10 September 2021

USS

Q&As in support of the consultation with UUK on the Schedule of Contribution, Recovery Plan and Statement of Funding Principles for the 2020 valuation

Q1. What's the Trustee's position on the validity of the 2020 valuation and the prospect of a 2021 valuation?

We've published a set of FAQs on the 2020 valuation, and a comprehensive briefing note on the likely outcome of a 2021 valuation. We wrote to employers in relation to the latter on 23 July.

Q2. Why is the Trustee completing the valuation before the employer-led consultation with affected employees and their representatives?

The JNC's decisions allow us to address members' immediate concerns around affordability by completing the valuation as soon as possible and, in turn, introducing rates significantly lower than those otherwise scheduled from 1 October 2021 (11%, under the 2018 valuation). Affordability is the principal reason members give for opting out of the Scheme – for opting out of having any workplace pension at all.

We can only do this because we have secured upfront commitments from employers on additional covenant support (most notably a 20-year moratorium on employers exiting the Scheme without the consent of the Trustee, effective from the date of signing the 2020 valuation) and because of the assurances provided by the second 'leg' of the dual-rate Schedule of Contributions (SOC) as detailed in our consultation with UUK.

The employer-led consultation with affected employees (and their representatives) will still feed into decisions. We are aiming to be in a position for employers to launch their consultation around the start of November.

We will not be able to implement any benefit changes until the employer-led consultation has been completed and responses have been considered.

If there are any subsequent changes to the JNC's proposals, following the employer-led consultation, we would need to consider the effect of such changes on the required contributions and may have to consult UUK again on the SOC, Recovery Plan (RP) and Statement of Funding Principles (SFP).

The effect of any changes would depend on their scale and nature. Some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time.

Q3. What happens if there are further changes agreed through the employer-led consultation or in negotiation?

If there are any subsequent changes to the JNC's proposals, we would need to consider the effect of such changes on the required contributions and may have to consult UUK again on the SOC, RP and SFP. The effect of any changes would depend on their scale and nature.

We need a final decision on benefit change to have been made – in the form of an executed deed of amendment – by 28 February 2022. We will need at least a full calendar month from that point to work with 320-plus employers to implement and communicate any changes.

We also need to allow for the possibility, as set out above, of a further consultation with UUK to run in tandem (in much the same way as we are consulting them now ahead of October's contribution rate changes).

Note that some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time. As such, the second 'leg' of the SOC detailed in our current consultation with UUK will come into effect from 1 April 2022 if:

- We do not have an executed deed of amendment by 28 February 2022
- There are changes to the JNC recommendation which require increases to the overall first 'leg' contribution rates and there is not sufficient time to consult UUK again on the SOC, RP and SFP

The assurances provided by the dual-rate SOC approach is one of the reasons we are prepared to replace the higher contribution rates that were already due to come in on 1 October 2021 (under the 2018 valuation) six months ahead of the benefit changes being implemented.

Q4. Why is 28 February 2022 so important?

We need a final decision to have been made on benefit change – in the form of an executed deed of amendment – by 28 February 2022 because we need at least a full calendar month to work with employers to implement and communicate any changes.

We also need to allow for the possibility, as set out above, for changes to be made to the JNC recommendation that require increases to the overall first 'leg' contribution rates. Here, we would need sufficient time to consult with UUK again on the SOC, RP and SFP. It is important to note, to this end, that some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time.

Q5. What has been agreed now on covenant support?

We have secured an upfront commitment from employers to provide additional covenant support including a rolling 20-year moratorium on employer exits without the consent of the Trustee (effective from the date of signing the 2020 valuation later this month).

This is vital to the outcome of the 2020 valuation and puts the scheme on a much more sustainable footing.

The first 'leg' of the dual-rate SOC also includes the debt monitoring and *pari passu* arrangements UUK consulted employers on earlier this year, and as set out in a detailed term sheet here.

Subject to our consultation with UUK on the SOC, RP and SFP, and the valuation being signed, these additional covenant support measures are set to be effective as a full package from 1 October 2021.

In the event the JNC's decisions on benefit change are withdrawn and **not replaced** by 28 February 2022, the covenant support is limited to debt monitoring and a much shorter moratorium (lasting until the point at which the next full actuarial valuation is signed, or a replacement moratorium is agreed – whichever comes first).

This is, therefore, akin to Scenario 1 of the Rule 76.1 Report (detailed in our Trustee Update of March 2021). As a result, it involves much higher contributions being phased in and cost-shared between employers and members every six months – from a total contribution rate of 34.7% in April 2022 to 57% by October 2025 – in the absence of subsequent changes to benefits and/or covenant support.

Q6. Have you finalised the Debt Monitoring Framework yet?

To all intents and purposes, yes. UUK consulted employers on the debt monitoring and *pari passu* arrangements earlier this year and we have begun preparing for this with our first data collection exercise which we began in April this year.

The final agreement is set out in a detailed term sheet here.

We are making some adjustments to the framework document to clarify a number of process points in direct response to feedback from employers. We have also taken on board lessons and feedback from the first data collection. However, the framework's scope and the way it will operate is entirely in accordance with the documents linked to above.

