USS Review Working Group
11.00am – 12.30pm, Monday 20 May 2019
Venue: Room 6, Wellington Square

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Date of next meeting – 11.00 – 12.30 Friday 21 June 2019, Room 6 Wellington Square

Invitees:

Professor Richard Hobbs (Chair)
Dr Martine Abboud
Mr Charles Alexander
Professor Danny Dorling
Mr Julian Duxfield
Professor Fabian Essler
Mr Charles Harman
Professor Sam Howison
Professor Jane Humphries
Professor Tim Jenkinson
Mr Jaya John John
Professor Sophie Marnette
Mr Lindsay Pearson

In attendance:
Prof Anne Trefethen
Mr Russell Powles, Aon
Ms Judith Finch, Conference of Colleges
Ms Jan Killick, Mr Stephen Rouse, Mr Lucian Hudson

Apologies:
tbc

USS Review Working Group

Meeting room 4, Wellington Square, 11.30am – 1.00pm

Minutes of the meeting of 25th April 2019

Present: Professor Richard Hobbs (Chair), Mr Charles Alexander, Mr Jaya John John, Mr Julian Duxfield, Professor Fabian Essler, Mr Lindsay Pearson, Professor Sophie Marnette, Professor Sam Howison, Mr Charles Harman, Professor Danny Dorling, Professor Tim Jenkinson

In attendance: Prof Anne Trefethen, Mr Russell Powles (Aon), Ms Shaunna–Marie Latchman, Ms Judith Finch

1. **Apologies for absence and welcome**
Dr Martine Abboud, Professor Jane Humphries sent their apologies.

The Chair welcomed Professor Tim Jenkinson as the replacement Social Sciences Division representative and Shaunna–Marie Latchman (S-ML) from PAD to present the communications item

2. **Conflicts of interest**
There were no new conflicts of interest declared.

3. Minutes of the previous meeting
The minutes of the meeting on 4th March 2019 were agreed.
There were no matter arising not addressed by the main agenda items

4. Council paper on Group's draft response to UUK on 2018 valuation
Noted by the Group

5. Final University response to UUK on 2018 valuation
The Group noted that there was some short-lived interest on social media in the University's response.

6. UUK response to USS on 2108 valuation

The Group noted that there were significant ambiguities within the UUK response to USS and agreed that it would be helpful in future similar responses for UUK to include a higher level of granularity in its feedback. For example the numbers of institutions by scale providing different views. Anne Trefethen (AT) who has joined the Employers Pension Forum (EPF), the UUK sub-group focused on USS issues, agreed that she would feed this back to UUK at a forthcoming EPF meeting and this would then be followed up with a letter to the UUK Chief Executive, Alistair Jarvis. A separate note will be circulated to Group members with a draft of this letter to UUK.

AT noted that the EPF was due to meet before Easter but this meeting had been cancelled.

Julian Duxfield (JD) to circulate a summary of UUK so that the group members are clear about UUK's structure and role.

7. USS update 4 April 2019 on 2018 valuation.

The Group noted that this was the most recent communication available from USS.

It was noted that the delays surrounding the UUK consultation and further delayed USS response means the timescales continue to slip and securing agreement on the 2018 valuation by 30th June looks highly unlikely.

It was noted that the USS Trustee is due to meet on meet on 30th April with an EPF meeting due 1st May.

The Working Group discussed the current situation and the agreed view was:

- The WG continues to believe that the report of the Joint Expert Panel (JEP), created by the JNC members of the USS following last year's impasse over funding of the USS scheme, offers a balanced compromise between UUK and USS over the necessary judgements applied to the USS valuations in relation to scheme costs.
- Along with many other UUK members, the University continues to support the JEP's findings as offering the best way forward for maintaining member benefits and the necessary costs associated with this.
- The WG also notes that prospects for that compromise appear to be receding with USS's latest published response to UUK that "it was not immediately clear that UUK's proposals are fully aligned with [USS'] principles for contingent support… the Board will reconvene at the end of April." We also note the comments that USS has had a series of meeting with the independent Pensions Regulator and these continue.
- This further slip in the original timetable reported by USS brings us closer by default to the announced further increases in employee and employer contributions in October 2019 and April 2020 planned by USS.

8. Communication issues

S-ML presented an overview of the current communications approaches and feedback from the recent the communication survey.

It was agreed that SM-L would update communications plan to reflect the comments from the meeting, including correcting the use of acronyms and/or names of organisations/ groups and amend the usage of the term 'direct benefits' rather than 'defined benefits' in the communications plan. In addition removing the text referring to 'communication messages'.
Any further comments regarding the communications plan should be sent to Lucian.Hudson@admin.ox.ac.uk or Shaunna-Marie.Latchman@admin.ox.ac.uk as soon as possible.

S-ML will draft a further e.mail for scheme members that:

- Provides an update of the 'story so far',
- provides a link to the appendix from the most recent webinar,
- provides a link to the YouTube video of the April webinar,
- provides a link to a page that contains the answers to the questions received in the staff survey.

The possibility of a further update communication from the V-C was discussed.

Date of next meeting: 20th May 2019

Notes of USS WG telephone conference call 13 May 2019

In attendance: Professor Richard Hobbs (Chair), Mr Charles Alexander, Mr Jaya John John, Mr Julian Duxfield, Professor Fabian Essler, Mr Lindsay Pearson, Professor Sophie Marnette, Mr Charles Harman

and Prof Anne Trefethen, Ms Jan Killick, Ms Judith Finch (observers, didn't vote)

The USS Working Group had a call to consider the material from UUK issued on 9 May with a short timescale to indicate a preferred option to UUK by close of 15 May on the USS trustee's options for the 2018 actuarial valuation. It agreed to form an initial view for Council and it would re-consider the matter at its meeting on 20 May 2019, ahead of the deadline for formal responses by 30 May 2019.

The Group noted the comments and feedback provided by working group members ahead of the call.

The Group reiterated its support for the views of the Joint Expert Panel on valuation assumptions and wished for a period of stability to allow for the second phase of the JEP work to be concluded and given full consideration.

The Group formed a strong majority view that the new option 3 presented by the USS trustee was a preferred option as:

- it allowed for a period of stability that would enable the JEP phase 2 to make its recommendations ahead of the 2020 actuarial valuation;
- it would not involve the disruption of an employee consultation; and
- the financial impact would be less than the other options in the next two years.

It was recognised that there was a risk that the outcome of a 2020 actuarial valuation may carry a worse financial impact given the movement in gilt yields over recent months. It was agreed that we should also communicate that our support for Option 3 was to enable time for full consideration of the existing JEP recommendations (eg re valuations) and planned JEP2 proposals and did not mean the WG agreed with the level of contributions calculated.

Suggested text to go to UUK

The University of Oxford has considered the material from UUK issued on 9 May with a short timescale to indicate a preferred option to UUK by close of 15 May on the USS trustee's 3 options for the 2018 actuarial valuation.

The University reiterates its support for the views of the Joint Expert Panel on valuation assumptions and wished for a period of stability to allow for the second phase of the JEP work to be concluded and given full consideration. Of the options presented, we believe option 3 presented by the USS trustee was a preferred option as:

- it allows for a period of stability that would enable the JEP phase 2 to make its recommendations ahead of the 2020 actuarial valuation;
- it would not involve the disruption of an employee consultation; and
- the financial impact would be less than the other options in the next two years.

The University's support for Option 3 is to enable time for full consideration of the existing JEP recommendations and planned JEP2 proposals and does not indicate support for the levels of contribution calculated.

USS

Mr A Jarvis
Chief Executive
Universities UK
Woburn House
20 Tavistock Square
LONDON
WC1H 9HQ

Your ref
Our ref BG/JMR
Date 7 May 2019

By email only

Dear Alistair

I am writing in response to the UUK response to the Trustee's technical provisions consultation, dated 19 March, and to set out the next steps for progressing the 2018 valuation, as agreed by the board at its meeting on 30 April.

The Trustee is writing separately today to Sir Andrew Cubie, Chair of the Joint Negotiating Committee, and is copying that letter to UCU and UUK. A further communication from the Trustee to participating employers has also been prepared and will be issued very shortly, along with relevant updates being made to the public website.

Completion of the 2018 valuation

The board noted UUK's response to the technical provisions consultation, and the questions and feedback from employers in relation to various aspects of the 2018 valuation, including the pricing of the Upper and Lower bookends, the rationale for the proposed level of deficit recovery contributions (DRCs), and the requirement for contingent contributions.

The board also reviewed UUK's proposal for a Contingent Contribution Arrangement ("CCA"), developed with Aon. The board concluded that changes would be needed to elements of UUK's proposed contingency arrangements in order for the Lower bookend rate of 29.7% to be applied, to provide adequate protection from short-term risks. These changes relate to some of the metrics applied for calibrating trigger events and the scale of increases required if and when triggered. The changes required provide the Trustee with the ability to address a material worsening of the scheme's short-term risk position – which, as we have previously set out, could have a detrimental impact on our ability to achieve the right outcomes in the long-term. This is the fundamental driver behind the contribution rates the Trustee requires under all of the options now available. The contingency arrangement put forward by UUK does not, in the Trustee's view, address this adequately in its current form, but modifications could be made to progress with this option.

A full response to the issues raised by employers, an explanation of how the UUK proposal for a CCA falls short against the framework and principles set out by the Trustee, and a summary of what modifications to the CCA would be required in order to deliver contributions at the Lower bookend is provided in the enclosed document, *"Trustee's reply to UUK's feedback and questions on the Consultation on the 2018 Technical Provisions"*.

In considering the advice of the Scheme Actuary, its covenant advisors EY Parthenon and PWC, and the executive, the Trustee concluded that there are now three alternative contribution structures by which the 2018 valuation could be completed and which it is now inviting the stakeholders to consider.

All three structures would be acceptable outcomes for the Trustee however, as there are considerable challenges to completing the process in a timely manner under Option 2 (an explanation of which is set out below), the Trustee would require an alternative path under Option 1 or Option 3 to be taken in advance of Option 2 being implemented.

The options as agreed by the board are as follows:

Option 1 – Upper bookend

The board agreed that the contribution rate for the current benefits should remain unchanged from the rate consulted on of 33.7%. This is set out as the Upper bookend but is essentially the amount the Trustee believes is required to pay for future service and address the deficit based upon a 31 March 2018 valuation date in the absence of any contingent support.

The contribution rate to apply from 1 October 2019 would be unchanged from the 2017 valuation outcome, but the rate to apply from 1 April 2020 would be lower (currently scheduled to be 35.6% under the 2017 Schedule of Contributions).

