**USS Review Working Group**
11.30am – 1.00pm, Thursday 25 April 2019
Venue: Room 4, Wellington Square

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## Agenda

1. Welcome and apologies for absence
   (new members: Prof Sophie Marnette and Prof Tim Jenkinson)

2. Conflicts of interest declarations

3. Minutes of previous meeting – 4 March 2019

4. Council paper on Group's draft response for UUK – *to note*

5. Final University response to UUK on 2018 valuation – *to note*

6. UUK response to USS on 2018 valuation – *to note*

7. USS update 4 April 2019 on 2018 valuation – *to note*

8. Communication update (including feedback from webinar on 8 April)

9. Any other business

Date of next meeting – 11.00 – 12.30 Monday 20 May 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
Professor Danny Dorling

**In attendance:**
Prof Anne Trefethen
Mr Russell Powles, Aon
Ms Judith Finch, Conference of Colleges
Ms Shaunna- Marie Latchman, PAD

**Apologies:**
Ms Jan Killick
Mr Stephen Rouse
Mr Lucian Hudson

**Council**

**USS Review Working Group**
Bannister Room, 6 Worcester St, 3.30 pm – 5.00 pm

**Minutes of the meeting of 4 March 2019**
Present: Professor Richard Hobbs (Chair), Mr Charles Alexander, Professor Jane Humphries, Mr Jaya John John, Mr Julian Duxfield, Professor Fabian Essler, Mr Lindsay Pearson, Professor Cecile Fabre, Professor Sam Howison

In attendance: Prof Anne Trefethen, Ms Jan Killick, Ms Rhiannon Curtis (Aon), Mr Stephen Rouse and Mr Lucian Hudson

1. **Apologies for absence and welcome**

Mr Charles Harman, Dr Martine Abboud, Ms Judith Finch, and Professor Danny Dorling sent their apologies. This was Prof Fabre's last meeting and Prof Hobbs thanked her for her insightful contribution to the Working Group meetings over the past year.

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

**3. Minutes of the previous meeting**
The minutes of the meeting on 19 February 2019 were agreed.

**4. Matters arising from the minutes**
The actions on communication items would be reviewed at the next meeting.

**5. To confirm the initial position on the 2018 valuation assumptions**

The Group agreed that its view on the 2018 valuation remained unchanged. It continued to support the JEP recommendations; the JEP recommended contributions level with Deficit Reduction Contributions (DRC) of 2.1% and the deficit recovery period should remain at c14 years (from 1 April 2020) in line with the 2017 valuation. The Technical Provisions valuation incorporating some, but not all, JEP recommendations resulted in a deficit of £3.6bn.

Prof Essler commented that USS appeared to have made adjustment for short term volatility, rather than taking a long term view.

**6. Material issued by UUK on contingent support**
The Group discussed the UUK consultation and the supporting commentary from Aon. It was noted that USS had the power to unilaterally impose higher employer contributions. The consultation by USS with UUK was a consultation, not a negotiation. USS's position appeared to be that if contingent contributions were not agreed then they would enforce the upper bookend position. Ms Curtis pointed out that the guidance from the Regulator suggested that if a deficit funding position improved then trustees should seek to maintain the level of DRCs from employers and reduce the length of the recovery period. This appeared to be USS's position for the 2018 valuation, maintaining DRCs at 5%.

Prof Hobbs said that change in the deficit from 2017 to 2018 showed the extent of volatility in valuations and that this volatility would be seen in any contingent contributions triggers set. There was a risk that in agreeing any contingent contributions (CCs) at this valuation it would be a permanent feature and accommodating fluctuations in CCs was not consistent with a sustainable arrangement.

Mr Alexander noted that the Aon proposal for CCs was set at a level that was unlikely to happen. Ms Curtis pointed out that it was unclear if the Aon proposal would be accepted by USS. It was noted that the rebate approach was based on the cost-sharing principle and that if there was savings then these were not for the employers' benefit only. It was understood that any CC with cost sharing would need a rule change agreed by the JNC and a one-off consultation with employees. Prof Trefethen believed that such a consultation could be difficult for employees to accept.

The Group agreed with UUK's summary under paragraph 3.3 that USS should explain why it did not support all the JEP's findings, including the need for CCs. The Group recognised the risk that if USS did not have a position that it was comfortable with regarding CCs or an upper book-end positon, that USS had the option not to finalise the 2018 valuation and continue with the 2017 schedule of contributions, with 35.6% payable in April 2020. Prof Essler reiterated that it was unfortunate that USS had not been able to await for the findings of the JEP's second phase of work before determining its position. The Group confirmed its view that the need for CCs had not been justified by USS.

**7. Draft response to UUK's consultation**

The Group considered the issues in the three questions posed by UUK.

1. *Do you have any specific comments on the proposed assumptions for the 2018 valuation, including views on the proposed upper bookend and lower bookend?*

The Group's view was that the DRCs should be aligned to the requirements set out in the JEP report (2.1%). The consultation on 2018 valuation assumptions did not adopt the JEP recommendations in full. The lower bookend was acceptable. USS was still seeking to start de-risking investments immediately, rather than wait as suggested by JEP.

