report on the 2020 valuation of the scheme.

The USS Trustee set out a range of pricing scenarios, alongside the level of covenant support defined under each scenario. In summary, the scenarios are as follows:

- **Scenario 1** – a total contribution rate of 56.2% (including 19.2% deficit contributions) – based upon the current covenant support, in effect the status quo.
- **Scenario 2** – a total contribution rate of 49.6% (including 14.9% deficit contributions) – based upon the package of covenant support measures that Universities UK (UUK) illustrated employers might be willing to collectively support based upon consultation feedback.
- **Scenario 3** – a total contribution rate of 42.1% (including 8.5% deficit contributions) – based upon a further strengthened package of covenant support measures identified by the USS Trustee.

Every scenario presented a significant increase in costs from the current contribution rate, which is 30.7% of salary (21.1% paid by the employer and 9.6% paid by the member).

The deficit the USS Trustee calculated for the scheme, based upon the scenarios above, ranged between £17.9bn in Scenario 1 to £14.9bn in Scenario 3.

UUK requested that the USS Trustee formally reviewed the decisions it appeared to have reached in presenting the illustrative outcomes. The USS Trustee's reply to this request (letter from Dame Kate Barker dated 29 March 2021) stated that it would reconsider its assumptions and decisions should the facts of the valuation change.

For example, if there were changes to the position on the covenant support package, future benefits, or post-valuation date funding experience. The USS Trustee's position, whilst making clear that the current benefit structure could not be maintained at acceptable cost, presented an opportunity to put forward a reformed hybrid Defined Benefit/Defined Contribution structure, backed with additional covenant support, which can be delivered for affordable contributions.

To assist employers in responding, UUK worked with its actuarial advisor, Aon, to illustrate a possible outcome to the valuation which employers may have been able to support. This combined a set of covenant measures, and a change in the balance of Defined Benefit (DB) and Defined Contribution (DC) benefits provided within the current hybrid scheme structure to enable current contribution rates to remain. UUK and Aon believed that the alternative covenant package suggested by UUK, together with the change in the balance of the hybrid benefits structure should enable the USS Trustee to take a less cautious approach to their valuation assumptions, and thus allow valuable DB promises to continue to be provided at the current contribution rate (30.7% of salary). UUK/Aon believed it would be feasible to provide a continued hybrid structure in the order of: a pension accrual rate of 1/85th of salary (with 3x lump sum), a DB salary threshold of £40,000 and indexation capped at 2.5% per annum, while retaining DC contributions of an overall 20% of salary above the threshold.

As part of this consultation, employers were encouraged to engage with their USS-eligible employees and seek their views, particularly in relation to benefit design preferences and potentially offering more flexible options for members.

UUK formally consulted all USS employers on the way forward, including covenant support measures, contribution levels and affordable benefit structures, together with options for addressing the scheme's high opt-out rate. The consultation ran from 7 April to 24 May 2021. Employers were invited to respond to 15 questions.

OVERVIEW OF EMPLOYER RESPONSES

UUK received 141 responses from employers, which together represent nearly 96% of the active membership of the scheme.

The majority of respondents, representing nearly 93% of the active membership of USS, provided full or conditional support for the UUK proposed package for concluding the 2020 USS valuation. UUK tested whether the concerns of those employers offering conditional support had been addressed through a further short consultation in July 2021, and in the second consultation (see separate report) the backing from employers was nearly 94% of the active membership.

In headlines terms, employers collectively said:

- That the current contribution rates (21.1% employer and 9.6% member) are at the limits of sustainability and that these rates should be more than adequate to provide good pension provisions. Among the minority of employers that indicated that they would be willing to pay higher contributions, most indicated that they would only be willing to do this in the shorter term;
- The vast majority of employers stated, reluctantly, that they would provide additional support to the scheme covenant – in terms of a moratorium on exit without the USS Trustee's consent (subject to clarification of further details), and also to the introduction of a debt-monitoring and pari-passu framework (again subject to clarification on a number of important details on the operation and metrics of the arrangement);
- The vast majority of employers (over 90% by weighted numbers) preferred to keep a hybrid arrangement for the 2020 valuation – where this was considered to offer value for money. A minority preferred to move to Defined Contribution (DC) arrangements;
- Employers provided strong support (75% by weighted numbers) to explore Conditional Indexation (CI) as a possible future solution beyond the 2020 valuation – and with some employers only accepting the UUK package for this valuation as a condition for exploring alternative future options, such as CI;
- Very strong employer support (and supported by engagement and responses from eligible employees) for the introduction of more flexible and lower cost options for members (over 90% by weighted population), with a strong majority (over 80% by weighted population) seeing DC as an appropriate option to address the member opt-out as it would help with affordability, flexibility/suitability, and portability – the main reasons why eligible employees are choosing to opt-out of the scheme; and

- Almost unanimous support (again, over 90% by weighted population) for a post-valuation governance review.

