The 2017 USS valuation, the Joint Expert Panel, and the current consultation with employers

A webinar event for USS employers

Introduction

Introduction from Professor Alistair Fitt

Vice-Chancellor of Oxford Brookes University and member of the Employers Pensions Forum

Overall structure for the webinar

The 2017 USS valuation, the Joint Expert Panel, and the current consultation with employers

1 **Introduction from the Chair**

Professor Alistair Fitt, Vice-Chancellor of Oxford Brookes University

2 **The context to this webinar event**

Brendan Mulkern, Universities UK

3 **The JEP's recommendations, and what they mean for employers**

John Coulthard, Partner, Aon, actuarial adviser to Universities UK

4 **The consultation by UUK with employers and your responses**

Vicky Mullins, Universities UK

5 **Questions from employers**

6 **Close**

Professor Alistair Fitt, Vice-Chancellor of Oxford Brookes University

How to ask Questions

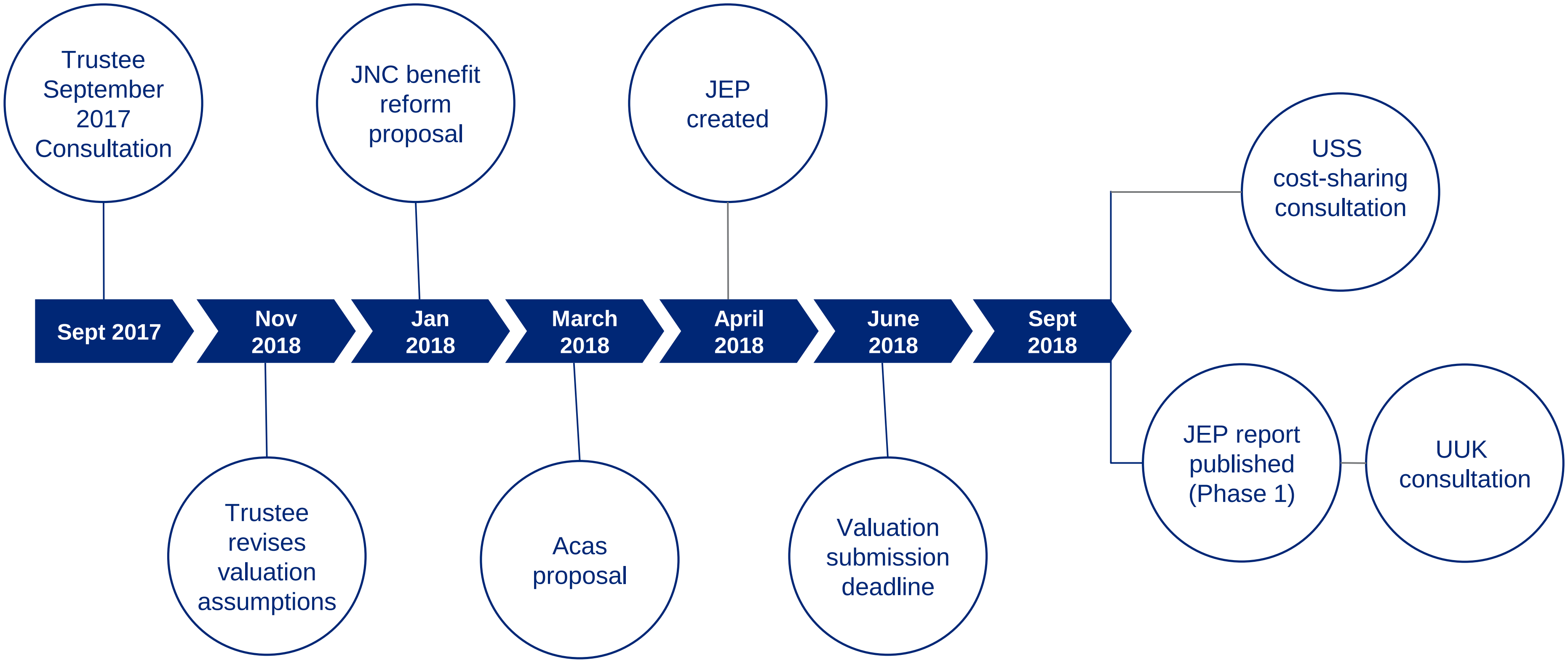
You can submit questions in the Q&A box to the bottom right of your screen

