USSEmployers

THE USS 2020 VALUATION

FINDING THE RIGHT SOLUTIONS

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

7 April 2021

DISCLAIMER

To allow Universities UK (UUK) to share information provided by the USS Trustee to support this UUK consultation with employers, the USS Trustee has requested that the following disclaimer is included at the outset of this document:

> This consultation document (which includes any appendices, annexes or enclosures) is issued by Universities UK ("UUK"). The statements and conclusions expressed in this consultation document are UUK's own and (save in the case of annexe C) do not purport to reflect any advice or recommendations of Universities Superannuation Scheme Limited (the "Trustee") in its capacity as the sole corporate trustee of the Universities Superannuation Scheme. To the extent that material provided to UUK by the USS Trustee has been incorporated as part of, or summarised in, this consultation document, that material has been provided to UUK for information purposes only and on a non-reliance basis.

> Note:
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> Figures in this consultation document that have been provided to UUK by the USS Trustee have been calculated using assumptions consistent with the relevant scenario shown (as detailed in the Trustee Update document dated 3 March 2021) and assume the level of covenant support required for that scenario. Further, these figures are for illustration only. Before confirming the contribution requirements of a revised benefit package, the USS Trustee would need to consider the assumptions applicable to any specific proposal after taking actuarial advice from the Scheme Actuary."

CONTENTS

This formal consultation is to seek employers' views on covenant support, contributions and benefit structures and related matters to develop a solution to the 2020 USS valuation.

As part of the valuation process UUK is seeking employers' views on the three covenant support scenarios outlined by the USS Trustee in its sub-rule 76.1 report, and on an alternative approach developed by UUK with support from our actuarial advisers (Aon) which draws on our current understanding of employers' views.

Section 6 of this consultation lists the questions on which we are seeking views from employers – please provide responses, as far as you are able, to these 15 questions in your consultation response.

To support employers, a more detailed commentary on some of the questions and issues for consideration are included within the annexes, particularly in respect of supporting the covenant (annexe C), conditional benefit considerations (annexe D) and flexibility (annexe E). A separate advice note from Aon will also be shared shortly.

This document is in eight parts overall, which are:

EXECUTIVE SUMMARY

On 3 March 2021 the USS Trustee presented an Update Report on the 2020 valuation of the scheme. Alongside this update report the Actuarial Report prepared by the scheme actuary for the USS Trustee was presented to the Joint Negotiating Committee (JNC), as required under sub-rule 76.1 of the scheme rules.

The Actuarial Report is important because it signals a key step in the overall valuation process, as the JNC is asked to formally decide how it wishes increases in contributions to be dealt with. The JNC has three months from the issuing of the sub-rule 76 report, or such longer period as the trustee may allow, to decide – in essence – whether the response to a call for higher contributions should be an increase in the employer and member contribution rates and/or lower benefits provided in the future.

The USS Trustee has 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 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 trustee.

Every scenario presents 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 has calculated for the scheme, based upon the scenarios above, ranges between £17.9bn in scenario 1 to £14.9bn in scenario 3.

UUK requested that the USS Trustee formally reviews the decisions it appears to have reached in presenting the illustrative outcomes, and as part of this raised a number of specific questions. The USS Trustee's reply to this request says that it will reconsider its assumptions and decisions should the facts of the valuation change, for example if there are changes to the position on the covenant support package, future benefits, and post-valuation date funding experience etc. This presents an opportunity to maintain a reformed hybrid Defined Benefit/Defined Contribution scheme for affordable contributions.

UUK is now formally consulting 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.

To assist employers in responding, UUK has been working with its actuarial advisor, Aon, to illustrate a possible outcome to the valuation which employers may be able to support. This combines 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 believe that the alternative covenant package suggested by UUK within the materials, 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). We believe 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 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 are encouraged to engage with their USS-eligible employees, and seek their views, as employers consider the consultation material and prepare their responses to some of the questions, particularly in relation to benefit design preferences and potentially offering more flexible options for members. UUK will be providing a range of communications materials to help employers do this.

UUK would welcome formal responses from employers by **5pm on Monday 24 May 2021.** The consultation questions are included in section 6 on page 31.

SECTION 1: INTRODUCTION AND APPROACH

On 3 March 2021 the USS Trustee presented an Update Report on the 2020 valuation of the scheme. In this update report, which included a range of supporting documents, the USS Trustee followed-up its Technical Provisions consultation from the autumn of 2020 with a revised and updated range of contribution requirements. Each of the contribution scenarios is linked, as before, to different levels of covenant support.

Alongside the update report the Actuarial Report prepared by the scheme actuary for the USS Trustee was presented to the Joint Negotiating Committee (JNC), as required under sub-rule 76.1 of the scheme rules. The report is important because it signals a key step in the overall valuation process, when the conclusions reached so far by the USS Trustee are presented and the JNC is asked to formally decide how it wishes to deal with increases in contributions. In this case, each of the scenarios presented would be significant increases from the current levels of contribution. The JNC has three months from the date the sub-rule 76 report is issued, or a longer period if the USS Trustee allows, to decide – in essence – whether the response to a call for higher contributions should be an increase in the employer/member contribution rate, or lower benefits provided in the future.

Universities UK (UUK), on behalf of the 340 USS employers, is concerned that some of the assumptions the USS Trustee has presented are unnecessarily prudent and do not fairly value the strong covenant support offered by employers. UUK has requested that the USS Trustee reviews its assumptions and pricing, considering a rounded view of covenant support, future benefit structures and contribution levels.

This consultation by UUK with employers serves two main purposes. The first is that it allows UUK to provide an update to employers on the current, challenging situation, with a perspective on the indicative outcomes which have been identified and presented. The second is to formally seek views and direction from employers on some key questions – on covenant support, future benefit structures, addressing the high opt-out rate and contribution affordability – so that UUK can progress the negotiations with the University and College Union (UCU) within the JNC. The full list of questions for employers is included in section 6 from page 31. Discussions are also ongoing with the USS Trustee, especially in the light of the covenant support measures the Trustee is seeking.

ENGAGING WITH YOUR GOVERNING BODIES

As we have stated in previous consultations, we ask that employers engage with their governing bodies about these USS issues, and in responding to this consultation confirm that the views and opinions expressed are those of the institution.

A briefing document is included at annexe B to provide background information for governing bodies and other interested parties.

ENGAGING WITH YOUR USS ELIGIBLE EMPLOYEES

We would encourage employers to engage with their staff (those who are members of USS, or eligible to be so), staff representatives and pensions working groups (or similar where they exist) on the issues discussed in this report. We believe it would be useful to:

- explain and share details on the financial and economic challenges;
- describe the roles and responsibilities of those involved;
- illustrate and seek views on the potential options and outcomes, and
- identify some of the new flexibilities and options which might be implemented to improve this workplace pension arrangement, for example seeking views on the option of a new lower cost pension saving option to address the high opt-out rate.

We have provided briefing material and other communication materials to employers, and we hope you will feel able – and equipped – to engage with USS-eligible staff and capture their views. We will continue to support employers throughout the period of this consultation.

FINDING A SOLUTION

To achieve an acceptable and affordable outcome to this valuation – and not put at risk the suitability of USS as the provider of good workplace pensions for the many eligible staff who work in the higher education sector – we believe there will need to be flexibility on all parts.

We start with flexibility from employers. Employers have expressed some concerns about the valuation approach. However, there will likely need to be some willingness on the part of employers to show movement, for example in relation to the covenant support measures, if they wish to create a lower cost from which reforms can be considered. However, employers through their governing boards need to be fully aware of the long-term consequences of granting additional covenant support.

There will be a need for movement and flexibility from the other parties too, as part of achieving an overall solution. From the USS Trustee this means movement on the assumptions and, for example, the level of prudence which it would prefer in the calculations, its position on any recovery plan and on the quantum and structure of covenant support measures.

For scheme members we are likely to need some movement on the design and form of future benefits – to ensure they remain affordable – and to hear members' preferences on the introduction of additional options, for example to introduce a lower cost of entry choice to address the high opt-out rate.

In this consultation, we think it is important to try to bring together all the various strands of information, and to present the potential outcomes which might be reached to employers in overall terms.

SECTION 2: COMMENTARY ON THE VALUATION TO DATE

THE 2020 ACTUARIAL VALUATION

We have read with interest the USS Trustee's explanations for why it decided to proceed with a valuation of the scheme at 31 March 2020, one year earlier than required by legislation. In doing so we understand that the USS Trustee will take account of the longer-term experience of investment returns, alongside the specific developments since 31 March 2020, and ensure these are fully factored-in to the final valuation outcome. We have asked our actuarial advisor, Aon, to say more on this in a supplementary advice note for employers.

COVENANT

Covenant lies at the heart of any Defined Benefit (DB) scheme valuation, and USS is no different in that respect. What is different is the degree to which the USS Trustee's opinion appears to have shifted on the covenant compared with prior valuations, and the weight that it proposes to attach to different aspects of the overall covenant package. The USS Trustee has attached considerable weight to the one event of Trinity College, Cambridge choosing to exit from USS. We have raised our concerns about the relative weight it has given to this unique event in our letter to the USS Trustee seeking a review of the illustrative outcomes presented, and we remain unconvinced by the response. The USS Trustee has chosen to create a huge cost differential between different covenant support packages (over 14% of salary between the existing level of covenant support and the scenario with the USS Trustee's preferred measures), which, in our view and the view of our advisers, significantly undervalues the core covenant of the scheme's employers.

In this consultation, in section 3, we put forward an alternative covenant support package for employers' views; this is in the spirit of wanting to do everything possible to achieve a fair outcome. In this consultation we ask if employers are willing to support this package as part of achieving a fair and affordable overall outcome which might be acceptable.

Given its prominence in recent commentary, we feel it necessary to make clear the position on the USS Trustee's assertion that commitments were made by employers at the time of the 2018 valuation on covenant which have not been kept, and therefore the covenant is now effectively weaker than it was assumed to be at the time of the 2018 valuation. We simply do not agree with this characterisation of events, and believe it to be inaccurate. Employers did collectively agree in good faith to consider extra covenant support measures such as a long-term rule change on employer exits, but this was always based upon the need to fully and fairly define the arrangements which were proposed to be adopted, to better understand their justification, and for UUK to further consult with employers about them.

This work has progressed significantly over the last year, however we still do not have satisfactory detail and/or definition of the proposed changes (for example the de minimis provisions which are to apply, and on 'covenant enhancing' secured borrowing) – although we do believe that we are close on the matter of debt monitoring and indeed the USS Trustee has recently confirmed that it intends to make its first collection of data from employers. We remain appreciative of the USS team for all its work in these detailed, complex deliberations, including inputs to our specialist working groups on covenant matters. We hope that the USS Trustee will understand that this was always a very substantial task. We should not seek to place blame for not having been able to agree and implement the measures discussed in 2018 and that the gaps in justification, and in technical detail, need to be filled to see measures in the round before they can be put into operation. As stated, we set out in this paper a alternative package of covenant support measures which we believe are justified, meet the USS Trustee's objectives, and are implementable.