These proposals are due to be discussed over the summer (2021) with the University and College Union (UCU) representing members, UUK, and the USS Trustee at the Joint Negotiating Committee, which is responsible for approving any scheme rule changes and concluding the 2020 valuation.

UUK was grateful to employers for taking the time to engage with the issues in such detail, to discuss the material with their governing bodies and leadership teams as well as with staff, and to respond in such comprehensive terms.

EMPLOYER RESPONSES IN MORE DETAIL

UUK received 141 responses from employers to the consultation, representing nearly 96% of the active membership of the Scheme. This included responses from 60 of the largest employers (with more than 500 scheme members). There were a significant number of responses from employers with smaller numbers of staff in USS, which gave UUK confidence that the consultation adequately reflected the diversity of employers in the scheme.

At the beginning of the consultation UUK identified that the path to an acceptable outcome was narrow and, whilst the responses provided by employers generally supported the continued exploration of the potential outcome, if anything the path became narrower due to the largely expected conditions and caveats which employers (not unreasonably) attached to their support.

Many of the answers to the consultation, understandably, did not give a simple yes/no answer to the individual questions given the complex and interlinked nature of the issues. Therefore, the percentages included in this paper are often contextualised with commentary or coding beyond a simple ‘support/oppose’ or ‘yes/no’ answer.

51 out of 141 respondents, which represented 46% of the membership, provided definitive, unconditional support for the UUK proposal.

A further 73 employers, representing nearly 47% of the membership, expressed partial or conditional support for the UUK proposal and within this population are:

- A small number of large employers (4) and a number of smaller employers (26) which stated that they would only support the UUK proposal if it were a short-term solution which could (for example) “pave the way for a superior and sustainable long-term solution” such as Conditional Indexation; and
- 14 limited participation employers which stated that they could only support the proposal if there was a suitable de-minimis which applied to the debt-monitoring framework to reflect their limited participation in USS.

11 employers representing 1.7% of the membership were unclear as to whether they supported the proposal or not.

6 employers representing 1.3% of the membership expressed outright opposition with 4 of these employers (1.2% of weighted population) preferring to move to a wholly-DC approach.

The conditional support provided by employers

In its consultation UUK set out what it believed might be reasonable conditions which should be linked to any approval of aspects of the 2020 valuation, and these were largely endorsed by employers. There were some important additions, and adjustments, expressed by employers and the collective set of conditions which UUK believes now exists is broadly as follows:

(a) That the support for any individual aspect of the valuation is dependent on securing an acceptable overall outcome (for example, backing for covenant support is dependent on keeping contributions at their current level and achieving the illustrated benefit reforms).

(b) On covenant support measures there are a number of individual strands:

(i) Employers are able to secure enduring value;

(ii) Employers have clarity over the process and the manner in which the arrangements would be operated by the USS Trustee;

(iii) There is the means to exit from the arrangements, most likely collectively, if they are not operated acceptably and/or value is not gained from the arrangements;

(iv) That an appropriate de minimis provision is introduced for the pari-passu element in particular;

(v) The term “covenant enhancing” secured borrowing, which is to be exempt, is sufficiently understood;

(vi) The arrangements are reviewed and can be adapted in light of forthcoming changes to accounting standards;

(vii) That the concerns of employers on the definition of some of the mechanics are able to be resolved satisfactorily, for example the use of gross and/or net debt;

(viii) That an open and meaningful process of review can be implemented which allows any decision of the USS trustee to be considered again with involvement of different personnel, and with the opportunity for employers to make further representations.

(c) Contributions remain at their current level.

(d) The flexibilities outlined by UUK in its consultation paper are implemented, in particular the lower cost saving option and a DC-alternative option for employees.

(e) A review of governance is undertaken, with the terms of such a review to be consulted upon.

(f) The USS Trustee responds convincingly to challenges regarding the choice of the valuation date, either through moving the valuation date further back, or continuing with a 31 March 2020 date but taking full account of post-valuation experience.

(g) That implementation of the proposed adjustments to the hybrid scheme design do not themselves limit or inhibit the efforts of UUK and employers to explore other ways to make the scheme more sustainable and affordable in the long-term.

It may not be possible for any solution to respond in full to all conditions which have been raised of employers, but it is considered that the vast majority – outlined above - are either ones that UUK considers are central to any outcome which it would back on behalf of the employers collectively, or they are ones to which at least partial recognition can be given.

UUK further tested whether a number of the concerns expressed by employers had later been addressed through a short consultation in July 2021. The feedback from this second consultation is set out in a separate report.

