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Your ref
Our ref CY/DH
Date 25 October 2023

By email : Vivienne.Stern@universitiesuk.ac.uk

Dear Vivienne

Conclusion of the consultation with Universities UK on the Technical Provisions and Statement of Funding Principles for the 2023 Valuation

Thank you for your letter dated 29 September 2023, setting out the response to the Trustee's consultation with UUK on the methodology and assumptions for the Technical Provisions and the Statement of Funding Principles for the 2023 actuarial valuation ("the TP Consultation"). Thank you also for the constructive dialogue our teams have had throughout the 2023 valuation process, and the wide engagement among the employer group.

We are pleased to receive UUK's support for our consultation proposals, which allows us now to conclude the TP Consultation process. We have also given careful consideration to your detailed feedback on those matters that were within the scope of the consultation, together with the comments you have provided on other matters related to the valuation.

In this letter we confirm the outcome of the TP Consultation, and we address the points raised in your feedback.

We also set out the next steps in the valuation process, recognising the further progress that the stakeholders have made in reaching agreement on the benefit and contribution decisions arising from the valuation, as set out in the joint statement from UUK and UCU dated 5 October 2023. We note that those decisions remain subject to statutory consultation, and indeed to UUK's and UCU's own consultation with their constituents.

This letter will be published on the 2023 valuation pages of the uss.co.uk website.

Outcome of TP Consultation

We requested feedback on the following core elements of our proposals, on which consultation with UUK is required under the Scheme Rules and the Pensions Act 2004 before any decision can be taken by the Trustee:

1. Proposed discount rates, both for the purposes of valuing Technical Provisions and determining future service contributions.
2. Remaining proposed assumptions set out in the Statement of Funding Principles (covering inflation, mortality, and the other demographic assumptions).
3. Any other aspect of the assumptions and methodology underlying the Technical Provisions.
4. Any other matter included in the Statement of Funding Principles.

In light of the support provided for our TP Consultation proposals, we can now confirm that we will adopt those proposals for the next stages of the valuation process, as set out later in this letter.

As a reminder, this leads to the following key results for the 2023 actuarial valuation:

Past service funding position	**Results as at 31 March 2023 (£bn)**
Value of Scheme Assets	73.1
Technical Provisions	65.7
Surplus	7.4

Future service benefit basis	**Aggregate contribution requirement (% of salary)**
Current benefits	16.2
Pre-April 2022 benefits	20.6

Request for formal pricing of pre-April 2022 benefits

As requested, we have included, in the covering letter to the JNC and the accompanying Rule 76.1 report, details of the aggregate contribution requirements in respect of pre-April 2022 benefits, calculated on the basis of the assumptions and methodology decided by the Trustee following the TP Consultation. We note that the proposed introduction of those benefits from 1 April 2024 is currently the subject of a statutory consultation process, led by employers, with affected employees and their representatives, due to close on 24 November ("the Member Consultation"). Furthermore, UUK and UCU have also been carrying out their own internal consultations.

Having considered advice from the Scheme Actuary and taken into account UUK's response to the TP Consultation (amongst other factors), no further reduction to the required contribution rate has been made on account of the surplus.

Pricing of pre-April 2022 benefits is expected to be formally confirmed when the Trustee comes to consider, at its 10 November Board meeting, the JNC decisions and recommendations emerging from its 30 October meeting.

Expedited timeline to achieve an earlier change to contribution rates

The date originally targeted under the accelerated valuation timeline for implementation of changes to benefits and contributions was 1 April 2024. We note that stakeholders' progress is currently ahead of schedule in reaching agreement on benefits and contributions and we are supporting their efforts to further expedite the valuation timeline.

In particular, we understand that the stakeholders are now targeting the JNC meeting on 30 October to table the following decisions under the cost-share process (Rule 64.10), on which UUK and UCU have been consulting their respective memberships:

- Reintroduction of pre-April 2022 benefits for future service from 1 April 2024 (subject to the outcome of the Member Consultation exercise which is currently underway).