To meet the statutory deadline of 30 June 2019 under this Option, the JNC would need to decide that it would not be making any alternate cost-sharing proposals or benefit changes under Rule 64.10 (and thus the default cost sharing position under Rule 76.8 applies) at, or very shortly after, its meeting on 17 May. If the JNC were to use the 3 months allowed to it under the rules, after submission of a Rule 76 Report, to decide on benefit or other changes, the statutory deadline would be missed.

Option 2 – Lower bookend and a contingent contributions arrangement

The board agreed that the Lower bookend would be set at 29.7% which would be subject to an acceptable proposal on contingent contributions to address the additional risk being taken.

The board considered the UUK/Aon proposal for contingent contributions and has set out in the enclosed document the Trustee's reply to UUK and what changes it requires in order for the proposal to be acceptable to the Trustee at the Lower bookend.

Given UUK has been clear that this Option will require any contribution increases triggered by the CCA to be shared with members, this Option would require agreement by the JNC, a statutory consultation with affected members and their representatives and the preparatory tasks associated with that, and then the rule change would be confirmed and executed. The process would be lengthy which, combined with the complexity of the changes involved, would likely lead to a completion date in around June/July 2020. Contribution rate increases as at 1 October 2019 and 1 April 2020 would therefore apply and the statutory

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deadline (in the absence of a Schedule of Contributions/Recovery Plan under Options 1 or 3 being completed in advance) missed by some 12 months.

Option 3 – 2020 valuation

This is a new Option and can be characterised as an alternative contingent mechanism to Option 2.

The contribution rate would initially be set at 30.7% (9.6% members and 21.1% employers) and that would apply from 1 October 2019 (subject to the valuation being completed in time for changes to be implemented so as to meet the cut off dates for an October payroll change).

A 2020 valuation would be undertaken and, subject to that and ongoing discussions between stakeholders, the contribution rate would remain unchanged until 1 October 2021 when it would increase to a minimum of 34.7% in the absence of an alternative Schedule of Contributions from a completed 2020 valuation.

As with Option 1, to meet the statutory deadline of 30 June 2019 under this Option, the JNC would need to decide that it would not be making any alternate cost-sharing proposals or benefit changes under Rule 64.10 (and thus the default cost sharing position under Rule 76.8 applies) at, or very shortly after, its meeting on 17 May. If the JNC were to use the 3 months allowed to it under the rules, after submission of a Rule 76 Report, to decide on benefit or other changes, the statutory deadline would be missed as well as the cut-off date for a change to the 1 October 2019 increase (the payroll cut-off is 31 August 2019).

Covenant

The board concluded, having received advice from EY Parthenon and PwC, that the employers' covenant remains strong but should be placed on "negative watch". Two factors gave rise to the "negative watch": (i) the risk of strong employers exiting the scheme; and (ii) the risk to the scheme of employers increasing debt levels.

The board supported PwC's recommendations that:

- Employers' debt levels be monitored against a number of metrics with the Trustee seeking clarification of employer business plans should the metrics exceed certain levels. This monitoring would be part of an annual attestation;
- Institutions wishing to grant security in the future to lenders (on existing or new debt) should be required to grant *pari passu* security to the trustee; and
- Should these measures prove to be inadequate or fail to obtain employer support consideration would need to be given to additional measures.

The board concluded that satisfactory implementation of debt monitoring and rule changes in relation to exiting employers (see below) were important to the adoption by the Trustee of the assumptions underpinning valuation Options 2 and 3 being offered to employers.

Clarification of withdrawing employer rules

PwC's advice to the Trustee is that Trinity College, Cambridge withdrawing (if that is the decision it ultimately takes) does not in itself weaken the covenant. However, should one more strong employer withdraw from the scheme then the covenant would be downgraded from "Strong" to "Tending to Strong".

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PwC has advised that a clarification to the rules which strengthens the Trustee's discretionary powers to determine whether an employer can exit the scheme would support maintaining the current covenant rating.

The contribution Options outlined above assume that UUK will work with the Trustee to ensure both the rule change and debt management process can be put in place. The clarification to the rules is the most pressing of these issues and requires a rule change to be put forward to the JNC for consideration in the coming weeks and execution of that rule change in advance of the completion of the 2018 valuation.

17 May JNC and Rule 76 Report

There is a board meeting on 16 May, at which the Trustee will review any feedback from stakeholders on the Options for completion of the 2018 valuation described above, the support for debt monitoring, and a clarification to the scheme rules. The board has reserved making a decision on the issuing of the Rule 76 Report until that meeting.

Should the JNC be unable to make a decision supporting a rule amendment and the Options put forward to the JNC to complete the valuation at its meeting in May, it is likely that the board will elect to finalise the Rule 76 Report and issue it to the JNC shortly thereafter.

Thank you for your constructive engagement on these issues. We look forward to discussing these issues further with UUK in the coming weeks, and stand ready to support your discussions, in order to conclude the 2018 valuation in a timely manner.

Yours sincerely,

Bill Galvin
Group Chief Executive Officer

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Universities Superannuation Scheme

2018 Actuarial Valuation

Trustee's reply
to
UUK's feedback and questions
on the
Consultation on the 2018 Technical Provisions

7 May 2019

Contents

1. Introduction

This document sets out the Trustee's response to the feedback received from Universities UK (UUK) on the Consultation on Technical Provisions and Statement of Funding Principles for the 2018 actuarial valuation (the "Consultation"). The Consultation relates to the funding position as at 31 March 2018 for the USS Retirement Income Builder, and ran from 2 January 2019 to 15 March 2019.[1]

UUK's response to the Consultation was received in a letter dated 19 March 2019. This response included:

- A proposal from UUK (developed with Aon) on a contingent contribution arrangement;
- Feedback from employers on the Consultation;
- Feedback from employers on UUK's proposal for contingent contributions.

Full details of these documents are listed in the References section at the end of this paper.

Based on the feedback received through the Consultation process, Section 2 of this paper summarises the Trustee's proposal for contributions, involving three alternative structures. Each of these alternatives is consistent with the Trustee's risk appetite and predicated on the employers' covenant remaining strong.

In its Consultation feedback UUK explicitly posed several questions to the Trustee, which are addressed in Section 4. More generally, the feedback received suggests that it might be helpful for the Trustee to clarify certain aspects of the valuation before responding to these questions. This clarification is provided in Section 3.

In Section 5 we present the Trustee's response to UUK's proposal for contingent contributions. In summary, the Trustee views UUK's proposal – as described in the consultation feedback – as being insufficiently strong to support a reduction in contributions from the Trustee's Upper Bookend to the Lower Bookend. However, a version of the UUK proposal for contingent contributions with modified parameters would be acceptable to the Trustee. This is also presented in Section 5.

The 2018 valuation, as with the 2017 valuation, is taking place against a backdrop of significant uncertainty. This uncertainty brings some difficult challenges. Not only are interest rates from secure investments at very low levels from a historical perspective, the outlook for future real investment returns from all assets is substantially lower than in the past. The ability of the scheme to depend on its sponsoring employers to 'insure' returns higher than those currently available for secure long term investment is hampered by uncertainty about the future of the higher education sector. This uncertainty is evident from:

1. Uncertain government policy on issues such as student funding and foreign student migration, as well as the uncertainties to future research funding and other issues associated with Brexit.
2. The risks that stronger employers will leave the scheme (a route chosen by Trinity College Cambridge).
3. The unwillingness of our sponsoring employers to pay higher contributions in the short term as a buffer against future uncertainty (as expressed in all consultation responses to date).

Much of the more vocal public discussion on the valuation has stemmed from those who believe that the Trustee should not use the next two decades to gradually reduce the reliance on equity returns in funding pension promises, as an increasing allocation to lower yielding, but more certain, investments

[1] The USS Retirement Income Builder is the name for the defined benefit (DB) section of the scheme.

is more expensive. It is indeed likely that pensions could be initially funded more cheaply than under the Trustee's proposals. It is also true that an alternative higher-risk strategy, if it failed, could have very significant impacts for the higher education sector, and ultimately for the security of the defined benefit pensions promised under trust, which is the primary responsibility of the USS Trustee.

2. Trustee's contribution proposal

In the light of feedback received from UUK through the Consultation, the Trustee proposes three alternative contribution structures (see Table 1):

- **Option 1: The Trustee's Upper Bookend** as set out in the Consultation document on technical provisions where no contingent contributions are provided. This corresponds to a total contribution rate of 33.7%.

- **Option 2: The Trustee's Lower Bookend** with a base contribution rate of 29.7% supported by UUK's contingent contribution proposal, as outlined in the Aon paper, but with modification to the Trigger Threshold, contingent contribution step-up profile, the averaging for the technical provisions-based Trigger Metric and the updating of the gilts-plus basis for the technical provisions-based Trigger Metric (see Section 5 of this document).

- **Option 3: A 2020 valuation approach,** under which the initial contribution would be set slightly higher than the Lower Bookend at 30.7% with a commitment to the next valuation being undertaken at 31 March 2020. This approach would not involve any contingent contributions. The rationale here being that the contribution over the period 1 October 2019 to 1 October 2021 would be equal to that payable on average under Option 2 over this two-year period if maximum contingent contributions were triggered at the earliest opportunity. Should no agreement on the contribution rate from the 2020 valuation be implemented before 1 October 2021, then the contribution rate would rise to 34.7% from that time. The rationale for this is similar: the contribution over the period 1 October 2021 to 1 October 2023 would be equal on average to that payable over this two-year period under Option 2 if maximum contingent contributions were triggered at the earliest opportunity (including the step-ups).

These contribution alternatives are all considered by the Trustee to be within its risk appetite. Moreover, they are all predicated on the employers' covenant being rated and remaining "strong".

Table 1: Comparison of contributions under the 3 options.

	1/10/19 - 30/9/20	1/10/20 - 30/9/21	1/10/21 - 30/9/22	1/10/22 onwards
Option 1: Upper bookend	33.7%	33.7%	33.7%	33.7%[1]
Option 2: Lower bookend *with no CCs activated*	29.7%	29.7%	29.7%	29.7%[1]
Option 2: Lower bookend *with maximum CCs activated*	29.7%	31.7%[2]	33.7%	35.7%
Option 3: 2020 valuation	30.7%	30.7%	34.7%[3]	34.7%[3]

1 Assumes no revised contribution agreed as a result of the 2021 valuation.
2 Assumes the contingent contribution steps up after one year.
3 Assumes no revised contribution agreed as a result of the 2020 valuation.

3. Clarifications on issues related to 2018 valuation

The formal feedback we received from UUK indicated that we have not been as clear as we had hoped in relation to certain key points associated with the valuation and the Consultation. In this section we address these points.

3.1 The valuation approach is risk-based

The Trustee takes a risk-based approach to the funding of the DB section of the scheme, in the expectation that this will deliver, over the long term, sufficiently high investment returns while keeping contribution requirements affordable should adverse scenarios be realised. This expectation is reflected in the calculation of contribution requirements, albeit at a "prudent" level as required by legislation.