Q7. What are the process points you're clarifying in the debt monitoring framework?

The points of clarification are:

- Consistency with the final terms agreed with UUK (set out in a detailed term sheet here): removal of references to 'Scenario 2'; amending the commencement date to 1 October 2021; confirmation that the exemptions available to 'de minimis' employers are extended also to those employers on Limited Participation terms.
- Referencing the employer's right to appeal directly to the Trustee Board and the explanatory documents published on 16 June ('Debt monitoring framework - How we will work with you' and 'Consideration of covenant support measures in future valuations'); wording and tone changes consistent with these documents.
- Additional clarity on the treatment of properties held solely for investment.
- Confirming that employers can choose to use insurance values (subject to audit) in place of book value.

Subject to the consultation with UUK on the SOC, RP and SFP, and its written agreement to the additional covenant support measures, we will finalise the framework and contact the employers we consider to be under the Limited Participation terms exemption.

Q8. What does the second 'leg' of the SOC mean in practice?

The second 'leg' is the pre-agreed 'back-stop' position in the event that:

- We do not have an executed deed of amendment by 28 February 2022
- There are changes to the JNC recommendation which require increases to the overall first 'leg' contribution rates and there is not sufficient time to consult UUK again on the SOC, RP and SFP
    - *Some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time.*

It is effectively a modification of the position set out under Scenario 1 in the 76.1 report (detailed in our Trustee Update of March 2021), but with contributions stepping-up over a four-year period.

As a result, it involves a schedule of total contributions that initially rises to 34.7% in April 2022 but steps up every six months thereafter (per the SOC document), ultimately reaching 57% by October 2025 in the absence of further changes to benefits and/or covenant support.

The assurances provided by the dual-rate SOC approach and the second leg is one of the reasons we are prepared to introduce new contribution rates six months ahead of the benefit reforms being introduced.

Q9. When will the employer-led consultation with affected employees and their representatives take place?

As in previous valuations, we will be helping employers to fulfil their statutory duty to consult with all affected employees (not just existing members of USS) and their representatives on the benefit changes and contribution split proposed by the JNC.

The consultation will need to run for a minimum of 60 days, and we're currently producing the consultation materials – including a modeller.

As well as ensuring these materials are accurate and legally sound, we also need to ensure they are available in a range of accessible formats and languages. This will take some time but we are aiming to be in a position for employers to launch their consultation around the start of November.

Given the seasonal break in December, we expect the consultation to run until mid-January.

Once it has been completed and any feedback or amendments have been considered, we will be able to finalise and implement the agreed benefit changes. We will separately consult employers thereafter on the Statement of Investment Principles.

If there are any subsequent changes to the JNC's original proposals following the consultation, we would need to consider the effect of such changes on the required contributions and may have to consult UUK again on the SOC, RP and SFP.

The effect of any changes would depend on their scale and nature. Some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time.

As set out above, we need a final decision to have been made on benefit change – in the form of an executed deed of amendment – by 28 February 2022 **and** sufficient time (if necessary) to reconsult UUK on the SOC and RP. Otherwise, the second 'leg' of the SOC would come into effect from 1 April 2022.

Q10. What deficit recovery contributions (DRCs) would be required?

The DRCs in the dual-rate SOC for the 2020 valuation differ between the first and second 'legs'. Note that, under both 'legs' (which should supersede the 2018 valuation contribution rates from 1 October), the future service cost of funding the current benefits differs from the 2018 valuation.

From the date at which the 2020 valuation is signed (expected to be later this month) until the dates set out below, no DRCs would be payable (but the Enhanced Opt Out and Voluntary Salary Cap rates applicable from 1 October would be 6.3% - *see Q14, below*).

Under the first 'leg' of the SOC:

- DRCs would commence from 1 April 2022 and include allowance for the fact that, until then, the contributions payable under this leg of the SOC are less than the contributions required to fund the unchanged benefits accruing in that period.
- From 1 April 2022, when the proposed benefit changes are assumed to have been implemented, the DRCs would be equal to 6.3% of salaries and are payable for the length of the recovery plan until 31 March 2038.

Under the second 'leg' of the SOC (absent any subsequent JNC decision on benefit change or covenant support):

- DRCs would commence from 1 October 2022 and include allowance for the fact that, until then, the contributions payable under this leg of the SOC are less than the contributions required to fund the benefits accruing in that period.
- From 1 October 2022, DRCs would commence at 3% and then increase every 6 months until they reach 20% at 1 October 2025. They would remain at this level until 31 July 2032. The higher DRCs and shorter recovery period reflect the lower level of covenant support provided under this 'leg'.

For the accounting year ended 31 July 2021, we believe that the FRS 102 liability should be based on the 2018 SOC. To the extent that the accounts are published after 30 September 2021, we expect there should be disclosure of the post balance sheet date conclusion of the 2020 valuation.

Q11. Why has the recovery plan been extended under the second leg of the SOC compared to Scenario 1 of the Rule 76.1 Report and the Trustee Update published in March?

