



A consultation by Universities UK with USS participating employers

**The 2018 actuarial valuation and the
provision of contingent support**

27 February 2019

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1 Introduction

- 1.1. The USS Trustee has advised Universities UK (UUK) that it will require tangible support from scheme employers in order to back the additional risk associated with moving towards the recommendations for scheme funding put forward by the Joint Expert Panel (JEP). Therefore, UUK has taken up the recent invitation from the USS Trustee to prepare contingent contribution (CCs) arrangements which meet the USS Trustee's principles. This is not a position which UUK expected to be in, given the earlier indications from the USS Trustee that it would set out the terms for CCs. Making this move, and taking the first step to fully define workable arrangements, demonstrates UUK's commitment on behalf of employers to achieving an outcome acceptable to all parties.
- 1.2. This paper describes the context within which the proposed arrangement is put forward and, most importantly, sets out the trade-offs that employers should look at when considering the extent of their support for such an arrangement, compared with the other outcomes which would be likely to emerge should no CCs arrangement be implemented.
- 1.3. With the necessary backing from employers, UUK believes that the proposed arrangements represent a credible and proportionate outcome that, with some give and take on all sides, all stakeholders could find acceptable. Crucially, this includes the University and College Union (UCU), with which UUK continues to actively engage.
- 1.4. It will be recognised that even if the proposals are broadly acceptable to employers, in the light of the trade-offs with other potential outcomes, there is no guarantee that the proposed arrangements will be acceptable to the USS Trustee. UUK has engaged closely with the USS executive team on these issues. **The proposals have been developed by UUK in a genuine spirit of seeking a balanced solution.**
- 1.5. The final section of this paper sets out some particular areas on which the views and comments of employers are invited.
- 1.6. The closing date for the USS Trustee's consultation with UUK on these issues is 15 March 2019; UUK would welcome the **comments of employers by 13 March 2019**, if at all possible, so that a collective response from employers can be provided to the USS Trustee by the deadline. **Employers are asked to provide responses which represent the view of the institution. While we recognise that this is a challenging timescale, employers are encouraged to engage with their governing bodies in framing their responses.**

2 Setting the scene

- 2.1. On 2 January 2019 the USS Trustee commenced a consultation on specific matters relating to the 2018 actuarial valuation. This consultation is in relation to the central assumptions underlying the USS Trustee's valuation of the liabilities (otherwise known as the scheme's technical provisions, or TPs), and on a draft statement of funding principles (SFP).
- 2.2. The consultation on the TPs has been intrinsically linked with a related consultation on CCs. In short, the USS Trustee has indicated it would require contributions to increase to an 'upper bookend' level – the detail of which is proposed in the TPs consultation –

although it could, through the mechanism of a 'rebate' (a new term developed by the USS Trustee), consider contributions at a 'lower bookend' level if *appropriate* contingent support is provided to stand behind the additional risk which the USS Trustee believes would be involved. It seems clear from the USS Trustee's material that contingent support really means CCs. This means higher contributions that can be activated should there be a significant deterioration in scheme funding.

- 2.3. The USS Trustee initially suggested that it would publish its proposal for CCs and communicate them to employers through UUK. However, more recently it has published a *framework and principles* around which any CCs arrangement should be based. The latest material on the framework and principles was issued to employers by UUK on 11 February 2019. The USS Trustee has advised UUK that the closing date for its consultation on these matters will be extended to 15 March 2019 (having initially been 28 February 2019).
- 2.4. The current position is therefore that the USS Trustee has invited UUK to bring forward specific proposals for a CCs arrangement (and has provided data to UUK to assemble its proposals, the latest of which was received in the last few days). UUK has instructed its advisers, Aon, to prepare a proposal which would meet the USS Trustee's 11 principles. The details have been considered by UUK and are attached.
- 2.5. Before considering those specifics, it is important to look at the broader context in which CCs might operate, and this is set out below.