The six primary aspects of the valuation

UUK's consultation sought the views of employers in six main areas, and the following provides a summary of the responses in each.

Contributions

Most respondents were concerned by increases in contribution rates from both an employer and member perspective.

The vast majority of employers (113 employers representing over 92% of the active membership) affirmed their support for the view, expressed in the consultation material, that the current contribution levels of 21.1% and 9.6% are at the limit of sustainability. 17 respondents, representing nearly 4% of the membership, stated they might be willing to increase contribution levels. 11 respondents (representing 0.12% of the membership) did not answer this particular question.

Employers were also asked to separately consider the level of employer contribution they might be willing to pay to USS following the 2020 valuation, which in some cases led to different answers to those above. This is because some were willing to pay more in the short term but not for the longer term. However, many institutions noted that their affordability limit has been reached.

For the employer contribution, there was clear majority backing for 21.1% to be seen as an upper threshold for the long-term, although there was recognition that the existing schedule of contributions may take contributions above this level for a limited period and employers would need to find extra money by adjusting their plans should this happen. Indeed, a number of employers said that they viewed a figure which is lower than 21.1% as a long-term norm, some quoted 20% and some a level of 18%.

96 employers (representing nearly 75% of the membership) would be ready to pay 21.1% at maximum, or less. 32 employers (representing nearly 21% of the membership) could be willing to pay slightly more or more than 21.1%. 13 respondents (representing 0.45% of the membership) did not answer this particular question. Of those willing to pay more, this generally fell into two camps:

1. Those employers willing to temporarily pay the planned October 2021 increases (from the 2018 valuation) whilst exploring other solutions, such as Conditional Indexation (CI). However, this might not fully recognise that with a 'no change' solution costs would rise considerably again, likely from April 2022. Given the time required to explore and potentially implement CI, this does not appear to be a feasible solution to the 2020 valuation, and only a minority of employers stated that they would agree to temporarily pay the October 2021 employer rate whilst this option was explored.

2. A small number of Limited Participation employers, for example some post-1992 universities with very small numbers of members in USS who were willing to pay the equivalent rates to those in Teachers' Pension Scheme to align with the remainder of their academic staff.

Almost all responses expressed the view that the current member contribution rate is at the limit of affordability, and there was widespread concern at the prospect of increases above the 9.6% level from October 2021. Several respondents carried out internal surveys asking staff about their perspective on a rise in member contributions, with many institutions reporting high percentages of staff that would consider dropping out of the scheme if the contribution rate increased past its current level, decreasing the strength and viability of the scheme. For these reasons there was a sense of urgency expressed by employers to look at lower cost saving options.

104 employers (representing 78% of the membership) answered that at or around 9.6% should be the maximum contribution level for members. 12 respondents

(representing nearly 12% of the membership) were willing to consider higher member contributions. 25 respondents (representing 6% of the membership) did not answer this particular question. The maximum contribution figure cited was 11%; however, respondents noted that their potential willingness to have members contribute more is not unconditional, but rather would be strongly tied to the benefits that would be provided by the scheme.

A firm majority view that contributions should be no higher than current levels means that some level of benefit reform is clearly necessary (in conjunction with other measures, eg covenant support).

Benefits

There is broad support for the retention of the hybrid structure, with employers believing that it still provides a viable structure on which to base the 2020 valuation outcome.

122 employers (representing 94% of the membership) answered yes to the retention of the hybrid structure. 6 employers (representing 1.8% of the membership) stated that it is unlikely that the scheme will remain affordable under a hybrid structure, and that a defined contribution approach could support the scheme to become more sustainable. 13 respondents (representing 0.15% of the membership) did not answer this particular question. The vast majority of respondents noted that the hybrid benefit structure is one of the key advantages of the Scheme and should be maintained if that is feasible.

The theme of value for money emerged consistently in the responses to the question on benefits, with many employers believing that retention was the appropriate headline strategy although this does depend on the price of the guaranteed elements of the hybrid – and the view that at the proposed prices the value for money was at or near the limit of acceptability. If a modified hybrid scheme was to be materially weaker than the one illustrated by UUK, many employers would take the view that DC might well provide a better alternative (although many commented that a move to DC would itself bring challenges regarding the management of the costs of legacy DB arrangements).

Conditional Indexation

Overall, there was strong support (97 employers, representing 75% of the membership) for exploring conditional benefit models such as Conditional Indexation (CI) as a potential offering following the conclusion to the 2020 valuation. Some responses were more optimistic that such a solution could provide a sustainable solution, whilst others were more sceptical but nevertheless wished to explore and not rule this out. 17 respondents (representing over 11% of the membership) did not support the exploration of CI or other conditional benefit models; an additional 8 employers (representing 7.9% of the membership) requested further information on how this would work in practice before commenting. 19 respondents (representing nearly 1.6% of the membership) did not answer this particular question.