The Trustee needs to form a view of how much risk is associated with its approach and the level at which that risk becomes a concern. A key consideration for the Trustee is the action that would be necessary should that limit be breached. This would likely involve either or both of a substantial reduction in investment risk and/or a substantial increase in contributions.

It is not in anyone's interest to allow the scheme to get into that position. The Trustee, therefore, must take action (in a proportionate way) as that limit is approached in order to avoid much more drastic action should the limit be breached.

This is why we must pay attention to short-term risk despite having a credibly robust long-term plan to deal with long-term risk. Over the short-term (for example the period between triennial valuations) the risk associated with funding the scheme may increase beyond the Trustee's limit (i.e., its risk appetite). This has been explored in the Consultation document in Sections 5 and 6, which examine risk through the lens of (i) reliance on the employers' covenant, (ii) the average discount rate spread, and (iii) specific adverse scenarios for investment returns. As risk is multifaceted, different risk metrics and perspectives such as these are needed to develop a balanced view.

3.2 Technical provisions is the funding basis

Technical provisions define the basis for funding the DB section of the scheme and set the cost of accrual of future benefits. This is informed by the long-term risk appetite in 20 years' time, which in turn is based on the closeness of the target level of assets to a self-sufficiency basis (see below). The output from this analysis is an investment strategy that migrates from an initial strategy on the valuation date to a lower-risk long-term strategy in 20 years' time, from which a prudent discount rate is derived.

3.3 Self-sufficiency and reliance risk

Self-sufficiency is the level of assets and an investment strategy that together would ensure there is a high probability (greater than 95%) that all accrued benefits will be paid without the need for any further contributions from either employers or members. Note that self-sufficiency does *not* involve a risk-free investment strategy; it involves an investment strategy that takes an acceptable level of risk that corresponds a high probability of meeting all benefit payments without further contributions.

It is important to clarify what self-sufficiency is, and is not, used for in the valuation.

In the valuation the *distance to self-sufficiency* is used primarily as a measure of *risk*. This risk reflects the possibility that the *reliance* of the scheme on the employers becomes too great.

As the scheme's accrued DB benefits are fixed real cash flows, the uncertainty in future investment returns goes hand-in-hand with a level of uncertainty in future contribution rates. Given that the current level of reliance is well above the long-term target these uncertainties have the potential in the short term to push us further from achieving that long-term goal. So it is important to distinguish the following:

- The projected distance to self-sufficiency in 20-years' time is a measure of *long-term reliance risk.* By setting this distance at £10bn in real terms in the Upper Bookend, the Trustee is controlling long-term reliance risk consistently with the employers' long-term risk appetite (as initially communicated to the Trustee in the 2017 valuation).
- The current distance to self-sufficiency (i.e., the current self-sufficiency deficit) is a measure of *short-term reliance risk*. Monitoring short-term reliance risk is important to ensure the scheme does not get too far away from its track of reducing long-term reliance to £10bn.

It is also important to be clear about what self-sufficiency is *not* used for:

- Self-sufficiency is *not* the Trustee's primary funding metric (the funding metric is technical provisions). As such, self-sufficiency does *not* define the target funding level.
- A self-sufficiency portfolio is *not* the target for USS' investment portfolio, even in 20 years' time.

The Trustee can accept a short-term reliance risk that is materially higher than the target long-term reliance risk because the period of visibility of the covenant is long. However, there is still a limit to the level of short-term reliance risk that the Trustee would feel comfortable with and the Trustee's view is that the current level is high. As such the Trustee wishes to:

- Manage the possibility of short-term reliance risk going beyond acceptable levels, and
- Move more reliably towards the long-term reliance target.

What is key here is that the distance to self-sufficiency is used as a risk metric, and, importantly, that the acceptable level of that risk metric is different for the short term and the long term.

3.4 Self-sufficiency and contributions

As stated above, the current self-sufficiency deficit is a measure of short-term reliance risk and, consistent with this role, it impacts the required contributions in the following way:

- The current self-sufficiency deficit impacts *only* the deficit recovery contribution (DRC). This is because an elevated level of this deficit reflects an elevated level of short-term reliance risk, and one way of addressing this elevated level of short-term reliance risk is by accelerating deficit repair with a higher DRC. Or more simply put, if in the future our assumptions turn out to have been inadequate, a higher DRC puts us in a better position to respond.
- The current self-sufficiency deficit does *not* impact the future service contribution.

3.5 DRCs and the Consultation

Although this Consultation was not the formal consultation on the deficit recovery plan, this Consultation did in fact encompass the deficit recovery contribution (DRC) and feedback was indeed received on this. The quantum of DRC that was included in the Consultation document was:

- DRC = 5% for the Upper Bookend (corresponding to a future service contribution of 28.7% of salary and 33.7% total);

- DRC = 2.1% for the Lower Bookend (corresponding to a future service contribution of 27.6% of salary and 29.7% total).

What we did not consult on in this consultation were the detailed parameters of the full recovery plan, which will be part of a later formal consultation on the Schedule of Contributions (SoC). As has been the case with previous actuarial valuations, the SoC Consultation will take place once the technical provisions have been finalised.

4. Trustee's responses to questions raised by employers

In the Consultation feedback provided to the Trustee by UUK four major questions were asked:

1. Why were two of the Joint Expert Panel's proposals – deferring de-risking and smoothing contributions – not included in the Lower Bookend?
2. How does the Trustee justify the Upper Bookend as the correct price for pensions?
3. What is the rationale for the DRCs for the 2017 and 2018 actuarial valuations, and how are they consistent?
4. Why are contingent contributions needed?

In this section we answer these questions.

4.1 Why were two of the JEP's proposals – deferring de-risking and smoothing contributions – not included in the Lower Bookend?

To address this question it is helpful to review the relevant discussion in the Consultation document (especially sections 4.2, 6.1 and 7.2) and also in the presentation delivered at the 2018 Institutions' Day last December by the Chief Risk Officer and the Scheme Actuary (available on the USS website).

The answer to the above question essentially boils down to *managing risk*. The contribution rate the Trustee requires in this valuation – or indeed, in any valuation – depends on the amount of risk that is being taken: risk that the contributions will prove insufficient and higher contributions will be required later.

Individually, each of the JEP's proposed changes is worthy of consideration, but they must be considered collectively in terms of their overall impact on the aggregate risk in the valuation – and set against a balanced judgment on an acceptable risk position.

Four of the JEP's suggestions, detailed below, each involve a greater dependence on uncertain investment returns, and therefore a greater risk that those returns do not materialise. These suggestions are:

- Increasing the long-term reliance in 20 years' time.
- Allowing for future investment outperformance (relative to the technical provisions discount rate) in calculating DRCs.
- Deferring de-risking of the investment strategy.
- Smoothing future service contributions over future valuation cycles.

Each of these potential adjustments increases the dependency on the valuation assumptions (especially investment returns) being realised and reduces the robustness of the valuation to adverse outcomes. Should the value of investments, for example, suffer a major fall in the short-to-medium term then the scheme would be in a materially worst position as a result of any of these adjustments.

The last two of the JEP's four proposed adjustments listed above – deferring de-risking and smoothing future service contributions – were not considered explicitly in the development of the Lower Bookend. We now discuss these in turn.

4.1.1 Deferring de-risking

Before we discuss this proposed adjustment, it should be noted that any investment de-risking strategy sets the direction for investment management over the next three years before being reviewed as part of the next valuation.

De-risking the investment strategy over time builds greater certainty into the funding plan and reduces the risk that we are unable to generate the cash flows required in future to pay benefits. True, de-risking comes at the cost of foregoing the likely – but not certain – higher returns of investing in 'riskier' assets. It also helps to ensure that the amount that employers and members might need to pay in future to secure benefits is more likely to be within their means to fund even in adverse scenarios. The price of de-risking ultimately reflects the nature and the value of the promise that has been made to members, in terms of a defined level of income in retirement.

Delaying this de-risking has the impact of back-end loading the de-risking programme thereby exposing the scheme to greater funding risk over the medium term. It also exposes it to additional risks over the long-term associated with an accelerated de-risking tempo. Importantly, delaying de-risking would increase the possibility of future shortfalls could be too great for employers to support.

4.1.2 Smoothing contributions

Smoothing contribution rates (and so paying the average expected contribution rate) over several valuations would involve paying less now than is currently required to fund the future benefits being accrued, in the expectation that these future benefits will cost significantly less in future years (and so make up the current shortfall). This increases the likelihood that future generations will have a larger deficit to address if funding assumptions around future investment returns and interest rates do not come to pass, i.e., if experience is poorer than expectation.

It would also be inconsistent with the Trustee's view that a relatively high DRC is needed in the short-term if that level was then effectively cut by an averaged future service contribution rate that is below the short-term cost of accrual.

Adopting all of the JEP's proposed adjustments would fall outside the Trustee's risk appetite, but different combinations of these could be implemented whilst staying within the Trustee's risk appetite (both with and without contingent contributions).

The Trustee's approach to risk is to balance its investment strategy and its contribution strategy such that enough risk is taken in the investments to generate returns that help keep the costs down – but not so much risk that it puts the achievement of the strategy itself as a whole at risk.

The potential consequences of taking greater risk must be quantified (see Sections 5 and 6 of the Consultation document), and credible options for managing material downsides coming from that risk must be available. The Trustee has certain legal, regulatory and fiduciary duties to ensure that the pensions promised to members are secure and can be paid when due.

The Trustee acknowledges that the conclusion requires judgment to be exercised as there is no uniquely "right answer" to the methodology used or the individual parameters. The unwelcome but incontrovertible fact is that different objective perspectives on this valuation have come to a conclusion that it is at the limits of the acceptable risk position. In particular, see the discussion in Section 5.1 of the Consultation document, which summarises the views of employers, Aon (UUK's actuarial advisor), PwC (the scheme's covenant advisor), the Pensions Regulator and the Scheme Actuary.

Although it did not quantify the risks associated with its proposals, the JEP report did recognise that there were a number of different paths the Trustee could adopt which would to lead to a required contribution rate of below 30% of salary.

We do believe that a contribution rate slightly below 30% could be acceptable provided it was subject to an appropriate level of contingent support being put in place to help offset the additional risks involved should they materialise. Clearly the amount of contingent support required will increase with the amount of additional risk built into the valuation.

In summary, adopting all four of the JEP's above suggestions would increase the risk in the valuation to such a degree that it would lie outside the Trustee's risk appetite (even with contingent support in place).

4.2 How does the Trustee justify the Upper Bookend as the correct price for pensions?

To address this question it is helpful to review the relevant discussion of the Upper Bookend in the Consultation document (especially Section 7.1 and Appendix B).