The position in the Trustee Update (and associated Rule 76.1 Report) was, at that stage in the process, purely a question of the cost of funding a given level of benefits to inform subsequent discussions and decisions. The indicative recovery plans did not, therefore, represent any formal conclusions on affordability.

The Trustee Board has now revisited the recovery plan, based on the decisions the JNC has subsequently made, and considered different approaches to setting the required contribution rate.

Having taken formal advice on affordability specifically in relation to the dual-rate SOC approach, the Board has chosen to phase in the increases required under the second 'leg'. This results in a period of lower contributions while contributions are stepping up. To compensate for this, the 10-year recovery plan corresponding to Scenario 1 in the Rule 76.1 Report (and March Trustee Update) has been changed to a 12.33-year recovery plan.

The alternative options for dealing with this ranged from moving to the full required rate of 57% from April 2022 or, under a shorter recovery plan, scheduling considerably higher contributions in subsequent years to compensate for the delay in moving to the full required rate.

Q12. Why does the second leg of the SOC include contributions that employers say are unaffordable?

The 2020 valuation has found that current benefits are being underfunded and the deficit has increased. This means higher contributions are required in the absence of benefit changes.

Our advisors have told us that affordability varies considerably across the sector and there are some institutions which may find higher contribution rates challenging, particularly over a sustained period of time.

The highest rates under the second 'leg' of the SOC are likely to be challenging for many employers, requiring deeper and more substantial changes. Our advisers have recommended that increases are phased in over time to allow employers the time to make necessary changes to their business models.

We have, accordingly, decided to phase in the increases required under the second 'leg' of the SOC over four years. This also gives the JNC the opportunity to make a decision on benefit changes before contributions get considerably higher.

Q13. Why would the DRCs be lower, at 3%, for the period 1 October 2022 to 31 March 2023 without a benefit change deed?

Per Q10, no DRCs would be paid under the second 'leg' of the SOC until 1 October 2022. The overall contribution rate in this scenario would, in the meantime, go exclusively towards the future service cost.

From October 2022, DRCs would start at 3% and increase every six months thereafter.

Ultimately, this is a matter of balancing the phasing and affordability of the stepped contribution increases required under the second 'leg' of the SOC and recognises that under-funding the future service cost will (all else being equal) only add to the deficit.

Q14. Why is the employer part of the Enhanced Opt Out (EOO) and Voluntary Salary Cap (VSC) rate increasing to 6.3% from 1 October 2021?

The employer element of these rates changes in line with DRCs. That is why it would change to 6% from 1 October 2021 under the SOC for the 2018 valuation.

For the 2020 valuation, we've agreed to introduce new contribution rates six months ahead of the associated benefit changes being agreed and implemented. Among other things, this addresses immediate concerns regarding affordability.

However, it means the future service cost of the current benefits will be higher than the total contributions being paid for a short period of six months. Based on the future service cost rates set out in our Trustee Update of March 2021, this effectively means we are prepared to 'under-fund' current benefits by at least 2.4% of pay per month – and as much as 5.8% – until April 2022.

One consequence of this is that the DRC rate associated with the JNC's proposed benefit changes (under the first leg of the dual-rate SOC) is paid *now* in respect of the EOO and VSC rates. This reflects the appropriate contribution rate outcome for the 2020 valuation where the final implementation of those benefit changes and affordability is not a constraint (see Qs 11 and 12 above).

Q15. In what circumstances would the second leg of the SOC be implemented?

The second 'leg' of the SOC detailed in our current consultation with UUK will come into effect from 1 April 2022 if:

- We do not have an executed deed of amendment by 28 February 2022
- There are changes to the JNC recommendation which require increases to the overall first 'leg' contribution rates and there is not sufficient time to consult UUK again on the SOC, RP and SFP
    - *Some changes could be implemented more easily and more quickly than others. Other changes would require reconsidering certain aspects of the valuation and would take more time.*

Contributions would initially rise to 34.7% in April 2022 but, in the absence of any subsequent changes to benefits or covenant support, would step up every six months thereafter (per the SOC document), ultimately reaching 57% by October 2025.

Q16. Why does the Trustee consider it is acceptable not to introduce the 1 October 2021 increases in full, as scheduled under the 2018 valuation, given current benefits are being underfunded?

We are only prepared to introduce the new contribution rates in October 2021, six months ahead of the benefit reforms being introduced, because:

- JNC decisions on benefit change have now been made under Rule 64.10 in response to the Rule 76.4 determination (the cost of the current benefits) and the 20-year rolling moratorium;
- JNC decisions have also been made regarding a moratorium commitment and cost-sharing on the second 'leg' of the dual-rate SOC (detailed in our consultation with UUK) which ensures the rising cost of funding the current benefits will be addressed in any event.
- We have secured upfront commitments from employers on additional covenant support – most notably the rolling 20-year moratorium on employer exits without the consent of the Trustee (effective from the date of signing the 2020 valuation later this month) and debt monitoring and *pari passu* arrangements (effective from the 1 October 2021)