THE OCTOBER 2021 CONTRIBUTION INCREASES

We are concerned at the prospect of the October 2021 increases (from the 2018 valuation outcome) being activated, as they will by legal default unless other actions are taken. We think it would be helpful for the USS Trustee to hold open the possibility that these backstop increases might be deferred or delayed (as it has power to do, subject to consultation), to allow the stakeholders more time to find a solution this summer – especially if the prospect of an acceptable outcome to the 2020 valuation appears close. We have concerns about the October increases, not only from the perspective of employers with the financial strain and knock-on effects caused by a 23.7% contribution rate but also a great concern for members facing an 11% contribution rate, and the effect this could have in terms of opting- out and the subsequent break in valuable cover and protections from the scheme. We trust that the USS Trustee will take this into account as it decides about the planned increases, and it is acknowledged that either a revision to the current Schedule of Contributions or a new Schedule would be required, and that the USS Trustee would likely require material reasons to be able to justify such a change to the Pensions Regulator.

VALUE FOR MONEY

We recently asked the USS Trustee to review the contribution requirements it has presented, and also to respond to a series of specific questions, and it has responded in a letter dated 29 March 2021. At this stage we intend to continue with the strategy of close engagement with the USS Trustee to find ways that we might lower the overall cost, however we have continuing concerns that the cost of the pensions promises under the USS DB section now offers diminishing value for money for members and employers. Some of the fractions of DB benefits illustrated by the USS Trustee which would be earned for current contributions (for example in scenario 2, a pension accrual rate of 1/155th to 1/170th of salary) would appear to represent very poor value for the contributions paid. The economic and regulatory context in which DB promises are provided, alongside the prudence planned to be adopted by the USS Trustee has very real consequences in terms of value for money which members and employers attach to the scheme benefits gained.

THE SUB-RULE 76.1 REPORT AND ACCOMPANYING DOCUMENTATION FROM THE USS TRUSTEE

The USS Trustee has produced a significant volume of information for employers and members as part of this latest update report. Alongside the headline report – which itself has four appendices, including on covenant (and on covenant support measures in particular) and analysing UUK's response to the Technical Provisions consultation – the USS trustee has included papers on:

- Prudence in the 2020 valuation
- Reconciling the outcome of the 2018 valuation with the 2020 valuation
- Why the trustee decided to proceed with the 2020 valuation
- Analysis of the Joint Expert Panel's recommendations and their adoption
- A letter from the Pensions Regulator dated 26 February 2021

The USS Trustee controls most aspects of the valuation. For example, it decides when a valuation should be undertaken (so long as they are no more than three years apart, which is the regulatory limit), it compiles the data and the calculations of the scheme's assets and liabilities, and crucially it decides on the assumptions which lie behind the assessment of the scheme's health. It is required to consult with – but not gain the agreement of – UUK (as the formal representative of the scheme's 340 employers) on the approach and assumptions which are to be used.

In short, the USS Trustee's role, under legislation and the scheme rules, is to determine the cost of the scheme, with a primary obligation to protect the rights which have been built up already (and prioritise the payment of deficit recovery contributions (DRCs) accordingly). This is ahead of any consideration for the pension rights which members might build up in the future. While the USS Trustee also determines the costs of future benefits, the form and design of future benefits is a matter for the stakeholders, as is deciding how changes in cost will be met either through contribution increases or benefit reforms.

Employers appreciate the quantity of information the USS Trustee has presented in recent updates, and throughout the valuation. However, despite the amount of detail, it is still difficult, certainly at this stage, for employers and members to see in overall terms (or in the round as we have repeatedly requested) what the outcome to this valuation might be.

A REQUEST TO REVIEW THE VALUATION ASSUMPTIONS

Based on significant employer feedback and concerns, UUK responded to the USS Trustee's latest material to raise several specific questions, and to formally ask the USS Trustee to revisit its approach, its proposed assumptions and illustrated figures.

While the scheme may have a reasonable funding position on a 'best estimate' basis, we understand that the USS Trustee must adopt a prudent approach by law. Employers recognise that the level of prudence (and therefore the size of a deficit) is the decision of the USS Trustee. It is clear that, based on the USS Trustee's update report and from the Rule 76.1 report itself, reform would be needed to achieve affordable and sustainable contribution levels for scheme members and employers. Employers are not arguing that the scheme's status quo can be maintained but we think that the USS Trustee has moved the dial too far and has not given appropriate credit in specific areas.

The USS Trustee has recently responded to the request to undertake a review. The reply overall is disappointing and the responses to some of the questions remain unconvincing and/or re-state positions which have been expressed previously. Nevertheless, if we are to take some encouragement we might do so from the USS Trustee being willing to reconsider its position should the facts change – either in relation to covenant support, future benefits, and post-valuation experience (noting that this could be for better or worse), or a combination of these factors. We continue to press the USS Trustee to evolve its assumptions. However, to achieve these necessary changes and progress the valuation it is vital that we also continue to engage with employers on the various developments, and seek further views and guidance to seek a fair, affordable and sustainable solution.

THE DETAILS PRESENTED BY THE USS TRUSTEE

The USS Trustee has presented valuation outcomes under three scenarios, each of which are dependent on the covenant support measures which are available to the USS Trustee. The following table sets out the contribution requirements which would apply, at least in hypothetical terms, under each of the USS Trustee's illustrated scenarios should the scheme's default cost-share arrangements be applied:

Trustee's scenario	Proposed overall contributions (current 30.7%)	Employer (current 21.1%)	Member (current 9.6%)
1	**56.2%** [+25.5%]	**37.6%** [+16.5%]	**18.6%** [+9%]
2	**49.6%** [+18.9%]	**33.3%** [+12.2%]	**16.3%** [+6.7%]
3	**42.1%** [+11.4%]	**28.5%** [+7.4%]	**13.6%** [+4%]

All figures quoted are contribution levels expressed as a percentage of salary.

Scenario 1 is effectively a status quo option where the covenant is the (considerable) backing which has historically been provided by employers since the scheme's inception (further supported by pensions law, in particular around the UK pensions law relating to employer debt in UK multi-employer pension schemes). scenarios 2 and 3 are based on extra covenant support measures, with scenario 2 based on the illustrative proposals put forward by UUK in November 2020 and with scenario 3 being the version of covenant support sought by the USS Trustee.

COVENANT SUPPORT MEASURES

We asked the USS Trustee to respond to specific questions on the covenant support measures, as set out in our letter to the USS Chair dated 10 March 2021, and we made clear that we needed to receive convincing responses. The USS Trustee has responded to this request, and our questions, in its letter dated 29 March 2021 which we are still reviewing. To show our willingness to find solutions, some months ago we put forward covenant support measures on an illustrative basis – knowing that we would have to take these formally to employers at a later point if they appeared acceptable – and which are now used to back the USS Trustee's scenario 2. Broad headlines of the key areas of each of the covenant support scenarios illustrated by the USS Trustee are shown below, and more detail can be found in annexe C.

Scenario 1
No additional covenant support.
Scenario 2 (UUK proposal, November 2020)
Debt monitoring: De minimis to limit metric testing to material employers.
Pari-Passu (equal) security on new secured debt: Metric E threshold for Gross Secured Debt: 20% of Net Assets (Removal of additional test on gross assets from Metric E)
Rule change on employer exits: 6 year rolling moratorium on employer exits without USS Trustee consent.
Scenario 3 (USS Trustee proposal, March 2021)
Debt monitoring: De minimis to exclude smallest employers from metric testing (total income < £50m and gross assets < £50m)
Pari-Passu (equal) security on new secured debt: Metric E thresholds for Gross Secured Debt: 10% of Net Assets and 10% of Gross Assets
Rule change on employer exits: 12 year rolling moratorium on employer exits without USS Trustee consent. Expiry of moratorium after end of Recovery Plan period for 2020 valuation

The USS Trustee considered the employer responses to its consultation on the debt monitoring framework proposed in July 2020 and has made some positive changes within the finer detail of the framework. Annexe C contains the revised framework documents, which should be reviewed by employer finance specialists as part of this consultation.

Annexe C also contains proposed arrangements to introduce a rule change for a long-term moratorium on employer exits without USS Trustee consent, which employers may wish to share with their legal advisers. Upon conclusion of this consultation, UUK will seek updated legal advice on outstanding matters such as the date of commencement of any longer-term rule change.

To demonstrate once again our commitment to finding a solution, in this consultation at section 3 we set out an alternative, updated series of measures primarily to encourage further discussion, but which could be supportable as part of the potential overall outcome outlined in this paper – and we welcome employer views on them. We emphasise that these are very difficult requests placed upon employers, and we hope demonstrate UUK's wish to secure an outcome to this valuation which might be acceptable; any support from employers would be conditional upon the other aspects of the valuation as set out at the beginning of section 3.

OTHER COVENANT SUPPORT

We note there has been very limited appetite for exploring other, contingent covenant support measures in recent consultations and since the USS Trustee's rejection of the contingent contribution proposal put forward under the 2018 valuation. Employers should note that any 'contingent' measures referred to here are quite separate and distinct to the debt monitoring, pari-passu and rule change measures discussed elsewhere in this document. The reference to contingent refers to measures which would be triggered upon future events, for example the pledge of an asset to the Trustee which it would be able to realise in the event of extreme funding scenarios, or contingent contributions automatically triggered in such circumstances.

In response to the 2020 Technical Provisions consultation, employers were generally sceptical of how contingent covenant support approaches could work collectively and alongside the cost-sharing aspects of the scheme. As such, there was limited appetite to explore this option (particularly if the 'price' of lower pension contributions is offset by extra contributions to another contingent support vehicle). However, should the Trustee have a particular proposition that they felt could operate effectively and for the benefit of all parties then employers would be pleased to hear more.

We have not heard more from the USS Trustee in this respect. We think it is important that we check again with employers at this stage of the valuation process if they believe there are contingent covenant support measures which might be further investigated. Therefore, we have included a question in this consultation to assess whether there is significant appetite amongst employers to consider other areas of covenant support such as contingent contributions or asset pledges.

CONTRIBUTION RATES

Employers have repeatedly and consistently made clear that they are committed to supporting the scheme and wish to continue to provide attractive and valuable benefits for members, but that this commitment needs to be financially sustainable. Through all our discussions with employers, and most notably in responses to the USS Discussion Document and the Technical Provisions consultation, employers have made clear that the current contribution rates are at the limit of what is considered sustainable.

The table below summarises contribution rates throughout the history of the scheme:

	Member	Employer	Total
April 1975 - March 1980	6.25%	12.00%	18.25%
April 1980 - March 1982	6.25%	14.00%	20.25%
April 1982 - March 1983	6.35%	14.00%	20.35%
April 1983 - March 1995	6.35%	18.55%	24.90%*
April 1995 - December 1996	6.35%	18.55%	24.90%*
January 1997 - September 2009	6.35%	14.00%	20.35%
October 2009 - September 2011	6.35%	16.00%	22.35%
October 2011 - March 2016	7.50%	16.00%	23.50%
April 2016 - April 2019	8.00%	18.00%	26.00%
April 2019 - October 2019	8.80%	19.50%	28.30%
October 2019 - September 2021	9.60%	21.10%	30.70%
1 October 2021 onwards	*11.00%*	*23.70%*	*34.70%*

* Note – for the period 1983 to 1996 employers paid an enhanced rate of 18.55% rate to pay down an inherited deficit when previous pension schemes merged with USS, such as FSSU, which granted members additional service. Once that was paid off the rate reverted to its previous level.

It is notable that the employer contribution rate has increased substantially since 2016 and is set to increase again from 1 October 2021 unless an outcome to the 2020 valuation can be reached before then – we commented further on this in section 2. While the USS Trustee implemented this outcome as part of the 2018 valuation, stakeholders clearly envisaged that the 2020 valuation would be concluded ahead of these October 2021 rates being implemented.