The Upper Bookend for the 2018 valuation reflects the Trustee's decision on the appropriate contribution to cover (i) the cost of accrual of future pension benefits along with (ii) the cost of deficit recovery. It involves a number of changes to the assumptions used in the 2017 valuation, including several suggested by the JEP that don't materially increase risk. The specific changes incorporated into the Upper Bookend are as follows:

- Updated asset values to allow for actual investment returns realised over the period 31 March 2017 to 31 March 2018.
- Higher base mortality and lower rates of future mortality improvement.
- Change in retirement age which increases to 66 for service after October 2020.
- Higher discount rates reflecting the higher expected investment returns produced by the FBB approach as at 31 March 2018.

These changes are justified based on evidence and analysis conducted by the Trustee and its advisors. Moreover, there is little evidence to support material changes to any of the other assumptions used in the valuation. Applying these changes to the valuation leads to a higher effective discount rate for technical provisions of 0.92% above CPI (vs. 0.71% for 2017) and a lower future service contribution requirement of 28.7% of salary (vs. 30.6% for 2017).

The other component of the price of pensions embodied in the Upper Bookend is the cost of deficit repair, i.e., the DRC. The DRC for the Upper Bookend for the 2018 valuation has been set at 5% of payroll (vs. the initial value of 6% for 2017), making a total contribution for the Upper Bookend of 33.7% of payroll (vs. the initial value of 36.6% for 2017, which was later revised down to 35.6%). The rationale for the level of DRC set for the Upper Bookend is discussed in the next question.

Together, these two components of the price of pensions (the cost of future accrual of benefits and the cost of deficit repair) justify the contribution rate for the Upper Bookend.

4.3 What is the rationale for the DRCs for the 2017 and 2018 actuarial valuations, and how are they consistent?

To address this question it is helpful to review the relevant discussion of the DRC in Section 7.1 of the Consultation document.

The answer to this question again essentially boils down to *managing risk. Both valuations have high levels of risk and the level of DRCs for both the 2017 and 2018 valuations were set taking account of not only the technical provisions deficit but, importantly, the prevailing level of risk.* Setting a higher DRC is a way of reducing the short-term reliance risk. This is because getting higher contributions earlier reduces the current distance to self-sufficiency, which is our measure of short-term reliance risk.

Short-term reliance risk has been a growing concern for the Trustee as the current self-sufficiency deficit has grown to well over £20 bn. As a result the DRC for the Upper Bookend was set at 5% for 2018. This compares with an initial value for the DRC in 2017 of 6%, which was subsequently revised downward to 5% to reflect some of the positive post-2017 valuation experience. See Table 1.

Table 1. Comparing the DRCs and technical provisions deficit for the 2017 and 2018 valuations.

	2017 valuation	2018 valuation (Upper Bookend)
DRC	6%	5%
Revised DRC	5%	N/A
Technical Provisions (TP) deficit	£7.5 bn	£3.6 bn

The obvious question that arises from Table 1 is: Why is the 2018 Upper Bookend DRC the same as that for the 2017 valuation despite the technical provisions deficit being so much lower?

The answer is that the setting of the DRC involves an assessment of risk: the higher the risk, the higher the Trustee's view on the DRC, all other things equal. Both valuations involved high levels of short-term reliance risk and this, not just the technical provisions deficit, was a major factor in setting the level of DRC in both cases. In other words, the DRCs have been set with an emphasis on the pace of improvement in the funding position rather than simply spreading the TP deficit at the respective valuation dates over the same period.

One way to see that the levels of risk were high in both valuations is to compare different risk metrics for each. Table 2 shows four different risk metrics for the two valuations, the first two of which were addressed in the Consultation document. The first risk metric (current reliance) suggests that the 2018 funding position is slightly lower risk than the 2017 funding position, but the other three risk metrics suggest the opposite, that more risk is being taken in funding the scheme in the 2018 valuation relative to the 2017 valuation.

Table 2. Comparing risk metrics for the 2017 and 2018 valuations.

Risk metric	2017 valuation	2018 valuation (Upper Bookend)
Current level of reliance (current distance to self-sufficiency)	£22.4bn	£20.8bn
Average TP discount rate as a spread over CPI	CPI + 0.71%	CPI + 0.92%
<u>Ratio:</u> TP / self-sufficiency liability	82%	80%
<u>Ratio:</u> Future service contributions / self-sufficiency cost	68%	65%

Note also that second risk metric in Table 2, the discount rate spread over CPI for the 2018 valuation's Upper Bookend, is almost identical to that in the original September 2017 version of the 2017 valuation, which the Trustee views as setting the benchmark for the maximum level of risk in the valuation without contingent contributions (see Section 5.1 of the Consultation document). So the Upper Bookend is considered close to the maximum acceptable level of risk.

In summary, the level of DRCs for the 2017 and 2018 actuarial valuations are largely determined by the elevated levels of short-term risk in both valuations.

4.4 Why are contingent contributions needed?

To address this question it is helpful to review the discussion of the rationale for contingent contributions in Section 2 of the supplementary document published by the Trustee entitled: "A framework for Contingent Contributions". It is also helpful to review the discussion of risk in Section 5.1 of the Consultation document and the discussion of DRCs in Section 7.1.

The answer to this question again essentially boils down to *managing risk.*

As noted in the answer to the previous question, the Upper Bookend for the 2018 valuation is close to the maximum acceptable level of risk. Moreover, a major reason for the high DRC was the high-level of risk associated with the scheme's short-term reliance on the covenant. As a result any increase in risk, or weakening of the valuation basis, or reduction in contributions, from this level would need to be compensated by other risk-mitigating measures. Contingent contributions are a suitable risk-mitigating measure for this purpose.

Reducing contributions to the Lower Bookend without a risk-compensating mechanism would increase the short-term reliance risk beyond the Trustee's risk appetite.

5. Trustee's response to UUK's contingent contribution proposal

The Trustee has reviewed UUK's proposal for contingent contributions that was developed with its actuarial advisor Aon. The results of that review are presented in this section.

In summary the Trustee's assessment of the contingent contribution arrangement proposed by UUK is that, **in its current form it is of insufficient strength to support a reduction from the Trustee's Upper Bookend to the Trustee's Lower Bookend.**

The key points in relation to the Trustee's assessment of the proposal are as follows:

- ***Mechanism:*** The mechanism for contingent contributions proposed by UUK is slightly different from that suggested in the Trustee's document "A framework for Contingent Contributions".
- ***Principles:*** UUK's proposal unfortunately fails to satisfy two of the Trustee's eleven principles, which were outlined in the above document. These are the principles of Alignment (Principle 3) and Quantum (Principle 7). It is also not completely consistent with the principle of an Objective Metric (Principle 2), but the Trustee considers UUK's proposal with respect to this principle is workable.
- ***Bookends:*** UUK's proposal to shift the Upper and Lower Bookends is not consistent with the Trustee's risk appetite.
- ***Parameters:*** UUK's proposal for the Trigger Threshold and step-up size for contingent contributions is not consistent with the Trustee's risk appetite.
- ***An acceptable version of UUK's proposal:*** The Trustee has identified a version of the UUK proposal that is consistent with its risk appetite. The main differences with the UUK proposal involve:
  - A different Trigger Threshold level.
  - A different step-up size for contingent contributions.
  - The trigger metric is agreed to be the technical provisions deficit on a gilts-plus basis, as suggested by UUK but:
    - Without the proposed annual recalibration of the gilts-plus spread, and
    - With the averaging changed to an average over 40 business days, instead of UUK's proposal of a three-day average over the previous three month-ends at the end of a quarter.
  - A different trigger event definition.

Each of these points is elaborated in the sub-sections below.

5.1 The contingent contributions mechanism

UUK's proposal for contingent contributions differs from what would be acceptable to the Trustee.

First, the design of the UUK proposal seems to be motivated to a large degree by a desired outcome for the probability of contingent contributions being triggered. The Trustee does not consider this an appropriate way to design a contingent contribution mechanism, especially as it has made it clear that the purpose of contingent contributions is to mitigate short-term reliance risk. The Trustee believes that the mitigation of short-term reliance risk should be much more central to the design of the mechanism than a desired trigger probability.

Second, the UUK proposal is based on a trigger metric linked to the technical provisions deficit measured on a gilts-plus basis that is recalibrated annually. This technical provisions-based metric is averaged over a quarter of month-end values for the deficit to reduce volatility which is associated with a measurement on a single day. Furthermore, for contingent contributions to be triggered UUK propose that this metric needs to be observed to be above the Trigger Threshold level for two consecutive quarters. The Trustee is prepared to accept the proposal to use a technical provisions-based trigger metric, but only if it is (i) measured as a 40-business-day moving average (in order to further minimise volatility and reduce the chances of false triggers) and (ii) monitored on a gilts-plus basis without being recalibrated (which would introduce an element of judgement into the arrangement, as well as some uncertainty as to whether the Trustee's concern for short-term reliance risk would be adequately addressed).

Third, UUK proposed an implementation timescale of six months after a trigger event. Whilst this is a little longer than the Trustee had envisaged, it is nonetheless prepared to accept UUK's proposal for the implementation timescale, provided the trigger parameters are consistent with its risk appetite.

5.2 Consistency with the Trustee's 11 contingent contribution principles

The Trustee considers that the UUK proposal falls well short in relation to two of its eleven principles and falls slightly short in relation to a third.

In terms of the latter, the proposal falls slightly short in term of Principle 2 (Objective Metric) because it advocates that the appropriate trigger metric for contingent contributions should be the technical provisions deficit, which involves an element of subjective judgement. The Trustee is prepared to accept this suggestion as it can be made workable if the monitoring of the trigger is based on a calculation of the technical provisions deficit evaluated as a spread over gilt yields (i.e., on a gilts-plus basis).

The two principles that UUK's proposal fails are Alignment (Principle 3) and Quantum (Principle 7), which are discussed below. However, with a change in the trigger parameters (described below) the Trustee believes that the UUK proposal can be made consistent with both of these principles.

Principle 3. Alignment

"The mechanism for triggering contingent contributions should be sufficiently sensitive to data that could signify that current contributions may not be adequate.

"This means that the mechanism for contingent contributions must be aligned to the underlying reason or concern behind the requirement for contingent contributions, and must lead to a trigger event that reflects that concern at the appropriate time."

The UUK proposal is not consistent with this principle. This is because it is not well aligned with the Trustee's key concern which led to the requirement for contingent contributions, namely the concern of short-term reliance risk.

The Trustee has been clear that contingent contributions are a risk-mitigating arrangement to address the risk to short-term reliance. This is required because moving below the Trustee's Upper Bookend through the implementation of certain of the JEP suggestions introduces additional risk, as has been spelled out at the December 2018 Institutions Meeting and the Consultation Paper. It is important that the trigger mechanism is aligned with increases in short-term reliance risk.