The context for this webinar event

Brendan Mulkern

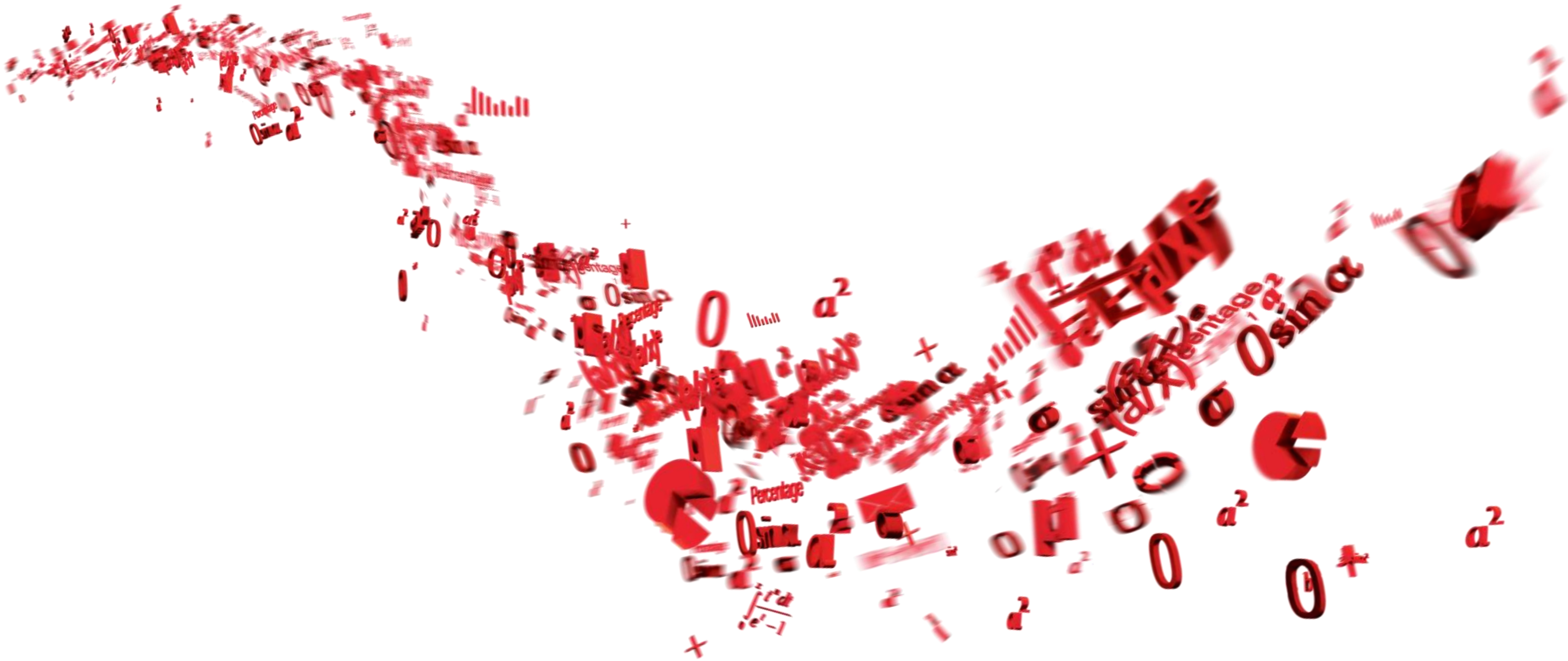
Universities UK

2017 valuation (to date)