*2. Do you support UUK putting forward a proposal for a CCs arrangement to the USS Trustee as it requested? If not, would you prefer to pay at the upper bookend level, or what would your preferred response be?*

The Group did not support a CC arrangement. It was agreed it would be unfortunate and premature to adopt a CC arrangement, and be saddled with this approach, before the JEP 2 work commenced. As set out in the response to question 1, the proposal was not necessary if the initial JEP findings were adopted in full. In addition a CC arrangement would require a further consultation with members and it added complexity.

*3. Do you find the proposal for a CCs arrangement set out in the Aon note (attached to this paper) acceptable, taking all factors into account? If not, what aspects would you wish to change?*

The Group noted that if a CC arrangement were to be imposed, all things considered, the proposal put forward by Aon had some merit provided:

- A CC arrangement was time-limited;
- There was no commitment to any future CC arrangement;
- It would be reviewed as part of JEP 2 and JEP 2 would inform the next valuation;
- It was targeted at a Technical Provisions, not Self-sufficiency, valuation; and
- The timetable for triggers and contribution adjustments proposed by Aon were reasonable.

The Group noted the difficulty in being asked to consider the Aon proposal when it was unclear that USS would accept some of its assumptions e.g. Technical provisions valuations.

It would not be drawn on responding to the question would it “pay at the upper bookend” as it was a decision contingent on unknown positions.

There was a discussion on long term stability and sustainability of USS in the future and the prospects for JEP 2.

Ms Curtis agreed to prepare a draft response for consideration by the Group.  It would be circulated on Wednesday and feedback was required by close of business on Thursday 7 March.  The agreed draft response would be presented to Council on 11 March for Council’s approval ahead of the deadline for submission to UUK on 13 March 2019.

**Action RC/All**

**7. Any other business**
There was no other business.

**11. Next meeting**
The next meeting to be confirmed.  The meeting scheduled for 15 March was cancelled.

The meeting closed at 5:00 pm

**USS WG 0419**
**Item 4**

**COUNCIL**

**Report of the meeting of the USS Working Group held on 4 March 2019**

**CONFIDENTIAL**

## 1. USS 2018 valuation and the provision of contingent support

Ref. Nos. COU/1

### (a) Summary

Following the findings of the Joint Expert Panel in 2018, USS is proposing to complete an out of cycle actuarial valuation effective 31 March 2018. UUK, as the employer representative on USS matters, is seeking views on the valuation assumptions and in particular contingent contributions. The USS Working Group's draft response to UUK on this matter is presented here for approval. .

### (b) Action required of Council

Council is asked to **endorse** the draft response to UUK on the 2018 valuation and contingent support prepared by the University's USS Working Group.

### (c) Committees considered by

| Committee | Date | Reference to original paper | Reference to minute of decision | Decision (endorsed/approved etc) |
|---|---|---|---|---|
| Council | 4 February 2019 | (C(19) 160) | Minute 6 | The draft response on this matter would be circulated to Council |

### (d) Key issues

Since the previous Council meeting, UUK has issued to employers a proposal for contingent contributions as part of its consultation on the 2018 valuation, together with supporting analysis from its adviser, Aon.

The Working Group's draft response to the three questions posed by UUK is attached as an Annex. The deadline for feedback to UUK is 13 March 2019.

As a reminder USS had proposed upper and lower "book-ends" with total contribution rate payable of 33.7% at the upper book-end or 29.7% at the lower book end, with a requirement for contingent support in the form of additional contributions available from employers in the case of the lower book-end. Under the cost sharing formula contributions of 33.7% would be split 23.0% employer and 10.7% employee.

The Working Group remained of the view that the findings of the Joint Expert Panel (JEP) should be adopted by USS in full. This had not been done in the USS's 2018 valuation consultation and, furthermore, USS had not justified maintaining the same level of deficit reduction contributions (5%). The Working Group was not persuaded that contingent contributions were necessary, although the Pensions Regulator was strongly steering USS towards requiring them. Should contingent contributions be imposed the Working Group felt that there were elements of UUK's proposal, prepared by Aon, that were reasonable.

The Working Group wished to emphasise that any contingent contribution arrangement should be temporary as the second phase of the JEP covering the valuation process and governance (and later long-term sustainability) had only recently started.

*Strategic Plan*

As noted previously, at this stage the key issue relating to the strategic plan is the affordability of the additional employer contributions proposed. At the time of writing, meeting the increase in employer contributions to 22.5% planned for October 2019 (if not superceded by the 2018 valuation) would result in the University running at an operating cash deficit of c£15m p.a. by 2022/23 (assuming no change to the current cost-sharing arrangement of 65:35).

*Risk analysis*

As details of any contingent contributions are unknown as this stage it has not been possible to provide Council with analysis of the risks associated with a contingent contribution framework.

*Cost and sustainability*

The costs of the increase in employer contributions is £4m pa for a 1% increase in the contribution rate.

Currently the University pays 18%, increasing to 19.5% in April 2019 and potentially to 23% under USS's proposed upper book-end.

*Further background information*

UUK consultation document – The 2018 actuarial valuation and the provision of contingent support: Clip 2 on Council's SharePoint site;

Aon proposal – The 2018 valuation and contingent contributions: Clip 3 on Council's SharePoint site.

