A discussion on the future of USS

The USS Trustee announced in November that they would commence a new valuation of the scheme in order to properly consider feedback from USS employers following the stakeholder panel's recent review of the 2017 valuation.

Wednesday (2 January 2019) marked the start of a consultation with Universities UK (UUK), which acts on behalf of the employers, on the proposed Technical Provisions for the 2018 valuation.

The accompanying report sets out the financial risks faced by the scheme and proposes ways in which an increase in risk could be supported by contingent measures. In order to reduce the regular payroll contributions deemed to be required of members and employers as a result of the 2017 valuation.

Under the 2017 valuation, your employer's contribution towards 'the match' will end, and total contributions will increase in three phases, between 1 April 2019 and 1 April 2020, from 26% today (8% members, 18% employers) to 36.6% (11.7% members, 24.9% employers). Find out more about how these changes will affect you.

The required contribution rate that will emerge from the 2018 valuation will depend upon how much more optimistic the scheme's assumptions can be about the future returns from its investments, and how any more optimistic assumptions can be tangibly supported by the scheme's sponsors.

Our report to UUK sets out the most important considerations of the Trustee in this regard, and reflects our primary duty: to ensure the defined pension benefits offered to members are secure and can be paid when due.

Defined benefit pensions promise a set level of benefits in retirement and so the funding arrangements and investments that will create the future pension payments must be secure in order to ensure that these can be reliably paid when they are due.

As was the case with the 2017 valuation, the most material issue we must face is the increased cost of the assets in which we can invest your contributions today in order to fund a set level of benefits in future. It is the Trustee’s view that today’s higher prices are likely to lead to a lower level of returns from these assets.

The Trustee is consulting with UUK on - among other things - ways in which contributions might automatically increase, if investment returns in the short term prove less than sufficient to close the current gap between the scheme’s assets and the estimated cost of providing pensions already promised by the scheme.

We will be consulting UUK - who will in turn engage with the scheme's employers - on these issues until 15 March 2019.

Thereafter, we will finalise the contribution rate required - and the Joint Negotiating Committee will be asked how it wants to respond to any conclusions. We will continue to keep you updated as things progress.

Please note: Our consultation is with UUK, as the body which formally represents employers in the scheme rules. If you have any questions or comments about the consultation, we ask that you raise them with your employer in the first instance to ensure they are captured as part of the overall process. We have provided some initial FAQs below, and there is a wide range of material on our website relating to the 2017 valuation, which may also be of use. You can also submit questions about the valuation using the Contact Us form.

FAQs

Why is USS carrying out another valuation?

You may have read about alternative funding proposals that have been put forward by a panel assembled by UCU and UUK which could result in lower contributions than those required by the Trustee under the 2017 valuation.

The panel's proposals would require employers to take on greater risk, and both members and employers to pay higher contributions, than USS was advised they were originally willing to support.

UUK recently consulted employers on the stakeholder panel's proposals and subsequently announced that employers are willing to support them, subject to the Trustee providing more information on the additional financial risks involved - and if and how they could be managed, and mitigated.

To make sure the implications of this development are considered in line with the laws governing pension schemes, USS is carrying out a new valuation of the scheme's funding position - as at 31 March 2018.

See: Concluding the 2017 valuation

Does that mean cost-sharing is cancelled?

No. The 2017 valuation is now more than six months overdue, and the Trustee has a legal obligation to complete it and implement cost-sharing, beginning in April 2019.

We hope the 2018 valuation will result in an alternative way forward being agreed by the Joint Negotiating Committee before the significantly higher cost-sharing increases are planned to come into effect from 1 October 2019 onwards.

However, given the timescales of the processes involved, we can’t now avoid the proposed April 2019 contribution increase.

See: Changes to USS that will affect you

Why can't USS apply the Joint Expert Panel's recommendations to the 2017 valuation instead, and avoid the cost-sharing increases?

The 2017 valuation is now more than six months overdue, and the Trustee has a legal obligation to complete it and implement cost-sharing.

As such, the Trustee could only revisit such fundamental issues as market risks, investment strategies and contribution levels by holding a new valuation, as at 31 March 2018, with an accompanying Technical Provisions consultation.

This is the only way material changes in the positions stated to date (through the 2017 valuation) could be addressed properly and in time to avoid the full extent of the cost sharing.
In addition, only a new valuation would allow a sufficiently robust, informed position to be developed, and the latest data and market experience to be properly incorporated.

**Does USS accept all of the JEP recommendations?**

Each of the panel’s recommendations is worthy of consideration in isolation, but each one introduces varying degrees of additional risk.

The panel’s report did not explicitly consider or quantify the additional financial risks involved in adopting its proposals - either in isolation or in aggregate - and this is something employers, via UUK, have since asked us to assess and address.

The potential consequences of taking greater risk must be quantified, and credible options for managing material downsides must be available: the Trustee has a legal, regulatory and fiduciary duty to ensure that the pensions promised to members are secure and can be paid when due, and that the scheme is sustainable into the future.

The Trustee has now assessed the risks involved with each element, as well as in aggregate, and has set out the overall level of financial risk it is prepared to contemplate taking (based upon the collective strength of the employers which support the scheme and in ensuring that members’ benefits are properly funded).

The panel’s report did recognise that there were a number of different paths that the Trustee could adopt which would have the effect of reducing the required contribution rate* - and the Trustee has set out a path that can achieve this, the risks involved, and the financial commitments it would need in order to do so. It is now formally consulting UUK (on behalf of employers) on its position.

