Universities UK

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Dear Carol

The USS Trustee's consultation on the proposed methodology and assumptions for the scheme's Technical Provisions and the Statement of Funding Principles for the 31 March 2023 actuarial valuation

Thank you for the USS Trustee's consultation on the proposed methodology and assumptions for the scheme's Technical Provisions and the Statement of Funding Principles for the 31 March 2023 actuarial valuation, set out in a document dated 19 July 2023 published to Universities UK (UUK) and to all of the scheme's participating employers. The supporting information, and the engagement with employers such as the two webinar events, have been well-received and appreciated.

This is the first of the formal consultations on the valuation which are required by law. UUK's role is to represent (as the scheme's employer representative body) the view of employers on the matters proposed by the USS Trustee. This consultation concerns the method and assumptions that are proposed to be used in calculating the scheme's Technical Provisions (TPs) and on related aspects of scheme funding, and also on the matter of the proposed Statement of Funding Principles (SFP) for the 2023 valuation.

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Our consultation with USS employers

UUK has received responses from 83 employers which together represent approximately 93% of the active membership of the scheme. We would like to thank employers who have responded in such numbers, and so fully, to the consultation material. These employer responses have been used to form UUK's views, which are set out in detail in the annex to this letter.

Summary of key points

Employers welcome the fact that the scheme is in a much stronger financial position than at previous valuations, largely due to wider economic conditions. The scale of the transformation in the financial position is extraordinary, and employers have expressed some concern at the speed of change and the exposure to a further reversal in the scheme's financial health. The data you have provided to employers has been helpful in respect of the likelihood of contribution increases at the next and subsequent valuation. Our general sense is that employers wish to be cautious and proportionate in making responses to this improved position and, not surprisingly, they identify improved stability as a cornerstone for the other decisions to be taken in concluding the valuation.

In relation to the specific consultation on the TPs, employers expressed near unanimous support for finalising the valuation in line with the approach and assumptions proposed by the USS Trustee. It is important to employers that this is done according to the accelerated timeline in order to deliver the earliest conclusion of the 2023 valuation.

UUK has also used this consultation opportunity to seek views and comments from employers on the broader strategic outcomes desired at this valuation. On these, whilst not unanimous, the vast majority of respondents have expressed support for the approach set out in the joint UCU/UUK statements which (amongst other things) commit both sides to pursuing an outcome which is demonstrably sustainable, and which would improve benefits to pre-April 2022 levels from April 2024, alongside lower contributions for members and employers (with the reduction cost-shared 35:65 between members and employers respectively, reflecting the scheme's cost-share provision). **As part of compiling the rule 76.1 report for the Joint Negotiating Committee's (JNC's) consideration, we request the USS Trustee includes the formal pricing of pre-April 2022 benefits, in line with the request of the JNC in March 2023.**

We would like to extend our thanks to you and the USS team for preparing the materials and infrastructure for employers to deliver the consultation on proposed changes with affected employees and representative bodies, which has commenced as planned and which can therefore conclude in sufficient time to enable the JNC to make formal decisions on future benefits and contributions by December 2023.

Employers have repeatedly emphasised their desire to secure longer term stability in the scheme. They recognise the importance of retaining the surplus for stability of future contributions, as demonstrated in the projections carried out by the USS Trustee's investment adviser and referenced in the note dated 15 August 2023 from the Pensions Regulator (section 6). Based on the indicative pricing, which suggests that a material reduction in contributions to 20.6% of salary is possible at this valuation, alongside an improvement in future benefits to the pre-April 2022 level from April 2024, the clear preference of employers is to retain the indicative surplus for stability and not seek to reduce contributions further.

We note that respondents are particularly mindful that members and employers are currently overpaying contributions, based on the indicative contribution requirements compared to those required for the 2020 valuation. One element of this is the current Deficit Recovery Contribution (DRC) of 6.2% of salary, which is unnecessary given that a considerable TPs surplus is expected. Acknowledging the current cost-of-living challenges faced by members, and the significant financial pressures faced by many scheme employers, respondents stress the importance of reducing contributions to the level required as soon as possible, or at the very least removing the DRC element as an interim position. We are ready to support the USS Trustee with a high priority consultation with employers on a new/revised Schedule of Contributions, with an expedited timeline, in order to facilitate an earlier change to member and employer contribution rates.