We have now received figures from the USS Trustee which indicate that the overall contribution rate would have to increase to at least 42.1% of salary and possibly as high as 56.2% for current benefits. Given that many employers have strongly indicated that current contributions are at the limit of what is considered sustainable, UUK has asked the USS Trustee to illustrate options based upon current contribution rates. These benefits are considered later in the paper, and indeed our actuarial advisor, Aon, has helped UUK consider a more rounded and detailed view of the possible outcomes at the current contribution level than indicated in the USS Trustee's illustrations.

As we set out earlier in this document, one of the main aims of the consultation is to receive views from employers to take into negotiations through the JNC with UCU colleagues; effectively to gain a mandate for these discussions.

We are therefore asking for employer views on the level of ongoing contributions you would wish to make to the USS pension scheme.

INDICATIVE BENEFITS TO BE PROVIDED

Another element which impacts upon the outcome of the valuation is the future benefits which are to be provided. Past benefits are protected and are therefore not subject to any change, but future benefits can change. Considering the pricing set out by the USS Trustee, the benefits will likely need to change as the costs presented are neither affordable nor sustainable, and risk pricing members out of the scheme.

We have already touched on the pricing, and the high rates and short recovery plan periods seemingly being set so that employers will need to provide further covenant support measures to USS to ensure that the deficit can be paid off over a reasonable period of time. We will now examine the valuation through a different lens and instead of looking at the cost for current benefits we explore the design and type of benefits that might be provided based upon current contribution rates, as employers have told us that the current contribution rates are at the limits of acceptability.

As a starting point, the USS Trustee has provided indicative figures on page 18 of its recent Update on the 2020 Valuation document. The USS Trustee explained:

Under Scenario 1, with deficit recovery contributions assumed to be 19.2% of pay, it is difficult to envisage any meaningful defined benefit pension being provided under the hybrid structure. We assume alternative forms of pension provision (and essentially DC provision) would need to be considered.

Under Scenario 2, deficit recovery contributions are assumed to be 14.9% of pay which would leave 15.8% to fund new pensions. Very significant changes would be required to both the defined benefit and defined contribution elements to maintain total contributions at 30.7%. For example, assume the DB salary threshold was reduced to £40,000. Depending on whether indexation on pensions for future service were capped at 2.5% per annum or not, the accrual rate could need to be between 1/155ths and 1/170ths. These illustrative parameters also assume DC contributions above the salary threshold would change from 20% to 12%.

Under Scenario 3, deficit recovery contributions are assumed to be 8.5% of pay. This would leave 22.2% to fund new pensions. Less significant but still very material changes would be required to maintain total contributions at 30.7%. For example, assume the DB salary threshold was reduced to £40,000. Depending on whether indexation on pensions for future service were capped at 2.5% per annum or not, the accrual rate would need to be between 1/100ths and 1/115ths. Again, these illustrative parameters also assume DC contributions above the salary threshold would change from 20% to 16%.

In presenting these figures, the USS Trustee states that:

> "At this stage, we have not considered in detail the assumptions we would wish to use in such circumstances, so they would be subject to further review. Contribution rates may also be subject to review if any benefit changes were likely to influence the average age of the defined benefit members."

Our commentary on the scenarios presented by the USS Trustee are as follows:

Under Scenario 1, the USS Trustee is requesting that the deficit contribution is 19.2% of pay, which at current contribution rates leaves 11.5% of pay for future benefits. The USS Trustee acknowledges that if they take this approach it would mean the end of the hybrid benefit design with members effectively receiving a Defined Contribution (DC) benefit of 11.5% of salary but paying 9.6% of this cost. This would likely lead to a mass opt-out of members, and the effective end of the USS as we know it.

Under Scenario 2, with a deficit contribution of 14.9% of pay, 15.8% is available to fund new pension benefits. The USS Trustee illustrates a very weak hybrid design, which does not compare favourably in terms of value for a DC offering of 15.8%, with members paying 9.6% of this cost.

Under Scenario 3, where significant covenant support measures are required, the deficit contribution is set at 8.5% of pay, and 22.2% remains to fund new pension benefits. This is where the benefit debate becomes more balanced, as we see a more familiar looking hybrid outcome, albeit with reduced DB salary threshold and a stretched accrual rate, even with capped indexation.

These illustrations show, as we mentioned earlier, that controlling the deficit and in turn the deficit recovery contribution is a key part of this valuation. Until we know how the deficit can be addressed, it is extremely difficult to determine how the future benefits can be delivered in a sustainable and affordable way.

The USS Trustee has provided UUK with the following table which summarises the potential benefit structures resulting in 30.7% contribution rate:

Scenario	DC contribution rate above threshold	Salary threshold	Accrual rate for indexation:		Estimated DIS / ill-health element % pay
			Current	Capped at 2.5% p.a.	
2	12%	£40k	1/170	1/155	1.6%
		£30k	1/165	1/145	1.7%
3	16%	£40k	1/115	1/100	2.1%
		£30k	1/110	1/95	2.2%

BRINGING THE USS TRUSTEE'S ILLUSTRATIONS TO LIFE

In considering changes to the hybrid scheme design, it is important to look closely not just at the relative costs of DB and DC pension provision, but also at the value of the benefits provided and crucially at the other features and attributes of each these pensions saving approaches (and of course the USS hybrid incorporates both DB and DC provision). We should consider the attractiveness and suitability of these designs for employees with different demographics, but also with different earnings profiles and patterns, career trajectories, family circumstances, retirement objectives etc. Whilst the attractions of a DB pensions promise are clear and well known, we should also consider the value for money of that promise to both members and employers, and also whether employees consider them desirable and suitable for **their** particular circumstances.

As employers develop the initial thinking which is set out in this paper about future proposed benefit design, we recognise it will also be necessary to consider some of the following aspects of the future approach to benefits:

- On value for money, to find ways to fairly compare the benefits derived from the DB section with those emerging from DC provision.
- The importance of death and incapacity benefits, how they are designed (eg should they continue to be primarily DB in nature), and should they be part of the collective costs paid by all members and employers.
- The level of subsidy to the DC section for investment management costs etc.
- The pension and tax free cash options available to members with either/ both DB and DC provision, and indeed the broader options for members at

retirement and how they are funded.

- The issue of pensions portability and the extent to which scheme design can (and should) facilitate it.
- The pensions choices and flexibility which can be made available for members to help them plan and finance their lives in later years, and how those might affect the longer-term funding of the scheme, and other scheme trends (which is covered in more detail in annexe E).

Clearly some aspects of this work would take some time to complete, and will undoubtedly run beyond the immediate timescale of the 2020 valuation – but it will be important in further enhancing, and then explaining and communicating, any future changes to the scheme.

IMPACT OF DEFINED CONTRIBUTION ONLY BENEFITS

We asked the USS Trustee whether the deficit reduction contribution would remain as shown in the sub-rule 76.1 report for a DC only scheme so employers could understand the impact of such an outcome. The USS Trustee has advised that any formal proposal would need to be considered with Scheme Actuary advice sought at that time (we think we should interpret this response to mean that it would review the level of DRCs outlined should there be no future DB accrual in the scheme; we think such a statement not completely unreasonable although we hope that any changes there are in DRCs, if indeed there are any, would be relatively small).

Some of the factors of moving to wholly DC provision might indicate a more cautious approach; and other factors suggest lower risk levels in the longer term. Given the advice the USS Trustee has received to date, the USS Trustee has allowed for deficit recovery contributions equal to the figures shown in the sub-rule 76.1 report when illustrating the potential effect of a change in benefit structure, however as noted the USS Trustee will take further advice from the Scheme Actuary as benefit options are developed.

The closure of the DB section would, were it to occur, not in itself change the employers' capacity for risk or volatility in the scheme. The USS Trustee has indicated that this would still be as quantified in the risk management framework, and such a step could change the shape of scheme risk in key ways, and it may also result in a different employer appetite, over time, for tolerance of contribution volatility in the DB section of the scheme. The USS Trustee would need to understand the attitude of employers in this changed context before determining whether this would impact the DRCs illustrated.

The closure of the scheme would, all other things being equal, reduce the quantum of liability risk (measured by the self-sufficiency metric) being managed by employer contributions, over time. The USS Trustee would need to consider its appetite for deviation from the self-sufficiency position in both the short and long term, in light of the reduced duration of liabilities and prospect of negative cashflow. It would also need to consider the covenant commitments it would require, in any case and in particular if employers wished to pursue return seeking strategies in a closed DB scheme.

The contribution rate for death and ill health benefits would need to be adjusted depending on what benefits are offered. For the current membership, the contribution rate in respect of the current death and ill health benefits is of the order of 3% of pay p.a. Of this, the 3x salary death in service lump sum is c. 0.5% of pay.

There is another possible option that has begun to emerge which aims to provide an income in retirement but relaxes the guarantee so that the cost of the scheme can be reduced as well as the volatility of contributions required to fund it. We explore our current understanding of *conditional benefit* options in annex D, and we have also asked Aon to comment further on conditional benefit approaches in its advice note. This approach could provide a new future approach to benefits but is undoubtably complex to design, define and administer, so would likely take some time to fully develop in to a feasible and implementable solution.

SECTION 3: AN ALTERNATIVE APPROACH DEVELOPED BY UUK – A PATHWAY TO A SUSTAINABLE SCHEME?

Throughout this 2020 valuation process employers and UUK have been suggesting that the valuation needs to be considered in the round, and that each of the key component parts of the valuation (covenant, risk, funding approach, benefits, and flexibilities) all influence one another and there is inter-dependence between them. This point is acknowledged by Dame Kate Barker, Chair of the USS Trustee board in her letter to UUK dated 17 March 2021, where she says, 'The Trustee believes that a holistic approach is required to develop a solution to the funding challenge, where the financial assumptions, covenant support proposals and benefit options are considered in concert, rather than in isolation.' This is a helpful development and acknowledgement from the USS Trustee.

In this section we aim to provide an alternative path through this valuation which would put the scheme on a more sustainable footing for the future while maintaining reformed hybrid DB/DC benefits for current contribution levels.

Any scheme with Defined Benefits, whether for past service only or into the future, will be subject to economic volatility and have different levels of resilience to that volatility, so there are no guarantees that we won't be here again and there will be further work to do beyond this valuation. However, the approach we set out below takes a pragmatic view of where we are and seeks to provide the very best pension benefits we can for members in challenging economic times, but in a sustainable and inclusive way.

This approach leans heavily on what we consider was the spirit of the Joint Expert Panel's (JEP) report; it will however require compromise and collaboration from all parties involved in the USS valuation process.

The pathway starts with covenant support measures. Whether we agree with the rationale or not, it is clear from the scenarios set out that the USS Trustee is prepared to insist that the scheme deficit is paid off quickly – something which is materially (and disproportionately) detrimental to the immediate generation – if employers do not provide the covenant support measures the USS Trustee has requested. The USS Trustee also seems prepared to impose impossible contribution requirements regardless of their impact on members and employers if the covenant support measures are not forthcoming. In such circumstances, there appears little alternative but for employers to avert what would be lasting damage and try again to find acceptable covenant measures.

We believe that covenant support measures which meet, and in fact exceed, the USS Trustee's request *in respect of the rule change component* would deliver the greatest value for money for employers (in terms of its impact upon the deficit recovery contributions) and have the potential to be supported by employers. We have raised substantial arguments to challenge the USS Trustee's rationale for seeking a long-term rule change – and our concerns remain – however the proposed rule change measure set out in the table below is put forward for employers to consider. If there is employer support, the proposed measures would then be taken forward to the USS Trustee as a genuine movement, which can hopefully secure an overall acceptable outcome.

