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THE CASE PUT FORWARD BY UNIVERSITIES UK, REPRESENTING ALL USS EMPLOYERS, FOR THE CONCLUSION OF THE 2018 ACTUARIAL VALUATION IN LINE WITH THE TRUSTEE'S OPTION 3 APPROACH

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Introduction

This paper has been prepared by Universities UK (UUK) and is a presentation of a formal proposition for the Joint Negotiating Committee's (JNC's) consideration in relation to the conclusion of the 2018 actuarial valuation. The paper sets out, in headline terms, the position of UUK in relation to the trustee's proposed option 3 and why UUK believes it represents the best available solution for the stakeholders at this time. UUK is content to provide further detail if that would be helpful.

Headline objective

UUK wishes to conclude the actuarial valuation in line with the trustee's option 3 as presented in the letter from Bill Galvin to UUK dated 7 May 2019 (which was sent simultaneously to UCU and to Sir Andrew Cubie, the Chair of the JNC).

What this outcome would mean is that, first and foremost, USS members would continue to secure the same benefits in USS as they do now. This is hugely important, and the JNC should consider it a significant achievement if the valuation can be finalised in this way.

In terms of contribution requirements, option 3 provides for an aggregate contribution rate of 30.7% of salary for the period to 30 September 2021 (and 34.7% of salary thereafter unless and until this contribution rate is replaced by the contribution requirements emerging from the 2020 valuation). Whilst it is ultimately a matter for the JNC, UUK believes that the same proportions as set out under the default cost-share provisions of Rule 76 should apply to these contribution requirements, meaning that the change in contribution rates to the 30.7% overall contribution level should be shared under the default rules resulting in a member contribution of 9.6% of salary, and an employer contribution of 21.1% of salary. This means that employers again agree to bear the majority share (65% employer, 35% member). This reflects the basis for cost sharing decided on by the scheme's stakeholders. It would also be consistent with the basis of the Joint Expert Panel's (JEP's) recommendations.

Crucially, option 3 allows the JEP – in which both UUK and UCU is firmly invested – to publish its second report and for the recommendations in that report to be taken into account in the valuation of USS which will take place as at 31 March 2020.

Finally, as part of concluding the valuation under option 3, the trustee has sought rule amendments which would prevent an employer from leaving USS without the trustee's consent – and at this stage UUK supports such a change in moratorium form. Employers have also offered their conditional support for the development of new requirements relating to debt monitoring and the prioritisation of secured debt. It is hoped that the JNC will recognise the way that these measures strengthen even further the security of members' rights in USS, and we hope and expect that UCU will consider the rule amendments – and related covenant support measures – to be desirable.

The JNC is also invited to recognise that should the additional measures sought by the trustee not have been supported by employers, the overall contribution rate would be [at least] 33.7% of salary (under the trustee's proposed option 1). The extra support granted by employers has helped to secure a reduction in the contribution requirements payable by employers – of at least 3% of salary (the gap between option 1 at [at least] 33.7% of salary and option 3 at 30.7% of salary until 30 September 2021).

The efforts made by UUK to reach this point

It is important to put on record the steps taken by UUK to reach this point at which the stakeholder have a conclusion to the 2018 valuation available to them. These steps include:

- in March 2018, agreeing the creation of the JEP as a group which could take an independent look at the USS valuation and provide insight, comment and perspective for stakeholders on the actuarial valuation.

- in November 2018, following a consultation with employers, confirming to the USS trustee a willingness of employers, expressed conditionally, to bear additional risk in relation to the 2017 valuation in order to reach an outcome in line with the JEP's recommendations.

- in December 2018, consulting with employers on the remaining elements of the 2017 valuation, and pressing the trustee on matters relating to the recovery plan and on the schedule of contributions – and very strong responses on the inadequate justification of the level of deficit recovery contributions and on the non-sustainability of the later contribution rates for employers and members. This consultation ultimately involved gaining the support of employers to the lawful conclusion of the 2017 valuation and to putting the focus on the 2018 valuation and an outcome which takes into account the JEP's recommendations.

- in January 2019, consulting with employers on the trustee's technical provisions relating to the 2018 valuation and on the headline outcome regarding an upper bookend level of contribution, and a lower bookend level if contingent support can be provided.

- in February 2019, UUK commenced a consultation on a contingent contributions arrangement, which – if acceptable to employers, and in due course to the trustee – would secure the lower bookend contribution level. UUK secured the conditional support of employers to such an arrangement, despite the challenges in doing so.

- in May 2019, following the latest deliberations by the USS trustee – the consultation by UUK with employers on the three options which were put forward for the conclusion of the valuation – and securing the conditional support of employers to further explore option 3.