The key elements of the JEP's report

John Coulthard
Partner, Aon



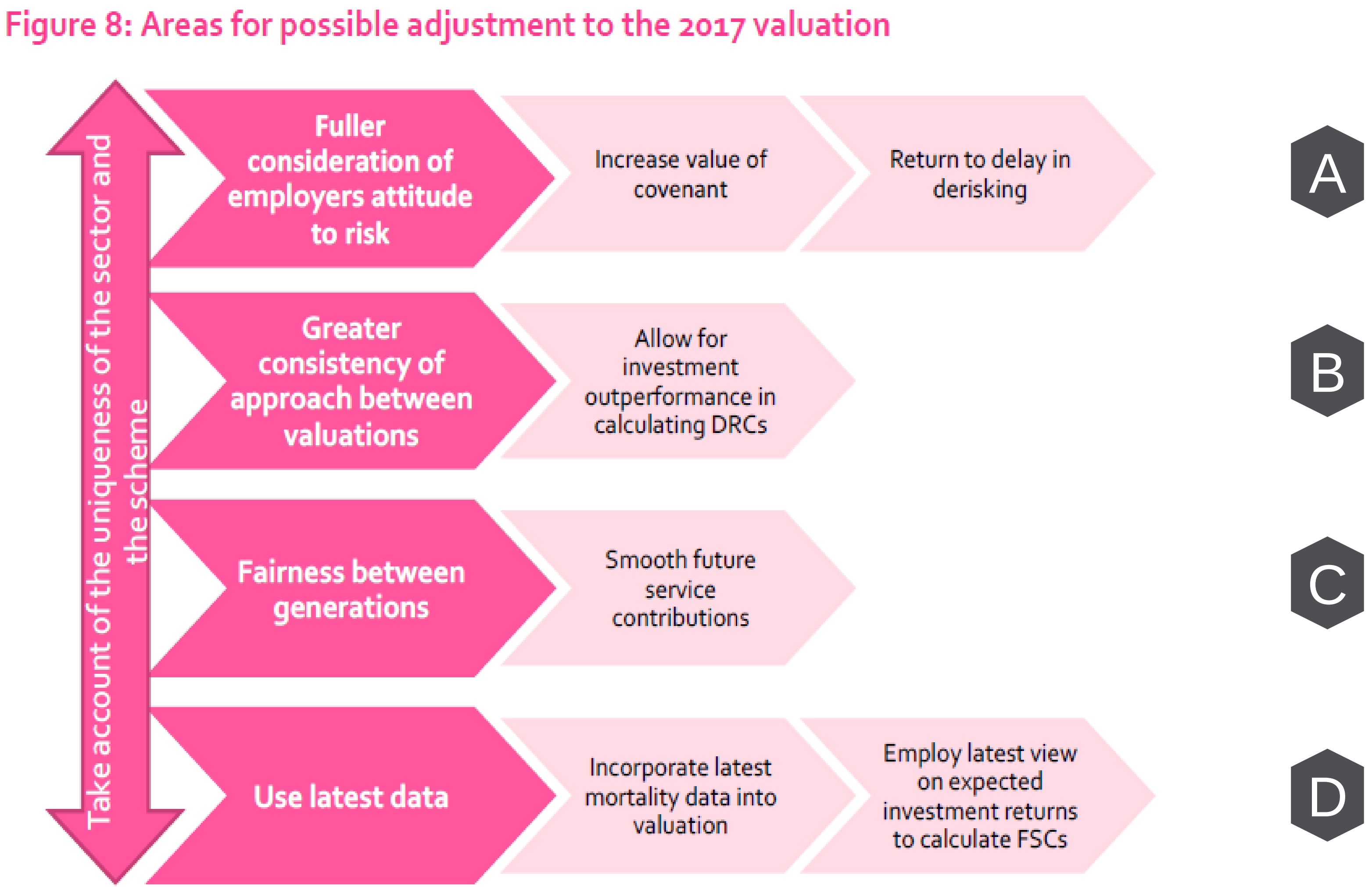
The key recommendations of the JEP Report