**(e) Public Sector Equality Duty**

As a public body, the University has an active duty to consider the impact on equality in all decision making.

*(i)* ***Negative Equality impact***

It is considered unlikely that this item will have a negative equality impact by creating or contributing to a risk of discrimination, harassment, victimisation or other prohibited conduct.

*(ii)* ***Positive Equality impact***

It is considered that this item will have no impact on equality.

(iii) ***Evidence****:*

The University's actuarial advisers, Aon, provided support to the Working Group in preparing the draft response.

**(f) Further information**

Additional information may be obtained from Julian Duxfield, Director of HR (julian.duxfield@admin.ox.ac.uk)

**Annex**

**Universities UK (UUK)**
**A consultation by UUK with USS participating employers**
**The 2018 actuarial valuation and the provision of contingent support**

**Response by the University of Oxford**

The University is pleased to respond to UUK's consultation on the 2018 actuarial valuation and the provision of contingent support. The University understands that UUK will prepare a collective response on behalf of employers when responding to the USS Trustee's:

- Consultation on the proposed Technical Provisions and Statement of Funding Principles for the 2018 actuarial valuation dated 21 December 2018;
- Invitation for UUK, in consultation with employers, to propose a contingent contributions arrangement that they feel able to support (following the USS Trustee's decision not to propose a contingent contribution arrangement that it would be willing to accept).

This response has been prepared by a working party set up by Oxford University Council to consider the funding and benefits of the USS. In reaching its views, the working party has sought specialist advice from independent actuaries.

**Formal consultation response**

UUK has invited employers to respond to their consultation by expressing views on the following three specific questions to which we provide our response.

1. *Do you have any specific comments on the proposed assumptions for the 2018 valuation, including views on the proposed upper bookend and lower bookend?*

   The University's overarching view is that the proposals put forward by the JEP had the support of both the employers' and employees' representatives and should be acceptable to the USS Trustee without the need for contingent support. Therefore, the University does not agree with the proposed assumptions for the upper bookend which makes no adjustment for any of the JEP proposals. The University supports UUK in its proposal to ask the USS Trustee why they take a different view to the JEP that contingent support (other than that already available to them) is required now before any of the JEP proposals can be implemented or phase 2 of the JEP completed.

   Even without any of the JEP proposals being factored into the 2018 valuation the University notes that the upper bookend assumptions result in the deficit reducing from £7.5Bn to £3.6Bn with no apparent reduction to the deficit contributions (which appear to remain at 5%). The University does not support this approach to setting deficit contributions and believes an approach consistent to that used for the 2017 valuation should be adopted (i.e. similar recovery plan end-date and outperformance allowance) with consideration given to what employers can reasonably afford over the longer term.

   The University would also point out that the upper bookend assumptions assume that de-risking starts immediately following the valuation (rather than being deferred 10 years, as was assumed in the 2014 valuation and recommended by the JEP) and that maintaining deficit contributions at 5% at a time when risk/volatility is being reduced and the deficit has halved is inappropriate.

Whilst the lower bookend allows for some, but not all, of the JEP proposals the University could accept the assumptions proposed for the lower bookend which produces a deficit of £2.2bn and an overall contribution rate of 29.7% as an interim step until the JEP completes its phase 2 review.

2. *Do you support UUK putting forward a proposal for a CCs arrangement to the USS Trustee as it requested? If not, would you prefer to pay at the upper bookend level, or what would your preferred response be?*

No. The University does not believe that a CCs arrangement is needed to support the lower bookend position. The University believes that the levers already available to the USS Trustee allow sufficient flexibility to control the contributions payable to the USS during a period of sustained deterioration in the funding level. The added complexity (and monitoring costs) associated with a CCs arrangement, that would require further consultation with members on rule changes, would be premature given the intention of the JEP to consider CCs arrangements as part of its phase 2 review.

As discussed in our response to question 1, the University does not believe it is appropriate to pay the upper bookend level, as defined by USS, given the reduction in the deficit from the 2017 valuation (i.e. from £7.5Bn to £3.6Bn using the upper bookend assumptions). The USS Trustee's proposal to maintain deficit contributions at 5% regardless of the improvement in the funding position appears to reduce the recovery plan length by c5-7 years (compared to the 2017 valuation) and the University does not agree with this approach.

If the USS Trustee insists on using the upper bookend assumptions the University asks that UUK negotiate for lower deficit contributions by adopting a recovery plan which is more consistent with that agreed following the 2017 valuation (i.e. in terms of recovery plan assumptions and length) – as put forward by the UUK proposal.

3. *Do you find the proposal for a CCs arrangement set out in the Aon note acceptable, taking all factors into account? If not, what aspects would you wish to change?*

If a CCs arrangement were to be imposed on the University (for example, due to the majority of employers wanting to offer the USS Trustee a CCs arrangement) the proposed arrangement put forward by Aon on behalf of UUK has some merit provided:

- Any rule change required to allow implementation of a CCs arrangement would be time-limited to only be applicable until the next Schedule of Contributions is signed;
- There is no commitment to any future CCs arrangement being maintained after completion of the next formal actuarial valuation (due in either 2020 or 2021);
- It would be reviewed as part of the work to be undertaken by the JEP in phase 2 of their review and that the outcome of the JEPs phase 2 review would inform the next valuation;
- Technical Provisions (or a close proxy to them), not a self-sufficiency basis, would be used as the trigger metric; and
- The timetable/methodology proposed for by Aon for determining whether a trigger point is breached (i.e. covering frequency of monitoring, smoothing and the period over which a breach must be maintained) is taken forward.