- On that basis, the aggregate contribution rate for pre-April 2022 benefits of 20.6% of pay would be allocated 6.1% from members and 14.5% from employers (applying the same proportions as per the default cost-sharing provisions under the Scheme rules), recommended to be brought into effect from 1 January 2024.

In addition, as part of the JNC's response to the funding position identified in the Rule 76.1 Report, we understand the following proposed amendments will be tabled:

- A past service benefit uplift awarded on and from 1 April 2024 to all members who were in active service at any point during the preceding two years. This comprises a pension uplift of £215 p.a. and a lump sum uplift of £645 granted to non-retired members, with an additional £26 p.a. pension for pensioners in lieu of the lump sum uplift.

We are working closely with the stakeholders to plan the steps necessary to achieve this expedited timeline and have shared a proposed plan with the JNC.

Further engagement around Covenant Support Measures

We are keen to work constructively with employers to further embed the covenant support measures agreed as part of the 2020 valuation and ensure that the Scheme and its sponsors continue to benefit from having these important measures in place.

We have reflected on your comments in relation to covenant support and welcome further engagement on this, including participating in an employer working group and building our direct engagement with the finance director community.

We believe such engagement would also provide an opportunity to consider the review of the effectiveness of the covenant support measures that USS committed to undertake at the time of their adoption in 2021, work on which is already underway.

We look forward to working with your team to take this forward in due course.

<u>Feedback on consultation points</u>

Taking your feedback on each of the consultation elements in turn, we would make the following remarks, noting that some of these points will be discussed further in due course.

1. ***Proposed discount rates***

   We're pleased to note your collective support for the proposed discount rates.

   We understand, however, the concern from a minority of employers about the perceived influence of gilt yields in the way we set the discount rate assumption. For the purposes of clarification, the current valuation basis is set using an 'asset-based' discount rate approach which is then expressed – in line with normal convention – relative to prevailing gilt yields.

   Accordingly, the approach we adopt, as detailed in the TP Consultation documentation, starts from the expected investment return on the assets we hold and expect to hold in the future. The pre-retirement and post-retirement discount rates we select then include a margin for prudence from our best estimate of expected future investment returns.

   Furthermore, given that the assumed Valuation Investment Strategy includes exposure to gilt investments, it is not unexpected that the triennial calculation of Technical Provisions and future contribution requirements shows some sensitivity to movements in gilt yields, especially in a period where there has been such a significant move in yields.

We also think it's important to note that contribution rates would tend to be changed only following a formal valuation exercise, which is carried out every three years. In contrast, the quarterly monitoring reports we publish in between valuations are produced mechanistically and track the funding position in an approximate way; they are intended to give an early signal to the Trustee to check the ongoing adequacy of the funding plan, rather than having a direct and immediate impact on actual contribution rates.

Nevertheless, we are open to further discussions on this topic – building on the extensive engagement that has already taken place through the 2020 valuation and the Valuation Technical Forum for the 2023 valuation. We suggest this is picked up as part of the Stability Working Group discussions, consistent with the agreed Terms of Reference for that group. Through that forum we are also exploring the flexibility which currently exists in our valuation approach through our Integrated Risk Management Framework (IRMF).

2. ***Remaining proposed assumptions set out in the Statement of Funding Principles***

We're pleased to have your collective support for the other proposed assumptions, noting the following specific points raised.

Impact of high short-term inflation

We are happy to follow up on the request to explain more fully the potential impact of higher short-term inflation. We propose to carry out a short piece of modelling work to look at this and will publish a summary on our website illustrating the approximate impact on contribution requirements and the net funding position.

Allowance for future longevity improvements

The Scheme Actuary's review of the assumption for life expectancy at this valuation included taking into account the specific characteristics of the Scheme's membership. We expect that could explain the difference identified by your actuarial advisers to the assumptions adopted for some other schemes. It is the Trustee's intention that this assumption will be reviewed at the next valuation, again based on the mortality characteristics of the Scheme's membership as well as other relevant data, which is in line with your adviser's suggestion.