3 The legal and structural context – is contingent support necessary?

- 3.1 While UUK recognises that the USS Trustee has stated there is additional risk associated with the proposals put forward by the JEP – and employers would clearly want to understand the nature of such additional risks – when considering the particular context within which the scheme operates, it would be reasonable to form the view that a specific CCs arrangement is not necessary. This particular context includes the backing provided to USS by its sponsoring employers, and the specific rules and powers which are (almost uniquely in private sector defined benefit scheme terms) in the hands of the USS Trustee. These arguments are set out in more detail on page 5 of the Aon note dated 14 January, and it is hoped that the USS Trustee takes these into account in responding to the views expressed by employers in this consultation.
- 3.2 Nevertheless, both the USS Trustee and, it seems, The Pensions Regulator have made it clear that contingent support is required as a demonstration of employers' increased risk appetite, and that at this point in time the only credible arrangement to conclude the 2018 valuation in a timely manner would be CCs. As such, if employers and scheme members would prefer not to pay the upper bookend contributions (initially at least), then a CCs arrangement is indeed necessary.
- 3.3 A CCs arrangement would be new for the scheme, and it is very important that such a mechanism is carefully thought through prior to its introduction. It would also be helpful if the USS Trustee were to explain why it takes a different view to the JEP that contingent support (other than that already available to the USS Trustee) is now required, when the JEP took the view that this is something to be considered in JEP Phase 2. Employers will have noted that the USS Trustee appears hesitant to take into account two of the four risk-bearing JEP recommendations (see section 7.2 of the USS Trustee's 2 January 2019 consultation document) and yet requires contingent support, while the JEP put forward all of its recommendations believing that no such support was necessary.

4 The circumstances in which a proposal has been put forward by UUK, and considering the trade-offs

- 4.1 The view expressed to UUK by employers is that they support, conditionally, an outcome to the 2017 valuation which is in line with that put forward by the JEP. UUK has progressed its engagement with the USS Trustee and with UCU on this basis. In order to achieve an outcome like this, the USS Trustee has made clear that it believes that contingent support is needed to back the additional risk that it associates with the JEP's recommendations.
- 4.2 It is recognised that actuarial valuations of defined benefit schemes are not objective exercises. They require careful judgements. To fully analyse the issues, and to make genuine progress, we must also try to see the issues through the lens of the USS Trustee. It has the statutory responsibility to deliver the promised benefits, a point which it has repeatedly made clear on recent occasions, and it also has the legal powers under the scheme rules.
- 4.3 From all of the engagement that has taken place with the trustee board and with the USS executive in recent months, it is unlikely in UUK's view that the lower bookend value of contributions (and therefore an outcome at or close to the JEP recommendations) will be achieved if contingent support is not provided – despite the views of the JEP and the compelling case, which UUK believes exists, that such additional support is not appropriate in a scheme like USS.
- 4.4 It is important, therefore, that employers are given an opportunity to consider what such an arrangement might involve, and in this section – and in the attached document from Aon – the broad terms for a potential arrangement are put forward. The circumstances in which a proposal is put forward are crucial for employers to understand, so that they can give it fair and balanced consideration. UUK would emphasise the following points:
- (i) The arrangements presented by Aon in the attached paper have been developed in discussions between UUK and Aon – having engaged with the USS executive on these issues over recent weeks. Employers will be aware that it had been expected that the USS Trustee itself would bring forward proposed arrangements, however more recently its position changed and UUK was invited to bring forward its own proposals. UUK makes this first move in a genuine spirit of trying to achieve an outcome which all parties can find acceptable.
 - (ii) Both UUK and Aon believe that the proposals meet the 11 principles set out by the USS Trustee. While some discussions have taken place with the USS executive as the proposed arrangements have been developed, the formal view of the USS executive, or of the USS trustee board, has not been sought. Employers should consider the proposals on this basis, aware that they may or may not prove to be acceptable to the USS Trustee.
 - (iii) The proposed arrangements have been prepared solely on the basis that they represent appropriate CCs and therefore would provide for the lower bookend of contributions. The USS Trustee has advised that it would wish to place a 'rebate' value on any arrangements, from the upper bookend value, of such amount as it decides. UUK's view is that the proposals are put forward to meet any requirements associated with the lower bookend (and solely with that purpose). If the USS Trustee were not to accept the proposed arrangements at the lower bookend, UUK would expect employers to receive a clear and transparent explanation from the USS Trustee as to why this is not the case (given that the 11 principles set out by it have been met).