We hope this response will assist UUK in its negotiations with the USS Trustee in relation to the 2018 actuarial valuation.

For the University of Oxford
Council's USS Working Group

[7 March 2019]

**Universities UK (UUK)**
**A consultation by UUK with USS participating employers**
**The 2018 actuarial valuation and the provision of contingent support**

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UUK has invited employers to respond to their consultation by expressing views on the following three specific questions to which we provide our response.

1. *Do you have any specific comments on the proposed assumptions for the 2018 valuation, including views on the proposed upper bookend and lower bookend?*

   The University's overarching view is that the proposals put forward by the JEP had the support of both the employers' and employees' representatives and should be acceptable to the USS Trustee without the need for contingent support. Therefore, the University does not agree with the proposed assumptions for the upper bookend which makes no adjustment for any of the JEP proposals. The University supports UUK in its proposal to ask the USS Trustee why they take a different view to the JEP that contingent support (other than that already available to them) is required now before any of the JEP proposals can be implemented or phase 2 of the JEP completed.

   Even without any of the JEP proposals being factored into the 2018 valuation the University notes that the upper bookend assumptions result in the deficit reducing from £7.5Bn to £3.6Bn with no apparent reduction to the deficit contributions (which appear to remain at 5%). The University does not support this approach to setting deficit contributions and believes an approach consistent to that used for the 2017 valuation should be adopted (i.e. similar recovery plan end-date and outperformance allowance) with consideration given to what employers can reasonably afford over the longer term.

   The University would also point out that the upper bookend assumptions assume that de-risking starts immediately following the valuation (rather than being deferred 10 years, as was assumed in the 2014 valuation and recommended by the JEP) and that maintaining deficit contributions at 5% at a time when risk/volatility is being reduced and the deficit has halved is inappropriate.

Whilst the lower bookend allows for some, but not all, of the JEP proposals the University could accept the assumptions proposed for the lower bookend which produces a deficit of £2.2bn and an overall contribution rate of 29.7% as an interim step until the JEP completes its phase 2 review.

2. *Do you support UUK putting forward a proposal for a CCs arrangement to the USS Trustee as it requested? If not, would you prefer to pay at the upper bookend level, or what would your preferred response be?*

No. The University does not believe that a CCs arrangement is needed to support the lower bookend position. The University believes that the levers already available to the USS Trustee allow sufficient flexibility to control the contributions payable to the USS during a period of sustained deterioration in the funding level. The added complexity (and monitoring costs) associated with a CCs arrangement, that would require further consultation with members on rule changes, would be premature given the intention of the JEP to consider CCs arrangements as part of its phase 2 review.

As discussed in our response to question 1, the University does not believe it is appropriate to pay the upper bookend level, as defined by USS, given the reduction in the deficit from the 2017 valuation (i.e. from £7.5Bn to £3.6Bn using the upper bookend assumptions). The USS Trustee's proposal to maintain deficit contributions at 5% regardless of the improvement in the funding position appears to reduce the recovery plan length by c5-7 years (compared to the 2017 valuation) and the University does not agree with this approach.

If the USS Trustee insists on using the upper bookend assumptions the University asks that UUK negotiate for lower deficit contributions by adopting a recovery plan which is more consistent with that agreed following the 2017 valuation (i.e. in terms of recovery plan assumptions and length) – as put forward by the UUK proposal.

3. *Do you find the proposal for a CCs arrangement set out in the Aon note acceptable, taking all factors into account? If not, what aspects would you wish to change?*

If a CCs arrangement were to be imposed on the University (for example, due to the majority of employers wanting to offer the USS Trustee a CCs arrangement) the proposed arrangement put forward by Aon on behalf of UUK has some merit provided:

- Any rule change required to allow implementation of a CCs arrangement would be time-limited to only be applicable until the next Schedule of Contributions is signed;
- There is no commitment to any future CCs arrangement being maintained after completion of the next formal actuarial valuation (due in either 2020 or 2021);
- It would be reviewed as part of the work to be undertaken by the JEP in phase 2 of their review and that the outcome of the JEPs phase 2 review would inform the next valuation;
- Technical Provisions (or a close proxy to them), not a self-sufficiency basis, would be used as the trigger metric; and

- The timetable/methodology proposed for by Aon for determining whether a trigger point is breached (i.e. covering frequency of monitoring, smoothing and the period over which a breach must be maintained) is taken forward.

We hope this response will assist UUK in its negotiations with the USS Trustee in relation to the 2018 actuarial valuation.

