USSEmployers

RESPONSE FORM

A consultation by Universities UK with employers on the indicative outcomes of the valuation

CLOSING DATE: 24 MAY 2021

REPLY TO: PENSIONS@UNIVERSITIESUK.AC.UK

MAKING YOUR RESPONSE TO THE CONSULTATION

We welcome responses to this consultation from each and every one of the scheme's participating employers.

We are keen to have the widest possible range of views and perspectives ahead ofthe next steps of the 2020 valuation.

Through this consultation we are formally seeking views and direction fromemployers on some key questions, particularly on:

- Covenant support measures
- Contributions
- Future benefit structures
- Addressing the high opt-out rate and flexibilities
- Governance
- UUK's Alternative Approach

This template form is optional and can be used for the response from your institution,you may also want to feedback this information another way.

With these views, UUK can then progress the negotiations with the University andCollege Union (UCU) within the Joint Negotiating Committee (JNC).

Please send the response from your institution to pensions@universitiesuk.ac.uk by 5pm Monday 24 May 2021.

COVENANT SUPPORT MEASURES

1. Would you be willing to support the alternative covenant support package which UUK has outlined in section 3, as the means to achieve a solution which might be acceptable in the round (see also question 15)?

Yes. Reluctantly we support the covenant measures as amended by UUK in the consultation document. However, it is essential that there is a robust legal mechanic that permit all/some of these measures to fall away when conditions permit.

The sector has always provided covenant support to the scheme but the (now codified) proposals may result in increased operating constraints on providers in the future. However, if the alternative to this is a material increase in funding costs today (for employers and for staff) then the covenant package is the lessor of two evils.

There is also some equity in the employer providing increased support if other parties (USS and staff) are also being asked to make their own respective contribution to securing an affordable and agreed solution to the 2020 valuation.

We also ask that USS acknowledge and consider the implications that in codifying the covenant support in its proposed form a possible and unintended consequence could be that third parties ask to be put in the same position as USS, for example pension trustees of self-administered trusts and/or future new lenders/investors. The consequence of this could be to weaken the value of the covenant to USS.

COVENANT SUPPORT MEASURES

2. If the USS Trustee is not willing to accept UUK's alternative proposal (should there be employer support for it), would you be willing to support the USS Trustee's scenario 3 covenant support package to obtain a 'strong' covenant rating? If not, why is this and what level of covenant support would you be willing to provide?

Yes, but we have a strong preference for the UUK formulation as the USS metric E threshold at 10% carries greater risk of operational constraints on what are likely to be relatively minor operational issues in the context of USS.

COVENANT SUPPORT MEASURES

3. Are there areas of the covenant support measures which cause you particular concern, or which you would wish to see modified? Please provide details.

Yes. We have three concerns.

The first is the length of the 20-year rolling moratorium on scheme exits. While it is highly unlikely to be economically viable for most to leave the scheme, should economic circumstances become more favourable we would expect a robust legal mechanic to be written into the agreement, allowing for this provision to fall away if and when circumstances permit.

Our second concern relates to how USS will operationalise the covenant framework and its on-going costs. The covenant framework also points out that USS have historical powers to impose higher contributions on individual members but they have failed to explained how this interacts with the cost sharing rule or what happens at subsequent valuations.

Finally, UUKs package has increased the proposed rolling moratorium on employer scheme exists from 12 to 20 years, on the basis that it is believed this will give the USS Trustee the 'best value' and permit a longer deficit recovery plan. We would like to know the value of extending the moratorium by each year so the cost/benefit

can be evaluated.

Covenant packages given to lenders/investors are typically managed through an on-going personal relationship between staff of the provider and the lender. This will not be the case with USS. So understanding how USS intend to operationalise monitoring and engagement is important. We would be concerned, for example, if USS intended to outsource this to a professional services provider as this weakens relationship building.

We would ask that:

(a) A robust and documented mechanic is incorporated into the legal agreement on employer scheme exits that enables the 20-year rolling moratorium to fall away should circumstances permit.

(b) Consideration be given to putting a value (in terms of avoiding contribution rate increases) on each year extension to the moratorium on employer scheme exists so we are able to judge the cost/benefit of extending it.

(c) USS be required to explain how they will operationalise covenant monitoring and that USS should be required to disclose the annual cost of its covenant monitoring regime each year so the sector can monitor its proportionality.

(d) The final form of agreement should include explanations of how any additional costs imposed on a single employer (as envisaged under section 7 of the Debt Monitoring return Requirements Part B) interacts with the 65:35 cost sharing rule and what would happen at subsequent valuations.

COVENANT SUPPORT MEASURES

4. Are there other areas of covenant support you would wish to consider such as contingent contributions or asset pledges?

We strongly oppose the concept of asset pledges. We do not believe this can be equitably operationalised in a multi-employer scheme and would have a very poor administrative cost/benefit return.