In terms of the equal security for USS on new secured borrowing component of any covenant support measures (the so-called pari-passu provision), again we believe that if we can offer some flexibility to the USS Trustee we will try to do so, and have developed the proposal accordingly. In return, we would also need the USS Trustee to reciprocate on this flexibility.

We would emphasise that we are not asking employers to consider the measures in isolation; any statements of the support would be entirely conditional upon securing the kind of overall valuation outcome illustrated in this paper.

In the table below we provide a summary of the alternative covenant support measures on which we seek your views.

Alternative Approach (UUK proposal, March 2021)	
Debt monitoring	De minimis to limit metric testing to material employers.
Pari-Passu (equal) security on new secured debt	Metric E threshold for Gross Secured Debt: c15% of Net Assets and c15% of Gross Assets, (all subject to an appropriate de minimis provision)
Rule change on employer exits	20 year rolling moratorium on employer exits without USS Trustee consent (applying to all employers)

Would employers be willing to support the updated, alternative covenant support package which UUK has illustrated, as the means to achieve a solution which might be acceptable in the round? Or are there areas of the covenant support measures which cause particular concern and you would wish to see modified?

The covenant measures should now allow the USS Trustee to implement a recovery plan of sufficient length (somewhere between 15-20 years in duration) and with allowance for asset outperformance in line with the USS Trustee's scenario 3 assumptions (for a strong covenant). This approach could reduce the deficit recovery contribution to something in the region of 6%-7% of pay.

At current contribution rates, this provides around 24-25% of pay (30.7% minus 6% or so) for future service cost, in line with the future service contributions paid up until the 2017 valuation.

If we then look at the covenant support package alongside future benefits based upon 24-25% of pay, then it is clear that some element of benefit reform is still needed (if we are to keep to current contributions). If less DB benefit is building up in the future, then all things being equal there is less risk in the system going forwards. This should mean that, given this reduced future defined benefit risk, the covenant support package is even more valuable (as it is no longer being measured against current benefits, but future benefits with less DB in the system).

Our view and that of actuarial advisor, Aon, suggests that the combination of these factors should allow the USS Trustee, if it is minded, to make some allowance within the valuation assumptions and take a less prudent position than it has done based upon current benefits.

The USS Trustee has said it will reconsider its assumptions and decisions should the facts of the valuation change, namely: the covenant support package, future benefits, and post-valuation date funding experience. The Pensions Regulator has also expressed a similar view in that it will look again should the covenant support package and/or future guarantees for benefits change, although we do not know to what extent that might influence their views on the degree of prudence.

So, illustratively, where does that leave us?

The Aon note suggests that there are a few possible routes for the USS Trustee to take this all into account in the valuation assumptions, and of course we need to be careful that we don't double count any of the risk mitigating measures and bring too much risk back into the calculation. On what we would consider to be a reasonably prudent basis, benefits in the order of the following could be achieved:

DB salary threshold: £40,000

DC contribution above threshold: 20%

CPI indexation before and after retirement: capped at 2.5% p.a.

Pre-retirement discount rate	Accrual rate	Future service contributions	Deficit contributions	Total contributions	Recovery plan length
Gilts+2.75%	1/85	25.3%	5.4%	30.7%	c.18 years
Gilts+3%	1/85	24.5%	6.2%	30.7%	c.15 years

These figures are approximate and there could be alternative options in the middle of the ranges shown, i.e. a discount rate between gilts+2.75% and gilts+3% with a recovery plan length of between 15 and 18 years. In particular, the USS Trustee may prefer to have a lower bound of 6% on the deficit contributions, since this is the rate due to apply from 1 October 2021.

If instead, the accrual rate was to be maintained at 1/75 then a total contribution rate of 30.7% could be achieved by reducing the salary threshold to £30,000 with contributions as set out below.

Salary threshold: £30,000

DC contribution above threshold: 20%

CPI indexation before and after retirement: capped at 2.5% p.a.

Pre-retirement discount rate	Accrual rate	Future service contributions	Deficit contributions	Total contributions	Recovery plan length
Gilts+3%	1/75	26.0%	4.7%	30.7%	c.18 years

In practice, since the deficit contributions fall below 6%, then this option may be deemed unacceptable by the USS Trustee. Similarly, a scenario with an 1/80 accrual rate and a £40,000 threshold can be shown to cost no more than 30.7%, but it would also require a deficit contribution of under 6%.

All figures in the tables above allow for asset outperformance in the recovery plan of 0.5% p.a.

The above example designs make some assumptions about the preferred balance of advantage between amending the accrual rate, threshold, and adding the 2.5% cap. From our perspective:

- The accrual rate change applies to all members. To the extent there is a desire to protect lower paid staff, it is desirable for the accrual rate change to be minimised. We have assumed that stakeholders would wish to see no worse than around 1/85ths

- For the salary threshold, we have established that 43% of members have earnings of £40,000 or lower; and around two-thirds of members have 80% or more of the salary covered by £40,000. There is a balance here between protecting lower paid staff, but also ensuring a good proportion of benefits are covered by DB within the hybrid. We have assumed the minimum stakeholders would wish to see is a threshold of around £40,000
- For the 2.5% cap, our view is that the USS approach is unusual compared with most private sector schemes, and including a 2.5% cap is not unreasonable compared with wider market practice. Including this is necessary to enable the accrual rate and salary threshold to fall within acceptable zones
- Finally, we have assumed that the 20% DC contribution remains in place above the threshold. We felt this may be important as a lower threshold will bring an increased portion of members into receiving DC benefits.
- Additionally, if the DC contribution rate is lowered, then this will exacerbate cross-subsidies between institutions that have higher earning members, and others, which could undermine the mutuality of the scheme

It is possible that the USS Trustee will not allow these parameters to be applied, which would mean that further benefit changes would be needed. We very much hope that this is not necessary, and the purpose of the illustrations is to try to show what may be possible if employers can increase the covenant support to a similar, and in places better, level than used in scenario 3.

The chart below shows the distribution of salaries (by age), which gives an indication of the membership that could be affected by a change in the DB salary threshold. For example, 43% of the active membership would remain wholly in the DB section if the salary threshold were reduced to £40,000. Further membership demographics can be found in annexe A, including the distribution of the membership by age and years of USS service.

	£0-5k	£5-10k	£10-15k	£15-20k	£20-25k	£25-30k	£30-35k	£35-40k	£40-45k	£45-50k	£50-55k
<25	321	120	122	154	219	381	305	91	20	5	*
25-29	1,292	721	483	466	647	1,209	3,588	1,722	658	247	64
30-34	1,029	893	698	787	979	1,388	5,863	6,187	4,283	2,446	782
35-39	711	779	681	971	1,276	1,441	3,773	4,804	6,333	4,751	2,655
40-44	490	630	697	907	1,213	1,295	2,614	2,908	5,017	4,498	3,415
45-49	456	526	622	728	992	1,066	2,088	1,950	3,673	3,405	2,667
50-54	428	482	555	673	906	989	1,744	1,471	3,058	2,708	2,376
55-59	406	495	562	634	801	843	1,452	1,079	2,231	2,019	1,902
60-64	310	451	461	487	590	579	835	643	1,166	1,035	934
65+	300	378	376	367	434	358	384	319	478	367	308
Total	5,743	5,475	5,257	6,174	8,057	9,549	22,646	21,174	26,917	21,481	15,106

	£55-60k	£60-65k	£65-70k	£70-75k	£75-80k	£80-85k	£85-90k	£90-95k	£95-100k	£100-105k
<25	*	*	*	*	*	*	*	*	*	*
25-29	31	16	7	7	7	*	*	*	*	*
30-34	415	156	73	52	23	19	8	17	10	8
35-39	1,686	735	326	233	122	91	47	56	40	23
40-44	2,853	1,733	802	581	294	266	181	125	141	80
45-49	2,696	2,111	1,047	850	510	352	295	265	194	154
50-54	2,328	2,099	1,038	956	663	520	476	316	265	218
55-59	1,916	1,715	868	842	575	513	545	354	271	289
60-64	969	907	528	487	373	310	320	262	213	185
65+	393	351	201	217	179	144	178	147	114	117
Total	13,288	9,825	4,891	4,226	2,736	2,218	2,051	1,544	1,248	1,074

	£105-110k	£110-115k	£115-120k	£120-125k	£125-130k	£130-135k	£135-140k	£140-145k	£145-150k	£150+
<25	*	*	*	*	*	*	*	*	*	*
25-29	*	*	*	*	*	*	*	*	*	*
30-34	*	11	*	5	*	*	*	*	*	16
35-39	16	26	15	14	7	*	6	7	*	33
40-44	41	36	30	22	35	23	16	22	10	65
45-49	121	71	57	66	37	31	30	25	16	108
50-54	162	123	106	102	67	67	49	50	30	217
55-59	211	180	124	130	117	70	81	72	61	309
60-64	153	142	106	93	76	55	37	38	42	265
65+	64	86	57	52	39	34	31	19	22	124
Total	773	677	499	485	380	286	252	236	186	1,140

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We fully appreciate that benefit changes will be unwelcome for members of the scheme. However, unless both employers and members agree to pay much higher contributions we cannot see another solution to this valuation.

Employers are committed to providing the very best pension benefits possible for members, but the contribution to the scheme needs to be affordable and sustainable – for both members and employers. Through this consultation we want to hear employer views on this, but to date employers have told us that that current contributions are at the limit of acceptability. To put more money into pensions would require sacrifices from other areas, whether that would be other elements of reward, or impacts on university finances which in turn may impact research, teaching or the wider student experience – including investing in universities and enhancing the covenant which supports the scheme in the long-term.

How sustainable is this option – will we be back here again in three years' time?

The suggested approach would have a materially better than 50:50 chance of being robust at the next valuation, since the assumptions are chosen on a prudent basis relative to the expected returns on the scheme assets. However, it is important to note that this was also the case in the 2014 valuation when so-called Test 2 was designed to give a 70% chance of contributions not needing to increase at the next valuation, and a 90% chance of contributions not needing to increase by more than 3%.

With a DB structure and fully guaranteed benefits, it is impossible to be sure that a benefit design is sustainable in future. But there is a balance to be had. Making more significant changes to the benefits would result in a benefit structure that has more likelihood of being sustainable at subsequent valuations, but at the cost of providing a greater cut to guaranteed benefits for the current generation of active members. In coming to a suggested hybrid design, we have taken the view that employers would generally prefer 'minimal design alterations', and will see a move to 1/85ths, a £40,000 threshold along with the 2.5% pension increase cap as being potentially acceptable changes, when considering the alternatives. However, if employers would prefer different designs then please let us know in the consultation response.

A view on the sustainability of this option would need to take into account views of market movement, economic assumptions and the impact these will have on scheme funding. It is difficult to predict too far into the future but there is a good possibility that the 2023 valuation might, through this type of benefit adjustment, be on a more sustainable footing for the nearer future and allow more of a "minor-service" check at the next valuation date, if markets do not deteriorate.

As a final comment, if new entrants to the scheme were only eligible for a new DC alternative option, then this would over time substantially reduce the amount of DB liabilities in the scheme. With a dual discount rate approach being adopted by the Trustee, there should also be no need for any immediate changes to the assumptions to reflect a closed population. We have assumed that closing the hybrid scheme to new entrants is not the employers' preference at this point, but please let us know through your feedback whether you would like to explore this option further.