For the University of Oxford
Council's USS Working Group

12 March 2019

USSEmployers

# CONSULTATION ON THE PROPOSED 2018 TECHNICAL PROVISIONS ACTUARIAL VALUATION

# UNIVERSITIES UK RESPONSE

March 2019

www.ussemployers.org.uk

pensions-update@universitiesuk.ac.uk

@USSEmployers

# Contents

## Summary of employer responses

UUK received responses to the consultation which together represent 89% of the active member population of USS. We believe this represents a credible level of response to the consultation, in the time available. In terms of headline responses to the questions put forward to employers by UUK, these are as follows:

*1. Do you have any specific comments on the proposed assumptions for the 2018 valuation, including views on the proposed Upper Bookend and Lower Bookend?*

The responses from employers on specific points relating to the upper and lower bookend values are set out in the detailed UUK response, however the principal points raised by employers are:

- employers remain to be convinced that the upper bookend value of 33.7% is the 'correct' price for the current benefits as is suggested; we ask the trustee to fully consider the responses in the detailed response when deciding on this crucial upper bookend value.
- employers find it difficult to see the trustee's justification for why two of the Joint Expert Panel's (JEP's) recommendations are proposed to be excluded in finalising the lower bookend value. Employers are interested to understand more fully how the trustee has been able to decide which proposals meet a threshold of acceptability or not. In particular, employers note that finding just one of the excluded JEP recommendations to be acceptable – the smoothing of future service costs over a limited period (say three years) – would allow the lower bookend value to reduce below 29.7% of salary (to 29.2%, the figure illustrated by the JEP and which UUK used in consulting with employers, or close to it). It is not clear why this has been rejected by the trustee.
- employers believe that the proposed levels of Deficit Recovery Contributions included in the bookend values are unreasonable and have not been justified by the trustee, given that the scheme deficit is materially lower than it was as at 31 March 2017. Employers believe it unreasonable for such a significant component of the overall contribution not to be formally consulted upon at this point in time.

*2. Do you support UUK putting forward a proposal for a Contingent Contributions (CCs) arrangement to the USS trustee as it requested? If not, would you prefer to pay at the upper bookend level or what would your preferred response be?*

While most employers would prefer for the JEP recommendations to be implemented without CCs, a significant majority of employers support the development of a proposal by UUK to put to the trustee, recognising that UUK had expected the trustee to present a proposal rather than developing its 11 principles. At the same time, many employers still question why a CCs arrangement is necessary, given the legal and structural basis upon which the scheme operates (which was set out, in brief, by Aon in its note of 27 February 2019).

The small number of employers not supportive of the proposal remain to be convinced of the necessity of CCs to achieve the lower bookend (some ofthese reasons are set out in the Aon advice notes dated 14 January 2019 and 27 February 2019), and prefer the trustee to explain further why it believes CCs are needed.

*3. Do you find the proposal for a CCs arrangement set out in the Aon note acceptable, taking all factors into account? If not, what aspects would you wish to change?*

Reluctantly, and on the basis that it is the 'least worst' option, employers express support for the proposal for CCs put forward by UUK. The support of employers is conditional upon confirmation that the UUK proposal delivers a contribution rate in line with the lower bookend.

We would emphasise the crucial trade-offs which have needed to be considered by employers in fairly evaluating the proposal. In particular, it is clear that employers see the arrangements as temporary, any CCs must be cost-shared, and they are justified only in that they will allow stakeholders to find a solution to the current valuation. Employers also believe that CCs will allow them to look forward to the next valuation, and that the second phase of work by the JEP will be the means through which a genuinely sustainable longer-term solution can be found.

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It is clear from the consultation responses that employers wish to see an outcome to the USS valuation which is in line with the recommendations put forward by the JEP. The JEP's recommendations gave the stakeholders to USS an opportunity to achieve a settlement to what has been a difficult process. They also allow the longer-term sustainability of the scheme to be more carefully considered as part of a second phase of JEP work.

Please see the detailed response in this document in which further comments on the trustee's proposed technical provisions (and related assumptions) are set out in the light of the responses from employers, and also on the proposed CCs arrangement put forward by UUK. The proposals, which employers have confirmed they support on the terms set out above, are those as defined in the Aon note dated 27 February 2019, and we believe these proposals fully meet the 11 principles put forward by the trustee. The Aon paper provides more detail, in its Appendix 2, as to how those principles are met.

UUK's proposals have been communicated to the Pensions Regulator (tPR). At a meeting with tPR on 5 March 2019, a number of explanations and clarifications were provided by the UUK team, and tPR advised that they have no plans to offer any further comment on the proposals until after the USS trustee board meeting on 28 March 2019. (For the avoidance of doubt, tPR has not expressed a view on the proposal and this interaction with tPR should not be taken as potentially tPR having no issues with the proposal.)

The proposed CCs arrangement - now broadly supported by employers - was put forward on the basis that it represents a lower bookend solution which all parties could find acceptable. It has involved very careful consideration by UUK and by employers, recognising that difficult decisions are required. Crucially, the proposed arrangements could, we believe, be decided upon quickly, meeting the objective of submitting a timely valuation and implementing new contribution rates ahead of the planned October 2019 increases. It is hoped that the trustee shares this view.

If the CCs proposal is not supported by the trustee, UUK would expect employers to receive a clear explanation as to why this is the case given that the 11 principles set out by it have, in the view of UUK, employers and Aon, been met. It will also need to be clear how this valuation can best be resolved for all parties in the time available.

# UUK's detailed response

*Introduction*

This is a 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.