In addition to these headline consultations, the following is a summary of the activities of the last year undertaken by UUK in pursuit of a resolution:

- both formal and informal exchanges with UCU representatives, at least on a monthly basis;
- monthly formal meetings between the UUK and USS leadership, and often more frequent exchanges;
- five formal meetings with the Pensions Regulator, in addition to other exchanges;
- generally quarterly meetings of the Employers Pensions Forum to consider the

employers' perspectives and options;

- webinar events to support employer consultations;
- UUK Steer Co meetings, held fortnightly, to consider strategic direction of the valuations;
- ongoing input from UUK's actuarial advisers Aon, including ongoing exchanges with the USS team;
- continual engagement between the UUK pensions team and the USS team; and
- the establishment of a new public website setting out information for employers including advice UUK has received from Aon and Eversheds Sutherland.

UUK has committed considerable effort and resources to providing updates and information to employers, and to securing an outcome to the valuation which it believes can be found acceptable by the USS trustee, by the Pensions Regulator, and by the scheme's stakeholders.

In terms of the very latest commitments from employers, in order to secure an outcome in line with option 3, UUK – and the employers collectively – have confirmed their willingness to commit to a number of requirements from the trustee in relation to the protection of the covenant. This has not been straightforward; this represents the overall collective (but not unanimous) view of employers, supported by three-quarters of those employers who have responded to the consultation. These are significant commitments on the part of employers, and crucially involve rule amendments which are proposed for the JNC's consideration. These rule amendments would introduce a moratorium on employers leaving USS without the trustee's consent; the moratorium would run until the completion of the next actuarial valuation (which is due as at 31 March 2020 under the option 3 scenario). Meeting these requirements from the trustee is vital in securing the lower contributions under option 3 until 30 September 2021, compared with option 1 (at 33.7% of salary).

UUK would wish to make clear that the current support of employers is for option 3. However, this support by employers for option 3 is without prejudice to the future consultations on the recovery plan and schedule of contributions which will be needed to finalise an outcome in line with option 3.

Consideration of alternative outcomes

UUK believes that option 3 presents the most favourable of the outcomes available to the stakeholders at the current time. However, it is not the ideal outcome which employers might have envisaged. For example, employers did not enter this process anticipating employer contributions of 21.1% of salary. The option 3 scenario takes employers to the brink in terms of their ability to sustainably maintain contributions to USS, and indeed for most employers there will be a need for strategic changes to plans and budgets to accommodate the much higher contributions. However, it is important to reach an outcome to the valuation which employers can live with at this point in time – recognising that it is the trustee which holds the unilateral power to set contributions in USS (subject to consultation).

The Pensions Regulator has expressed its concerns about option 3. We believe that these issues are not insurmountable particularly if the trustee can evidence an enhanced covenant through the moratorium on employers leaving. However, it seems that the trustee will have pushed the Pensions Regulator to the limit on its tolerance of risk, and this is relevant since the trustee operates in a regulated environment (unlike UUK or UCU with regard to pensions).

Some may argue that the proposed option 3 outcome does not reflect adoption of the JEP's recommendations. In its report the JEP said "'The Panel believes that there are a number of different paths that the Trustee could adopt to reduce the contribution rate to below 30%; the charts above simply demonstrate one approach". Aon, UUK's actuarial advisers, has made clear that it believes that the proposed contribution rate under Option 3 of 30.7% of salary is close to the JEP recommendations. While UUK would have preferred an outcome of 30% of salary or under (notwithstanding the concerns of the Pensions Regulator), the legal obligation rests with the trustee to decide on contributions, and we believe significant practical progress has been made from the figure of 36.6% of salary proposed by the trustee for the 2017 valuation that the JEP reviewed.

The trustee has made clear that should option 3 not prove acceptable or implementable, the option 1 outcome illustrated in its consultations dated May 2019 would most likely apply. This option 1 scenario would involve an overall contribution of at least 33.7% of salary, which under the cost-share rules would involve employer contributions of 23% of salary and member contributions of 10.7% of salary. In this scenario, employers would wish to make clear that there is no prospect of employers paying contributions at 23% of salary, and benefit reforms would be proposed to the JNC in order to reduce the overall contribution requirements. This would mean that, in the view of employers, the benefits currently payable to members would not be able to be maintained, and benefit changes would have to be put forward for the JNC's consideration. UCU will recognise that members too will face considerable challenges at contribution levels of 10.7% of salary, and it is likely that there will be an increase in the numbers opting-out of the scheme – and this would be extremely damaging and self-defeating in terms of workplace scheme provision. Option 1 would not be an acceptable outcome however you look at it.