- and consequences for employers

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

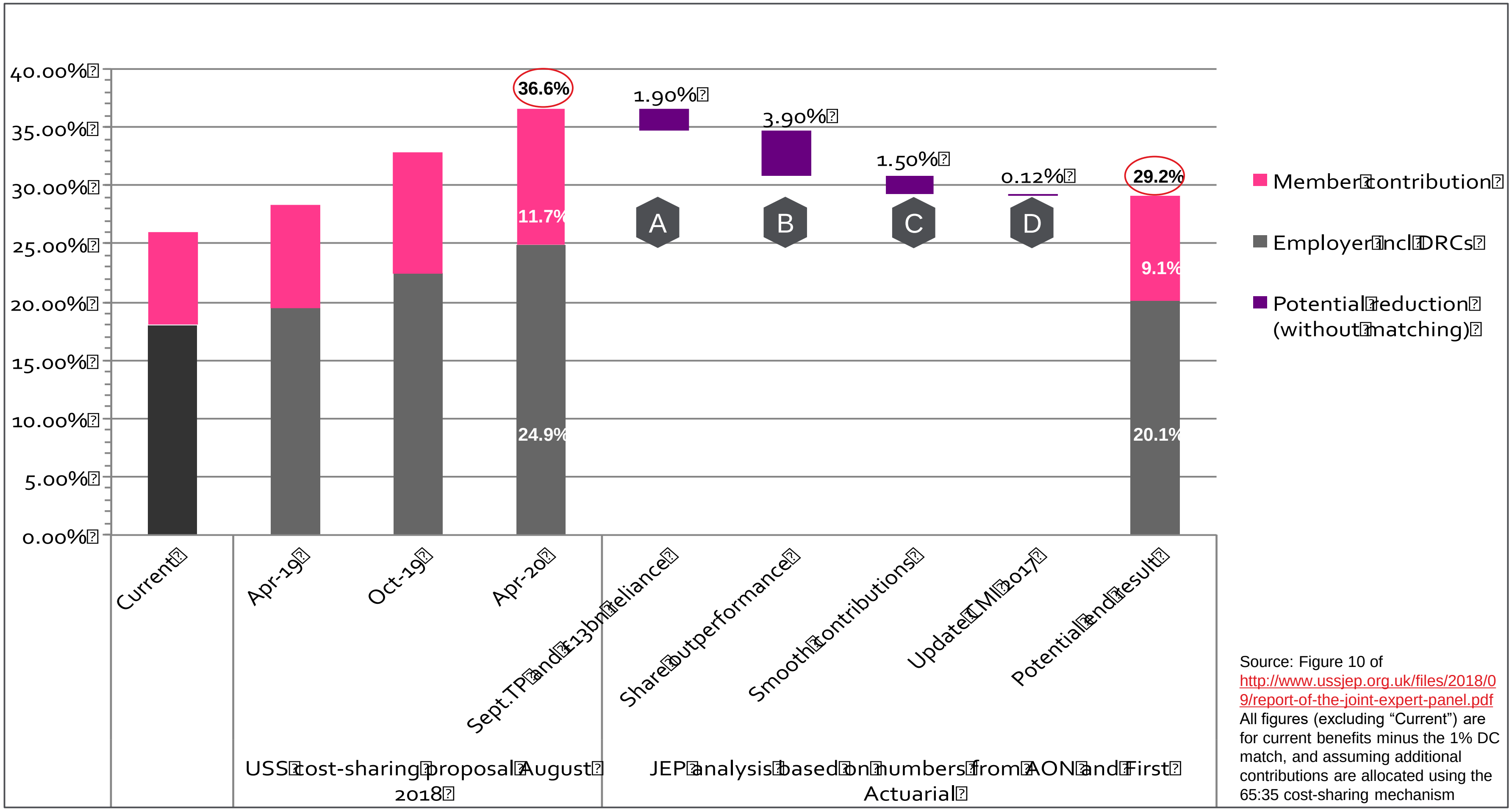
Prepared by Aon
Retirement & Investment

JEP recommendations – Four key changes



Source: Figure 8 of http://www.ussjep.org.uk/files/2018/09/report-of-the-joint-expert-panel.pdf

JEP recommendations – Four key changes



Source: Figure 10 of http://www.ussjep.org.uk/files/2018/09/report-of-the-joint-expert-panel.pdf
All figures (excluding "Current") are for current benefits minus the 1% DC match, and assuming additional contributions are allocated using the 65:35 cost-sharing mechanism

Total cost falls by 7.4% of pay under JEP recommendations

A. Revert to September Technical Provisions

- JEP recommends moving back to the September Technical Provisions.
  - Key change is no de-risking for the first ten years
  - Slightly higher discount rate being applied as set out in the JEP report

- UUK was supportive of the September 2017 consultation proposals, but stated:
  - Top end of acceptable risk
  - Small majority of employers accepted the risk proposed, but significant minority wanted less risk

- TPR queried the September Technical Provisions
  - At the limit of what would be accepted for a “strong” employer
  - Suggesting the covenant of the employers was only “tending to strong”

- The JEP has supported the Trustee conclusion on a “strong” covenant

Small majority had accepted the risk proposed

A

A. Move to £13Bn Target Reliance

- JEP recommends increasing the target “reliance on covenant” from £10Bn to £13Bn
  - Test 1 defines the covenant as a stream of cash contributions
  - 15 or 20 years of contributions of 7% of pay, starting in 20 years time
- This is a tough question for employers to answer!
  - But drives the discount rate and hence valuation result
- UUK supports JEP Phase 2 on a more fundamental review of the valuation approach
- Both Aon and First Actuarial advised the JEP that Target Reliance could be increased
  - 20 years of contributions described by the Trustee as "maximum reliance"
  - We consider the additional risk for employers “in the round” – addressed below