Employers have previously made clear to UUK that their support for the Joint Expert Panel's (JEP) recommendations is conditional upon understanding the terms of what (if any) contingent support is required by the trustee, and of the finalised contribution rates. Given that the expected sequence of events has changed and UUK has now been invited to bring forward its proposals for Contingent Contributions (CCs) (rather than a proposal being presented by the trustee), the trustee's requirements in relation to contingent support are not fully certain.

While the trustee's 11 principles give UUK some additional confidence that the proposal is credible, it is unclear whether the terms for CCs developed by UUK with its advisers will be acceptable to the trustee. We must, therefore, continue to treat the support offered by employers as conditional and entirely subject to what employers trust will be the trustee's acceptance (and, as appropriate, any details of that acceptance).

It is clear to UUK that employers are very much cognisant of the issues of risk in relation to USS. The supplementary material on risk which has been provided by the trustee, and also developed by UUK through its advisers Aon (such as the appendix to Aon's first advice paper dated 14 January 2019), has been extremely useful to employers, we believe. Employers have made it very clear that, whilst they wish to support a solution, they must understand and accept any additional risk that is involved and its implications, to protect the potential future impacts upon their finances and those of USS employers generally. Employers could not support a solution regardless of its cost or of the risk associated with it (whether current, or potential future). Indeed, several employers made clear that the upper bookend would be simply unsustainable, with the lower bookend requiring difficult choices and re-prioritisations to be made by employers. It is also clear from responses that employers are concerned about the impact of recent developments on scheme members, and for example on their views about future participation in the scheme.

*The proposed bookends in overview*

We note that the underlying methodology adopted for this valuation is broadly the same as that used in the 2017 valuation, including the trustee's funding tests. We support this approach by the trustee given the timescales within which the valuation is being undertaken, but UUK would also put on record its willingness, and that of employers generally, to examine and consider other approaches when the trustee considers that appropriate. We note also that the second phase of the JEP's work will look at some of these issues later in its work plan.

We note the presentation of upper and lower bookend values by the USS trustee, and importantly that the major difference between the two values is largely down to the proposed level of Deficit Recovery Contributions (DRCs) in each. The trustee makes clear that this is not a formal consultation on matters relating to DRCs – and yet the DRCs are so fundamental to their value, and therefore to the views expressed by employers on them. We think it unhelpful that DRCs are not part of the formal consultation at this point.

In terms of the upper bookend, we would firstly acknowledge that the proposals for the upper bookend are materially better than the contribution rate confirmed for the 2017 valuation (33.7% of salary compared with 35.6% of salary). That is good news, and we realise this in part reflects some welcome movement on the part of the trustee at this new 2018 valuation; of course it is also partly derived from the change in valuation date itself.

In its recent webinar, the USS Executive characterised the proposed upper bookend as *more risky* than the figure confirmed for the 2017 valuation. Aon's view is that this is not the case – as set out in the Aon note of 27 February 2019. We think it crucial to recognise that the value of the funding deficit has more than halved – £3.6bn compared with £7.5bn – although the trustee has proposed to adopt the same level of DRCs of 5% of salary. We argue below for a reduction in the level of DRCs, and we make clear that the introduction of an appropriate CCs arrangement allows the trustee to take a different view on the overall level of risk within the assumptions.

We think it important that the lower bookend is at, or very close to, the 29.2% contribution level, in line with the illustration provided by the JEP and on which UUK consulted with employers. Employers support the JEP's recommendations and the estimated employer contribution rate of 20.1% – although it is clear that such a level is at the very upper limit of sustainability (and there would be material impacts for many). We hope that the trustee will recognise that with employers offering broad support for a CCs arrangement in the form proposed by UUK, it would be helpful – in terms of moving quickly to settle the 2018 valuation by the appropriate deadlines – not to have to revert to employers to seek their views on a higher employer contribution than 20.1% of salary (and indeed for University and College Union's (UCU) views to be invited on a member contribution rate of greater than the 9.1% level illustrated by the JEP).

In the various consultation documents prepared in recent months we have seen the trustee continue its focus on self-sufficiency (and in particular *the gap* between the trustee's funding approach and a self-sufficiency position) as a primary funding metric. We see this carried across to the issue of CCs, in which it is clear that the trustee has a preference for the triggers to be activated by reference to a self-sufficiency measure. In recent days – in a webinar presented by the USS executive and in blogs from the USS team – we have heard that a figure of £20bn of self-sufficiency deficit is *'more than twice the level of reliance that employers told us they were ultimately willing to support, in the long-term, in carrying out the 2017 valuation'.* We do not believe that employers have expressed a view on the *current* level of deficit on a self-sufficiency basis – although we have of course previously expressed views on the targeted figure in 20 years' time (as part of the trustee's application of Test 1 for the 2017 valuation). We think it important, given how crucial this issue is as CCs are discussed, that the views of employers are not misunderstood here. We would like to understand if the USS Executive, or the USS trustee board, is forming any view of the 'risk appetite' of employers on the current gap to a self-sufficient level of funding, or indeed – as it sometimes alluded to – whether the trustee itself has a particular 'risk-appetite' in this respect.

*The proposed assumptions in detail*

We note, and welcome, that the trustee has proposed that some of the JEP's recommendations be adopted into their assumptions for the 2018 valuation. The trustee has taken advantage of the latest market conditions and data as at 31 March 2018, and indeed of updated mortality data; this is welcomed, and supported, by employers. Employers also welcome the proposed adoption of a normal pension age of 66 for the future accrual of defined benefit rights.

