USSEmployers

RESPONSE FORM

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

CLOSING DATE: 24 MAY 2021

REPLY TO: PENSIONS@UNIVERSITIESUK.AC.UK

MAKING YOUR RESPONSE TO THE CONSULTATION

We welcome responses to this consultation from each and every one of the scheme's participating employers.

We are keen to have the widest possible range of views and perspectives ahead of the next steps of the 2020 valuation.

Through this consultation we are formally seeking views and direction from employers on some key questions, particularly on:

- Covenant support measures
- Contributions
- Future benefit structures
- Addressing the high opt-out rate and flexibilities
- Governance
- UUK's Alternative Approach

This template form is optional and can be used for the response from your institution, you may also want to feedback this information another way.

With these views, UUK can then progress the negotiations with the University and College Union (UCU) within the Joint Negotiating Committee (JNC).

Please send the response from your institution to pensions@universitiesuk.ac.uk by 5pm Monday 24 May 2021.

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)?

Yes, but we would like there to be a carve out from the Metric E calculation in respect of secured assets that are equipment. This is requested as a pragmatic way of dealing with situations where certain funders require a charge or other security over equipment that they are funding.

COVENANT SUPPORT MEASURES

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?

Yes, though again we would wish to see a carve out from the Metric E calculation of equipment assets. Our preference would be for the UUK solution which favours a longer moratorium period on exiting the scheme in order to limit the Metric E threshold to 15%. The scope for the University to exit the scheme is extremely limited in view of the prohibitive S.75 charge and it therefore makes sense to increase reliance on this aspect of the covenant strengthening measures in order to create more leeway for small elements of secured debt, which may from time to time be a useful option for universities.

COVENANT SUPPORT MEASURES

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.

We remain uncomfortable as to the power that USS will have to impose mitigating actions on universities in breach of debt monitoring metrics. Whilst it is stated that there will be an appeals process the arrangements have yet to be drawn up and it is implied that any appeal will be to the Trustee who will have little incentive to seriously consider overturning their initial decision. The arrangements for the appeals process need to be made clear and agreed as part of concluding the valuation so that employers can have confidence in the process they are signing up to.

COVENANT SUPPORT MEASURES

4. Are there other areas of covenant support you would wish to consider such as contingent contributions or asset pledges?

No

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.

Yes. We have however made provision for 23.7% in our financial plans but it should also be recognised that USS is a multi-employer scheme with a diverse membership of 340 different employers with varying levels of affordability. Therefore as a Last Man Standing Scheme we ought to be sensitive to that fact and take a longer term view for the length of the recovery plan, noting that USS has yet to consult on this. It is in everyone's interest to bring along as many employers together as is possible.

Equally we have to be sensitive to the level of member contributions noting that USS has in the past considered that a contribution rate of 10% as being at the upper limit of member tolerance, noting that opt-out and withdrawal rates are increasingly being monitored as a cause for concern as this leaves more eligible members with no pension provision or life cover.

When addressing this question one also has to consider what employers and members will consider as value for money. In the public sector, schemes such as Teachers Pension Scheme (TPS) (available to post-92 academics), members pay between 7.4% and 11.7% with an employer rate of 23.68%, but the pension offering is significantly better value for stakeholders than the current USS offering. If USS benefits are going to be reformed further in order to keep costs within the current cost basis then we might get increased levels of opt-outs as members assess whether the pension offering is value for money, noting that this point has been acknowledged by both USS and Aon/UUK in recent reports. It is really difficult therefore to provide a fuller answer without seeing the potential recovery plan setting out the level and duration of deficit contributions, not to mention the potential for more de-risking and its impact on future costs. Stakeholders need to be confident that contribution rates will remain stable for the long term and members will want some reassurance that their benefits will not be eroded by inflation.

BENEFITS

6. Do you support the broad principle of seeking to retain the hybrid benefit structure?

Yes, we strongly support the broad principle of retaining the hybrid benefit structure but note that the three scenarios presented by USS in their update of 3 October makes it difficult to maintain a meaningful pension offering.

BENEFITS

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?

Yes we would consider it a reasonable benefit proposition given the circumstances we find ourselves in and the proposed benefit structure would be similar to the current design in place so less disruptive for members. Such a design is important as it allows for continued defined benefit accrual and a reasonable DC credit. In addition, it should ensure a continued positive cash flow so preventing USS from becoming a forced seller of assets to meet benefits and this should be reflected in the investment strategy and recovery plan, i.e. take a long term view in line with the nature and experience of the sector that underpins the scheme.

BENEFITS

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?)

We presume the question has been proposed on the basis that USS is not willing to alter its pre-retirement discount rate to enable the UUK proposition to come to fruition. If that was the case and it was a matter of considering the options outlined on page 18 of the Update Report we would have the following comments:

Scenario 1-even USS consider it as poor value so no.
Scenario 2-again poor value which could lead to an increased level of opt-outs and withdrawals.
Scenario 3-This benefit level is questionable and puts the pre-92 sector further behind its post-92 counterparts in terms of benefit offering.

BENEFITS

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

No. Unfortunately this is unlikely to be suitably addressed or put in place in time to meet the immediate pressures arising from the USS valuation. It is unlikely that USS would keep contributions at current levels whilst further exploratory work was taking place. Notwithstanding this, many of the larger USS participating employers are due to certify their auto re-enrolment compliance next year so we would want to be confident that any new arrangement was going to meet the legislative requirements.