We strongly oppose contingent contributions. These should be unnecessary given that USS has the opportunity to re-price the scheme at least every three years, noting that the scheme is currently on its third valuation in as many years. Our other concern with contingent contributions is how they would interact with the 65;35 cost sharing rule.

CONTRIBUTIONS

5. Do you agree that the current levels of employer contribution (21.1% of salary) and member contribution (9.6%) are the maximum sustainable – and should be the foundation for any solution?

a. If not, please state the level of employer contribution you would be willing to pay to USS following the 2020 valuation.

b. We would welcome any commentary on the reasons for your views.

c. We would also welcome employer views on the level of member contribution.

We are strongly of the view that at current contribution rates it should be possible to deliver a good pension scheme to staff and we have to do everything we can to prevent contributions rates rising beyond their current level. Current contribution rates should be the foundation of a solution to this valuation.

We undertook a staff survey as part of this consultation response (658 responses covering 15% of our USS members) with 74% of staff responding that they would not be willing to pay more for the same level of benefits.

Our view is informed by

(a) results of our own staff survey
(b) the increase in staff non-participation in the scheme on grounds of affordability,
(c) the persistent historical rise in contribution rates which has to stop at some point, and
(d) equity with our own self-administered trust for staff on lower grades, whereby the governing body then determined that the limit of affordability (for that scheme) was an employer contribution rate of 20%.

We strongly ask that UUK seek a deferral of the October 2021 increase in contribution rate under the 2018 Schedule of Contributions. This increase, while legally binding, was scheduled so that the results of the 2020 valuation would supersede it, informed by the contribution of the work of the Joint Expert Panel.

BENEFITS

6. Do you support the broad principle of seeking to retain the hybrid benefit structure?

We support the principle of offering staff a good, affordable and sustainable pension scheme that meet the needs of staff in retirement and is an asset to recruit and retain staff.

We are not wedded to the hybrid scheme as the only form of a 'good' scheme but it has an advantage of being able to flex the DB/DC mix along a spectrum.

On the other hand we would expect changes in the DB/DC mix to happen infrequently. If the mix changes at each and every valuation this is likely to undermine staff confidence in the scheme and hinder their ability to undertake forward financial planning.

BENEFITS

7. Looking at the illustrative hybrid benefits which UUK has put forward, would you consider this an acceptable outcome in terms of benefits at this valuation – based on the positions on covenant support and contributions laid out?

Reluctantly yes, in the context of the valuation outcomes. We would rather not see any changes to current scheme benefits but given the financial challenges set out in the USS valuation report we accept that this may not be possible without significant increases in contributions rates.

There appears to be no consensus among staff concerning changes to future benefits with 30% indicating a willing to consider changes to benefit structures (at current contribution rates) but 33% not willing to.

The illustrative reduction in DB salary cap represents a change of DB/DC benefit mix, <u>not a reduction in benefits</u>. This is a fundamentally important point that seems to get lost in the debate.

The reduction in future accrual rate (to 1/85 per Illustration 1) would, reluctantly, be an acceptable outcome if the alternative to this is a material increase in funding costs today (for employers and for staff) and is part of a package of changes including increased employer covenant support. However, an accrual rate at this level is probably at the floor of acceptability without undermining the schemes value for money less than half of current staff (43%) consider the current scheme offers value for money.

We reluctantly support the proposed change in post-retirement indexation to a 2.5% cap as part of the package of measures proposed by UUK, noting that it is common in many private sector DB schemes.

BENEFITS

8. If the illustrated hybrid would not be acceptable, what alternative benefit arrangements would you wish to provide (and please indicate alternative positions on covenant and contributions as appropriate)?

(For example, if the USS Trustee does not ultimately amend its assumptions, would you wish to offer a hybrid solution as set out in the USS Trustee's illustrations (p18 of the Update Report) or would you prefer to move to a different offering, such as DC provision?)

We would like UUK to explain why protecting benefits for existing scheme members and address future challenges by flexing the arrangements for new scheme joiners is not a viable option. This approach seems to be very common when pension schemes are faced with financial challenges.

BENEFITS

9. Would you wish to explore conditional indexation or other conditional benefit models as a possible solution (likely longer-term, beyond the 2020 valuation)?

It is worth exploring conditional defined contribution models as employers and staff need to have a better understanding of how such schemes work before they can made decisions one way or the other.

We are receptive to the exploration of conditional indexation. However, the challenge with anything that is conditional is that it reduces certainty and introduces judgement, both of which could be problematic.

FLEXIBILITIES AND OPTIONS

10. Would you like to see flexibilities implemented for members to move away from the current uniformity of the USS structure, and if so which flexibilities do you think are particularly important?

We strongly support the proposal to move away from a simple flat-rate contribution rate as a means of offering staff a lower-cost entry route into the scheme and in addressing other barriers to entry. This may help address the opt-out rate and encourage younger members to join the scheme. A flexible arrangement with different contribution levels would allow new and current members to have a scheme that is affordable to them and to allow them to increase or decrease their pension savings as they deem affordable throughout their career.

