



Universities UK

# USS valuation: taking stock, and next steps

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## A webinar for USS participating employers

*Professor Alistair Fitt: Vice-Chancellor, Oxford Brookes University and EPF member*

*Stuart McLean: Head of Pensions, Universities UK*

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*Brendan Mulkern: Senior Pensions Adviser, Universities UK*

## **Introduction from Professor Alistair Fitt** Vice-Chancellor of Oxford Brookes University and member of the Employers Pensions Forum

## USS valuation: taking stock, and next steps

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### 1 Introduction from the Chair

Professor Alistair Fitt, Vice-Chancellor of Oxford Brookes University

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### 2 Taking stock ... what we know, and a recap on the key developments

Brendan Mulkern, Universities UK

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### 3 The latest context and next steps

Stuart McLean, Universities UK

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### 4 2018 valuation – Contingent Contributions

John Coulthard, Aon

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### 5 Questions from employers

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### 6 Close

Professor Alistair Fitt, Vice-Chancellor of Oxford Brookes University

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# **Taking stock ... what we know, and a recap on the key developments**

Brendan Mulkern, Universities UK

## Taking stock, and a recap on the latest developments



- The 2017 valuation has been concluded, and has effectively created backstop levels of contributions
- We await further information from USS about the accounting provision for the £7.5bn deficit. The DRCs moved from 6% of salary to 5%.
- We understand now remitted to the Pensions Regulator
- The 2017 valuation contributions are wholly unsustainable for all stakeholders, and therefore equally interested in new outcome
- Primary objective is to ensure that October 2019 increases don't come into effect. Clear timescale challenges with this.

# **The latest context and next steps**

Stuart McLean, Universities UK

## USS valuation as at 31 March 2018

- 1 UUK notifies Trustee of support for JEP
- 2 Trustee concludes 2017 valuation and starts 2018 valuation
  - Backstop contribution increases
- 3 Deadline to complete valuation is 30 June 2019
- 4 Trustee sets contribution in **consultation** with UUK
- 5 Consultation commenced 2 January – deadline extended to **15 March**
- 6 What has changed?
  - One year of economic and membership experience
  - JEP recommendations

# The latest context and next steps

Table 3: Comparison of the 31 March 2017 valuation and 31 March 2018 if **no** contingent support is provided.