There are two other important elements that employers have consistently raised with UUK in earlier consultations:

- flexibility in the scheme offering to address the circa 15-20% opt-out rate;
- and scheme governance.

It is anticipated that to support covenant measures and a pathway to a sustainable scheme, both these elements will also need to be factored into the solution and roadmap. We cover both these elements in the next sections of this consultation document.

SECTION 4: FLEXIBILITY

ADDRESSING THE OPT-OUT RATE

The USS Trustee has data which shows that between 15% and 20% of employees eligible to participate in the scheme are choosing not to be members. This is an alarmingly high number. Many pension schemes have non-participation rates at around 5%. We currently have a two-tier scheme, where some people have a strong pension offering, but others are being priced out by a 9.6% member contribution rate and therefore have no pension benefits, nor the bereavement and incapacity benefits provided through USS unless the employer (or the individual) makes alternative life insurance provision for those members opting-out.

Through recent consultations and wider engagement with participating employers, we have had an overwhelming response to say that we must collectively look at ways to address the scheme's high non-participation rate.

Annexe D, provides background information and data in relation to the current opt-out rate in the scheme. Information is also provided setting out some of the possible approaches to addressing the non-participation rate, together with future potential flexibilities, which employers are invited to provide comments on as part of responding to this consultation.

SECTION 5: GOVERNANCE

Throughout this and recent valuation processes, employers have provided significant feedback to UUK and to the USS Trustee directly in relation to the governance and processes surrounding the actuarial valuation.

While a number of areas on governance were identified in the Joint Expert Panel's report, and good progress has been made in some of these areas through the tripartite talks (between USS, UCU and UUK), the feedback we are receiving from employers is that certain aspects of the governance of the scheme appear to hinder rather than assist the discussions – and do not act in the interest of scheme members or sponsoring employers.

As an example, employers have been asking to see valuation outcomes in the round since the very start of the 2020 valuation discussions, which commenced in late 2019. It is only now through this consultation that employers can start to see how the component parts of the valuation influence one another – with just three months to go until the statutory deadline. Even now, important parts of the valuation remain unknown for employers, for example, we have illustrative deficit recovery contributions in the material presented by the USS Trustee, but that formal consultation with employers is now set to take place much later in the process.

How can employers be expected to take such important decisions, which affect the future of their business in relation to covenant support measures and the scale of any benefit reforms, without a sound foundation for doing so, a strong degree of certainty and a clear appreciation of the enduring value of such commitments.

Employers have commented that the balance of power within the scheme looks at odds with how employers might have envisioned the scheme when employers created it. It would have been impossible in 1975 to envisage the scale of the scheme, the regulatory environment, and the fiduciary duties and responsibilities which the stakeholders now operate. Trust and confidence in the scheme have been strained in recent years. The scheme governance is long overdue a review.

SECTION 6: QUESTIONS FOR EMPLOYERS

(A) COVENANT SUPPORT MEASURES

1. Would you be willing to support the alternative covenant support package which UUK has outlined in section 3, as the means to achieve a solution which might be acceptable in the round (see also question 15)?
2. If the USS Trustee is not willing to accept UUK's alternative proposal (should there be employer support for it), would you be willing to support the USS Trustee's scenario 3 covenant support package to obtain a 'strong' covenant rating? If not, why is this and what level of covenant support would you be willing to provide?
3. Are there areas of the covenant support measures which cause you particular concern, or which you would wish to see modified? Please provide details.
4. Are there other areas of covenant support you would wish to consider such as contingent contributions or asset pledges?

(B) CONTRIBUTIONS

5. Do you agree that the current levels of employer contribution (21.1% of salary) and member contribution (9.6%) are the maximum sustainable – and should be the foundation for any solution?
   a. If not, please state the level of employer contribution you would be willing to pay to USS following the 2020 valuation.
   b. We would welcome any commentary on the reasons for your views.
   c. We would also welcome employer views on the level of member contribution.

(C) BENEFITS

6. Do you support the broad principle of seeking to retain the hybrid benefit structure?
7. Looking at the illustrative hybrid benefits which UUK has put forward, would you consider this an acceptable outcome in terms of benefits at this

valuation – based on the positions on covenant support and contributions laid out?

8. If the illustrated hybrid would not be acceptable, what alternative benefit arrangements would you wish to provide (and please indicate alternative positions on covenant and contributions as appropriate)?

   (For example, if the USS Trustee does not ultimately amend its assumptions, would you wish to offer a hybrid solution as set out in the USS Trustee's illustrations (p18 of the Update Report) or would you prefer to move to a different offering, such as DC provision?)

9. Would you wish to explore conditional indexation or other conditional benefit models as a possible solution (likely longer-term, beyond the 2020 valuation)?

(D) FLEXIBILITIES AND OPTIONS

10. Would you like to see flexibilities implemented for members to move away from the current uniformity of the USS structure, and if so which flexibilities do you think are particularly important?

11. Would you support the creation of a lower cost saving option for members and which of the parameters described in this paper are most important / or would need modification?

    (If yes, we would welcome employer views on the options to achieve this (potentially informed via engagement with eligible USS employees).)

12. Would you support the creation of an option for members to switch (from the hybrid structure) to wholly DC pension saving?

    (We invite employer views on whether the same deficit recovery contribution should be made for members choosing any new flexible DC alternative option, and what levels of member and employer contributions devoted to DC pensions saving should apply).

13. Would you wish to explore options for employers so that they can offer some variations to the USS standard benefits in the future – and if so, what would those variations be?

(E) GOVERNANCE

14. We would welcome views from employers in relation to the governance of the scheme and the valuation process (including views on the Joint Negotiating Committee). Specifically, would you support a post valuation governance review, and what areas what you like to see covered in such a review?

(F) UUK ALTERNATIVE APPROACH

15. As part of a solution to the 2020 USS valuation would you support the alternative covenant support package illustrated by UUK *(headlines – moratorium of a minimum of 20-years with debt-monitoring and a pari-passu arrangement for secured borrowing above c15% of gross/net assets)*, to provide a hybrid benefits package at current contribution rates in the order of *(pension accrual of 1/85 of salary [plus 3 times lump sum] up to a salary threshold of £40,000 with the CPI indexation of benefits [for active, deferred and pensioner members] capped at 2.5% per annum, and with DC above the salary threshold at an overall contribution of 20% of salary)*, together with a lower cost alternative to address the high opt-out rate, as well as a governance review of the scheme and valuation process?

ANNEXE A:
USS MEMBERSHIP DEMOGRAPHICS

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1a. Members by employment segments

Note: Participation terms as held by USS

1b. Heat map of members by age (5 year) and salary band (5k)*

	£0-5k	£5-10k	£10-15k	£15-20k	£20-25k	£25-30k	£30-35k	£35-40k	£40-45k	£45-50k	£50-55k	£55-60k	£60-65k	£65-70k	£70-75k	£75-80k	£80-85k	£85-90k	£90-95k	£95-100k	£100-105k	£105-110k	£110-115k	£
<25	321	120	122	154	219	381	305	91	20	5	*	*	*	*	*	*	*	*	*	*	*	*	*	
25-29	1,292	721	483	466	647	1,209	3,588	1,722	658	247	64	31	16	7	7	7	*	*	*	*	*	*	*	
30-34	1,029	893	698	787	979	1,388	5,863	6,187	4,283	2,446	782	415	156	73	52	23	19	8	17	10	8	*	11	
35-39	711	779	681	971	1,276	1,441	3,773	4,804	6,333	4,751	2,655	1,686	735	326	233	122	91	47	56	40	23	16	26	
40-44	490	630	697	907	1,213	1,295	2,614	2,908	5,017	4,498	3,415	2,853	1,733	802	581	294	266	181	125	141	80	41	36	
45-49	456	526	622	728	992	1,066	2,088	1,950	3,673	3,405	2,667	2,696	2,111	1,047	850	510	352	295	265	194	154	121	71	
50-54	428	482	555	673	906	989	1,744	1,471	3,058	2,708	2,376	2,328	2,099	1,038	956	663	520	476	316	265	218	162	123	
55-59	406	495	562	634	801	843	1,452	1,079	2,231	2,019	1,902	1,916	1,715	868	842	575	513	545	354	271	289	211	180	
60-64	310	451	461	487	590	579	835	643	1,166	1,035	934	969	907	528	487	373	310	320	262	213	185	153	142	
65+	300	378	376	367	434	358	384	319	478	367	308	393	351	201	217	179	144	178	147	114	117	64	86	
Total	5,743	5,475	5,257	6,174	8,057	9,549	22,646	21,174	26,917	21,481	15,106	13,288	9,825	4,891	4,226	2,736	2,218	2,051	1,544	1,248	1,074	773	677	

* Denotes where numbers <5

Excluding member records where salary data is not available (3556 members)

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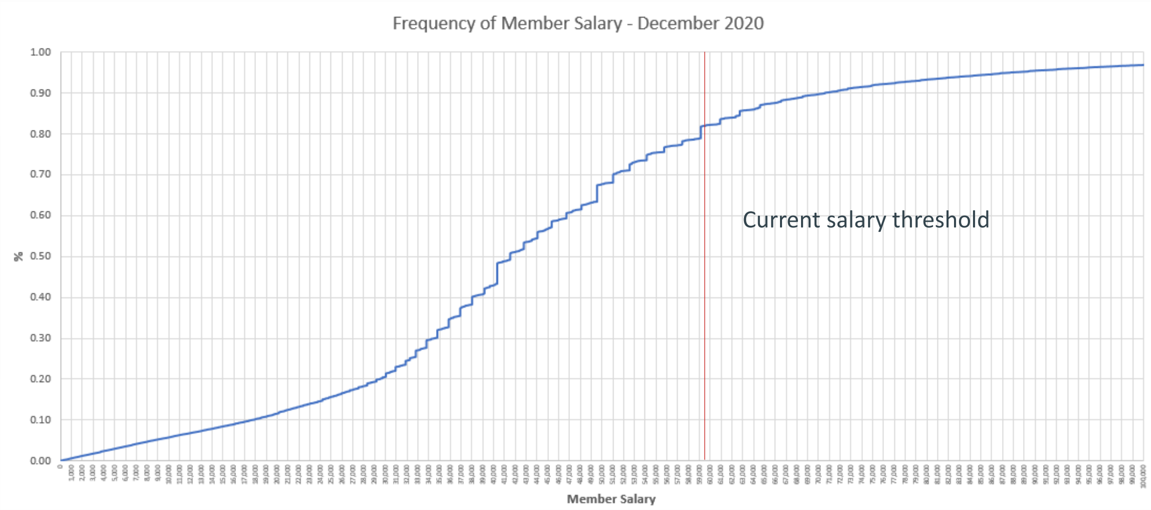
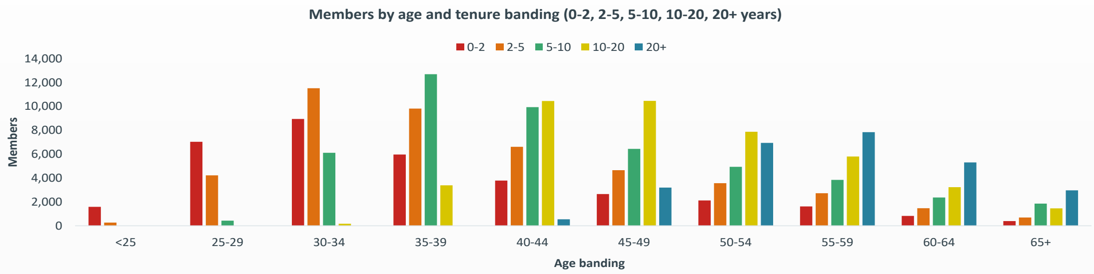
1c. Members by salary band (1k) – cumulative distribution



