

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 4, as the means to achieve a solution which might be acceptable in the round (see also question 15)?

The University is a strong advocate of USS and the covenant support which underpins this. Whilst recognising the importance of the provision of additional covenant support, the University Governors recognise that there is a potential contradiction between agreeing to measures which may be detrimental to the University and doing what is best for the sector, which indirectly may lead to a more sustainable pension position. We also consider the existing sector covenant to be undervalued by USS and The Pensions Regulator.

In terms of the specific support

Rule change on employers' exits – the University is comfortable with the 20-year rolling moratorium. The section 75 costs of leaving the scheme are extremely prohibitive and it is hard to envisage a scenario where the University could afford to exit.

Debt Monitoring – it is likely that we will not meet the de minimis threshold (although this would need to be confirmed) and will be required to complete the metric testing. With this in mind, there is insufficient clarity regarding the measures that USS may look to impose should the thresholds be breached and the University would need a better understanding of these measures before agreeing to such a proposal. We assume that in the event of not meeting the metric, the ultimate sanction would be to increase the employer's contribution rate. In addition, does the de minimis threshold not exclude smaller employers, who may be most at risk, at the potential disadvantage of larger employers? We are concerned that the University will be constrained by this level of third party control and therefore influence how Court manages the University and its finances in a sustainable way, which may impact on investment and jobs. Without further clarity, we cannot support this proposal.

Pari-Passu security on new secured debt - this is a significant issue for the sector. Firstly, it will create a two-tier system as only new debt will require security when the metric is exceeded. So in practice, two universities with equal balance sheet debt would have different requirements with regards to securitised debt. If USS requires security, this may have knock on impacts on universities' other borrowing arrangements for pre-existing debt. The impact on lenders also requires careful consideration. Will they price in the risk of USS security meaning that borrowing will be more expensive going forward?

The metric is set at a level that will capture relatively small levels of borrowing in a financially sustainable university.

We have some serious reservations regarding the impact of the additional support measures. We would need more information on the implications for breaching the debt monitoring thresholds and these need to be set out in a clear manner prior to being adopted. The University would not be supportive of additional measures being added as part of a future valuation exercise.

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?

Our response is similar to that for question 1. The lower de minimis level will have a significant impact on Universities, as would the reduced threshold for gross secured debt (10% of Net and Gross Assets as opposed to 15%). We are not supportive of this proposal and consider the UUK level more appropriate.

The UUK proposal has a longer moratorium and as noted previously, we are comfortable with this.

Our concerns are the lack of clarity surrounding the additional support, especially in terms of potential sanctions that would be imposed by USS assuming any metric breach.

As stated above, the University would not be supportive of additional measures being added as part of a future valuation exercise.

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.

The answers to questions 1 and 2 cover our main concerns.

COVENANT SUPPORT MEASURES

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

We do not support measures such as contingent contributions or asset pledges. The details of contingent contributions, included in previous documentation, discuss how the funds would require to be placed with a 3rd party. In essence, this is no different than providing additional contributions to USS and does not address the underlying affordability issues.

The use of asset pledges is likely to cause serious unintended consequences for the University. We have already reviewed the potential to provide asset security towards the deficit for our own pension scheme. It is clear that providing such a pledge resulted in the University having to provide

similar security for at least part of our existing unsecured borrowing (with a multiplier of 1.6 times). The debt monitoring measures in place state that this will result in USS requiring pari passu security for new secured borrowing or granting security for existing debt.

As a result, should the University provide security to USS over any assets, it must provide security on at least part of its existing borrowing which may also require further provision of security to USS. Consequently, the University would be seriously disadvantaged for trying to provide additional support to the USS scheme, when in reality this would weaken the University's position.

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.

The University has previously declared that the current contribution rates, both for the employer and employee, are at the maximum levels of affordability, and reaffirms this here.

Further increases will be unaffordable for both the members and the employers. We must address sector high opt out rates at the current contribution levels as the existing rates are already viewed as too expensive by some. In addition, funding for further increases to contribution rates will impact on University activities and will result in cuts to services and employment numbers.