Some might take the view that none of the options should apply, and for example UUK should only "accept" an outcome precisely in line with the JEP's recommendations. The flaw in this argument is that the decision belongs to the trustee, and therefore it is not within UUK's gift to secure this outcome. We also asked Aon to provide their expert view on the suggestion from some commentators that if the JEP recommendations were applied to a March 2018 valuation (which was a more favourable date than March 2017), then a contribution rate of 26% of salary would be appropriate. Aon's view was published online and we share the relevant commentary below:

> *We [Aon] have also been asked to give a view on whether a contribution rate of 26% would be more in line with the JEP recommendations. We do not believe that it is. This is a more difficult question because the JEP recommendations applied to a 2017 valuation, and the Trustees have subsequently decided to call a 2018 valuation as a device to consider the JEP recommendations (while retaining 31 March 2020 as the next actuarial valuation, as would have been the case had the JEP recommendations been considered as part of a 2017 valuation). However, when the JEP made their recommendations, they knew the 31 March 2018 position. This is both because Aon drew their attention to the improved position, and also the JEP requested this information from USS who provided it (Annex 9 of the JEP report).*
>
> *If the JEP had viewed the 2014 valuation outcome of 26% as being the correct rate*

for a short-term fix (ahead of the more fundamental review being carried out for JEP Phase 2 and to inform the 2020 valuation), then we believe they would have said so – rather than saying the Trustee could adopt a contribution rate below 30%. Likewise, if Aon had believed 26% would be a credible contribution rate for the Trustee and Pensions Regulator, then we would have said so in our Expert Witness commentary to the JEP.

Consideration of views and perspectives of UCU

UUK has engaged with UCU throughout the last two years or so to try to achieve a jointly acceptable solution to the 2017 and 2018 valuation. It is in our joint interests to secure a sustainable outcome for employers and members alike. It is recognised that it can be difficult for both UUK and UCU to manage what in some cases are strongly-held views which exist within their respective constituencies.

Up until recently, UUK believed that if option 3 can be secured, it would be an outcome which might be supported by UCU. For the reasons mentioned above, it's not the perfect outcome which the stakeholders might have envisaged, but it represents tangible progress and crucially allows the JEP to publish its second report and for the stakeholders to work with the trustee for its recommendations to be taken into account.

We are concerned – like UCU, we understand – with the 34.7% of salary contribution rate which will follow from October 2021 unless it is replaced by contribution rates from the 2020 valuation. We acknowledge the need to make clear the fact that the 30.7% of salary contribution will run for two years only – and there must be full recognition of the higher rate from October 2021. But we also recognise that, absent something unforeseen, there will be new contribution rates emerging from the valuation as at March 2020 which will supersede the 34.7% rate – and stakeholders will be in a position to respond to those revised rates in due course.

From UUK's perspective, the priority is to give the JEP the environment in which it can best deliver its report about the future, long-term sustainability of the scheme – and the circumstances in which its recommendations can be taken into account. The stakeholder bodies created the JEP, and wish to give it the best possible chance to again be effective. A 2018 valuation which, for example, concludes in line with option 1 would cut right across the JEP's plans for its second report. Concluding the 2018 valuation in line with option 3 gives the JEP phase two report its very best chance.

We acknowledge that there may be wider ideas available that could ultimately support a lower contribution rate than suggested by the JEP, such as alternative investment strategies. It is right that these are being considered by the JEP as part of phase 2, and such considerations do not belong in a 2018 valuation which is part of the quick fix envisioned by the JEP ahead of their more fundamental review.

We set out further details regarding the financial implications of higher contributions below.

Affordability and sustainability of pensions

Employers have responded to recent consultations by UUK to indicate their support, conditionally, for an outcome to the 2018 valuation in line with option 3. This would involve employer contributions of 21.1% of salary – and higher contributions thereafter – but with an actuarial valuation as at 31 March 2020.

In terms of the financial implications for employers, the increase in contributions from 18% of salary (the rate payable up to 31 March 2019) to 21.1% of salary would represent an additional £250 million paid into USS by employers, every year. To put this into context:

- this extra contribution which employers have put forward to achieve a settlement to the 2018 valuation is equivalent to 5,860 full-time roles for a full-time USS member paid the scheme-average salary (of £42,659 as at 31 March 2017);
- this extra contribution is equivalent to the income which institutions collectively would receive for approximately 27,000 students each year (based on a tuition fee of £9,250 per year in England)

In putting forward these equivalence numbers, UUK hopes that some context is given to what would be very significant increases in employer contributions to USS. There are over 340 participating employers in USS, and clearly they would each respond differently to increases in contribution requirements – and the capacity of some institutions to absorb increases would be better with some employers than with others. But UUK would hope that it is clear that there would be implications at almost all institutions of such material increases – whether those implications are in the form of changes to spending plans, delays in business projects, reductions in investments, changes in course provision and ultimately the risk of job losses – all of which would be damaging to the student experience.