* For presentation purposes the chart excludes member salary bands above £100k

[Restricted: Business Sensitive]

1d. Members by salary band (1k) – cumulative distribution

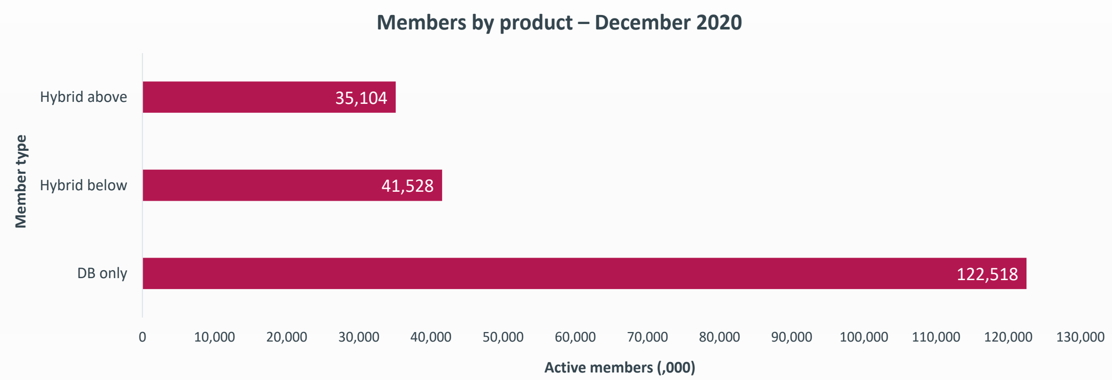


Member age banding	Tenure banding (years service)					
	0-2	2-5	5-10	10-20	20+	Total
<25	1,589	268	14			1,871
25-29	7,032	4,227	429	3		11,691
30-34	8,945	11,517	6,113	174		26,749
35-39	5,971	9,811	12,690	3,391		31,863
40-44	3,785	6,610	9,931	10,444	547	31,317
45-49	2,659	4,657	6,443	10,457	3,201	27,417
50-54	2,125	3,570	4,936	7,875	6,941	25,447
55-59	1,625	2,728	3,843	5,802	7,839	21,837
60-64	827	1,471	2,373	3,232	5,305	13,208
65+	399	697	1,857	1,460	2,969	7,382
	34,957	45,556	48,629	42,838	26,802	198,782

*Does not total to active membership as excludes member records where tenure or date of birth data is not available

[Restricted: Business Sensitive]

1d. Members by benefit type and salary threshold



* More than 18k 'Hybrid below' members did not make a contribution during the month of December 2020, but have funds in Investment Builder

[Restricted: Business Sensitive]

ANNEXE B: BACKGROUND AND CONTEXT BRIEFING

This briefing provides the background and context of the 2020 USS valuation, including a timeline of key developments.

USSEmployers

Background and context of the 2020 USS valuation

This briefing provides the background and context of the 2020 USS valuation and sets out the next steps before the valuation is expected to be concluded under the regular timetable by the end of June 2021[1].

Summary

Universities UK (UUK) has launched a formal consultation with employers in the Universities Superannuation Scheme (USS), seeking views on ways of creating a valuable, affordable, inclusive, and sustainable scheme for their staff for the long term.

Earlier this month, the USS Trustee said that the cost to maintain current benefits would need to increase substantially; by at least 11% and possibly up to 25% of salary.

Alongside the seven-week consultation (running from 7 April to 24 May), UUK will continue pressing the USS Trustee to reconsider its valuation assumptions, having recently expressed concerns to both the Trustee and The Pensions Regulator over the high level of prudence applied to the 2020 valuation.

The consultation outlines options for tackling the scheme's increasing costs, sizeable deficit, and high member opt-out rate. An alternative approach to the 2020 valuation is proposed which, if adopted by the USS Trustee, should reduce headline costs and provide scheme members with valuable pension benefits at sustainable and affordable contribution rates.

Employers are being asked if they can offer additional financial backing – or covenant support – to lessen the rise in contributions. Considered alongside other reforms, this could enable a significant defined benefit element to be preserved at current contribution levels. Employers are also asked whether they would support the introduction of a new, short-term flexible option for the growing number of early career staff who are currently being priced out of the scheme.

Download the briefing

ANNEXE C: ADDITIONAL COVENANT SUPPORTING MEASURES

DEBT MONITORING FRAMEWORK

The USS Trustee consulted on a debt monitoring framework in July 2020, which included arrangements for the granting of equal, or pari-passu, status on new secured debt where it exceeded certain thresholds. UUK responded to the trustee with the views of employers on 24 September 2020.

The USS Trustee has further considered the framework, and has provided updated documents for consultation. These should be reviewed by employer finance specialists as part of this consultation.

Attached to this annexe are three supplementary documents provided by the USS Trustee, which are as follows:

- Document C1: a consultation cover note on the covenant support measures.
- Document C2: sets out the detailed provisions for the debt monitoring framework (assumed to underpin scenarios 2 and 3).
- Document C3: the proposed arrangements for the introduction of a rule change on employer exits (again assumed to underpin scenarios 2 and 3). Employers may wish to share this information with their legal advisers.

In this consultation UUK wishes to invite the views of employers on a modified proposal for covenant support measures which we believe is at least equivalent to those assumed for the USS Trustee's scenario 3 and in fact in certain aspects exceeds those measures. The modified proposal would be along the following lines:

Alternative approach (Alternative UUK proposal, April 2021)	
Debt monitoring	De minimis to limit metric testing to material employers
Pari-Passu (equal) security on new secured debt	Metric E threshold for Gross Secured Debt: c15% of Net Assets and c15% of Gross Assets
Rule change on employer exits	20 year rolling moratorium on employer exits without USS Trustee consent

There are some particular aspects of the UUK proposal which we like to draw to the attention of employers:

De minimis provision on pari-passu

We are in discussions with the USS trustee about the precise form of any de minimis provision for the pari-passu provisions. The USS Trustee has assumed for scenario 3 that these would be set by reference to levels of income and assets, however we believe we need a more specific measure which focuses this measure on employers which are genuinely material to the USS covenant. We have discussed introducing two additional factors in the de minimis provision, namely (i) relating to the share of the scheme's liabilities attributable that a particular employer assessed on an appropriate basis and (ii) the proportion of USS members to an employer's workforce overall (to identify those employers for which USS is a very minor part of overall workplace pension provision). We are hopeful of finding an acceptable de minimis provision along these lines, and we will engage further with employers on this throughout the consultation.

Securing enduring value

We want to ensure that employers can gain enduring value for these covenant support measures should they be agreed, or otherwise for employers to be able to decide to exit from them. We expect that the trustee would want a period of notice of any such decision to exit from the arrangements – beyond any initial period confirmed (as is the case with the proposed rule changes which have a minimum term) – and for the USS Trustee to be able to then adjust its funding approach and assumptions accordingly. If this proposal receives the indicative support of employers, we will engage with the USS Trustee to find ways in which the arrangements can be established so as to offer some enduring value and/or with a mechanism for exit from such arrangements, and we will look forward to leaning upon the USS Trustee's help and expertise in finding and agreeing what will need to reasonable measures for both parties.

Covenant enhancing secured borrowing:

A central feature of the USS Trustee's proposed arrangements is that secured borrowing which is 'covenant enhancing' will be excluded from the pari-passu arrangements. This has not been defined at this stage, however this is important – and we look forward to working with the USS Trustee to find an acceptable basis for this exemption which we believe could be very useful to employers as they see the proposals developed and consider their potential support for them.

The modified UUK proposal as a package

We are keen for employers, and indeed the USS Trustee, to consider the proposal tables as a package. In the proposal we have gone much further on the rule change aspect of the package as it potentially offers greatest value to the USS trustee and the Pensions Regulator – and potentially creates the link to a longer recovery plan for the scheme deficit. But we believe that the proposed move on the rule change allows the USS Trustee to take a reasonable view on the proposed pari-passu arrangements, which again we believe go a long way to meeting any reasonable expectations of support – and the ability to present a strong and coherent case on covenant to the Pensions Regulator if that is needed.

We would emphasise that UUK will need to take further legal advice on the proposed measures should there be an indication from employers in this consultation that they might be able to offer their support. This legal advice would need to cover issues including any additional details on which further engagement might be needed, the legal execution of any arrangements, and – in relation to the rule change on employer exits – making the most effective transition from the existing temporary moratorium to the longer-term arrangements outlined (something on which we continue to have a dialogue with the USS Trustee).

HEADLINES SUMMARY TABLE

Scenario 1
No additional covenant support.

Scenario 2 (UUK proposal, November 2020)	
Debt monitoring	De minimis to limit metric testing to material employers
Pari-Passu (equal) security on new secured debt	Metric E threshold for Gross Secured Debt: 20% of Net Assets (Removal of additional test on gross assets from Metric E)
Rule change on employer exits	6 year rolling moratorium on employer exits without USS Trustee consent

Scenario 3 (USS Trustee proposal, March 2021)	
Debt monitoring	De minimis to exclude smallest employers from metric testing (total income < £50m and gross assets < £50m)
Pari-Passu (equal) security on new secured debt	Metric E thresholds for Gross Secured Debt: 10% of Net Assets and 10% of Gross Assets
Rule change on employer exits	12 year rolling moratorium on employer exits without USS Trustee consent Expiry of moratorium after end of Recovery Plan period for 2020 valuation
Alternative approach (Alternative UUK proposal, March 2021)	
Debt monitoring	De minimis to limit metric testing to material employers
Pari-Passu (equal) security on new secured debt	Metric E threshold for Gross Secured Debt: c15% of Net Assets and c15% of Gross Assets
Rule change on employer exits	20 year rolling moratorium on employer exits without USS Trustee consent

ANNEXE D: CONDITIONAL BENEFITS

Conditional benefits broadly use a defined benefits model but where only nominal benefits are guaranteed, but with the intention to provide greater levels of benefit where funding levels allow.

Collective defined contribution schemes which pool the investment risk across the members and target a benefit outcome are seen in various forms in other countries (eg the Netherlands, Denmark and Canada) however the legislation to allow schemes of that nature in the UK has not yet been approved but is due to be shortly for single employer schemes. There has also been discussion in the UK in relation to more innovative decumulation products that would provide mechanisms for providing some element of guarantees and pooling of risks for those that have built up DC savings in the accumulation stage.

CONDITIONAL INDEXATION

Conditional indexation can be achieved to a limited extent under current legislation ie only discretionary increases on pre-retirement benefits (so no guaranteed indexation) and increases limited to CPI or 2.5%, whichever is the lower for post-retirement increases. The challenge is how to deal with auto-enrolment as the minimum quality requirements needed by the auto-enrolment legislation for a CARE DB scheme like USS would not be satisfied if pre-retirement increases were to be granted on a discretionary basis. A change in those requirements had been proposed by several organisations responding to the recent DWP consultation. The DWP has now responded to this consultation. It confirmed that the alternative quality requirements for DB schemes will continue in place without change. The next statutory review will take place in 2023.