Works within Trustee’s tests (subject to employers being comfortable with more risk)

B. Deficit contributions – Share outperformance

- JEP recommends moving the deficit contributions back from 6% to 2.1% of salary
  - UUK requested this in its response to the September consultation

- Employers' unwillingness to accept contingent (or trigger) contributions increased the deficit recovery contributions from 2.1% to 6% of salary
  - but the JEP recommends that contingent contributions are considered as part of **Phase 2**

- Under the JEP proposals, the deficit at 31 March 2017 would reduce to about £4Bn
  - Favourable movements post valuation further support the case for reduced deficit contributions (under the current approach the deficit fell from £7.5Bn to £4Bn at 31 March 2018)

	£7.5bn deficit		**Illustrative £4bn deficit (added by Aon)**	
	Asset outperformance:		Asset outperformance:	
Recovery period from valuation date	0%	50% (added by Aon)	0%	50%
14 years	7.2%	2.8%	3.8%	Nil
17 years	5.7%	1.7%	3.0%	Nil

Assumes 2.1% paid for first two years of recovery plan

USS is yet to consult with UUK on deficit contributions

C. Smooth future service contributions

- JEP recommends smoothing the cost of future benefits
  - The cost of future benefits falls over time
  - Trustee assumes lower investment returns on growth assets in the early years, and "normal" (i.e. higher) returns from year 10 onwards

- The Trustee rejected a suggestion to use this approach during the September consultation
  - Leads to scheme receiving lower contributions than the theoretical cost of benefits in the early years, potentially adding to the deficit

- JEP has suggested a compromise of smoothing over six-years
  - This “refinement” will improve fairness among generations of members
  - But deficit contributions will effectively be lower in the early years than they would have been

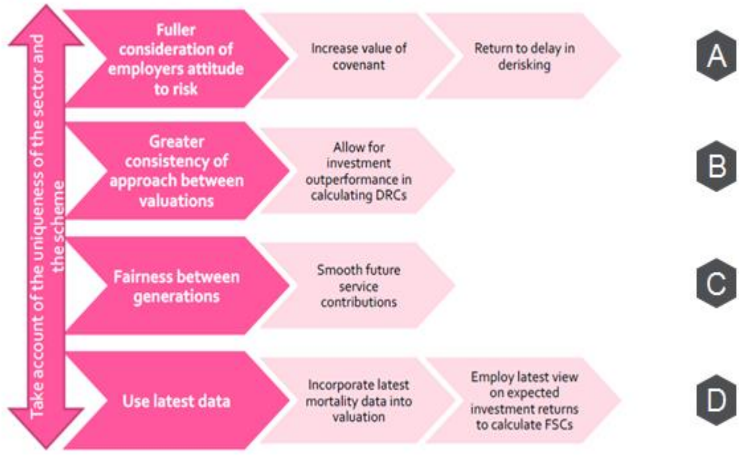
Could be viewed as refinement to accuracy or increased generational equity

D. Use latest data

- JEP recommends updating the mortality assumption (CMI2017) the latest published tables
  - Simply a refinement for new data

- JEP believes there are a number of different paths the Trustee could adopt to reduce the contribution rate to below 30%
  - Their approach for c.29.2% is just one approach
  - One alternative path might include allowing for changes to future investment expectations

Figure 8: Areas for possible adjustment to the 2017 valuation



Using new information is reasonable in our view, but ultimately a matter for Trustee

Additional risk for employers (1 of 2)

- If the JEP recommendations are adopted, then employers (and employees) would take more "risk".
  - Employers and employees would pay **lower** contributions now, for the same benefits;
  - Increased risk of either a) **higher** future contributions and/or b) future benefit changes