<u>Tiered contributions for same hybrid-scheme access</u> *(similar to public sector schemes, TPS, NHS and LGPS)*
In our staff survey 66% of responders expressed a 1st or 2nd preference for this option (43% 1st preference, 23% 2nd preference). We have concerns about 'cliff-edges' and a potential form of double taxation of higher-paid staff who might also have exposure to annual allowance (AA) and the life time allowance (LTA) tax burdens.

<u>Tiered contributions for a DC-only component</u> *(matched by tiered employer contributions)*
In our survey 67% of responders expressed a 1st or 2nd preference for this option (29% 1st, 38% 2nd). This could be an attractive proposition for staff, especially as a lower cost entry route into the scheme but also a means of improving pension portability for an increasingly international workforce and possibly as a device to aid tax planning for those exposed to AA and LTA issues.

FLEXIBILITIES AND OPTIONS

11. Would you support the creation of a lower cost saving option for members and which of the parameters described in this paper are most important / or would need modification?

(If yes, we would welcome employer views on the options to achieve this (potentially informed via engagement with eligible USS employees).

Yes, within the context of the flexibilities we have outlined in 10 above.

We support the creation of a lower cost savings option as a means of improving participation rates in pension arrangements, especially for younger and lower paid staff.

FLEXIBILITIES AND OPTIONS

12. Would you support the creation of an option for members to switch (from the hybrid structure) to wholly DC pension saving?

(We invite employer views on whether the same deficit recovery contribution should be made for members choosing any new flexible DC alternative option, and what levels of member and employer contributions devoted to DC pensions saving should apply).

We support the creation of a DC-only option, ideally with tiered contribution rates. In our staff survey this option was relatively popular with 67% of 1st and 2nd preferences (staff were given 4 preferences to rank). As an option it provides both early career staff, internationally mobile staff and possibly some high earners with extra flexibility should they wish to use it.

We do not believe it is tenable for staff in a DC only section to be asked to fund any part of the DB deficit. Staff would expect their DC savings to be fully invested into their DC investment funds. An additional contribution towards past DB deficit repair would be seen as an explicit tax on intergenerational equality. It would however, be fair for DC contributions to cover investment administration costs.

FLEXIBILITIES AND OPTIONS

13. Would you wish to explore options for employers so that they can offer some variations to the USS standard benefits in the future – and if so, what would those variations be?

Yes.

One option could be to review the rules of USS that restrict employers being able to offer an alternative pension arrangement such as an in house scheme. Exeter already provides its non-USS eligible staff with an attractive DC scheme. Having the ability to make our own scheme the DC-only option proposed in the consultation, as opposed to setting up a separate USS administered DC-only section, would be attractive and help the University address equality issues across all staff groups.

GOVERNANCE

14. We would welcome views from employers in relation to the governance of the scheme and the valuation process (including views on the Joint Negotiating Committee). Specifically, would you support a post valuation governance review, and what areas what you like to see covered in such a review?

We strongly support a governance review of the scheme as a matter of priority, so any new arrangements are in place before the next valuation is underway.

It has been frustrating to have followed the 2017 valuation with a productive Joint Expert Panel exercise which was partly aimed at promoting a shared understanding between all parties as the valuation was bought into land, only to find ourselves almost back to the position the sector was in back in 2017.

UUK ALTERNATIVE APPROACH

15. As part of a solution to the 2020 USS valuation would you support the alternative covenant support package illustrated by UUK *(headlines – moratorium of a minimum of 20-years with debt-monitoring and a pari-passu arrangement for secured borrowing above c15% of gross/net assets)*, to provide a hybrid benefits package at current contribution rates in the order of *(pension accrual of 1/85 of salary [plus 3 times lump sum] up to a salary threshold of £40,000 with the CPI indexation of benefits [for active, deferred and pensioner members] capped at 2.5% per annum, and with DC above the salary threshold at an overall contribution of 20% of salary),* together with a lower cost alternative to address the high opt-out rate, as well as a governance review of the scheme and valuation process?

Reluctantly we support the UUK package of proposals in the context of the USS valuation outcome, recognising that these come as a package. The University is concerned about the length of the proposed 20 year rolling moratorium but provided there are legal mechanics that permit this to fall away should circumstances permit, we would accept it.

Ideally we would rather there were not any changes to future benefit design but the scheme finances have deteriorated to such an extent, largely driven by external macroeconomic forces, that the UUK package represent a pragmatic set of proposals.

We would strongly encourage USS to reflect any post-valuation date experience in the main financial assumptions, to ensure that the valuation date is not disadvantaged by its timing which coincided with the UK Covid lockdown.

Please send your completed form to: pensions@universitiesuk.ac.uk by Monday 24 May 2021