Further specific points raised by employers

There were a number of individual points raised by employers which were either not captured directly in the eight-question structure that was helpfully proposed by the USS Trustee, or which deserve additional discussion and/or emphasis. One such point relates to covenant and the support measures, which I summarise below. We would like to propose further discussion on these points and my colleague Sharon Moore will be in touch to arrange this.

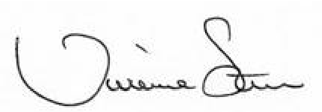
On the covenant, employers have recognised the continued importance of the enhanced support measures that were introduced as part of the 2020 valuation as a necessary long-term foundation for the scheme, but have again raised concerns about the broader impact and application of specific elements. We believe there are improvements, or refinements, to elements of the debt monitoring framework which might be considered, and that this could provide more reasonable arrangements based on the experience of recent years without changing the substantive nature of the measures. We would be pleased to discuss these with you further, with a view to establishing an employer working group to discuss the issues with the USS Trustee and its advisers.

Employers expressed continued support for prioritising joint work on the three workstreams which emerged from the 2020 valuation, following the conclusion of the substantive decisions in relation to the 2023 valuation. We hope we can therefore continue to progress the conditional indexation project, the governance review, and the consideration of lower cost and flexible pension saving options in the near future. We are also committed to continuing our discussions in the Stability Working Group, alongside UCU colleagues, to build our joint understanding of the stability data; the future outcomes which can be modelled; and options and specific mechanisms which might be implemented to achieve greater financial resilience. We hope we can rely on the continued support and engagement of USS colleagues with each of these initiatives.

I have included, as annexes to this letter, the UUK *Briefing Paper for Employers* and the supporting Aon advice note dated 26 July 2023, which were shared with employers to assist their responses. I trust that these will help the USS Trustee in considering our response.

We look forward to receiving the USS Trustee's determination of the contribution rates required for the current benefits (as the formal default) and for returning to pre-April 2022 benefits from April 2024, and subsequently working together to conclude the 2023 valuation processes.

Yours sincerely,



Vivienne Stern
Chief Executive

Annexes:

- *Headline views from UUK, informed by employer responses, to each of the questions posed by the USS Trustee in its TPs consultation*
- *UUK Briefing Paper for Employers*
- *USS Technical Provisions consultation – Aon comments*

Headline views from UUK, informed by employer responses, to each of the questions posed by the USS Trustee in its TPs consultation

Set out below are responses to the eight questions put forward by the USS Trustee in its technical provisions consultation; these responses have been prepared by Universities UK having reviewed and analysed the 83 individual responses provided by scheme employers.

(1) Proposed discount rates, both for the purposes of valuing Technical Provisions and determining future service contributions

There is collective support for the proposed discount rates, with employers welcoming the consistency of the approach and structure adopted by the USS Trustee which is starting to build from one valuation to another.

A significant minority of employers expressed concern over the apparent dominance of gilt yields in the USS Trustee's setting of discount rates, noting that this makes the scheme more susceptible to future changes in its financial position if future gilt yields vary. We would like to request further engagement with employers on this topic, and clarity on how the USS Trustee intends to recognise and manage the effect of changes in gilt yields going forwards.

(2) Remaining proposed assumptions set out in the Statement of Funding Principles (covering inflation, mortality, and the other demographic assumptions)

There is general support for the additional assumptions set out in the statement of funding principles.

On the proposed inflation assumption of 3% per annum, a number of employers recognised that this was low in current terms although more consistent with long-term expectations, and it would be helpful for the USS Trustee to explain more fully what the potential impact of higher short-term inflation might be and how its impact will be managed.

On the mortality assumptions, we noted that the full advice from the scheme actuary was not available at the launch of the consultation. Aon has since reviewed the additional information on the mortality and other demographic assumptions, supplied by the USS Trustee on 16 August 2023, and is broadly comfortable with the recommendations. Aon does note that the allowance for future improvements in longevity remains on the high-side compared with other UK occupational schemes and, while this was evidence-backed when put in place, they suggest that this is considered further at the next valuation in light of USS data.