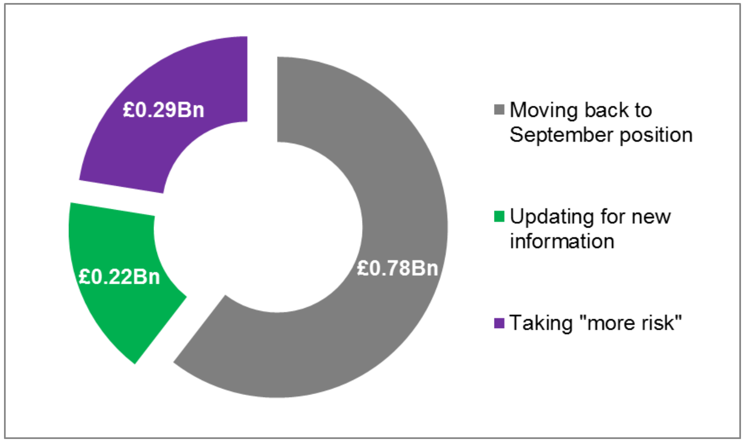
- Joint contributions over the three years from 1 April 2019.
  - Rule 76 proposals - about £8.3Bn
  - JEP proposals - about £7.0Bn or £1.3Bn lower

- Lower contributions increases the risk of paying higher future contributions
  - Or benefit reform
  - Higher contributions may be paid over a period.
  - A £1.3Bn shortfall needs 1% of payroll (i.e. £80M p.a.) over 17 years

Paying less now means greater chance of higher contributions in future (or benefit reform)

Additional risk for employers (2 of 2)

- Interpretation of risk taken on depends on your perspective:
  - Moving back to the September position for technical provisions and recovery contributions (£0.78Bn)
  - Updating for new information on mortality and future investment returns (£0.21Bn)
  - Taking more risk (£0.30Bn)



- We have considered the incremental risk relative to the Rule 76 backstop (current benefits minus 1% DC match). The position would look different compared with the January JNC proposal

- Trustee will form own views on additional risk, and may wish to consider how employers demonstrate greater risk taking capacity

Trustee will form own views on additional risk

Wrap up

- The JEP has recommended a two-phase approach:
  - Specific recommendations for the 2017 valuation, to try to allow this to be concluded swiftly
  - More fundamental review of risk, the valuation approach, and engagement

- The JEP proposals expose the employers/employees to more risk for the 2017 valuation.
  - Simplistically, the additional risk can be considered as requiring additional contributions or benefit changes in future

- (We await the reactions of TPR and the Trustee, and UUK will communicate these when available)

The consultation by UUK with employers and your responses

Vicky Mullins

Universities UK

UUK consultation questions

Universities UK

01 Would your institution support the JEP recommendations regarding the 2017 valuation, in overall terms, subject to the acceptance of such a position from the USS Trustee (and TPR as appropriate)?

02 What further information would you need to provide a final view for question 1?

03

a. Would you accept employer contributions at 20.1% (member contribution of 9.1%)?

b. If not, what balance of additional risk, higher contributions and/or benefit change would you prefer to see as an outcome?

Q2: Further information needed for Q1?

UUK wants to ensure that employers have information on potential implications of accepting the JEP, while recognising that the views of other stakeholders are not yet known and further information may became available over the consultation period.