This lack of alignment is evident in two respects:

(i) Using a TP-based (funding) metric is not completely aligned with addressing this short-term reliance risk, as the self-sufficiency based metric is. However, as mentioned above, this shortcoming can be adequately addressed.

(ii) The level of the Trigger Threshold that UUK propose (£10bn on a TP basis) is approximately equivalent to £30bn on a self-sufficiency basis. This is outside the risk appetite of the Trustee for short-term reliance. Hence this aspect of the UUK proposal is not aligned with the Trustee's concern for the requirement for contingent contributions, namely short-term reliance risk.

➔ ***The conclusion is that the UUK proposal fails Principle 3: Alignment.***

Principle 7. Quantum "In adverse scenarios in which contingent contributions are triggered, the aggregate quantum of the contingent contributions should be broadly similar to the Trustee's contribution requirement in the absence of contingent arrangements over a reasonable period of time. *"This means that contingent contributions, when triggered in an adverse scenario, should perform a broadly similar improvement role in that scenario to what non-contingent, fixed contributions would have done. There should be no significant detriment to the funding position (relative to fixed contributions) over a reasonable time period after the start of an adverse scenario. Another implication of this principle is that the time lag between a trigger event and the introduction of contingent contributions must not be excessively long."*

The UUK proposal is not consistent with this principle. This is because in an adverse scenario the aggregate size of the contingent contributions over multiple years are very much smaller than the size of the excess contributions associated with the Upper Bookend (the contributions in the absence of contingent contributions).

The contingent contribution mechanism proposed by UUK falls short of reaching the Trustee's Upper Bookend even in an adverse scenario. UUK propose a base contribution rate of 29.2% with contingent contributions triggering in adverse scenarios and stepping-up to a maximum of 3%. So the maximum total contribution in an adverse scenario is 32.2%, some 1.5% below the Upper Bookend of 33.7%.

If we take account of the step-up timing, the situation is even worse. In an adverse scenario the contingent contribution amounts payable in the six years after the valuation date are: 0%, 1%, 2%, 3%, 3%, and 3% on top of the UUK base contribution rate (the UUK lower bookend) of 29.2%. Adding these contingent contributions up comes to 12% of salary.

This is to be compared with the Upper Bookend of 33.7%, which is 4.5% higher than the UUK base contribution rate. The contribution rates in excess of the UUK base contribution rate that would be paid by the Upper Bookend over the six years following the valuation date are: 4.5%, 4.5%, 4.5%, 4.5%, 4.5%, and 4.5%. Adding these excess contributions up comes to 27% of salary. This is very much larger than the total of 12% of salary embedded in the UUK proposal.

➔ ***The conclusion is that the UUK proposal fails Principle 7: Quantum.***

5.3 The contribution bookends

The Trustee has noted UUK's proposal for changes to the contribution bookends and finds it neither compelling nor consistent with its risk appetite. As a result the Upper Bookend remains at 33.7% of salary (corresponding to no contingent contributions) and the Lower Bookend remains at 29.7% of salary (with a suitably strong contingent contribution arrangement).

5.4 The contingent contributions parameters

The Trustee finds the following parameters in the UUK proposal inconsistent with its risk appetite:

- The Trigger Threshold that UUK propose (£10bn on a TP basis) is approximately equivalent to £30bn on a self-sufficiency basis. This is outside the risk appetite of the Trustee for short-term reliance.
- The step-up profile for contingent contributions that UUK propose (from 1% to 2% to 3% of salary) is too small to adequately compensate for the increase in risk associated with a reduction in contribution rates from the Upper Bookend.

5.5 An acceptable version of the UUK proposal

The Trustee has identified an acceptable version of the UUK proposal that is consistent with its risk appetite. This involves the following modifications to be consistent with the Trustee's risk appetite:

- A different Trigger Threshold level of **£4bn** instead of £10bn. (Note that the technical provisions deficit on this Lower Bookend gilts-plus basis was £2.2bn on 31 March 2018 – not averaged.)
- A different step-up size for contingent contributions of **2%, 4% and 6%** instead of 1%, 2%, 3%.
- The trigger metric is the technical provisions deficit on a gilts-plus basis, as suggested by UUK, but with the following features:
    - **No annual recalibration** of the gilts-plus spread.
    - The averaging is an **average over 40 consecutive business days**, instead of an average over the previous three month-ends.
    - The technical provisions discount rate that corresponds to this basis is gilts + 1.44%.
- A different trigger event definition. In particular, a trigger event is defined by the trigger metric being above the Trigger Threshold for **40 consecutive business days** (approximately 2 months), instead of UUK's proposal of two quarter ends.

With these changes, the Trustee finds UUK's contingent contribution proposal acceptable and is prepared to implement it based on the contribution rate Lower Bookend of **29.7%**.

References

USS, "2018 Actuarial Valuation: A consultation with Universities UK on the proposed assumptions for the scheme's Technical Provisions and Statement of Funding Principles", 2 January 2019.

USS, "2018 Actuarial Valuation: A framework for contingent contributions", 7 February 2019.

UUK, "The USS Trustee's consultation on certain matters relating to the 2018 actuarial valuation," Letter from Alistair Jarvis to Bill Galvin, 19 March 2019.

UUK, "Detailed response from Universities UK (UUK), on behalf of scheme employers, to the consultation by the USS Trustee on proposed assumptions for the Scheme's Technical Provisions and Statement of Funding Principles," Annex to letter from Alistair Jarvis to Bill Galvin, 19 March 2019.

Aon, "Actuarial Valuation at 31 March 2018 – Initial Thoughts," Prepared for UUK by John Coulthard and Kevin Westbroom, 14 January 2019.

Aon, "2018 Valuation and Contingent Contributions," Prepared for UUK by John Coulthard, Kevin Westbroom and Andrew Claringbold, 27 February 2019.

Update from USS View in browser

USS

USS Update
09 May 2019

Dear colleagues,

The Board of the USS Trustee met last week to consider UUK's response to the proposed Technical Provisions assumptions for the 2018 valuation, including the associated contingent contribution arrangements, as well as the additional covenant analysis requested by the Pensions Regulator.

We have written to UUK setting out the Board's position in full and I wanted to provide you with a summary note in support of our formal response being circulated by UUK.

The valuation

The Board has considered UUK's response in detail and, as a result, has now set out three options for finalising the 2018 valuation.

The contribution rates we consulted on earlier this year remain the same (either a fixed rate of **33.7%** – option 1, or **29.7%** with a sufficiently strong contingent contribution arrangement – option 2) but a third option of **30.7%** is now being offered, subject to a 2020 valuation (a year earlier than scheduled).

The benefits currently offered to members would remain the same in all cases, and any of these options would achieve a significant reduction in the contributions required from 1 April 2020 under the 2017 valuation (**35.6%:** 11.4% from members and 24.2% from employers; contributions are currently scheduled to increase in October 2019 to 10.4% and 22.5% respectively, under the 2017 valuation).

Under option 2, changes would need to be made to elements of UUK's proposed contingent contribution arrangement to provide adequate protection from short-term risks in order for the lower rate of 29.7% to be applied.

These changes are explained in full in our response to UUK, but relate to some of the metrics applied for calibrating trigger events and the scale of increases required if and when triggered.

The changes required provide the Trustee with the ability to address a material worsening of the scheme's short-term position – which, as we have repeatedly set out, could have a detrimental impact on our ability to achieve the right outcomes in the long-term.

This is the fundamental driver behind the contribution rates the Trustee requires under all of the options now available. The contingent contribution arrangement put forward by UUK does not, in the Trustee's view, address this adequately in its current form but modifications could be made to progress with this option.

Covenant considerations

The Board also considered the latest advice on the 'covenant'; the strength of the collective financial support provided by sponsoring employers that underpins the scheme's ability to take investment risk (which can serve to lower the contribution rates otherwise required).

This analysis considered the effects of the government's Review of Post-18 Education and Funding, uncertainty over the UK's future relationship with the EU, increased cost pressures, and debt levels in the sector. It also considered the potential withdrawal of institutions with strong covenants.

The risk of strong employers withdrawing from the scheme has emerged as a key consideration, alongside the increased levels of borrowing seen in the past year.

If the risk of strong employers leaving the scheme were to materialise, for example, it would have a direct impact on the level of investment risk that we could justifiably expose the scheme to and our covenant advisors have signalled that they would recommend a covenant downgrade.

Options for managing these issues as effectively as possible will now be discussed with our stakeholders to protect the scheme's ability to take the level of investment risk assumed for the 2018 valuation.

This will be crucial for the sustainability of the scheme in the future, and for the benefits promised to members to remain secure.

Next steps

We have shared these developments with UUK and UCU and will need to consider their feedback before the outcome of the 2018 valuation – and the rates members and employers will pay – can be confirmed.

The Joint Negotiating Committee will meet shortly after the Trustee Board's next scheduled meeting in mid-May, and I will continue to keep you updated as these important matters develop.

Bill Galvin

Group Chief Executive Officer

Unsubscribe

USS

2018 Valuation update: 9 May 2019

USS has put forward three options for finalising the 2018 valuation, following consideration of UUK's proposed contingent contribution arrangements and its overall feedback on behalf of employers.

The first two options include the same contribution rates that USS consulted UUK on earlier this year (a fixed rate of 33.7% – option 1, or 29.7% with sufficiently strong contingent contribution arrangements* – option 2) but a third option of 30.7% is now being offered, subject to a 2020 valuation.

The benefits currently offered to members would remain the same in all cases.

Any of these options would achieve a significant reduction in the contributions required from 1 April 2020 under the 2017 valuation (35.6%: 11.4% from members and 24.2% from employers; contributions are currently scheduled to increase in October 2019 to 10.4% and 22.5% respectively).

The options

33.7% - fixed rate, reviewed in 2021/22

This is the rate the Trustee would require in the absence of sufficiently strong contingent contribution arrangements*. In the event that the Joint Negotiating Committee (JNC) could not decide on an alternative approach, the default cost-sharing rule would see members paying **10.7%** of salary and employers paying **23%** from 1 April 2020. The next scheduled valuation would be as at 31 March 2021 (the outcome of which would be expected in 2022).

29.7% - increases in certain conditions, reviewed in 21/22

If sufficiently strong contingent contribution arrangements can be agreed*, members would pay **9.3%** of salary under the cost-sharing rule and employers would pay **20.4%**. Contingent contributions could be triggered in certain conditions (which, in a 'worst case' scenario, could see the overall rate increase annually by 2%, up to a maximum of 6%). The next scheduled valuation would be as at 31 March 2021 (the outcome of which would be expected in 2022).