3. ***Any other aspect of the assumptions and methodology underlying the Technical Provisions***

Further consideration of the self-sufficiency measure of liabilities

We continue to monitor closely emerging developments in regulation, as we anticipate the introduction of a new DB funding regime. We would be happy to engage further on these aspects through discussions within the Stability Working Group, in the first instance. We recognise that the definition of self-sufficiency and its use in our IRMF remains of particular interest to stakeholders.

It may be helpful for us to clarify the high-level principles of our IRMF. The self-sufficiency basis is only one part of the overall framework and is a way of measuring and monitoring reliance on the employer group, and a signal for action or review if our reliance exceeds the Trustee's assessment of employers' capacity to take risk.

4. ***Any other matter included in the Statement of Funding Principles***

Allowance for Scheme expenses

In response to enquiries, we have prepared an explanatory note (annexed) detailing the reasons for the increase in the rate of contribution payable towards Scheme expenses. This note will shortly be published on our website.

In brief, the main contributing factors are:

i. The total number of members has grown significantly more quickly than the number of active members on which the expense allowance is calculated; and

ii. The cost of administering the Scheme has fundamentally increased since the current allowance was set in 2011. This is a result of the introduction of the hybrid benefit structure, the increase in regulatory complexity, additions to our member service offerings, and an increase in the costs associated with actuarial valuation exercises.

Covenant Support Measures and engagement with employers

We propose to address the specific points raised in relation to the covenant support measures when we take part in the further engagement with employers highlighted earlier.

5. ***Overall assessment of employer covenant***

We note your agreement to our assessment of covenant strength and that there were no comments on the approach to, and specific assessment of, Affordable Risk Capacity.

6. ***Investment strategy review***

We are very keen to hear views on investment strategy from the sector and, as we embark on our review of the Valuation Investment Strategy (VIS) for the 2023 valuation, we have developed a programme of engagement comprising three phases:

i. November-December 2023. A series of 1:1 meetings with a variety of institutions as well as wider engagement with the sector including through UUK's Employer Pension Forum.

ii. January-February 2024. Further 1:1 meetings with institutions and with the Employer Investment Discussion Forum (as well as other sector groups), and webinars that all employers can participate in. In these sessions we expect to focus in on the finer details of specific potential investment strategies as we work towards the 2023 VIS.

iii. April-May 2024. Formal consultation with employers on the Statement of Investment Principles (SIP).

We will also be exploring the interaction between investment strategy and future stability with the Stability Working Group.

We note the concern raised by some employers about the outcome of the TP Consultation potentially constraining the review of investment strategy. While the 2023 VIS will need to be compatible with the discount rates we have selected, in practice we believe the assumptions we have adopted will allow a suitable range of investment strategies to be considered.

7. ***Balance and trade-offs between investment risk, prudence and stability***

   We note that employers are generally content with the overall balance at this valuation and of course are pleased that the "no surprises" approach and collaborative spirit in which this valuation has been conducted has been so productive. I am confident that this approach will serve us well as we turn to investment risk and the review of the VIS.

<u>Related workstreams</u>

Thank you for confirming employers' support for prioritising further work on the following workstreams, following conclusion of the substantive decisions in relation to the 2023 valuation:

1. Conditional Indexation.
2. Governance review.
3. Introduction of lower cost and flexible savings options.
4. Exploring measures to improve stability.

We look forward to working with you to progress and support these workstreams in due course.

<u>The next stages of the 2023 valuation</u>

To support the stakeholders' expedited timetable, we are planning for the following steps to be completed over the next couple of months. A proposed implementation timetable has also been shared with the JNC.