The increase to rates provides no guarantee that future valuations will not require yet higher contributions. The previous changes to benefits gave a 90% chance that rate would not have to change at the next valuation date – this has proved to be incorrect. The issues of affordability and value for money of existing benefits must be addressed now as opposed to simply increasing contribution rates, especially when there can be no guarantee that rates will not need to increase again in the future. This situation creates uncertainty for both the employer and employee and hinders long term planning for both.

From our employee survey, 66% of those currently in the scheme responded that the contributions were somewhat or readily affordable. However, 91% responded to say that they were somewhat or very concerned if their contributions to USS were to increase. In addition, 92% of those not in the scheme state that the reason for this is that it is currently too expensive.

There are concerns that affordability may lead to indirect discrimination of staff on the basis of certain protected characteristics including age, gender and race.

This is a clear statement from our employees about affordability and that future increases are concerning. For prudence, we have built the October 2021 increases into our budget projections,

but this is impacting our ability to invest in academic priorities and professional services.

BENEFITS

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

From the employee survey, 67% responded that DB should be retained going forward.

The University believes strongly in meaningful, sustainable and affordable pension benefits for its employees. We require a pension scheme which meets these criteria and whilst other options must be considered, the principle of retaining a hybrid benefit structure has been endorsed by our staff members. However, such a scheme must continue to offer value for money. For example, the UUK proposals, if achievable, seem to offer a meaningful DB element for a reasonable cost. The proposals put forward by USS (with an accrual rate of 1/145) do not offer value for money and the provision of such a DB element for the current costs cannot be regarded as provision of a meaningful pension.

In any future scheme design, it is essential that we build in sufficient headroom in order that any fluctuations in the deficit can be accommodated without benefit or contribution alterations.

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?

The scheme is clearly valued by members, especially the DB element, and 89% of survey respondents agreed or strongly agreed this was a valuable part of their overall employment package. The UUK proposal retains a meaningful DB element whilst maintaining the cost at current levels. As a result, this would be a sensible approach which gives an overall acceptable package of benefit reform and covenant support.

There are some issues to consider, such as that the proposal does not create the flexibility required to allow those members who cannot afford to join to do so, without further flexibility.

With any DB scheme there will always be risk of increased contributions/discussions re benefit reform as part of every valuation exercise. The opportunity must be taken to future proof the scheme as much as possible, through structured, considered and long-term benefit reform that will avoid the constant change and uncertainty for both the employee and the employer at every valuation.

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?)

As noted in section 7, we believe the illustrated hybrid is acceptable and we do not have any material concerns, but we note in later sections that we would like additional flexibility for those members of staff where affordability is an issue. In addition, in any scheme design, the issue of intergenerational unfairness needs to be a high priority.

We accept that there may need to be marginal changes to the UUK proposal, as long as this doesn't change the substance of what is being proposed.

Consideration should be given to closing the DB element of the scheme to new entrants, who would be offered a DC element only.

We do not believe that the hybrid benefit offered by the USS proposal provides a meaningful pension or is value for money. Members are generally accepting of the current contributions, but this has priced out a number of employees within the organisation. A significant reduction in benefits will undoubtedly result in further withdrawals from the scheme.

If, in the very unpalatable circumstance that the USS Trustee does not amend its assumptions, the only solution is to move to a wholly DC scheme.

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)?

The main priority should be to try and achieve a level of meaningful benefits that are affordable on an ongoing basis. We do accept that this will be extremely difficult to achieve, and it is sensible to consider alternative models should further changes be required.

We do have some concerns around conditional indexation. There are issues around expectation and tensions if increases are not given, the complexity of this type of arrangement and member understanding of what is already a complex hybrid scheme. Some members may wish an increased DC component where they can benefit more directly from good investment returns.

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, we would like to see more flexibility within USS and this is supported by the staff survey where 61% of respondents noted they would like additional flexibility. Such flexibility should be focussed on ensuring that staff at all stages of their careers have the opportunity to join the scheme and build up meaningful pension benefits. More specifically, we would wish consideration of the following options

- Stepped contributions based on salary. This would allow those on smaller salaries to join the scheme with a smaller % contribution, and as the employee moves through the salary scale the % contribution rates would increase.
- Consideration of offering access to the DC element of the scheme only and giving employees flexibility on how much they can contribute which would be matched by an equivalent employer contribution.
- As noted in question 8, if the USS Trustee does not amend its assumptions, the only solution is to move to a wholly DC scheme.