30.7% - fixed rate until October 2021, reviewed in 20/21

This rate could be applied as an alternative to contingent contribution but is subject to a valuation in 2020 – a year earlier than scheduled. Under cost-sharing, members would pay **9.6%** of salary and employers **21.1%** until October 2021. If the contribution rate arising from a 2020 valuation cannot be agreed and implemented before 1 October 2021, the rate would rise thereafter to 34.7%. These rates reflect the contributions that might otherwise have been triggered under sufficiently strong contingent contribution arrangements*.

*USS does not believe that the contingent contributions arrangement proposed by UUK provides adequate protection from short-term risks in its current form but has set out how it could be adjusted to for this option to be progressed.

Next steps

USS has written to UUK, University & College Union (which represents members) and the Chair of the JNC setting out these options in more detail and will need to consider their feedback before the outcome of the 2018 valuation – and the rates members and employers will pay – can be confirmed.

Unless and until the 2018 valuation is finalised, the contribution changes previously announced under the 2017 valuation will be applied.

Have you seen?

- Protecting the promises made to members
- Member webinar March 2019
- Member webinar Q&As

Published date: 9 May 2019

Last updated: about 1 day ago

From: Stuart McLean <Stuart.McLean@universitiesuk.ac.uk>
Sent: 09 May 2019 09:45
Subject: USS 2018 actuarial valuation - consultation with USS employers on the options now presented by the USS Trustee to conclude the 2018 valuation
Attachments: Letter BG to UUK - 7 May 2019 pword.pdf; Trustee Reply to UUK's TP Consultation Feedback 2019 FINAL.PDF

To Vice-Chancellors, Principals and Chief Executive contacts

Dear Colleague,

USS 2018 actuarial valuation - consultation with USS employers on the options now presented by the USS Trustee to conclude the 2018 valuation

Further to my email of 12 April, the USS Trustee has now formally responded to the UUK consultation response in relation to the USS 2018 actuarial valuation consultation on technical provisions.

In short, the USS Board agreed three alternative contribution structures by which the 2018 valuation could be completed and which it is now inviting stakeholders to consider.

As such, UUK is engaging with USS employers once again to establish which of the three options is preferred.

Options

The options now available to employers (including a new option 3) are summarised below, but you are encouraged to carefully consider the attached papers from USS, which set out the rationale and conditions associated with each option:

1. Upper bookend – 33.7% (23% for employers and 10.7% employees) to apply from April 2020.

2. Lower bookend and a modified (from the UUK/Aon proposal) contingent contributions arrangement - initially contributions set at 29.7% (20.4% employer, 9.3% employee), but with three potential 2% contribution increases should the scheme funding deteriorate, potentially taking the required rate to a maximum of 35.7%. For the avoidance of doubt, this contingent contribution arrangement is a much firmer version proposed by the USS trustee, the details of which is set out in the attached USS note, and is not the version UUK/Aon proposed.

3. An initial contribution rate of 30.7% (21.1% for employers and 9.6% employees) to apply from October 2019. A 2020 valuation would be undertaken and, subject to that and ongoing discussions between stakeholders, the contribution rate would remain unchanged until 1 October 2021. In event of there being no agreement on an alternative Schedule of Contributions following the 2020 valuation, a default rate of 34.7% would apply.

Please note that for options 2 and 3, the Board concluded that satisfactory implementation of debt monitoring and rule changes relating to exiting employers would be required to maintain a strong covenant rating. Please do provide any comments on the feasibility of these conditions. The precise detail of what these changes are and how these arrangements will operate is still being considered by the USS trustee with the high-level terms set out in the enclosed documents. At this stage the trustee is looking for an “in principle” view from employers to work with the trustee on these measures to strengthen the employer covenant.

Action for employers

You will see in the documents that USS has asked for feedback from employers (through UUK) on their preferred option ahead of the USS Board meeting on 16 May. UUK appreciates that this is an extremely challenging timeframe for employers to consider the options and arrange discussions with relevant parties within institutions. As such, UUK has agreed with USS **that formal responses should be submitted to UUK by 30 May.**

Nevertheless, it would be extremely helpful for employers to **indicate a preferred option to UUK ahead of 16 May** as an initial steer to allow conversations to progress with both USS and UCU. Timely discussions are required to allow a solution to the 2018 valuation to be agreed ahead of the planned 32.9% October 2019 increases (22.5% employer and 10.4% employee) coming into effect.

Please carefully consider the USS consultation material attached, together with the material previously provided, and respond to the consultation on behalf of your institution to pensions@universitiesuk.ac.uk.

Employers are asked to provide responses which represent the view of the institution. Whilst we recognise that this is a challenging timescale, employers are encouraged to engage with their governing bodies in framing their responses.

Documents

We have asked Aon, UUK's actuarial advisers, to provide a short note on the considerations for each of the options above, which we hope to provide to employers in the next few days.

USS has set out in the attached document the Trustee's reply to UUK's feedback and questions on the Consultation on the 2018 Technical Provisions, including why it considers the UUK/Aon contingent contributions proposal to fall short against their framework and principles, their justification for deficit recovery contributions, and why some of the JEP's recommendations fall outside the trustee's risk appetite. While the trustee has the requirement to consult with employers, it does not necessarily have to gain the agreement of employers in relation to the valuation assumptions and technical provisions. Our immediate priority is to conclude the 2018 valuation as best we can for all stakeholders, and to mitigate the higher contribution levels established by the trustee as part of the 2017 valuation, which are scheduled for October this year and then higher still in April 2020 (35.6% with 24.2% employer and 11.4% employee) if no other changes are agreed.

Joint Expert Panel – phase 2

Employers will be aware that the Joint Expert Panel (JEP) is currently undertaking the second part of its work which looks at the valuation methodology, governance, and options for the long-term sustainability of the scheme; including possible reform options for the 2020 valuation. **There will shortly be a new call for submissions to the second phase of the JEP work** and UUK would strongly encourage employers to share views on these matters with both UUK and the JEP itself, so these comments can be factored in ahead of the next USS valuation.

If you require any further information or have any questions, please contact me at pensions@universitiesuk.ac.uk.

Best wishes,

Stuart

Stuart McLean FPMI | Head of Pensions | Universities UK
Email: stuart.mclean@universitiesuk.ac.uk | Direct: 020 7419 5491 |
Universities UK, Woburn House, 20 Tavistock Square, London, WC1H 9HQ

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Universities Superannuation Scheme (USS)
Date: 14 May 2019
Prepared for: Universities UK
Prepared by: John Coulthard FIA
Kevin Wesbroom FIA
Andrew Claringbold FIA

Completion of 31 March 2018 Actuarial Valuation

Introduction

The USS Trustee has set out three options to complete the 31 March 2018 actuarial valuation in its documents of 7 May 2019.

Options 1 and 2 are based on the "Upper Bookend" and "Lower Bookend" from the January 2019 consultation. Option 3 is a new option that can be interpreted as being largely in line with the JEP recommendations. We welcome this development, although it has come with two additional requests (in outline, without full details). The USS Trustee seeks indicative feedback from UUK by 16 May and formal feedback by 31 May. It seems to propose finalising that valuation at the Upper Bookend shortly after then, if another option is not supported.

We have been asked by Universities UK (UUK) to set out our thoughts on the three options, and on the additional requests the USS Trustee is making for debt management and the rules for departing employers. We begin with comments on Option 3.

Option 3 – New option

Option 3 requires the following contributions from the valuation date:

	Employer (†)	Member (†)	Total
1 April 2018 to 31 March 2019	*18%*	*8%*	*26%*
1 April 2019 to 30 September 2019	*19.5%*	*8.8%*	*28.3%*
1 October 2019 (‡) to 30 September 2021	21.1%	9.6%	**30.7%**
1 October 2021 onwards	23.7%	11%	**34.7%**

Notes:

(†) Employer and member figures assume 65:35 cost-sharing adopted to increases from 1 April 2019.

(‡) This assumes the 2018 valuation is completed by the payroll cut-off date of 31 August 2018 (the date advised by the USS Trustee).

The headline rate of 34.7% from 1 October 2021 is *provisional* as the USS Trustee would carry out another valuation at 31 March 2020 under this option (rather than waiting to 2021), and put new contributions in place. These new contributions could be higher or lower than 34.7% based on the facts at the time.

We believe Option 3 is a material movement compared with previous positions, and we welcome it.

In our view, the proposed contribution rate of 30.7% is reasonably close to the JEP recommendation. In saying this, the JEP provided an example approach with a contribution rate of c.29.2%, and said that: *"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."*

Moreover, employers (and members) have benefited in the short-term from the USS Trustee carrying out a 2018 actuarial valuation rather than considering the JEP recommendations as part of a 2017 valuation – which could have led to higher contributions coming into place much earlier, say from 1 January 2019 for illustrative purposes. If we "average" the USS Trustee's proposal over the period 1 January 2019 to 1 October 2021 (when the contribution changes following the 2020 valuation may be expected to be implemented), then this works out as 29.8% (i.e. three months of 26%, six months of 28.3%, and two years of 30.7%). So, at least at an "average" level, the JEP recommendations appear to be met.

That said, we are not clear whether 21.1% from October 2019 will be a feasible two-year contribution rate for all (or the majority of) employers. UUK will need of course to consider employer views in the limited time available.

Additional notes:

- 30.7% is described as the average contribution over the two years from 1 October 2019 under Option 2, assuming the USS Trustee's trigger step up applies at the *earliest* date possible. This is not obviously consistent with the USS Trustee's view that Option 2 cannot be implemented until around June 2020 at the earliest. The earliest a trigger contribution could then apply would be around 8 months later i.e. February 2021. This would lead to an average contribution rate over two years from 1 October 2019 of 30.4% rather than 30.7%.
- We have asked how the 30.7% is split between future service and deficit contributions, and have been advised that this will be confirmed after the Trustee Board has considered it. As Option 3 is based on Option 2, this may suggest a future service rate of 27.6%, along with a deficit contribution for the first two years of 3.1%. (The deficit contribution would then step up to an illustrative 7.1% from 1 October 2021, leading to a relatively short recovery plan.) Further commentary can be provided when more information is available.

Option 1 – "Upper Bookend"

Option 1 is the Upper Bookend mentioned in the USS Trustee's consultation, and requires the following contributions:

	Employer (†)	Member (†)	Total
1 April 2018 to 31 March 2019	*18%*	*8%*	*26%*
1 April 2019 to 30 September 2019	*19.5%*	*8.8%*	*28.3%*
1 October 2019 to 30 September 2021	22.5%	10.4%	32.9%
1 October 2021 onwards	23%	10.7%	**33.7%**

(†) Note: Employer and member figures assume 65:35 cost-sharing adopted for increases from 1 April 2019.