Workstream	**Commentary**
Rule 76.1 Report and contribution Determination Notice	We issued the Scheme Actuary's Rule 76.1 report and the Trustee's contribution Determination Notice to the JNC on 23 October. At the 30 October JNC meeting, we understand that the JNC is planning to consider decisions on the following points before making recommendations to the Trustee: - changes to future service benefits from 1 April 2024 - the contribution split between members and employers - early implementation of the contribution reductions - one-off pension and lump sum uplift - DC allocation into Investment Builder We have scheduled a Trustee board meeting on 10 November to consider any decisions and recommendations of the JNC.
Trustee consultation with UUK on new Schedule of Contributions to be agreed as part of the 2023 valuation	Before bringing the new contribution rates into force, we are required to consult on a new Schedule of Contributions (SoC) and complete the necessary Pensions Act 2004 documents. Subject to the outcome of the JNC decision-making process, we therefore plan to approve at the 10 November Trustee meeting a draft SoC for consultation with UUK over a two-week period during the second half of November. (This timetable would then allow, if agreed, an earlier reduction in contributions from 1 January 2024.)

Member Consultation on future service benefit changes	The Member Consultation process is currently underway, and the consultation period ends on 24 November. Following due consideration of employee feedback, the Trustee will determine at its meeting on 7 December whether it wishes to make any recommendations to the JNC. The JNC will then review the report from the Trustee at its meeting on 18 December and consider whether it wishes to propose any amendments.
Finalisation of valuation documentation	We have targeted the Trustee meeting on 19 December to approve sign-off of the 2023 valuation and finalisation of the Statement of Funding Principles, Schedule of Contributions and the associated actuarial certifications. This would be followed by submission of the valuation results to the Pensions Regulator.
Implementation of new benefits and contribution rates	Subject to completion of the above steps and operational readiness of the Trustee, we envisage the pre-April 2022 benefits being reintroduced for service from 1 April 2024, with past service benefit uplifts awarded at the same date, and with the lower rate of employer and member contributions being brought in from the earlier date of 1 January 2024.

We look forward to continuing to work with you towards the swift conclusion of the 2023 valuation. Please get in touch with me or other members of the USS valuation team if you have further questions.

Yours sincerely

Carol Young
Group Chief Executive Officer

cc: Jo Grady, UCU
Margaret Monckton, UUK
Sharon Moore, UUK

24 October 2023

USS briefing: The scheme administration cost allowance

Part of the overall contribution rate required to fund USS benefits is an allowance for the costs of administering the scheme. This allowance was set at 0.4% of active members' pensionable payroll during the 2011 valuation and has not changed since. However, as laid out below, various factors have increased the costs of administering the scheme.

In its consultation with Universities UK (UUK) on the proposed Technical Provisions for the 2023 valuation, the Trustee reflected this by proposing to increase the allowance by 10 basis points to 0.5%. This avoids any excess of pension administration costs being drawn from the fund rather than being funded by current contributions.

Why is the allowance being increased?

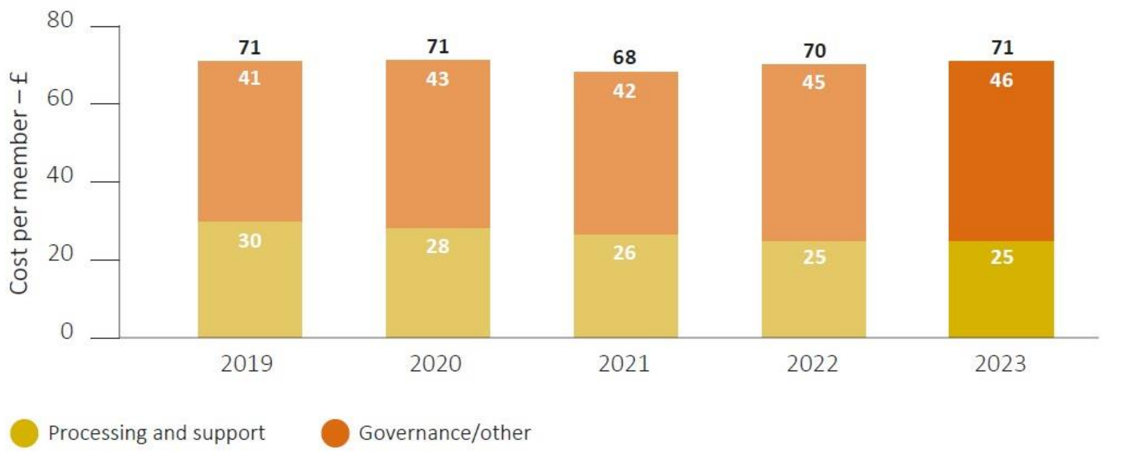
A lot has changed since 2011. The scheme is more complex, regulation has become more onerous, and the make-up of its membership has evolved with active member numbers growing more slowly than total scheme membership (i.e., also including deferred and pensioner members).