Another consideration would be the need to ensure that any conditional indexation was applied in a fair manner. There are already issues of trust prevailing between many stakeholders and USS and there would need to be a framework to ensure that a disproportionate amount of any "gains" are not used up to "de-risk".

A key consideration is the need to have a benefit structure in place that is readily understood by its membership and many members do not fully understand the hybrid model. Introducing a new layer of conditional indexation can only manage to make this more challenging for members and if not understood how can members truly value it?

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?

Yes. This question seeks to address the current opt-out rate but we have to be careful to compare like for like when considering opt-out rates as the education sector has a high number of different types of Variable Time Employees now eligible for USS and this was largely not the case until the advent of auto enrolment. Given the nature of these contracts, it is understandable that pensions is not a high priority for many younger staff, particularly when the contribution rate is higher than what might otherwise be payable in alternative schemes with a lower employer contribution.

A key consideration is value for money at an affordable rate. Employers cannot consider low opt-outs in isolation as a success if the employer contribution is low. At the moment there is a built in disincentive for new USS members in the way that new staff are obliged to pay a proportion of the deficit contributions and this is likely to become more accentuated as contribution rates increase.

There is reference to potentially introducing a tiered contribution structure but this is not without difficulties with the hybrid structure in place as we already have a tiered benefit structure that favours those on lower earnings. Therefore to implement a tiered contribution basis on top of this, is only going to discourage those with salaries above the earnings threshold. This is because those with earnings in excess of the earnings threshold will be asked to pay even more for no actual benefit. To make this clear, if the member rate increases to 11% from October then a member will be paying 3% (11%-8%) on earnings over the threshold for nothing in return.

Notwithstanding the above, the only way to address this issue is to offer an alternative lower cost pension arrangement, at least for an introductory period. This is not without some difficulties since some existing members might ask for the same option and some might see this as being a closure to new entrants by the back door. One possibility might be to enrol people into the "main scheme" and then if opting out provide say a DC offering as an alternative to opting out completely.

FLEXIBILITIES AND OPTIONS

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).)

Yes, we would support the adoption of a lower cost saving option for staff that have opted-out rather than as a substitute for the main pension offering. In any design it is important to understand the nature of the opt-outs and distinguish between those factors that are/not attributable to USS. For example, a lot of opt-outs are attributable to variable salary posts where the employment relationship is more short-term in nature. Also UUK should anticipate a higher opt-out rate next year regardless of changes to USS because most universities will be required to re-enrol staff into USS as part of their triennial statutory auto re-enrolment duties.

It is important to ensure that any alternative provision for opt-outs is underpinned by good levels of life and incapacity cover as this seems to be a valued staff benefit.

The above comments are consistent with the views of staff from the UUK survey we circulated.

FLEXIBILITIES AND OPTIONS

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).

Whilst we understand why this proposal might be attractive to some employees, our staff appear to value the hybrid model. We note the difficulties in requiring employee contribution towards the deficit recovery in a DC scheme.

FLEXIBILITIES AND OPTIONS

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?

We are interested in flexible options provided they are lower cost options for those members who would otherwise opt-out and have no pension or life cover. Any such pension proposition should be readily understood by members, be seen as value for money and not result in a higher cost for employers.

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?

We are surprised to see this question given that it was largely dealt with by the Joint Expert Panel in their second report and there does not seem to have been much if any change following those recommendations.

We would very much welcome a wider review of USS governance as it is clear that we are in a completely different working and regulatory environment than when the Scheme was originally set up. Back in 1975, USS mirrored many of the public sector schemes in place and its governance design was appropriate then. Nowadays the employer base is a lot more diverse with businesses to run. We now seem to have a situation whereby the pension provider is cajoling or in some respects dictating terms to the plan sponsors with little regard to the long term economic viability of those employers. This is not something that employers would tolerate from any of the service providers to their own in-house schemes.

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?

Yes. This question links covenant support and the resulting implications for the benefit offering as we attempt to keep pension spend at reasonable levels for both staff and participating employers. This is not a situation that we are comfortable with but USS has pushed ahead with the valuation despite our concerns over timing and the regulatory environment forces the stakeholders to make some difficult decisions.

Given this background:

<u>Covenant Support</u>

We reiterate the answer we provided in question 1 namely, “Yes, but we would like there to be a carve out from the Metric E calculation in respect of secured assets that are equipment. This is requested as a pragmatic way of dealing with situations where certain funders require a charge or other security over equipment that they are funding.”

<u>Benefit offering</u>

Yes we would reiterate the answer provided under question 7.

In summary, we are willing to support these UUK proposals (both the additional covenant support and the proposed adjustment to benefits) ***on the condition that USS give suitable weight to these changes when consulting on the recovery plan and schedule of contributions***, i.e. helping to negotiate a recovery plan length of some 15-20 years, allow for suitable asset out performance and deficit contributions of some 6%. It is a pity that USS were unable to provide more information and so greater clarity to stakeholders, i.e. their clients, before having to make such important and difficult decisions.

Please send your completed form to: pensions@universitiesuk.ac.uk by Monday 24 May 2021

Thank you for taking the time to respond to this consultation.

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