The USS Trustee has not moved from its initial proposal for the Upper Bookend, and specifically on its requested 5% deficit contribution (which relates to a deficit that has more than halved from £7.5Bn at 31 March 2017 to £3.6Bn at 31 March 2018 on the Upper Bookend assumptions). The USS Trustee's explanation is one of *principle* (to reduce short-term risk). There is no quantitative explanation of what the "trustee risk appetite" is in the short term, or justification for why 5% is required rather than any other figure.

The USS Trustee moved to a new discount rate approach at the 2017 actuarial valuation. Rather than expressing the discount rate as a margin relative to gilt yields, the USS Trustee defined prudence based on a 67th percentile investment return. When the USS Trustee updated its analysis for the 2018 valuation, the 67th percentile investment return gave a higher margin relative to gilt yields, which reduced the deficit. The USS Trustee views this as potentially creating additional risk, and has sought to counterbalance the impact of its own assumption update by now considering deficit contributions relative to a "gilts+" (self-sufficiency) value of liabilities. The whole approach is in our view unusual.

It would be possible to continue to debate the Upper Bookend, and the formal consultation on the Recovery Plan provides an opportunity for this. However – in the spirit of trying to conclude the valuation – for employers considering the merits of the three options, our guidance is that there is a limited prospect of the USS Trustee reducing the Upper Bookend of 33.7% by a material amount. The USS Trustee has already considered initial views from UUK, and it sets contributions under the Rules.

Nevertheless, and in anticipation of potentially similar discussions for the 2020 valuation (or more immediately if employers favour Option 1), we recommend asking the USS Trustee to justify its choice of deficit contributions in numerical rather than generic terms. It is difficult for stakeholders to see if the USS Trustee is being reasonable in relation to the 5% deficit contributions without this analysis.

Option 2 – Contingent Contributions

As Option 2, the USS Trustee has suggested a revised version of the Aon/UUK proposal.

The USS Trustee believes that Option 2 could not be implemented until June/July 2020, and that the contributions increases due on October 2019 and April 2020 would therefore apply. The USS Trustee suggests that Option 1 or Option 3 would be required to avoid these increases.

We set out below the key elements of Option 2 vs the Aon/UUK proposal.

Parameter	Aon/UUK proposal	USS Trustee's Option 2
Initial contribution rate	29.2%	29.7%
Chance of trigger applying	c.30%	c.60% *(†)*
Contribution step-ups	Three steps of 1%	Three steps of 2%
Trigger metric	Gilts+ proxy to Technical Provisions, recalibrated every year	Gilts+ proxy to Technical Provisions, with no recalibration
Trigger threshold	Trigger metric calculated quarterly based on average of three month-ends. Needs to be breached for 2 successive quarters	Trigger metric calculated daily averaged over rolling 40 business days (broadly 2 months). Needs to be breached for 40 successive business days

(†) Note: Figure supplied on 10 May be USS Executive, based on 3-year period from valuation date. It corresponds to the Technical Provisions deficit exceeding £4Bn on the Lower Bookend assumptions (so an increase of £1.8Bn to the £2.2Bn deficit at the valuation date on this basis).

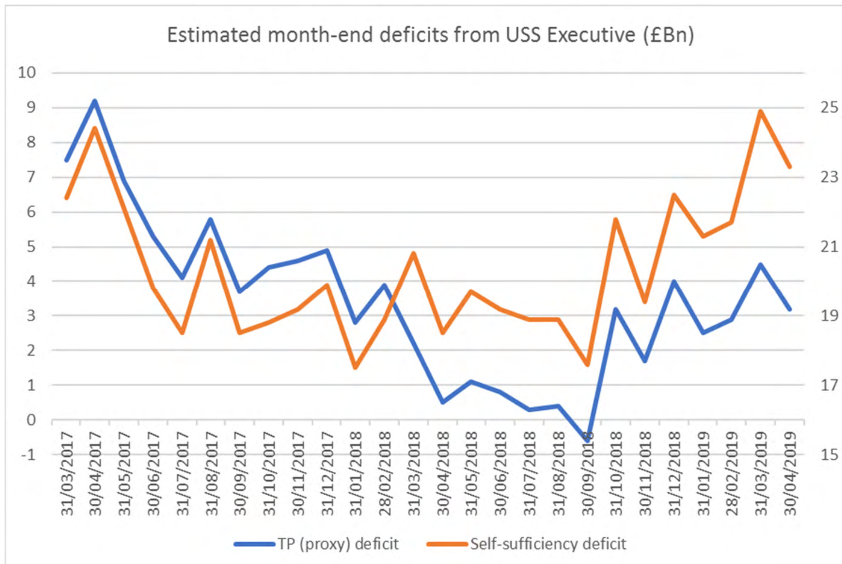
The USS Trustee sets out why it believes the Aon / UUK proposal does not meet its 11 principles. We explained why our proposals met the 11 principles in our 27 February advice. However, the principles are qualitative, and the USS Trustee's interpretation is that material changes would be needed for the proposal to be acceptable.

On a philosophical level, the USS Trustee has said that it did not like the proposal being based on a defined *likelihood* of contributions applying. We were surprised at this comment. Probabilities and trigger threshold are two sides of same coin (one defines the other, all else being equal). We believe it is easier to engage employers on the likelihood of a trigger applying, rather than trying to objectively define a threshold. We also note that the USS Trustee has not explained why £4Bn (rather than another figure) is an appropriate level for trigger threshold.

Although there is a possibility of paying lower contributions under this option compared with Option 3 (as 29.7% would apply for at least 8 months following implementation, and the trigger may never be hit), we believe that the proposal is unlikely to be acceptable for employers:

- The USS Trustee's proposal has *double* the chance of requiring additional contributions, with a c.60% likelihood. Rather than being "contingent contributions", the proposal could be characterised as requiring a higher level of headline contributions, with a low chance (c.40%) that 29.7% would be sufficient between valuations.
- For accounting purposes, employers may need to recognise the contingent contributions in full on their balance sheets (since they are paid on a best estimate basis).

- On the Lower Bookend basis, the scheme deficit was £2.2Bn at 31 March 2018. For the trigger threshold to apply, this needs to exceed £4Bn over the stated period. The chart below shows the month-end estimates of the deficit, which peaked at £4.5Bn at 31 March 2019. It would be unusual in our experience to agree contingent contributions between actuarial valuations that are expected to apply in normal conditions. The likelihood of the trigger applying may also now be higher than c.60% since the position is currently worse than at the valuation date, as illustrated below.



Note: Figure supplied on 10 May be USS Executive. They are approximate and should not be relied on.

- The contribution step-ups have also *doubled* (along with their probability of applying), to 2%. These are likely to be more difficult for employers (and members) to manage and plan for. This is attributed to the proposal in the USS Trustee's view failing principle 7 (Quantum) which arises (we would suggest) largely because the USS Trustee did not offer any movement on the Upper Bookend.

Given the effort that went into developing the contingent contribution proposal (and for employers in considering it) after the USS Trustee had decided not to set out its own proposal, it is particularly disappointing that it has been effectively rejected in this manner.

However, it is helpful that the USS Trustee has developed a new option (i.e. Option 3) which we see as effectively replacing Option 2 as a credible option. Some employers may also prefer the simplicity of Option 3 and the additional clarity provided on contributions ahead of the next valuation.

Additional requests – Debt monitoring process and Rule clarification

The USS Trustee has introduced two additional elements to the valuation. These have been introduced only a few weeks before the legal deadline of the valuation, and arise from the USS Trustee adviser's review of covenant. The USS Trustee regards these as important for Option 2 and Option 3 to be acceptable. It is not immediately clear why the requests are not relevant for Option 1 (as e.g. the longer document states that each of the options is predicated on the covenant remaining strong).

The USS Trustee requests an indicative view by 16 May. There is a stark contrast in the six working days UUK has been given to provide an initial response, with the two months or so that the USS Trustee has had to consider the Aon/UUK proposal. We set out initial comments on the additional requests below.

Debt monitoring process

The first element is a debt monitoring process:

> *"Employers' debt levels be monitored against a number of metrics with the Trustee seeking clarification of employer business plans should the metrics exceed certain levels. This monitoring would be part of an annual attestation;*
>
> *Institutions wishing to grant security in the future to lenders (on existing or new debt) should be required to grant pari passu security to the trustee; and*
>
> *Should these measures prove to be inadequate or fail to obtain employer support consideration would need to be given to additional measures."*

For the monitoring, many employers may be comfortable providing information to the USS Trustee provided that the requests are proportionate and do not lead to unnecessary discussions. Absent details of what the metrics are or where the trigger levels are set, it is difficult to comment further.

Institutions are asked to grant *pari passu* security to the USS Trustee where they provide security in future to lenders. The covenant adviser's concern is that if debt is secured against an employer's assets, then this becomes a priority call over the pension scheme, and may erode the covenant.

Some employers may share this concern, and the proposal would reduce their exposure to the effects of an individual employer becoming insolvent. Also, in our experience, unsecured debt is currently the "norm" in the universities sector.

UUK has asked for employer views on how palatable the request may be. It will be virtually impossible to achieve a considered view by the USS Trustee's Board meeting on 16 May, and until the USS Trustee sets out its requirements – which presumably will follow this Board meeting if there is sufficient employer interest in Options 2 or 3.

Rule clarification

The second new element is described as a clarification to the rules:

> *"PwC has advised that a clarification to the rules which strengthens the Trustee's discretionary powers to determine whether an employer can exit the scheme would support maintaining the current covenant rating."*

At present employers can choose to leave the scheme, but would need to meet their share of the statutory buy-out deficit (Section 75 deficit). The resulting cost will be prohibitive for most employers. Potentially the USS Trustee could already charge a higher exit cost under its contribution rule.

The USS Trustee's advisers have become concerned that, were another "strong" employer to leave, then they would downgrade the covenant to "tending to strong". We would welcome further details on why this conclusion has been reached, for it suggests that the covenant may in any event be at risk of a downgrade which could have wider implications for future valuations.

There is no detail yet available on what the request would mean, for example would employers be charged a defined premium relative to their statutory section 75 debt, or would the approach be bespoke to each employer.

Some employers may be comfortable with the proposal – for example as they are unlikely to wish to pay the buyout deficit (or higher) to leave the scheme, and to try to preserve the strong covenant rating afforded by the current mutual structure. Other employers may be concerned about the proposal. We understand that UUK will take legal advice on the proposal once details become available.

Closing thoughts

Previously employers had supported the JEP recommendations, which suggested a short-term fix, followed by JEP Phase 2, followed by a 2020 valuation. Option 3 is in our view reasonably close to this (albeit with a high headline rate applying from October 2021), and it is for employers to determine whether it is acceptable and preferable to the other options, and also whether the resulting contributions are achievable over a two-year period.