In terms of **complexity**, the most significant change came in 2016 when USS became a hybrid scheme – offering both DB *and* DC. All members of USS are part of the scheme's DB section. At 31 March 2023, around 168,000 members also had DC pots with USS. As well as introducing additional administrative, legal and compliance demands, this change has also introduced additional regulatory requirements which, since becoming an authorised Master Trust in May 2019, have become more complex.

Members with DC pots also have more decisions to make on their journey to and through retirement, so we have also invested in our support services, our online offering, and our Member Insight and Product Development teams.

The costs of carrying out the scheme's actuarial valuations, including supporting various technical discussion forums and commissioning bespoke analysis to support other stakeholder initiatives, have also increased. The table below shows that, despite the factors noted above and the impact of inflation, administration costs per member have not increased over the last five years.

Pension administration cost per member*



**The above ratios are shown following CEM Benchmarking adjustments to make them comparable across benchmarked schemes.*

The allowance grows as active members grow but overall membership has grown much more than active membership. While the number of active members has increased by 60%, the number of non-actives (deferred and pensioner members) has increased by more than 120% over that time period. (Total member numbers are up to 528,000, of whom 305,000 are non-active members, up from a total membership of 278,000 in 2011.)

As the 0.4% of pensionable payroll allowance only relates to contributions coming into the scheme relating to *active* members, the allowance no longer covers costs relating to the increased proportion of non-active members.

What are the impacts on contributions payable and on scheme costs?

In their response to the Technical Provisions consultation for the 2023 valuation, UUK estimate that the impact of the change would be to increase contributions payable towards scheme administration expenses by £15.8m per year in 2023 compared to 2020. This estimate includes salary inflation and active member growth over the three years; the increase on a like-for-like 2023 basis is c£10m.

The change will have no impact on the total costs that are being incurred and recovered from the fund. Rather, the change to the allowance aims to ensure all administration costs are funded by current contributions rather than having any excess over the allowance being recovered from the fund.

Are your costs under control?

We demonstrate above that pension administration costs per member have not increased over the last five years and it is central to our role in managing the scheme that we keep tight control of costs as every penny we spend is drawn from the fund we are working hard to build to pay members' benefits.

Looking more widely at the scheme's overall cost management and value for money performance, we appoint CEM Benchmarking to review our performance against comparable schemes each year.

The administration costs referred to above form a relatively small part of the overall costs of running the scheme – the table below taken from the scheme's annual report and accounts lays out a high-level breakdown of those costs for the last two years. Further information on scheme costs and performance is available in the annual report and accounts webpage.

Reported scheme costs

	Pension management		Investment management		Total	
Costs £m	2023	2022	2023	2022	2023	2022
Reported scheme expenses before pension deficit provision charges	**43**	**42**	**126**	**121**	**169**	**163**
Pension deficit provision (credit)/charge	(1)	6	(1)	25	(2)	31
Reported scheme expenses	**42**	**48**	**125**	**146**	**167**	**194**
Embedded investment management costs	–	–	92	91	92	91
Total costs of running the scheme	**42**	**48**	**217**	**237**	**259**	**285**

The total running costs have been independently assessed by CEM Benchmarking as being £117m a year (32%) less expensive than the median cost of peer schemes.

Nonetheless value for money assessment also needs to factor in:

- the benefits that are being delivered and the investments that will fund them,
- the quality of services we provide to members and sponsoring employers; and
- how we balance the costs of running the scheme with achieving good outcomes

Delivering value for money is a key focus and our performance in this area is reviewed in depth by the Trustee Board on an annual basis taking into account both our relative cost performance and the services that the scheme delivers. We lay out how we assess value for money and our recent performance on our Value for Money webpage.