Conclusion and formal request to the JNC

UUK believes that concluding the 2018 valuation in line with the trustee's option 3 represents the best outcome available to stakeholders. Following a consultation with employers on the option 3 scenario, UUK believes it has sufficient consensus for this outcome, although it should be made clear that this is a significant step for employers. They have a number of difficulties with the position and it is only with reluctance that employers seek this conclusion. Much is dependent on the continued constructive engagement between the trustee's officers and advisers, with specialists in university finances identified by UUK, to examine the details regarding any arrangements for debt monitoring and the prioritisation of future secured debt taken by employers.

Crucially, an outcome in line with option 3 allows the JEP to publish its second phase of work, and for its recommendations to be taken into account in the next valuation which will take place as at 31 March 2020.

The option 3 scenario takes employers to the brink in terms of their ability to sustainably maintain contributions to USS, and indeed for most employers there will be a need for strategic changes to plans and budgets to accommodate the much higher contributions.

It is important to consider how far all of the stakeholders have moved in recent times. Employers themselves have moved their position in order to support the recommendations put forward by the JEP in its first report. The trustee has moved its position, by initiating a 2018 valuation, and in option 3 we have contribution requirements which are some way from the 35.6% of salary contribution requirement with the 2017 valuation. We understand some would have preferred that the parties went further.

As we have stated in this note, we believed that the option 3 scenario was one that could be supported by UCU – and we hope it still can be. Employers have gone as far as they are able in expressing their support for option 3, bearing two-thirds of the increase in costs relative to current contribution levels. UCU has recently written to USS employers to demand the employer pays the entire share, plus the already introduced 0.8% of salary member contribution, from April 2019. Replies were required by a date in June and we are unaware that any employer has suggested they could meet this demand. In response to any request for employers to bear the full share of any increases, UUK would make the following points:

- By granting to the trustee the additional requirements sought on covenant, the overall contributions have reduced from 33.7% of salary to 30.7%. Employers are willing to share the benefit of this reduction with members. This is a crucial commitment from employers, bringing the contributions down to 9.6% of salary under option 3. Employers might alternatively have argued for the whole of the 3% of salary saving to be granted to employers, with resultant rates of 20% of salary for employers and 10.7% for members; but employers have not done so.

- The employer contributions of 21.1% of salary are at the very limit of sustainability for employers, and already an extra £250 million per annum is being paid by employers.

- The default cost-share rules already require that employers pay the lion's share of any increases; employers are paying broadly two-thirds of the contribution increases due (relative to current contribution levels).

UUK hopes that UCU will recognise that – for members across USS, whether UCU members or not – the option 3 outcome represents a sensible conclusion. This is a conclusion in which the current benefits are maintained, and UUK believes that most members will pay further moderate increases (their share of the contribution changes under the cost-share ratio, to 9.6% of salary) to achieve this.

The procedural steps to achieving UUK's objective

We are advised by the USS trustee that, in terms specific to the USS rules and its cost-share provisions, option 3 (at 30.7% of salary) should formally be expressed as a decrease in the overall contribution level, relative to the contribution requirements relating to the 2017 valuation (35.6% of salary). Having received inputs and advice from the USS trustee, the decisions for the JNC are as follows:

1. To receive draft rule amendments, proposed by UUK and developed in conjunction with the USS trustee, for the JNC's consideration under sub-rule 64.1.2 regarding a proposed moratorium on employers leaving USS without the trustee's consent. It is

UUK's understanding that once decided on by the JNC – if the JNC both recommends to the trustee (under Rule 79.7) and consents to the draft changes (under Rule 79.5) – this would allow the trustee to execute a deed of amendment and finalise the valuation in line with its proposed option 3 which would then be presented to the JNC formally under rule 76.

2. In accordance with rule 64.10, following receipt by the JNC of the trustee's determination that a decrease in the aggregate contribution rate payable by employers is required, to seek decisions from the JNC on (A) there should be no changes to benefits, and (B) the decrease in the aggregate contribution rate payable by employers (relative to the 2017 valuation and specifically the rate due from April 2020 under that valuation) shall be shared in the ratio 35:65 between members and employers.

3. It is important to recognise that (a) above is conditional upon (b), and the JNC is invited to confirm its approval of the rule changes subject to decisions on the valuation under rule 76 which are in accordance with (b) above.

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