- (iv) If there are no arrangements for CCs decided upon, it is likely that the outcome will be contributions at an upper bookend level. UUK will, with the support of employers, separately make responses to the USS Trustee on the assumptions behind the specific upper bookend figure of 33.7%, but it is clear that an upper bookend figure would require materially higher contributions from employers and members than are payable currently. Such contribution levels would be unsustainable and present an undeniable threat to investment and to jobs. To illustrate, taking for a moment the figure of 33.7%, this would derive employer contributions of 23% of salary and member contributions of 10.7% of salary under the cost-share formula. Without change in the level of the upper bookend contribution value, some level of scheme reform would be needed to moderate contribution levels and/or avoid damaging outcomes. It is important for employers to consider this scenario when assessing the acceptability of CCs.
- (v) UUK believes that cost-sharing of any arrangements is essential. This is consistent with the scheme's general cost-sharing provisions in which increases in contributions are shared on a defined basis (in the ratio 65:35 for employers and members respectively), and more generally in which the implications of bearing increased risk are shared. It seems fundamentally consistent with the scheme's cost-sharing provisions that if scheme members would be sharing the 'rebate' that is provided through the introduction of any CCs arrangement, then any triggered contributions should also be shared.
- (vi) Moreover, if no CCs are provided, the upper bookend level of contributions will be payable – and the proposed 33.7% contribution would result in contribution increases being shared under the cost-share formula. UUK recognises that cost-sharing of any contribution increases arising from a CCs arrangement may require a consultation to take place by employers with affected members and their representatives, for a minimum of 60 days. While UUK recognises the importance of such a consultation, and the procedural difficulties, it is nevertheless a fundamental element of the overall proposal which can be undertaken prior to the commencement of the arrangements, so that any CCs can be activated – should the funding position triggers be met – without any further consultation period.
- (vii) Were CCs not cost-shared, it would suggest that the 'rebate' solely belongs to the employer contribution rate, and this does not provide an attractive outcome for the member contribution rate which would then be set relative to whatever the USS Trustee determines is the upper bookend contribution level. So, in simple terms, without contingent support the upper bookend rate proposed by the trustee is 33.7%, which would be shared at 23% for employers and 10.7% for members under the cost-share formula. If the rebate were solely attributed to the employer, the overall contribution rate would be (indicatively) 29.7% with the same 10.7% of salary payable by members, with an employer contribution of 19%. We believe it is justified, on a number of counts, for any CCs to be cost-shared.
- (viii) The proposed CCs arrangement is a specific – and UUK believes (on balance) reasonable – response to the 2018 actuarial valuation. It is about finding a solution to what has been a very difficult process over the last 18 months or so. Employers will be aware that the JEP's first report identified a number of important changes that might be made to the USS Trustee's funding approach, but made clear that a broader review of the longer-term sustainability of USS would take place during 2019. This second phase of the JEP has commenced, and its report is due in the autumn. We would ask employers to consider the proposals for CCs in the light of the fact that this review of the future of USS will

be presented by the JEP later in 2019, and is likely to have an impact upon the next actuarial valuation of USS (scheduled for 31 March 2021). This means that any arrangements for CCs will be time-limited, specific, and – as we set out in point (ix) immediately below – reset by the next actuarial valuation.

- (ix) UUK believes that in formulating and agreeing in legal terms any CCs arrangement, it should be a provision which can be activated by the stakeholders in conjunction with the USS Trustee – as is proposed to be the case as part of the conclusion to the 2018 actuarial valuation – but then for a reset to take place at a next actuarial valuation of the scheme. This means that any CCs arrangement would cease once a new schedule of contributions is signed – which would not necessarily (but could) include a provision for a future CCs arrangement; the point being that such arrangements would not *automatically* be taken forward.
- (x) The timeline for the next few weeks and months is extremely compressed, with key decisions being made and outcomes reached (some of the key details are set out in section 5 below). It is important to the USS Trustee, to The Pensions Regulator – and indeed to all stakeholders – that the 2018 valuation can be concluded and submitted in good time. This is crucial. UUK believes that the proposals for a CCs arrangement represent the best opportunity of concluding the valuation of USS, and wishes for employers to take this into account – and trusts that the other scheme stakeholders will do too as they respond over the coming weeks.