The trustee has indicated that it would be *prepared to consider* two further measures, namely (i) movement of the target reliance at 20 years from £10bn to £13bn in real terms and (ii) reducing DRCs by allowing for outperformance in the recovery plan or increasing the length of the recovery plan. The view from employers is that these movements would be considered appropriate – and indeed entirely justified in both respects – on their own merits. Moreover, if it were needed, the case for them would be further strengthened given the support which employers have indicated they would be willing to provide through CCs.

Employers are unclear why two of the JEP's proposals have not at this stage been supported by the trustee, in particular (i) deferring when de-risking of the scheme's investments starts and (ii) the smoothing of future service contributions over an appropriate period (the JEP had suggested two valuation cycles). The trustee's rationale is, we believe, in part built upon the assessment of the average discount rate relative to CPI and Gilts, which is shown on page 15 of the consultation document. If we set aside the limitations of these measures in assessing an overall funding approach in this way (for example, the approach to deficit recovery would not feature in this kind of assessment), we believe that employers wish for full recognition to be given to the uniqueness of the covenant provided to the scheme by USS employers. This was presented in convincing terms by the JEP in its report. The 'benchmarking' which is illustrated by the trustee on page 15 of its consultation document is considered to be of limited value, and does not provide justification that some, but not all, of the JEP's proposals should be incorporated. Adopting all of the JEP's recommendations is we believe further substantiated by the proposed addition of a CCs arrangement.

On the proposed levels of DRCs to be included in the upper and lower bookend values, as we have said it is important that the views of employers can be taken into account now given their fundamental importance to the overall bookend values. Clearly, if the trustee maintains its view that a formal consultation on DRCs will take place later, the comments made below are without prejudice to the formal responses which will follow. This is the element of the trustee's proposals on which the most substantial comments have been made by employers. We should start by reiterating that employers have continued difficulty in seeing the justification for a 5% DRCs value in the recovery plan which has been confirmed for the 2017 actuarial valuation. The decision to undertake a 2018 valuation allowed the latest market conditions to be taken into account (as at 31 March 2018), which helpfully provided a more favourable calculation of the deficit (some 42% of the deficit value as at 31 March 2017), and yet the trustee has proposed DRCs of 5% of salary within the upper bookend value. Employers have some difficulty with the logic of the trustee's approach in this area, and they support the view expressed by Aon in its paper dated 27 February 2019 that a materially lower figure would be justified (and 3.5% was used in its illustration of the gap between the bookends). In addition, as USS is an open scheme with a long term investment strategy this further supports the merits of long recovery plans with asset outperformance.

With respect to the level of DRCs proposed in the lower bookend value, it seems clear from table 4 on page 19 of the trustee's consultation document that much lower DRCs can be justified. Indeed, we know that some would argue that no DRCs are required at all, given that it would not be unreasonable for a level of outperformance - similar to that used before - to be included in the recovery plan. We think that lower DRCs would be particularly justified if an acceptable CCs proposal were put in place. Once again, employers support the approach adopted by Aon in its advice paper of 27 February 2019, which is to illustratively include 2.1% DRCs[1] - which is important in the development of the CCs proposal and to quantifying the gap between the bookends - on the basis that it will enable the lower bookend value to be 29.2% of salary. This is considered important is being able to achieve an acceptable outcome for all parties.

With the publication of new mortality guidance last week, we would expect the trustee to consider the latest tables in due course, which if these trends apply to the USS membership would likely see a further reduction in liabilities.

In the interests of transparency, we think it may be helpful for the formal advice of the USS scheme actuary to the trustee on the proposed assumptions for the 2018 actuarial valuation to be shared with employers. If the trustee considers that appropriate, UUK would be pleased to receive and then circulate that material to support further understanding of these matters.

*UUK's proposal for Contingent Contributions (CCs)*

The responses from employers generally support the view of the trustee that the covenant provided by USS employers is strong, and they note that this is backed by considerable advice gained by the trustee on this issue. This underpins the proposal for CCs which was put forward to employers. We understand that the trustee plans to undertake further tailored work around the 2018 valuation. UUK and employers will be pleased to provide any further inputs or assistance needed.

The JEP report made clear that the issue of trigger contributions *'is an issue to be addressed for the longer term, and as part of a wider review'*, and employers have confirmed that they back the findings of the JEP. We cannot escape the fact that the development of a CCs proposal is made more difficult given this context. We do, however, recognise the trustee's position and have developed a proposal accordingly, although we would want to make clear that employers are still fully behind an outcome in line with that put forward by the JEP.

We think that focussing on contingent *contributions* - and not giving consideration at this stage to contingent assets, negative pledges etc - is right, although we are also supportive of the JEP's particular view that other forms of support should be looked at as part of a longer-term review.

The majority of responding employers confirm that they support the proposals put forward by UUK. It is clear that they do so reluctantly, as the least undesirable of the very difficult alternatives put to them at this time and in the spirit of offering a final measure through which an acceptable conclusion to recent difficulties can be found by all parties.