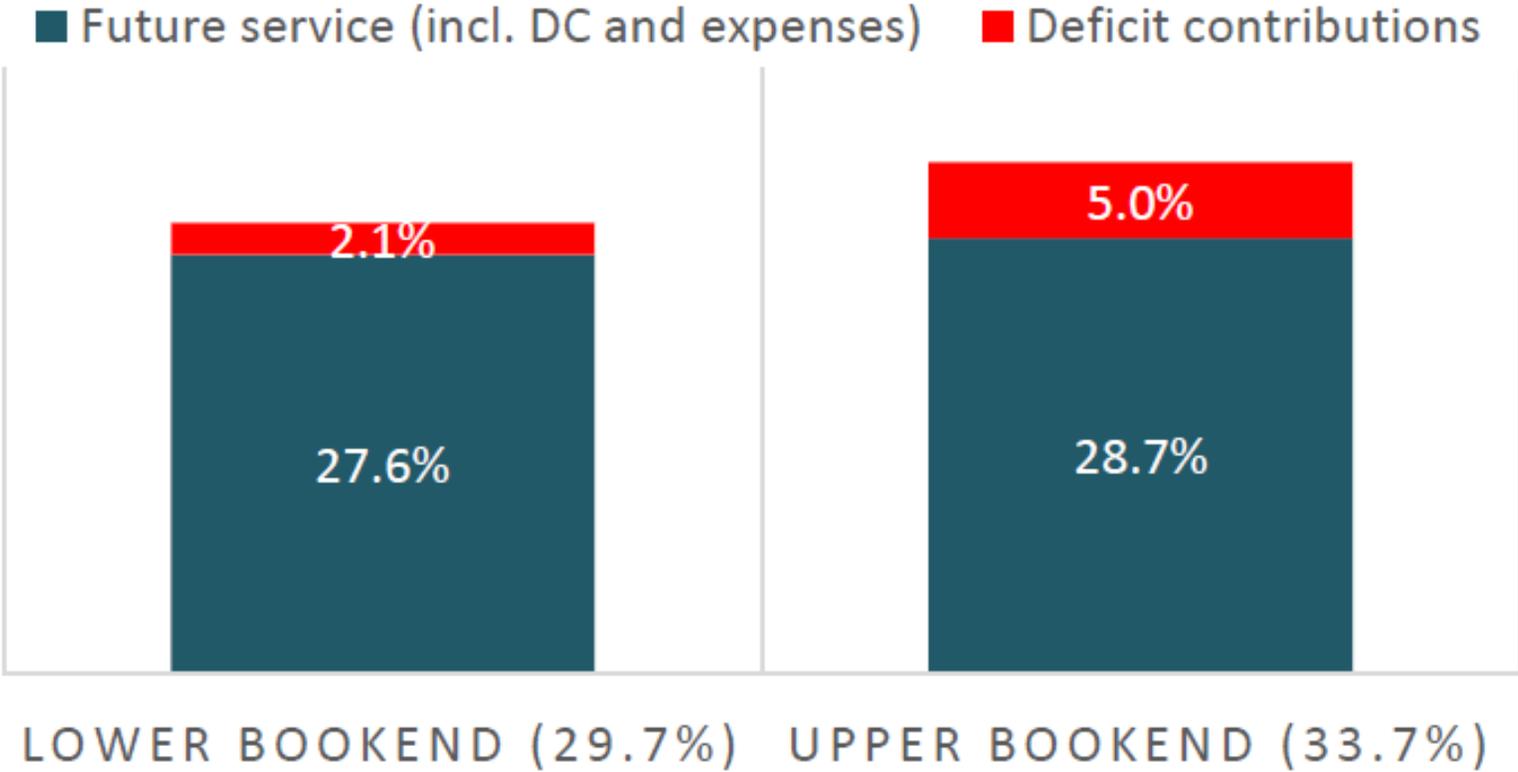
Prudence percentile level: Reliance in 20 years:	Rule 76.1 Valuation at 31 March 2017	Valuation at 31 March 2018 with no contingent support
	67 <sup>th</sup> £10bn	67 <sup>th</sup> £10bn
Technical Provisions (TP)	£67.5bn	£67.3bn
Self-sufficiency (SS)	£82.4bn	£84.5bn
Assets	£60.0bn	£63.7bn
Deficit on TP basis	£7.5bn	£3.6bn
SS basis	£22.4bn	£20.8bn
Total contributions:*		
<i>Future service contribution</i>	30.6%	28.7% (NRA 66)
<i>Deficit recovery contribution</i>	6%	See discussion point below
<i>Total contribution</i>	36.6%	See discussion point below
<b>Average discount rate above current gilt yields</b>	<b>1.20%</b>	<b>1.33%</b>
<b>Average discount rate above CPI assumption</b>	<b>0.71%</b>	<b>0.92%</b>

# The latest context and next steps

Table 4: Deficit Recovery Contributions (DRCs) for different terms and investment outperformance

DRCs required (% of salary)		Deficit recovery period (years from 31 March 2018)							
		14	13	12	11	10	9	8	7
Level of outperformance (proportion of BE returns over TP)	0%	3.5	3.9	4.3	4.8	5.5	6.3	7.5	9.1
	5%	3.0	3.3	3.7	4.2	4.8	5.7	6.8	8.3
	10%	2.5	2.8	3.2	3.6	4.2	5.0	6.1	7.6
	15%	2.0	2.2	2.6	3.0	3.5	4.3	5.3	6.8
	20%	1.4	1.7	2.0	2.4	2.9	3.6	4.6	6.1
	25%	0.9	1.2	1.4	1.8	2.3	3.0	3.9	5.3
	30%	0.4	0.6	0.9	1.2	1.6	2.3	3.2	4.6
	35%	0	0.1	0.3	0.6	1.0	1.6	2.5	3.8
	40%	0	0	0	0	0.3	1.0	1.8	3.1
	50%	0	0	0	0	0	0	0.4	1.5

# The latest context and next steps



# The latest context and next steps



The Trustee's principles for contingent contributions	
1. Efficacy	7. Quantum
2. Objective metric	8. Durability
3. Alignment	9. Covenant
4. Robustness	10. Legally Binding
5. Safety Valve	11. Payment certainty
6. Materiality	



# 2018 valuation – Contingent Contributions

Prepared for: Universities UK  
Prepared by: John Coulthard FIA, Kevin Wesbroom FIA  
February 2018

Prepared by Aon  
Retirement & Investment

**QAS** Institute<sup>®</sup>  
and Faculty  
of Actuaries  
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## Trustee proposal for 2018 valuation

