

**The following note was issued to heads of participating institutions on 21 May 2021**

Colleagues,

The Trustee Board met last week for the first time since UUK launched its consultation with you on ways of addressing the 2020 valuation.

In line with our commitment to review our funding assumptions based on new developments, we considered some of the options UUK has put forward for consultation with employers. We looked at these alongside post valuation experience, including notable market data from 31 March 2021, and further advice from the Scheme Actuary and our covenant specialists.

We also reflected on the extensive group and one-to-one meetings we have had with many of you over the course of April and May.

**UUK's consultation**

The options on which UUK is currently consulting demonstrate a clear desire to find a holistic solution to the funding challenges facing the Scheme.

Our initial assessment of the modified hybrid (DB/DC) benefit structure included in UUK's consultation was that it could be implemented by 1 April 2022 for a total contribution rate of **34.7%**. That contribution rate is based on the funding framework associated with the covenant support assumptions used for 'Scenario 3' in the Trustee Update published in early March. There is more work to do on the assumptions appropriate to the different set of covenant support measures and benefit structures on which UUK is consulting.

We are hopeful that we might be moving closer to covenant commitments that would provide grounds for us to formally review the Recovery Plan and discount rate assumptions.

We welcome the suggestion of a longer 20-year moratorium on employer exits and continue to have constructive discussions with UUK and employers on the details of debt monitoring and *pari passu* arrangements. We hope that, over the coming weeks, we can bring these discussions to a positive conclusion for the benefit of the wider Scheme.

Together with the benefits structure included in UUK's consultation, a more favourable overall rate than 34.7% could yet be achieved. But we must now wait to see what mandate UUK is given by employers and how that translates into formal proposals tabled by them at the [Joint Negotiating Committee \(JNC\)](#) that we can formally price.

UCU may also want to consider alternative proposals and formally present those at the JNC and we stand ready to support that process. Our role as Trustee is to price the contribution and benefit structures UUK and UCU put forward.

We believe there are grounds for cautious optimism. A way forward is emerging that could address affordability concerns and put the Scheme on a more sustainable footing, but which could also see members continue to build up a meaningful level of inflation-protected income for life in retirement. Benefits members have already built up are protected by law and the Scheme Rules. They cannot be changed as a result of the 2020 valuation.

## **What happens next?**

All of this will depend on the outcome of UUK's consultation, and any proposals subsequently tabled at the JNC by UUK or UCU. We recognise difficult choices need to be made by all parties; choices that will not be easy for employers, members or the Trustee. To this end, we have agreed to the JNC's request to a three-month extension to the time allowed under the Scheme Rules for the JNC to decide how the contribution increases will be addressed. We recognise how challenging negotiations are likely to be and how providing more time to the JNC could have potential benefits to the process and eventual outcome.

The extension will take us to the end of August.

This does mean that the 1 October 2021 contribution increases (scheduled under the 2018 valuation) are highly likely to apply, due to the time it will take to complete the necessary statutory consultation processes following a JNC resolution.

## **Alternative benefit designs**

Looking further forward, changes to the existing hybrid (DB/DC) benefit structure could be implemented for 1 April 2022 – provided the JNC makes decisions on benefit change and covenant support in August.

We believe alternative benefit designs, such as Conditional Indexation and Collective Defined Contribution models, would take significantly longer to implement. This is particularly true if they were to rely on enabling legislation and where new pension benefit designs, decision frameworks and governance models would need to be negotiated and agreed. The full regulatory and legal implications of such models would need to be understood. A wide range of issues would also need to be considered including intergenerational fairness, authorisation requirements and the relationship with existing benefits.

We would be happy to support stakeholders if they wanted to explore such approaches but, given the likely time required to reach any formal conclusions at the JNC, a schedule of contributions reflecting the requirements of the 2020 valuation would need to be put in place. This would mean contributions increasing above those scheduled for October 2021 in the absence of any JNC decisions in the meantime. The scale of any such increases would depend on the covenant support measures provided by employers. Any phasing of increases from 1 April 2022 onwards would depend on our assessment of affordability and the need to ensure members' benefits are being appropriately funded.

We will, however, continue to be as flexible, collaborative and constructive as we can in discharging our statutory and fiduciary duties and ensuring that current and future benefits are being adequately funded.

## **Experience since 31 March 2020**

We have been performing a detailed analysis of the position of the Scheme as of [31 March 2021](#) – a year after the valuation date.

There have been some notable developments in that time. Nominal interest rates and asset values have increased, which are positive developments for the scheme funding position. On the other hand, inflation expectations seem to have increased significantly, while expectations for future expected investment returns have reduced – both of which put pressure on scheme funding and contribution requirements.

We are actively assessing the net impact of these competing effects. Early assessments suggest that they might have marginal or no 'net' effects on the funding position, but there is more analysis to do. Some of the key adjustments made to reflect market conditions as at March 2020 seem to have been validated (such as changes to self-sufficiency 'low risk' benchmarks and allowance made for substantial asset outperformance).

### **Prudence – a new note for employers**

Employers have been fielding questions from members on expected investment returns and prudence. Mirko Cardinale, Head of Investment Strategy and Advice at USS Investment Management, addresses some misconceptions on these points in more detail [here](#). We also touched on this issue in our latest [member webinar](#), and we have also published a [separate technical briefing note on the different factors that influence prudence](#).

There are a few points worthy of note that we have set out in [a new, separate note for employers](#).

### **Debt monitoring and *pari passu* proposals – new FAQs for employers**

Finally, we know from our recent meetings with institutions and with UUK that the debt monitoring and *pari passu* proposals are an area of particular focus for employers when considering their response to UUK's consultation.

We appreciate there is naturally a concern about the way in which the proposals might be operated in practice. We want to allay those concerns but, at the same time, we can't pre-judge the range of situations which might occur. The framework needs to work in a pragmatic and efficient manner for all stakeholders and not hamper effective decision making in the sector.

We have published [a new set of FAQs](#) to answer some of the more immediate questions that have been raised. We will work on publishing a more complete statement of principles to provide employers with a clear and enduring point of reference on how we will apply the framework in practice.

**Bill Galvin**, Group Chief Executive