Scheme Flexibilities and lower cost option for members

124 respondents (representing nearly 96% of the membership) supported the implementation of flexible options for members (17 respondents, representing 0.2% of the membership, did not answer this particular question), and 85 employers (representing nearly 74% of the membership) stated that it would perhaps also be appropriate for some employers (notably small non-higher education institutions) to exceptionally, depending upon their circumstances, be allowed to use a more appropriate core offering should flexibilities be introduced (34 respondents, representing nearly 19% of the membership, did not agree with this view due to the mutual nature of USS; and a further 22 respondents, representing 3% of the membership, did not answer this particular question or would require more information). Respondents cited options for flexible Defined Contributions offerings, and emphasised portability as a key aspect for this. A number of employers touched on the possibility of a tiered member contribution structure and whether this might be a feasible option.

There was total (100% of those responding to the question, 125 respondents representing nearly 96% of the membership) support from responding employers for the creation of a lower cost saving option for members. 16 respondents, (representing 0.18% of the membership) did not answer this particular question. Many employers had sought the views of their employees in responding to the consultation, and this was a key area where there is clear demand for this option from eligible employees. An important point made by many employers is that this should be a member option and should not undermine the main scheme offering.

Most employers (112, representing over 83% of the membership) responded to say that a Defined Contribution option seemed to be the most appropriate option as this could address the reasons for member opt-outs including, affordability, suitability of benefit and portability. (10 respondents, representing nearly 9% of the membership, did not agree with this view with some noting difficulties over deficit recovery contributions; and a further 19 respondents, representing 4% of the membership, did not answer this particular question.) There were mixed views on how any Defined Contribution option could work – for example – employers wishing to make this option good value and that it provides good benefits on its own merits, but that the vast majority of members should be reminded about the benefits available from the USS main scheme. The value of the employer contribution to any lower cost option is a key consideration.

Governance

122 respondents (representing nearly 95% of the membership) welcomed a post valuation governance review. 3 respondents (representing nearly 1.2% of the membership) stated that they did not think a post-valuation governance review would be helpful. 16 respondents (representing 0.17% of the membership) did not answer this particular question. Areas of consideration highlighted by employers were; the appropriateness of UCU's role as sole member representative body given its limited coverage across 340 institutions in terms of UCU members, consideration of UUK as the employer representative body and whether this role should be passed to UCEA, further consideration of the JEP recommendations, and many employers raised concerns in relation to the trust, transparency and accountability of the USS Trustee, including the valuation process.

Covenant Support

There was broad but conditional support from employers for the alternative covenant support package set out in the UUK consultation materials, and notably less support for the USS Trustee's covenant support package which underpinned Scenario 3. The key differences between these packages are: the length of the rolling moratorium on employer exits (15 years under the Trustee's Scenario 3, and 20 years for the UUK package); and the terms of the pari passu, or equal treatment for USS, requirements on any new secured debt (for Scenario 3 the de minimis provision is set to exclude employers with total assets of less than £50m and also annual income of less than £50m, with the Metric E trigger set at 10% of secured borrowing compared to gross/net assets; the UUK package goes further with a de minimis provision to exclude USS employers that are not considered material and sets the Metric E trigger at c15%).

126 respondents (representing over 90% of the membership) would conditionally support the UUK alternative package, 15 employers (representing nearly 6% of the membership) declined to support or said they would only do so based on multiple key conditions.

45 employers (representing 38% of the membership) would not support the USS Trustee's Scenario 3 package under any circumstances, 72 (representing over 51% of the membership) said they might be able support (mostly reluctantly, and some subject to receiving further information) Scenario 3 if UUK's alternative proposal was not accepted. However, most respondents reiterated they would prefer UUK's proposal. 24 respondents (representing over 6% of the membership) did not answer this particular question or would require more information on how the USS Trustee's proposal would work in practice.

On the question of other areas of covenant support, 110 respondents (representing nearly 87% of the membership) stated they would not support either contingent contributions or asset pledges, often due to the complexity and lack of feasible options. 5 respondents (representing over 7% of the membership) would require more information on any feasible and practical options, and how these could work in practice. 13 respondents (representing 0.28% of the membership) stated they would be open to consider contingent contributions or asset pledges. 13 respondents (representing over 1% of the membership) did not answer this particular question.

The next consultation with employers

UUK sought the direction of employers, through a short consultation from 18 June to 5 July 2021, on potential modifications to the indicative outcome of the 2020 valuation. The majority of respondents, representing nearly 94% of the active membership of the scheme, indicated they could, as part of an overall valuation package, support the USS Trustee's counter proposal on covenant support and provide backing for the modified valuation outcome. The feedback from this second consultation is set out in a separate report.

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