1. Level of risk
2. Trustee and Regulator view
3. Deficit funding
4. What conditions might the Trustee require

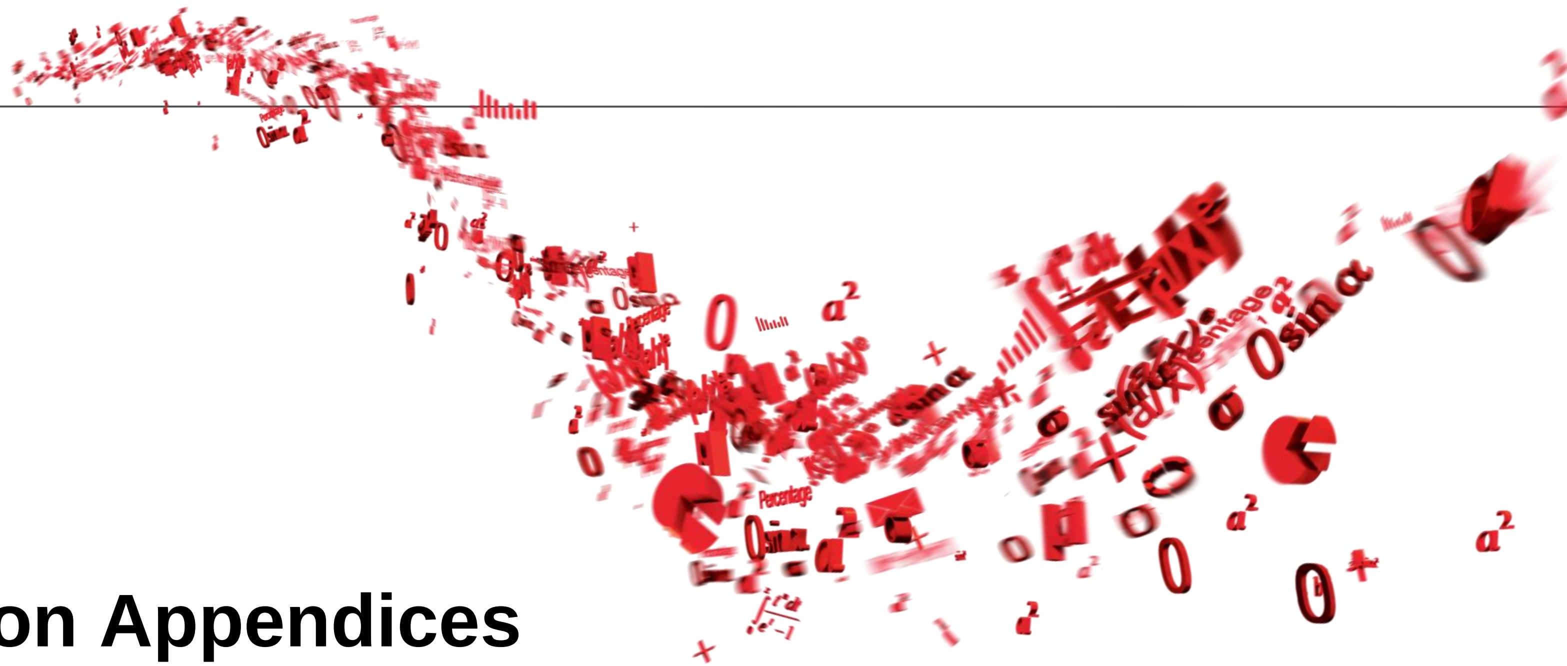
Questions from employers

Brendan Mulkern, Universities UK
John Coulthard, Aon

Close

Alistair Fitt

Vice-Chancellor of Oxford Brookes University and member of the Employers Pensions Forum



Aon Appendices

Additional risk – Contributions under different approaches

	November 2017 / Rule 76	→Move to September position	→Take account of new information	→JEP recommendation
DB up to salary threshold	28.1%	26.8%	25.9%	24.6%
DC above salary threshold	2%	2%	2%	2%
Investment subsidy	0.1%	0.1%	0.1%	0.1%
Admin expenses	0.4%	0.4%	0.4%	0.4%
Deficit recovery contribution	6%	2.1%	2.1%	2.1%
Total	36.6%	31.4%	30.5%	29.2%
Employer contributions	**24.9%**	**21.5%**	**20.9%**	**20.1%**
Employee contributions	11.7%	9.9%	9.6%	9.1%
Total contributions over 3 years from 1 April 2019	**£8.31Bn** (i.e. 2.45+2x2.93)	**£7.53Bn** (i.e. 3 x £2.51Bn)	**£7.32Bn** (i.e. 3 x £2.44Bn)	**£7.02Bn** (i.e. 3 x £2.34Bn)

For consistency with the Rule 76 (November 2017) figures, it is assumed that the 1% DC match is not provided. An £8Bn payroll is assumed.

Context and Disclaimers

- At UUK's instruction, Aon acted as an "expert witness" to the JEP.
- The JEP has recommended a two-phase approach:
  - Specific recommendations for the 2017 valuation, to try to allow this to be concluded swiftly.
  - Carry out a more fundamental review of risk, the valuation approach, and engagement – ahead of the 31 March 2020 valuation, with work commencing as soon as the 2017 valuation is completed.
- In this presentation we share advice to UUK on the specific changes recommended by the JEP for Phase 1. This paper is prepared for UUK, and we have given permission for it to be shared with USS participating employers on the understanding that the report is solely for the benefit of UUK. We do not accept any responsibility for any other party relying on it.

This presentation, and the work relating to it, complies with 'Technical Actuarial Standard 100: Principles for Technical Actuarial Work' ('TAS 100') and 'Technical Actuarial Standard 300: Pensions' ('TAS 300')