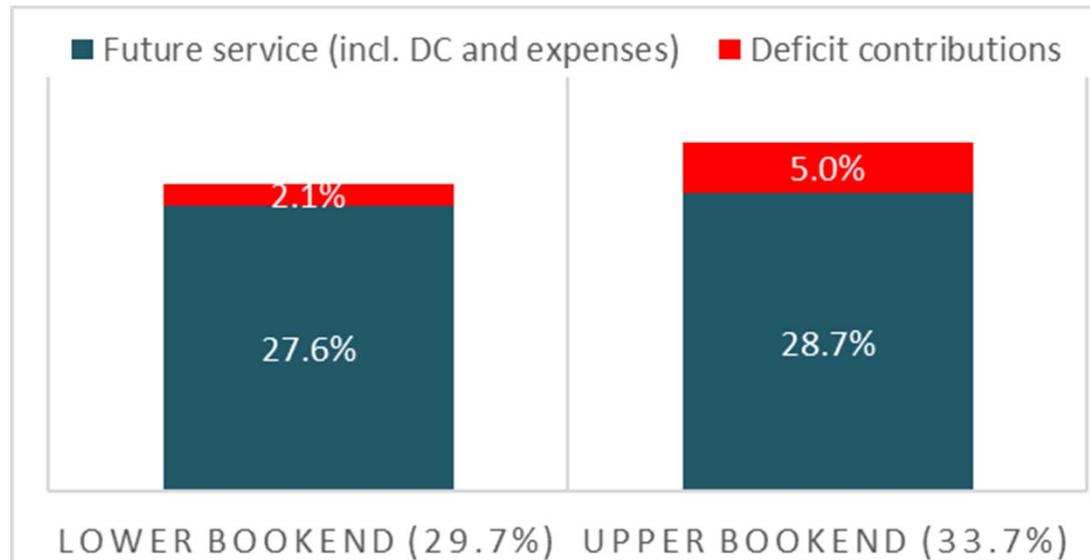
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- JEP report published 5 months ago now (13 September 2018)
- JEP recommended **29.2%** at 31 March 2017 though noted other paths exist for getting to a contribution rate below 30% (including allowing for more recent market conditions)
- Trustee decided to call 2018 actuarial valuation to consider the JEP recommendations

**2018 valuation called to consider JEP recommendations**

## The “bookends”

- USS Trustee is consulting on a **range** of potential contributions for existing benefits (less the 1% DC employer matching contribution)



Notes:

- Lower Bookend = “slightly below 30%” [29.7% from example provided], if satisfactory contingent support is given
- Upper Bookend = 33.7% of pay, if employers offer no additional formal support

1. Most of gap is due to deficit contributions (not being consulted on)
2. Maximum difference in contributions over 3 years is about £1.0Bn (“small” cf. scheme)

## Contingent Support

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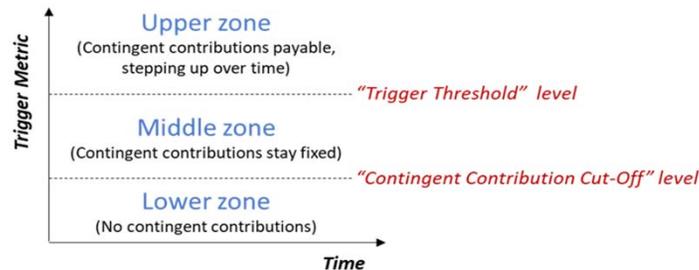
- In our view Contingent Support is worth considering to try to find an approach all stakeholders can live with
- Two ideas for Contingent Support in USS's 2 January consultation (negative pledges and contingent contributions)
  - From 7 February USS note, negative pledges seem off the table
  - If employers wish to explore this further, please let Universities UK know
- USS Trustee has subsequently developed 11 principles, and invited UUK to put a proposal to the Trustee.
  - Our initial thoughts are set out below
  - We aim to be consistent with the 11 principles (however please note that the Trustee principles do not define the trigger event)

**Contingent Support aims to bridge different views**

## Initial thinking – Potential structure (1 of 2)

Aon have discussed the following initial thinking with UUK:

- Any proposal conditional on the Trustee accepting JEP recommendation as base contribution rate
- Only triggered in more extreme conditions (not by normal market movements, as strong covenant supports waiting until next valuation)
- Phased contribution increases with three potential step-ups, with each step equal to 1/3 of difference between Upper Bookend and Lower Bookend



*Note: Consistent with 2 January consultation, though 7 February paper suggests maximum contingent contribution "is likely to be slightly greater"*

Source: USS Executive consultation paper dated 2 January 2019

- Lower Bookend of say 29.2%, and Upper Bookend that is sufficiently high for the Contingent Contributions (close to 33.7%) to be deemed to have value by the Trustee