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).

We support the creation of a lower cost saving option. The responses to Questions 8 and 10 set out the areas we would wish to be explored.

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).

As mentioned in the previous question, this would be helpful especially for those in the early stages of their career who are not able to afford the full contribution levels. Whilst the University would prefer less volatility in pension contributions, the majority of staff support the revised hybrid model. However, the University has concerns regarding the affordability of the DB element and there may come a point in time that this no longer offers value for money. The flexibility offered by a DC only model provides a more meaningful pension for the contributions that individuals and employers can afford.

The University is concerned about intergenerational unfairness, given that all employees pay for deficit recovery, regardless of whether the individual is a new member of USS or a long-standing member. These new members are subsidising the deficit recovery for long-standing members, when there is no portion of the deficit recovery relating to them.

We consider that a model can be constructed whereby DC contributions do not include any deficit recovery, but that the employer contribution to this element can be tailored, leaving employer resource to fund deficit contributions relating to DB.

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 have provided some details on variations in our response to the previous questions.

Consideration should be given to allowing USS eligible staff at the lower end of the grades to join the University's own DB scheme with the potential to transfer to USS at a future date.

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 would very much welcome a governance review.

Firstly, we would wish to see a much more transparent approach from the Trustee when setting out consultation materials and how valuations are arrived at. For example, in the consultation on the Technical Provisions, we were presented with a wide range of options, but it was unclear how answers to this would feed into this stage of the consultation. This is one example of how this makes the whole consultation process difficult from an employer perspective.

We had previously noted that we did not support the 31 March 2020 valuation date at such a time of flux and strongly advocated waiting until the statutory deadline of 31 March 2021. We also have similar concerns on the lack of clarity on how USS deals with post valuation movement in asset valuations. It would have been helpful to see some analysis of this in the funding figures provided.

Proposed changes need to be properly explained and documented so that the University can understand the full impact of any proposals.

In addition, sufficient time needs to be given to the University and its employees, so consultation can be meaningful and implications assessed.

Our staff responses indicated that they would welcome more visibility and comparative information on investment performance and running costs. Importantly, USS needs to consider its stance on ESG investing and, given the size of the fund, the societal and sustainable impact of its investment strategy.

Staff also noted that equality in pension provision was important and that affordability can have an impact on equality.

We would also wish this review to consider how a stronger voice can be given to all USS members. There are a number of employees in USS who are not UCU members and consideration is required as to how they are represented along with employees who are eligible to join the scheme, but are not yet USS members.

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?

As noted above, the University has significant concerns about the pari-passu covenant support and the lack of clarity on the debt-monitoring framework. However, the University needs to balance up all factors regarding the future of USS and our key consideration is affordability to both the employer and employee.

We are broadly in support of the UUK proposal but require further exploration of key areas. We would not support stronger covenant measures without all the other changes to benefits and importantly, the lower cost alternative to address not only the high opt out rate but also affordability for staff members on lower salaries. We would also wish additional headroom to be built into the assumptions, to protect against continued scheme alterations.

It is impossible to conclude this matter with a meaningful and affordable solution unless all parties involved are prepared to accept compromise from their current position in some way.

Failure to reach a compromise is likely to result in a scheme that is unaffordable for all. As a result, it would be likely that withdrawals from the Scheme would rise and the additional costs of supporting it would curtail university activities. The USS pension would no longer offer value for money and increased costs may weaken the sector, putting further pressure on the covenant in due course and making wholly DC saving as the only alternative.

The indicative proposals put forward by USS to retain existing benefits are unaffordable and the level of benefit offered for current contributions does not offer value for money for members or employers. Overall, while noting our caveats about building in additional headroom into the assumptions, we consider the UUK proposal to be well thought through, affordable to employers and employees whilst still offering meaningful benefits.

In its current form the USS scheme is at the margin of affordability for the employers and employee members, but the proposed increase to contribution rates make it unaffordable. This raises concerns over the strength of the employers covenant and risks increasing drop out and non-take up by employees. Unless fundamental change is implemented, the scheme will not be sustainable.

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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