The USS Trustee has introduced two additional requests, and has given UUK only a few days to test indicative support. The severe time pressure stems from:

- The statutory deadline for the 31 March 2018 valuation of 30 June 2019. Here, we note that the Pensions Regulator's preference is for the best outcome to be reached, rather than one agreed under pressure simply to meet the deadline. *(Source: TPR's 2019 annual funding statement.)*
- The proximity of the 1 October 2019 contribution increase. Here, we note that this could be pushed back a few months through an interim schedule of contributions. This would require another USS Trustee submission to the Pensions Regulator, but it is within the USS Trustee's gift to do this.

If employers support Option 3 indicatively, then the USS Trustee could finalise the valuation based on Option 3, and also agree a separate timetable to discuss the additional requests. In suggesting this, we observe that the next valuation under Option 3 is only ten months away, and the USS Trustee has made the additional requests very late in the formal process. This timetable could be relatively short to give employers (as well as the USS Trustee) the assurance that the position is resolved well ahead of the 2020 valuation. We would be pleased to discuss this further.

Compliance

The advice in this report 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').

Q&A: three options for concluding the 2018 USS valuation – May 2019

On 9 May 2019, the USS Trustee proposed three options for concluding the 2018 valuation.

The following questions and answers address the three options, and other issues relating to the finalisation of the 2018 valuation.

They are intended to be drawn from to assist with any enquiries received locally by employers.

They are not exhaustive. For further assistance in answering questions about the 2018 valuation process, please contact pensions@universitiesuk.ac.uk

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1. What has the USS Trustee proposed and what is new?
2. Why has the USS Trustee refused to implement the full JEP?
3. What is the likelihood of further delays to this process, and what is UUK doing about it?
4. Can/will the USS Trustee still impose the upper bookend?
5. What modifications to the UUK/Aon contingent contributions proposal has the Trustee suggested?
6. Why should contributions increases be cost-shared with members?
7. Why can't employers push for a vote of no confidence in the USS Trustee Board?
8. What are the next steps?
9. What is the Joint Expert Panel doing now?

1. What has the USS Trustee proposed and what is new?

The USS Trustee has proposed three potential options to conclude the 2018 valuation. The first option – contributions of 33.7% (known as the upper bookend) – has previously been communicated to employers. The second option includes contributions of 29.7% (the lower bookend), combined with a significantly stronger contingent contribution arrangement than that proposed by UUK (see question 5 for more).

Following consideration of UUK's response to the 2018 valuation consultation, the Trustee has put forward a new, third option, which proposes contributions of 30.7% payable until a 2020 valuation – a year earlier than planned. Should members and employers fail to reach an agreement over how to conclude the 2020 valuation, a default rate of 34.7% would then apply.

2. Why has the USS Trustee refused to implement the full JEP?

The USS Trustee's reasons for not implementing all of the Joint Expert Panel's (JEP) proposals are detailed in their formal response to Universities UK (UUK), which is available on the USS Employers website. In short, although the Trustee has modified a number of assumptions to align with the JEP, not all of the JEP's recommendations fall within the Trustee's risk appetite.

Employers and members should note that the JEP's report maintained 'there are a number of different paths the USS Trustee could adopt to reduce the contribution rate', and that its recommendations were illustrative of one such path.

3. What is the likelihood of further delays to this process, and what is UUK doing about it?

It remains a priority for UUK to ensure that alternative arrangements are in place before the implementation of further contributions increases in October 2019 and April 2020. The timescales are certainly challenging, but if employers and members can decide on a way forward shortly after the next USS Trustee Board meeting on 16 May, then it is possible for the valuation to be completed and submitted before its statutory deadline of June 30.

For this reason, UUK has asked employers for an indication of their preferred way forward by 16 May, to ensure that progress in discussions with both USS and the University and College Union (UCU) can be made at the earliest possible opportunity.

UUK remains committed to seeking a balanced solution that is acceptable to the USS Trustee, the Pensions Regulator, UCU and employers.

4. Can/will the USS Trustee still impose the upper bookend?

In the absence of an agreed alternative arrangement, the USS Trustee may elect to submit a valuation report by the statutory deadline of June 30 based on option 1, with the required level of contributions (33.7%) shared 65:35 between employers and scheme members.

5. What modifications to the UUK/Aon contingent contributions proposal has the Trustee suggested?

To 'strengthen' the proposed arrangement in their view, the USS Trustee has recommended changes to the metrics applied for calibrating trigger events, and the scale of the required increases, were they to be triggered.

Specifically, the UUK/Aon proposal failed to meet the Trustee's principles for 'Alignment' and 'Quantum'. The Trustee has recommended that the stepped increases be 2%, 4%, and 6% (as opposed to 1%, 2%, and 3%), and also specified a requirement for a trigger threshold level of £4 billion, as opposed to £10 billion proposed by UUK/Aon. This significantly increases the likelihood of the contingent contributions being triggered.

6. Why should contributions increases be cost-shared with members?

It is an important principle of the scheme that contribution increases are split 65:35 between employers and scheme members, and UUK believes this principle should be maintained for any contributions increases arising from the 2018 valuation.

It is possible that at future valuations the level of contributions required to fund future benefits could be lower than those arising from the 2018 valuation; having a set cost sharing formula is therefore vital for ensuring that both members and employers benefit from lower contributions, should they come to pass.

7. Why can't employers push for a vote of no confidence in the USS Trustee Board?

The USS Trustee Board includes a majority of members nominated by UCU and UUK alongside experienced independent members with expertise in pensions and finance. Wholesale changes to the composition of the USS Trustee Board would impede the chances of reaching a satisfactory conclusion to the 2018 valuation in time to implement a new arrangement before the higher cost sharing increases due in October 2019 and April 2020. Removal of the USS Trustee Board would also likely lead to intervention from the Pensions Regulator.

Phase 2 of the Joint Expert Panel is currently considering evidence on the governance of the scheme, as well as aspects of the valuation process, and is expected to report in the autumn with recommendations.

8. What are the next steps?

UUK has written to all employers to establish which of the three options proposed by the USS Trustee is preferred. Employers have been asked to give an indication in advance of 16 May so that UUK can relay this to the USS Trustee Board, which is meeting that day, and also to UCU at the Joint Negotiating Committee, which meets the following day (17 May).

Employers are then asked to confirm a fuller, formal response by 30 May.

It will then be vital for employers and members – represented by UUK and UCU at the Joint Negotiating Committee – to agree a way forward quickly, and before the significantly higher cost sharing increases fall due in October 2019.

9. What is the Joint Expert Panel doing now?

The Joint Expert Panel is currently considering evidence to aid the second phase of its work, which is concerned with the valuation methodology and scheme governance.

Through this work, the JEP hopes to identify a long-term, financially sustainable solution to ensure benefits remain attractive and affordable.

The panel expects to report on this phase of its work in the autumn.

USS WG 0519
Item 8

USS Joint Expert Panel

Second call for submissions

The Joint Expert Panel on the Universities Superannuation Scheme (USS) is continuing its second phase of work on the USS valuation.

The first part of our work has focused on the valuation process and its governance. It included a consideration of the roles and involvement of UCU and UUK in the valuation process so that a more collaborative process can be adopted for future valuations; the interaction of bodies with a formal role in the valuation, including the Trustee and JNC; and considering the potential for the involvement of Scheme members in the valuation process and how more effective engagement with employers can be achieved.

The Panel issued a call for evidence on these issues in February and which closed in March. We are very grateful for the responses received which have been considered by the Panel.

The Panel is now focused on the second part of it work. This considers how the long-term sustainability of the Scheme can be secured. It includes:

1. Developing an approach to future valuations that is clear (and clearly understood by stakeholders) and which can deliver both a sustainable scheme and a shared set of principles.
2. An exploration of different paths to the valuation of technical provisions and other aspects of the valuation methodology, including Test 1.
3. Considering questions of risk sharing, including adopting a different approach to contributions (which could, in turn address issues of intergenerational fairness and equality); examining further the question of mutuality and the question of employer appetite for risk; and the potential for risk sharing.

We are particularly interested in hearing views and evidence on principles that could be adopted by the stakeholders and that could underpin an approach to future valuations; issues relating to supporting the long-term sustainability of the scheme; and approaches to the valuation methodology. You should feel free to respond to all three parts of the call for evidence or any one part

Submissions on the above matters or comments for the attention of the Panel are warmly welcomed and should be sent by 14 June 2019 to submit@jep.org.uk

We look forward to hearing from you.

This entry was posted in News on 10th May 2019 [http://www.ussjep.org.uk/second-call-for-submissions/] by Admin.

Universities UK

Universities UK ("UUK") is the collective voice of 136 universities in England, Scotland, Wales and Northern Ireland. Members are the vice-chancellors or principals (executive heads) of universities in England, Wales, Scotland and Northern Ireland.

The UUK Board comprises up to 24 directors and Prof Louise Richardson is a Board member.

UUK has certain responsibilities under USS rules. – making appointments to the USS trustee board and the JNC.

USS Trustee director appointments

The USS trustee board consists of between 10 and 12 non-executive members. Currently, there are 12 non-executive directors. The board will comprise of:

• Four directors appointed by Universities UK;

• Three directors appointed by the University and College Union (UCU) at least one of whom must be a pensioner member; and

• Between three and five independent directors.

JNC

The joint negotiating committee (JNC) is established under the rules of the scheme and its constitution, powers and responsibilities are set out in the rules.

The JNC's purpose is to initiate, consider and/or approve amendments proposed by the USS trustee to the scheme rules. If, following a valuation, the cost sharing provisions under the rules are triggered the JNC also has the power to decide on contribution increases or decreases and/or benefit changes in respect of the scheme. There are also a number of specific governance decisions that require the JNC's approval (including the appointment or removal of independent directors to the trustee board and increases in fees for directors and certain other committee members, such as those sitting on the advisory and investment committees).

The JNC comprises five representatives of Universities UK (UUK) and five representatives of the University and College Union (UCU), together with an independent committee member who acts as Chair. Sir Andrew Cubie has chaired the committee since 1 September 2008.

Employers Pensions Forum

The Employers Pensions Forum (EPF) was established by GuildHE, the Universities and Colleges Employers Association (UCEA) and Universities UK (UUK) in 2007 as a broad based forum for HEIs to discuss current and longer term pensions issues and to develop a strategy that will enable the HE sector to continue to offer staff access to high quality pensions schemes as an important part of the total remuneration package.

Membership of the Forum consists of representatives drawn from Vice-Chancellors, Finance Directors, HR Directors, Registrars and Chairs of Governing bodies, all with considerable experience in this area.

The EPF has two sub committees:

USS Group which focuses on the Universities Superannuation Scheme (USS) of which the majority of individual members can be found working in pre-92 HEIs.

Local Government and Teachers' Schemes Group which focuses on the various Teachers' Pension Schemes and the Local Government Pension Schemes (LGPS) operating around the UK which are mainly offered to staff working in post-92 HEIs.