**NB thinking likely to develop as we receive more information from USS Executive**

## Initial thinking – Potential structure (2 of 2)

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- Our starting point is that the trigger metric should be Technical Provisions, not Self-Sufficiency, corresponding to how the scheme is funded
- Deterioration should endure for a reasonable period e.g. 2 or 3 quarter-ends, and there should be some smoothing (e.g. average of last three months)
- At least 6 months between the trigger being breached and increased contributions applying to allow the JNC to consider alternative approaches, and to allow institutions to mitigate the impact of paying additional contributions
- Should be proportionate, and should not be overly complex given that JEP Phase 2 will provide a broader review
- Contingent contributions assumed to be “cost-shared”
- The next actuarial valuation is important in providing a reset (whether at 31 March 2021 or potentially at 31 March 2020)

**Key issues include: initial contribution, chance of hitting trigger, how much paid, lead time**

## Potential structure vs 11 USS Trustee principles (1 of 3)

USS Principle	USS Description of Principle	Does initial thinking meet principle?
<b>1. Efficacy</b>	The structure of any contingent contribution arrangement should be practical, transparent, unambiguous and as simple as possible	Yes
<b>2. Objective metric</b>	The metric that is used to trigger contingent contributions should be objective and not require subjective judgments, interpretations or a decision-making process	<b>We prefer Technical Provisions. This is “subjective” [and so is self-sufficiency!], but should cope better with more extreme events. (Potentially a “Gilts plus” proxy could be used which meets principle 2, but this would be more volatile which should be reflected in a higher Trigger Threshold)</b>
<b>3. Alignment</b>	The mechanism for triggering contingent contributions should be sufficiently sensitive to data that could signify that current contributions may not be adequate	Yes – the USS Trustee’s Statutory Funding Objective is to be fully funded on Technical Provision, so using this ensures a direct alignment to how cash contributions are set
<b>4. Robustness</b>	The mechanism for triggering contingent contributions should be robust in the sense it is not triggered solely in response to short-term market volatility	Yes – include smoothing and requirement for Trigger Threshold to be breached for 2/3 quarter ends  Technical Provisions more robust to extreme events than self-sufficiency

## Potential structure vs 11 USS Trustee principles (2 of 3)

USS Principle	USS Description of Principle	Does initial thinking meet principle?
<b>5. Safety valve</b>	Contingent contributions once triggered should be terminated over a reasonable period should data suggest that they are no longer needed	Yes
<b>6. Materiality</b>	Contingent contributions once triggered should be sufficiently material such that, if they were sustained over the long term, they would substantially improve the funding position in adverse scenarios	<b>Yes – the difference between bookends is material, though in any event the next valuation will afford the chance to change contributions again (subject to consultation)</b>
<b>7. Quantum</b>	In adverse scenarios in which contingent contributions are triggered, the aggregate quantum of the contingent contributions should broadly similar to the Trustee’s contribution requirement in the absence of contingent arrangements over a reasonable period of time	<p>We do not suggest “over-shooting” the Upper Bookend, and prefer the Upper Bookend to be the highest contributions</p> <p>Consistent with principle 9 (covenant)</p> <p>However, the Trustee will have the statutory valuation process to make further changes as appropriate</p>

## Potential structure vs 11 USS Trustee principles (3 of 3)

USS Principle	USS Description of Principle	Does initial thinking meet principle?
<b>8. Durability</b>	The contingent contribution arrangement should remain in place until a revised Schedule of Contributions comes into force following a future valuation	Yes  The next valuation which will take place after JEP Phase 2 provides an opportunity to reset the approach
<b>9. Covenant</b>	The contingent contributions should be consistent with the findings of the most recent review of the employers' covenant	<b>Yes. (The USS Trustee use this principle to justify stepping up the contingent contributions, and we would support this)</b>
<b>10. Legally binding</b>	The contingent contribution arrangement should be legally binding and documented as part of the Schedule of Contributions	Yes, though legal advice may be needed on implementation aspects
<b>11. Payment certainty</b>	The Trustee must be sufficiently comfortable that contingent contributions would be paid in full if triggered	Yes, Contingent Contributions would be recorded in Schedule of Contributions  There should also be enough time for the JNC to consider any alternative approach

## Wrap up

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- Employers supported JEP recommendations, but told not on offer unless employers can provide satisfactory Contingent Contributions
- Assuming we engage on this basis, we have developed some initial thinking with UUK and compared it with the 11 Trustee principles
  - USS Executive are providing some further information to help flesh out initial thinking and show potential consequences to employers
  - A second “Aon note” will follow along with a UUK consultation
- If you have any views or questions in the meantime, please share them with UUK

## **Questions and Answers**

Your opportunity to raise questions  
for the panel

## **Close**

**Thank you for joining today's webinar event**

You can be in touch with UUK's pensions team at  
[pensions@universitiesuk.ac.uk](mailto:pensions@universitiesuk.ac.uk)

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