Significant changes to the current scheme would be required to introduce any element of conditionality.

We have done some exploratory work on condition indexation with Aon and with support of the USS Trustee. The headlines of our analysis to date are set out in the box below. Greater detail on some of the factors to consider are provided in the Aon advice note.

- Gives greater certainty from a member's perspective as the conditionality applies to preretirement increases only (ie, active and deferred revaluation).
- There would remain a need for flexibility over the contribution rate to fund

guaranteed benefits, if the desired level of contributions proved to be inadequate

- This structure applied to a CARE arrangement such as USS Income Builder is currently not auto-enrolment compliant. It may be possible to structure DB benefits in an alternative way so as to satisfy one of the 'alternative quality requirements' tests. Broadly, this enables a DB scheme to meet the quality requirement where certain conditions are satisfied, including – significantly that the benefits provided to the member are calculated by reference to factors which include the contributions made to the scheme by, or on behalf of, the member. Fundamentally, the DB element of members' pension would be 're-expressed' (for future service), defining it not by way of the underlying rate of accrual as now, but as a level of pension calculated by reference to the contributions received.
- Post-retirement pension increases would be subject to a minimum level of inflation capped at 2.5%, but conditional increases above this level could also be considered if desired.

Scenario	DC contribution rate above threshold	Salary threshold	Indicative accrual rate (based on no pre-retirement indexationand indexation capped at 2.5% post
2	12%	£40k	1/110
		£30k	1/105
3	16%	£40k	1/75
		£30k	1/70

USS has also kindly illustrated what type of benefit could be provided through this approach for current contribution levels – albeit further and more detailed consideration would need to be given for the expectation and method for granting any indexation.

We expect that there will be a level of interest in further exploring the opportunities which conditional indexation might provide and potentially into other conditional benefit models, such as collective defined contribution schemes, as and when legislation allows. However, taking a realistic view of the considerations set out in the Aon note and the collective work needed to explore and agree a conditional indexation approach, this appears to be something which will be challenging to agree and implemented within, or close to, the timeline for the 2020 valuation.

As part of considering the potential impact of “conditional indexation”, we asked the USS Trustee for an indication of the accrual that could be provided if based on providing the minimum legal level of guaranteed increases for future accrual, ie no pre-retirement increases, and post-retirement increases of CPI capped at 2.5%.

The table above shows estimates of the maximum structures which could be provided, with no additional margin for adverse experience (other than the prudence currently within the assumptions). For these figures the same assumption for the 2.5% cap has been used as in the other scenarios. As such these figures provided by the USS Trustee should only be considered indicative.

If this were used as the basis of a ‘conditional indexation’ structure, under this type of arrangement, the pension benefit would have no guaranteed increases before retirement and only CPI capped at 2.5% a year in retirement. Increases above this level would be granted on a discretionary basis, but once granted cannot be taken away.

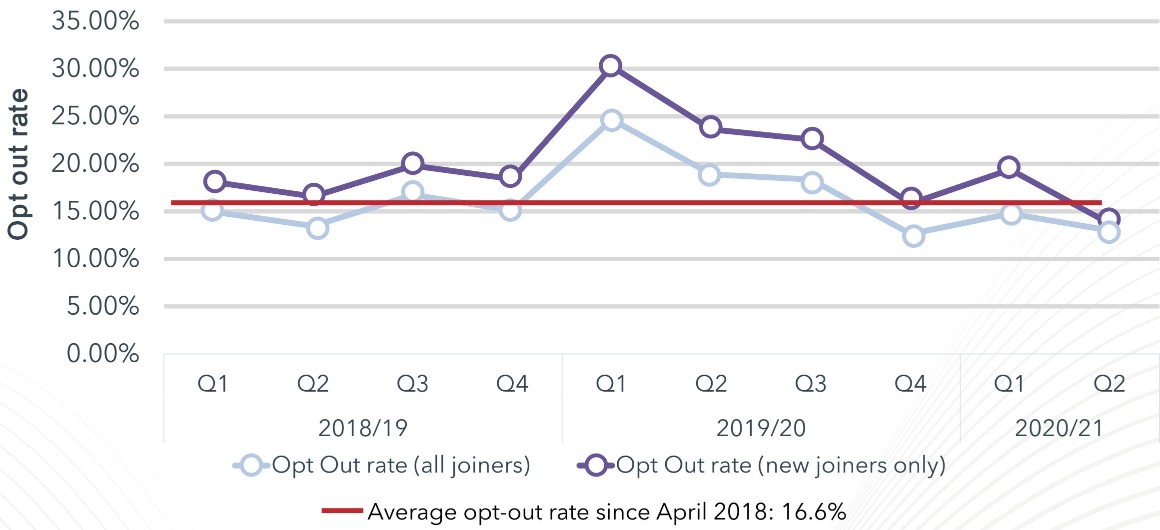
ANNEXE E: FLEXIBILITY AND OTHER OPTIONS

ADDRESSING THE OPT-OUT RATE

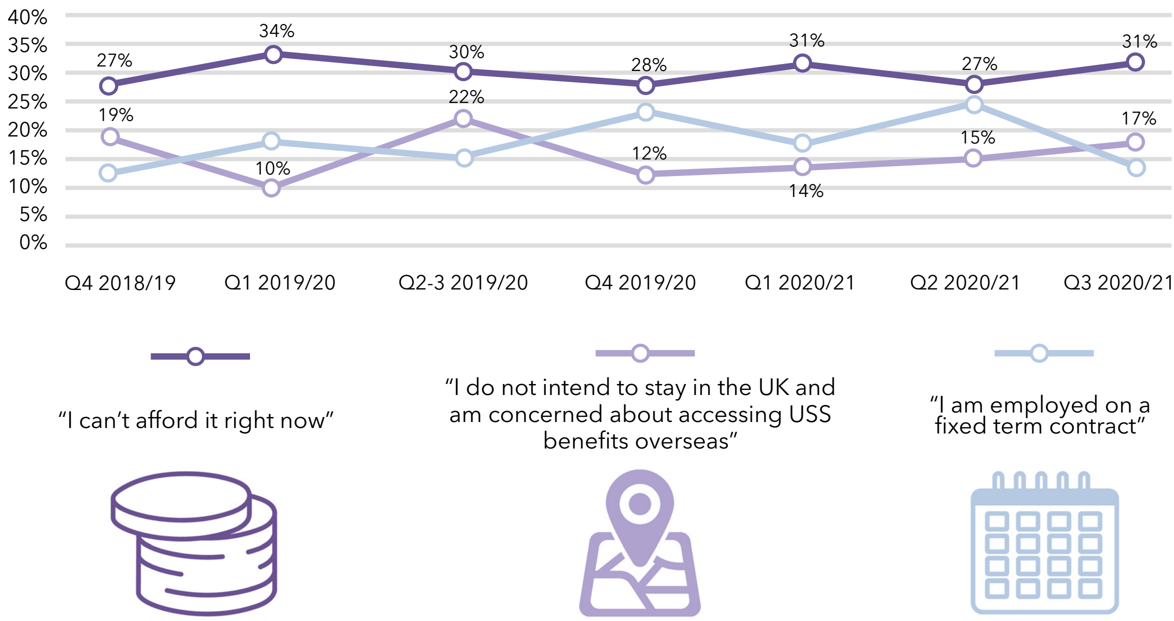
The USS Trustee has data which shows that between 15% and 20% of employees eligible to participate in the scheme are choosing not to be members. This is an alarmingly high number. Many pension schemes have non-participation rates at around 5%. We currently have a two-tier scheme, where some people have a strong pension offering, but others are being priced out by a 9.6% member contribution rate and therefore have no pension benefits, or bereavement and incapacity benefits also provided through USS unless the employer makes alternative life insurance provision. for those members opting-out.

It is appreciated that the non-participation rates will vary from employer to employer and there will be specific reasons for particular members choosing to opt-out/withdraw from the scheme. The chart below shows the reasons that members provided for choosing to opt out of the scheme.

The data USS holds in relation to opt outs is not perfect as not all employers are resourced to collect and submit this data to USS, and there may also be a combination of reasons why members are choosing to opt out of scheme membership. We would encourage employers to explore the opt out levels and reasons for this locally, and to share this data with USS if you are able to do so.

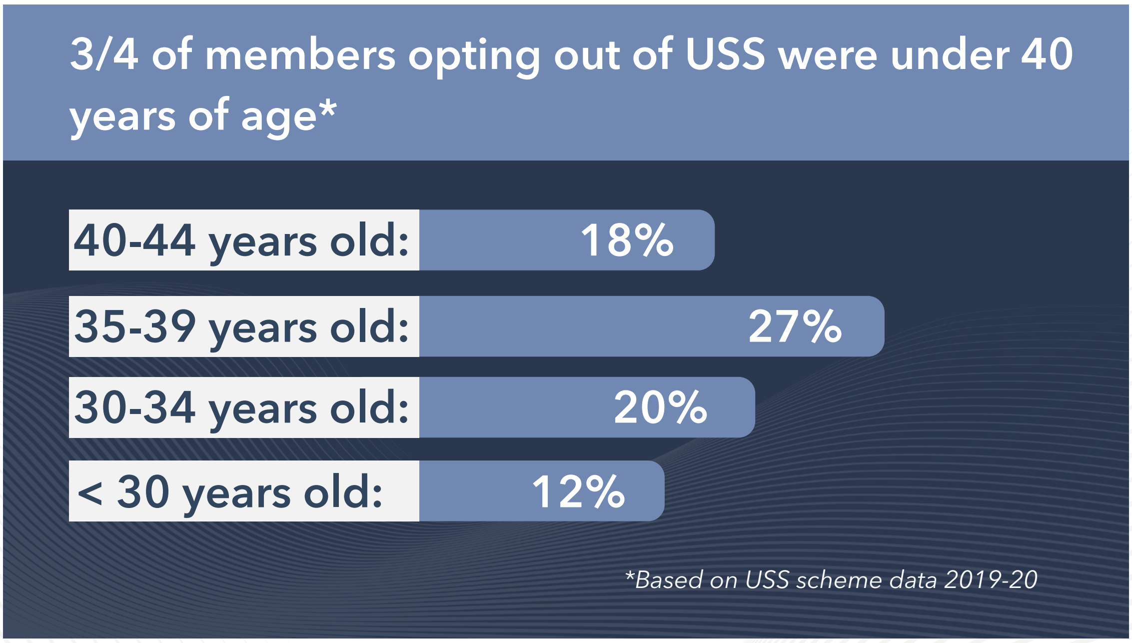


Source: USS opt-out reasons and trends: Q4 2018/9 - Q3 2020/21 (results are based on a sample of employers who respond to the quarterly request. The sample varies over time but all times represent at least 30% of the USS membership



The data clearly shows core themes for people deciding to opt-out, with affordability, expected time in post/academia, and not intending to stay in the UK being the main reasons.

When we dig a bit deeper into the data, we can see the 3 out of every 4 people opting out of the scheme are aged under 40 years of age, and often citing the reason that they "can't afford it right now". However, any solution to address scheme opt-outs should also consider staff with more itinerant higher education careers, as this is a theme within the USS data.



The JEP commissioned a piece of work on meeting the needs of members which also recognised concerns over the one-size-fits-all offering – see the second JEP report.

It is perhaps unsurprising that younger people, typically on lower salary bands, have competing priorities on their finances than more established colleagues. However, we must be careful not to generalise, as there will be people across the breadth of the eligible membership choosing not to be in the scheme for a variety of reasons including financial pressures.