*JEP report, page 63

**Is USS reviewing its methodology for the 2018 valuation, given the comments made about it in the JEP report?**

It is important to note that, while it passed high level comment on the methodology, the panel did not recommend any specific changes to it.

Its recommendations are based on how different underlying assumptions could be applied to achieve a different outcome in terms of the contributions required of members and employers.

The panel’s report also recognised that there were a number of different paths that the Trustee could adopt to reduce the required contribution rate.

The new valuation - incorporating an assessment of the panel’s proposals - gives our stakeholders the opportunity to revisit key issues in time to achieve an alternative way forward before the significantly higher cost-sharing increases come into effect from 1 October 2020 onwards.

Avoiding the October cost-sharing increases would not be possible if we were to wait for the panel to complete its second proposed phase of work - which we understand will consider matters such as methodology - and for any recommendations arising from it to be considered by the scheme’s stakeholders or, in turn, the Trustee.

In the meantime, members can be reassured by the independent judgement of the Trustee, which is a critical part of the checks and balances of running a mutual pension arrangement. The Trustee has no other agenda than to ensure that the defined pension benefits USS members earn are secure and can be paid as they fall due, and that the scheme is sustainable into the future.

**What role does the Pensions Regulator have to play in this process?**

The Pensions Regulator is a key stakeholder, and it is important for all parties involved in the valuation process to understand its perspective on the central issues at hand.

Ultimately, the regulator can direct how the Trustee should calculate the technical provisions, change the benefits, and/or set the contribution rates of members and employers. This is why such weight must be given to complying with the legal and regulatory requirements of a valuation.

The regulator has been updated by the Trustee appropriately, after the Board has made decisions. UUK and UCU have also engaged with the regulator.

USS’s engagement has informed the regulator’s assessment of the Trustee’s position. Notably, the Trustee has robustly defended the strength of the covenant and the valuation in all meetings with the regulator.

The consultation report submitted to UUK addresses the matters raised in the regulator’s most recent letter to the scheme’s stakeholders (December 2018).

**What role does UUK have to play in this process?**

Universities UK (UUK) is the body that formally represents employers participating in USS on the Joint Negotiating Committee. It is also the body that is formally consulted by Trustee on the Technical Provisions assumptions for a valuation. For more information about UUK, visit www.universitiesuk.ac.uk.

**What role does UCU have to play in this process?**

University and College Union (UCU) is the body that formally represents members on the Joint Negotiating Committee. For more information about UCU, visit www.ucu.org.uk.

**Is USS acting in the best interests of members and employers in the way it is funding the scheme?**

The Trustee has no other agenda than to ensure that the pensions promised are secure, and the scheme is sustainable into the future. It has, accordingly, set out the overall level of financial risk it is prepared to contemplate taking in funding secure defined pension benefits that can be paid when due - and is now consulting UUK (on behalf of employers) on its position.

The issue of the ‘right way’ to fund USS pensions has generated much debate.

On the one hand, the Trustee is accused of being recklessly prudent in its funding assumptions, and so requiring contributions that are unnecessarily high. On the other, the Trustee is alleged to be taking bets that the Higher Education sector might not reasonably be able to cash in, to keep pension promises unreasonably affordable.

See: Perspectives on funding pensions

**Is USS listening to its stakeholders?**

Yes - it has listened carefully to the arguments put forward by the Joint Expert Panel, and subsequently by UCU and UUK. This is clear from its decision to hold a new valuation and seek a fresh mandate from employers on the level of risk to be taken in funding the scheme’s defined benefit pensions.

However, the potential consequences of taking greater risk must be quantified, and credible options for managing material downsides must be available: the Trustee has a legal, regulatory and fiduciary duty to ensure that the pensions promised to members are secure and can be paid when due, and that the scheme is sustainable into the future.

It has, accordingly, set out the overall level of financial risk it is prepared to contemplate taking, but this is dependent on employers being willing to support the scheme in the event of the risks involved coming to pass (as was the case when the Trustee consulted employers on the technical provisions proposed for the 2017 valuation).

**Why isn’t USS prepared to build up a funding surplus, as has been claimed?**
The contribution requirements from the 2017 valuation - and those that will arise from the 2018 valuation - are based on the cost of the defined benefits accruing at that point in time being properly funded and therefore paid when they fall due.

If the Trustee’s assumptions are borne out then these costs, and the resulting contributions, would be expected to reduce at subsequent valuations (held at least every three years). If they are not borne out, the level of short term risk would be exacerbated.

It is important to note that the combined contribution rate under the 2017 valuation amounts to a c.40% discount on the current economic cost of defined benefits accruing in the USS Retirement Income Builder. (That is, the contributions calculated by the Trustee are 40% below what they should be if the benefits were to be secured with matching assets).

Projections based on current contributions would involve even less of the full cost being met, affecting the deficit position in the short term (when the Trustee is required by law to demonstrate every three years that the scheme is sustainable) and weakening the ability of the scheme to recover in the long term if things do not go as expected.

This is precisely why, with every valuation, the Trustee establishes a funding plan that looks to manage the many interlinked short and long term risks at that point in time, such that it can expect to arrive at its target position in 2037 with a high degree of confidence.

This is important, as it protects the security of the pensions members have earned.

What will USS do with the additional contributions it requires under cost-sharing, or under the contingent contribution arrangements it is proposing?

They will be invested in line with the scheme’s investment strategy to fund the benefits members have earned.

Videos

Ali Tayyebi, Scheme Actuary, speaking at the 2018 Institutions’ Meeting

Guy Coughlan, Chief Risk Officer, speaking at the 2018 Institutions’ Meeting