4.5 We hope that the above points are helpful to employers as they consider the CCs proposal which is detailed in the Aon advice attached to this paper.

5 Timeline and key milestones

5.1 The following represent the key dates within the overall timeline for the next few months:

13 March 2019	UUK would welcome the comments of employers, if at all possible, so that a collective response from employers can be provided to the USS Trustee by the deadline. Employers are asked to provide responses which represent the view of the institution.
15 March 2019	UUK to respond formally to the USS Trustee in respect of the 2018 TPs and SFP consultation
28 March 2019	USS trustee board meeting
Early April 2019?	Formal response from the USS Trustee to the consultation
May 2019?	Consultation on Recovery Plan and on Schedule of Contributions
30 June 2019	Statutory deadline for submitting the valuation to The Pensions Regulator
End July 2019	Crucial date for finalisation of the accounting provision for USS which many employers will need to make (and it is hoped a new schedule of contributions is signed by this date)
1 October 2019	2017 valuation contribution increases (22.5% employer, 10.4% member) implemented unless superseded by a new schedule of contributions

6 Communication

- 6.1 If employers have further questions they should be in contact with UUK's Head of Pensions, Stuart McLean, and his pensions team at pensions@universitiesuk.ac.uk.
- 6.2 UUK is considering the further supporting material that can be made available to employers in the limited time that is available, and will do what it can to respond to questions so that they can be seen more widely. Please look out for further emails, and for material posted on the USS Employers website at www.ussemployers.org.uk.
- 6.3 UUK will be making the consultation document and Aon note public on the USS Employers website.

7 Next Steps

- 7.1 We thought it helpful to set out in simple terms how things might progress in the light of responses to this consultation.
- 7.2 If employers are broadly supportive of the CCs arrangement put forward, the arrangement will be presented to the USS Trustee, and it will be invited to confirm whether or not it finds the arrangement acceptable in reaching the lower bookend value of contributions. If this is achieved, an outcome in line with that proposed by the JEP is attainable in which the same benefits are maintained – without, of course, the employer matching contribution – with some level of increase in contributions for employers and members (depending on the final level of the lower bookend value). The second phase of the JEP will progress looking at longer-term sustainable outcomes for the scheme.
- 7.3 If the USS Trustee rejects the proposed CCs arrangement, the rebate will not be available, and employers and stakeholders must face the prospect of materially (and unsustainably) higher contributions to maintain the current benefits. This would have substantial implications for employers and members, with contributions (subject to finalisation of the upper bookend value) of 23% for employers and 10.7% for members, with considerable implications for the finances and workforce of many institutions, and inevitable discussions regarding scheme reforms.
- 7.4 There are clearly a whole range of other possible scenarios, and UUK and employers will respond to emerging developments. That said, the timescale is such that the particular path available to employers – and we must hope it is the one which is in line with the JEP's recommendations – is identified quickly so that the October 2019 contribution increases can be averted.

8 Questions

8.1 We invite employers to respond to this consultation by expressing their views on the three specific questions set out below (alongside any further views which institutions would wish to register):

1	Do you have any specific comments on the proposed assumptions for the 2018 valuation, including views on the proposed upper bookend and lower bookend?
2	Do you support UUK putting forward a proposal for a CCs arrangement to the USS Trustee as it requested? If not, would you prefer to pay at the upper bookend level, or what would your preferred response be?
3	Do you find the proposal for a CCs arrangement set out in the Aon note (attached to this paper) acceptable, taking all factors into account? If not, what aspects would you wish to change?

Earlier documents, to which employers might refer in responding:

Title	Web location of file
USS 2018 Actuarial Valuation – Technical Provisions and Statement of Funding Principles consultation document	https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/2018-technical-provisions-consultation.pdf
Advisory note on 2018 Technical Provisions consultation	https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/uss-actuarial-valuation-31-3-2018-initial-thoughts-aon.pdf
USS Employers – Technical Provisions Q&A	https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/2018-technical-provisions-q%26a.pdf
USS 2018 Actuarial Valuation – A Framework for Contingent Contributions	https://www.ussemployers.org.uk/sites/default/files/field/attachemnt/uss-2018-actuarial-valuation-framework-contingent-contributions.pdf