The USS Scheme provides valuable benefits; even through a reformed scheme, with any of the options discussed in this consultation, the value would stand out extremely well against the vast majority of private pension offerings. However, as we explored in the earlier section on contribution rates, we have seen contribution rates rise over recent years, with the member rate now at 9.6% and due to rise again to 11% in October 2021 unless more sustainable levels of contribution are achieved through this valuation.

Through recent consultations and wider engagement with participating employers, we have had an overwhelming response to say that we must collectively look at ways to address the scheme's high non-participation rate. Effectively, employees are giving up the valuable employer contribution which would otherwise be made to the pension scheme.

POSSIBLE APPROACHES TO ADDRESSING THE OPT-OUT RATE

In this consultation we invite views from employers on ways to address the non-participation rate. We would like to suggest that employers seek views from employees and employee representatives (including UCU and other Unions) to assist in informing employers' answers to some of the questions, particularly in relation to benefit design and potentially offering more flexible options for members, and to determine how the intergenerational unfairness in terms of access to pensions can be addressed.

Overall lower member contribution for lower main scheme benefits

One approach would be lowering the standard member contribution rate. However, with employer contributions at the threshold of acceptability, that would mean addressing the reduction in the form of benefit reforms. Nevertheless, if returning the member rate to say 8% were to address the issue for modest benefit reforms then that would present a possible solution – albeit opt-out rates were still relatively high in USS even before the more recent increases in contributions, typically at around 16%

Tiered contributions

In past valuations tiered contributions have been explored, as many employers will be familiar with this concept from the public sector schemes. The amount members contribute to the scheme is based upon their level of pensionable earnings, so that higher contribution rates are paid by higher earners.

It has previously been highlighted that the hybrid structure together with the membership profile of USS means that very careful consideration will be needed to balance a fair approach and any unintended consequences of a tiered contribution structure.

The USS Trustee has, at UUK's request, provided an illustrative example of how such a structure could look based upon current benefits at current contribution rates in the table below:

Band	Salary	Approx number of members, as at 31 March 2020	Example structure: starting at 6%	Example structure: starting 7%
1	£0-£30k	43,000	6%	7%
2	£30-£40k	46,000	7.7%	8.3%
3	£40-£50k	49,000	9.5%	9.5%
4	£50k-threshold	63,000	11.2%	10.8%
5	All salary over the threshold	N/A	9.6%	9.6%

The bands in the table above are constructed with no aggregate change to member contributions (i.e. the total members' contribution remaining at 9.6% of total salaries).

The contribution rates in bands 1-4 apply to all salary, i.e. in a similar approach to that used in public sector schemes, rather than all members pay the same level of contributions on each band of salary, e.g. all members paying 7% on the first £30k of their salary. A member earning over the threshold and thus falling in Band 5, would pay the rate in band 4 up to the salary threshold, and 9.6%

on salary above the threshold. The salary figures used are based on member's actual (rather than full time equivalent) earnings.

There are different possible approaches to determining the contributions applicable in bands 2-4 such that the aggregate position remains the same. In this example the USS Trustee has considered contribution structures such that there are uniform increases between the bands (subject to rounding).

USS has a Voluntary Salary Cap arrangement, which has been designed to offer an option for higher earners to manage pensions tax implications. In short, the member chooses the level of salary upon which they wish to pay pension contributions, and thus builds up a lower benefit accordingly. Consideration could be given to extending this option to members, potentially to below the salary threshold, and whether this option would appeal to eligible employees not currently participating in the scheme.

We think that the information from the USS trustee on illustrative tiered contribution structures is extremely interesting, but any such changes would require considerable thought. For example, the other scheme features would also need to be considered (such as the share of any contribution attributable to deficit recovery, and more generally how this would contribute to greater intergenerational fairness). This is likely therefore to be part of discussions in the longer-term about complementary elements of scheme flexibility.

The other aspect to consider from the USS Trustee's example above is that this is based on the current benefits, so would need to be seen through the lens of higher contribution rates or a revised hybrid structure. For example, if the alternative proposal was ultimately supported which lowered the salary threshold down to circa £40,000 then it is difficult to see how the tiering system could operate.

A tiered contribution model would also introduce complexity for members. Two examples are: (1) if earnings exceeded the salary threshold the contribution rate would be unique to that member, and (2) what is often called the cliff-edge, in that members moving from one tier to another could see their increase in pay affected by the contribution increase, potentially in terms of a net pay reduction.

EXAMPLES OF WHAT OTHER DEFINED BENEFIT SCHEMES ARE DOING

Other pension arrangements have offered other more flexible options to members, as shown in the table below:

Civil Service Partnership Scheme
• The Civil Service offers a DC alternative. It is fully separate from the main scheme (contract based) • It is non-contributory with an automatic age related employer contribution • Employee contributions are matched up to an additional 3% • Low uptake (<2%) but opt out also very low (<2%)

Civil Service Partnership Scheme Contributions	
Age at the last 6 April	Percentage of pensionable earnings
Under 31	8%
31 to 35	9%
36 to 40	11%
41 to 45	13.5%
46 or over	14.75%

LGBS 50-50 option
• The LGPS has reduced cost DB pension. • Employee contributions are half (2.75% – 6.25%) as are benefits. Ancillary beneftis provided in full. • Free movement in and out – and reenolment into the main scheme • Low uptake and used as tax management by some

Network Rail
• Offers a DC arrangement (trust-based) in addition to DB through RPS • Open to all but some employees may have this as their only option • Employee contributions 0–5%; employee contributions 3–7% • Includes death in service cover (insured but equivalent), and incapacity cover (insured)

The Local Government Pension Scheme has a reduced cost DB pension option, where broadly employees pay half the amount and received half the amount of benefit. Our understanding is that take up of this option has been low, and that many using this facility have been higher earners to manage pensions tax implications. This is not the target objective of this exploration, and pensions tax options already exist within USS. That said, we invite employer views on offering a lower cost DB option, where members could pay half the amount to receive half the benefit.

USS has a Voluntary Salary Cap arrangement, which has been designed to offer an option for higher earners to manage pensions tax implications. In short, the member chooses the level of salary upon which they wish to pay pension contributions, and thus builds up a lower benefit accordingly. Consideration could be given to extending this option to members, potentially to below the salary threshold, and whether this option would appeal to eligible employees not currently participating in the scheme.

Flexible Defined Contribution

Another route would be to offer a flexible Defined Contribution (DC) option. This option has the potential to address not only the affordability reasons for opting out of the scheme but also the concerns of people not expecting to be in the sector, or indeed the UK, for very long, due to the potential additional portability of the DC offering. It could be a valuable steppingstone into the main section of the scheme, or a short-term alternative when needed.

There are various ways in which a flexible DC offering could be designed and there are some key considerations to take into account. An advantage of such an offering is that there is already a DC element within the USS hybrid, so combining DB and DC benefits is nothing new. For example, a person becomes eligible to join USS but is uncomfortable with the 9.6% member contribution rate for the main scheme due to other financial commitments/priorities. Rather than opt out of the scheme altogether and have no pension, that individual could choose to pay a lower amount into the USS Investment Builder (DC), say 4%, and still benefit from an employer contribution. At a future point when the person can afford to be in the main scheme they are already starting from a base where they are used to paying some pension contributions and have a pensions pot to combine with the main scheme offering.

Some fundamental questions to consider when designing a possible lower cost DC option

What should the minimum member contribution be?

Some schemes are non-contributory, but consideration would need to be given to the employer contribution for auto-enrolment and value purposes. It might also be desirable to target a minimum combined contribution to the DC section, perhaps to align with what is considered reasonable across the private sector, such as at least in line with the Pensions and Lifetime Savings Association (PLSA) standards at 12%. So, possibly 4% member and 8% employer, or 6% member and 6% employer.

What should the employer contribution be?

Regular membership in the main scheme at present has a deficit recovery contribution. We would invite employer views on whether the employer should effectively cover the deficit contribution for members choosing the flexible DC alternative section. It is difficult to envisage a situation where a member with fully DC future benefits is required to contribute to a DB deficit. Should the employer contribution to the DC pot simply be the regular total contribution (currently 21.1% of salary, less deficit recovery and other costs)? Or should it be less, such as a matching or scaled contribution? There is a simplicity and fairness in the former approach. However, consideration would be needed to ensure the lower cost option met its intended aims in addressing the opt-out rate, rather than creating a shift in membership from the main scheme to any cheaper DC alternative, with potential unintended consequences for the future funding of the main section.

Consideration would also need to be given to bereavement and incapacity benefits in any DC option.

Possible (non-exhaustive) ways in which a lower cost DC scheme could interact with the main scheme are as follows:

The member pays a lower amount in return for lower amount from the employer, for example:

4% member 8% employer

Should a matching option be considered? This might help members dial up their contributions each year until they reached the main scheme contribution rate, as it might be financially difficult to move from a 4% contribution to 9.6% contribution in one leap.

Member contribution	Employer contribution
4%	8%
5%	9%
6%	10%
7%	11%
8%	12%

The above example has symmetry with the current 8% member and 12% employer DC rates for those members with earnings above the DB salary threshold.

The above range could be offered with a static employer contribution rate of say 12% (or other number) irrespective of the member contribution. This has the benefit of providing a greater contribution to those who might need it more at the 4% range, but doesn't encourage greater individual savings. Evidence of both models are seen within the private sector. Indeed, the section could even be designed to offer employers the choice of whether to choose to increase the employer contribution locally.

Finally, while this section is predominantly about addressing the needs of those employees not currently participating in the scheme, it is worth pointing out that should members (or indeed employers) wish to pay a higher amount towards pension provision, they can do so by voluntary contributions to the USS Investment Builder (DC) section, or locally using supplementary or other reward provision outside of USS. This is noted as some employers might have concerns over the mutual and collective offering through USS and would wish to differentiate their reward package, potentially in recognition to pension benefit reforms.

POSSIBLE FUTURE FLEXIBILITIES

The creation of a DC section, similar to that set out above, also creates future options and potential flexibilities in the overall reward offerings. Not in the scope of this consultation but, in the matching example above, it might be that, rather than putting an additional 4% in the pension scheme, that 4% could be used by employers in another element of reward – perhaps in a different shorter term-savings vehicle, or some other reward means.

For some employers in USS, possibly non-Higher Education Institutions, the DC offering might, in time, be a more attractive core offering for that employer's workforce and become the default offering rather than solely a member option. That is one for employers to consider for the future, and would require a review of employer participation terms as well as consideration for wider funding implication.

COMMUNICATIONS AND ENGAGEMENT

At the start of this section we set out that the main objective for a lower cost and flexible offering is to address the intergenerational unfairness in the current one-size-fits-all scheme and to encourage, and provide access to, a valuable pension offering for as many people as possible.

Within the reasons provided by members in the opt-out data, there are clues to suggest that employers, the USS, and member representatives could do much more to encourage participation in the scheme and promote the benefits of being in the scheme. The lower cost option is not suggested to create a two-tier system – we already have one of those – but to create a steppingstone to the main scheme and consider how to encourage people into the main scheme at intervals. Such as, after two-years of membership, at career or age milestones, and potentially an auto-enrolment style approach where members are periodically re-enrolled in the main scheme and would have to re-apply for any DC option.

USSEmployers

www.ussemployers.org.uk

pensions@universitiesuk.ac.uk

@USSEmployers