(3) Any other aspect of the assumptions and methodology underlying the Technical Provisions

Employers would like to see further engagement from the USS Trustee on the approach adopted with its self-sufficiency measure, and the assumptions which underpin it. There is little direct impact at this valuation from the self-sufficiency assumption, given the improved funding position, but it could feature more prominently at future valuations and therefore some form of further engagement following this 2023 valuation, and potentially a review, would be welcomed by employers. We recognise that low-risk measures such as this will feature in the new DB funding code, and believe this makes it even more important that we discuss the approach and, for example, avoid any sense that self-sufficiency would be carried over to the new DB regime without first undertaking a more detailed discussion and review with employers and other stakeholders.

(4) Any other matter included in the Statement of Funding Principles. Whether employers are willing to agree to debt monitoring and pari passu arrangements and the long-term rule change required to support a strong covenant

A significant minority of employers have queried the proposed increase in the rate of contribution payable towards scheme expenses and would like further explanation. It will be important for UUK and employers to see a stronger justification for the proposed increase and for it to have collective backing, especially given the magnitude of this increase in monetary terms (an indicative £15.8m per annum between the 2020 and 2023 valuations). UUK has referred to some additional information which we believe would help employers in the UUK Briefing Paper dated 26 July 2023, although you may have other more helpful details.

In relation to the covenant support measures, employers recognise the value gained by them although there are continuing concerns regarding the pari-passu measure in particular. Employers also raise questions about the metrics which are being operated, and requested clarification of the USS Trustee's approach.

We welcome the fact that the USS Trustee's engagement with individual employers has extended and improved in recent times. However, employers would like to see this develop further, so that you can listen to their views and respond with your own updates, plans and reassurances. We think this might usefully be done in a small-group setting which we would be willing to establish and support. We believe it will be particularly important to engage with the finance director community, and whilst we believe there is continued support for the measures overall from employers, there is work to do to engage and we hope make refinements and improvements to the framework and to its practical application.

(5) The Trustee's overall assessment of employer covenant, including assumptions made about the level of financial support employers are collectively able and willing to give the Scheme and their Affordable Risk Capacity

There is widespread agreement with the USS Trustee's assessment of the employer covenant as strong, and the collective ability of employers to support the scheme over the long-term. Clearly the position is not uniform across all of the scheme's employers. Employers regard it as helpful that the USS Trustee, in its outlook for the sector at section 6.5 of the consultation document, recognised the risk to individual institutions' financial position which, if realised, could potentially have a detrimental impact on the overall covenant, although this is something you might continue to emphasise. We have no comments on the approach to, and specific assessment of, affordable risk capacity.

(6) The assumed Valuation Investment Strategy (VIS) and strategic mix of return-seeking assets and matching assets

(Note that more extensive engagement with employers on the investment strategy will take place in the later stages of the valuation process.)

There is strong support for the planned review of investment strategy, although it is clear that the USS Trustee will need to think very carefully about when and how this engagement takes place. It is clear from responses that employers will be giving this a high-level of priority, and it will be important to create sufficient time for the review and indeed that specific briefing and support will be needed to ensure that employers can readily engage with the details and complexities. We would like to work with you to find the best approach to the investment strategy discussions so as to maximise engagement.

We should also mention that some employers have raised concerns about the sequencing of the technical provisions consultation and the risk that it might constrain the planned review of scheme investments and the statement of investment principles (SIP). While we recognise that the sequencing is part of the expedited valuation process overall, we would welcome a discussion to see if we can assist in allaying any concerns and/or in deciding on the approach and timing of the SIP review.

(7) The balance and trade-offs between investment risk, the degree of prudence and stability (of benefits, contributions, and funding levels), both at this valuation and looking ahead

It appears that employers are generally content with the overall balance for this valuation, which does suggest that the preparatory work undertaken by the USS Trustee, the explanations in the quarterly monitoring updates, and the 'no-surprises' approach to the 2023 valuation and engagement on it, have been fruitful. However, several employers expressed concern that we have seen a more than £20bn swing in the past service funding position, which does suggest that the issue of investment risk does need to be further considered. The forthcoming review of investment strategy and of the SIP will be timely and welcomed by employers.

(8) Any other aspect of this consultation

We have no further comments.