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*[1] It should be recognised that, in the lower bookend scenario, the deficit would be an indicative £2.2bn - and DRCs of 2.1% of salary would be equivalent to a 15 years recovery plan with no outperformance. Some level of outperformance is considered entirely reasonable and proportionate.*

Employers have also expressed a number of further necessary conditions to their acceptance:

1. there is strong support for the proposal that CCs are cost-shared under the scheme's cost-sharing provisions; this is confirmed as being of fundamental importance to employers.
2. for any given CCs proposal, in the context of a scheme with a long-term investment strategy and a strong covenant, what really matters for employers (and employees) is – what is the likelihood of the triggers applying, how much is then paid, and what period of notice is given. Beginning with the likelihood of the trigger applying, the probability of CCs being triggered appears high at 30% and many employers believe that this likelihood would ideally be lower reflecting that CCs should only be triggered in exceptional circumstances – and more in line with the starting point referred to by Aon in its advice note of 27 February 2019 of 10%. We believe that, on balance, employers could live with the proposed 30% probability but it would be remiss not to also reflect the clear statements of concern.
3. employers are clear that they see the CCs arrangement as temporary, designed to achieve an acceptable solution through to the next actuarial valuation (which will provide the opportunity to look at the position afresh). It will also enable the JEP to progress, and conclude, its second phase of work. Employers also recognise the power of the trustee to call a further actuarial valuation as one of its further defences should the scheme's funding position materially worsen (for example it would have the power do so as at 31 March 2020 if that were considered appropriate), and indeed some employers have expressed the view that 2020 should be the date of the next valuation.
4. the time periods set out in the Aon proposal, for example the period over which changes in the funding position are measured, and the period of lead time available to the stakeholders before any CCs are implemented, generally seem acceptable to most employers. Employers consider it essential that any arrangement provides for the Joint Negotiating Committee to have a period within which it can consider the stakeholder response to a deterioration in the funding position, and in our view six months is the shortest period that is feasible.
5. employers wholly support the view that the assessment period needs to be sufficiently long, and the probability set sufficiently, to avoid CCs being triggered by something which is part of the normal cycle of volatility within a three yearly actuarial valuation period. In the view of employers, the CCs arrangements are intended for circumstances which are clearly beyond any predicted norm. However, there is some reluctant support for a likelihood of 30% as part of a final settlement to the valuation, alongside quarterly monitoring (with three-month averaging), and with the trigger threshold being breached if the trigger is met for two successive quarter-ends. We think this is consistent with the view of the Pensions Regulator, expressed in its letter dated 11 December 2018, that it expects employers to demonstrate that they can fully support additional investment risk – in particular *'that they can fully support that risk if it is not rewarded'*. An assessment period which is too short would not allow such an assessment – as to whether additional risk has been rewarded – to be reasonably made.
6. employers believe it helpful to see any additional risk associated with the JEP's recommendations as being the difference between the upper and lower bookends in the construct presented by the trustee. This is in line with the 2 January consultation document. While there is then a theoretical 'underpayment' compared with the position had the upper bookend applied, the sums involved are not material in the context of the covenant, and the right place to address this is at the next valuation.

7. employers believe that the proposal for three steps of increased contributions are appropriate given the strength of the covenant and its enduring, long-term ability to respond to what will always (in relative terms) be a short-term funding change, and also contribution steps of 1% each are appropriate as a means of bridging the gap, over time, between the two bookend values.

## Comments on the draft statement of funding principles

We note the additional wording which has been included in the draft presented for consultation which relates to the trustee monitoring the short-term self sufficiency position. Looking back, we note that this wording was not included in the *draft* Statement of Funding Principles (SFP) presented for consultation in respect of the 2017 valuation, but was included in the final version of that 2017 SFP. In its advice paper of 27 February 2019, Aon states that it has no material concerns with the trustee documenting that it is monitoring the self-sufficiency deficit, although it would prefer this monitoring to have no role in the proposal for CCs; we agree with this view.

It appears that the reference to the 'economic basis' has been dropped; it is no longer defined, unlike for the 2017 and 2014 statements. In its advice paper of 27 February 2019, Aon states that this may suggest that the trustee is disbanding Test 3 which compared the net assets of the sector with the deficit of the scheme on an economic basis together with a 1-in-100-year bad event, or the approach could be retained but on a self-sufficiency basis. We would welcome the trustee's clarifications as to why references to the economic basis have been removed.

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**USS WG 0419**
**Item 7**

# 2018 Valuation update: 4 April 2019

The Board of the USS Trustee met on Thursday 28 March to consider UUK's response to the proposed Technical Provisions assumptions for the 2018 valuation and the associated contingency contribution proposal.

It was not immediately clear to the board that UUK's proposals are fully aligned with its principles for contingent support, and it believes that more work is required to understand the issues that this might present.

In addition, the trustee needs to engage further with the Pensions Regulator, who has separately requested additional work assessing the employer covenant and employers' ability to support scheme risk, in particular given developments since the 2017 valuation.

Further analysis is therefore required before full consideration can be given to these complex issues. This work is being given full priority, and the Board will now reconvene at the end of April.

The employer (UUK) and member (UCU) representatives on the Joint Negotiating Committee were given a briefing on these developments at a meeting on Wednesday.

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