UUK Survey on the 2017 USS Valuation

Identifiers

1. (a) Name of Respondent: Chris Granger

   (b) Position: Director of Finance

   (c) E-mail address: c.p.granger@bham.ac.uk

   (d) USS Employer: University of Birmingham

2. **Please confirm that the content of this questionnaire (and related documents) has been discussed such that the views expressed can be considered to be the authorised view of the institution.**

   Yes

Risk and Reliance

The questions in this section should be considered alongside the USS Technical Provisions consultation and the Aon commentary. Issues that employers should consider in relation to risk are also summarised in section 1, paragraphs 7 to 15, in the UUK paper.

3. **(a) Does your institution support the level of risk (ie the level of reliance being placed on the employer covenant) being proposed by the USS trustee for this valuation?**

   - My institution believes it would be appropriate to take more risk
   - **My institution accepts the level of risk being proposed by the trustee (UOB response)**
   - My institution wants less risk to be taken, acknowledging the implications this might have for the benefits and/or costs

   (b) Do you have any additional views or concerns regarding the level of risk being proposed?

   We believe that the overall level of risk being proposed in the valuation approach, and the consequent reliance upon the employer covenant, is appropriate. It is our view that the employer covenant remains strong and significant reliance should be placed upon it in the valuation process. We view the independent covenant review undertaken by PwC and EY as an objective assessment of the sector covenant that should inform the level of reliance to be placed upon the employers.

   The changes implemented in the 2014 valuation helped to reduce scheme risk and it is clear that even with the Technical Provision position proposed by the trustee that significant scheme benefit changes are necessary, and we believe that further managed risk reduction in the long term is desirable. We therefore expect that post the 2017 valuation USS will explore more fundamental options for a sustainable retirement benefit provision, that provide greater flexibility for employers and employees as part of a total remuneration approach, that may be considered in advance of the 2020 triennial valuation.

   Please also see comments in response to question 11.

4. **If the USS trustee decides to take action between valuations because short-term reliance on the employers has become too great, what action do you believe should be taken (potentially temporarily)?**
   - Additional contributions to the scheme to alleviate risk (not towards benefits)
   - Changes to future service benefits
   - **<u>My institution's position would depend on the outcome of the 2017 valuation</u> (UOB response)**

   Given the volatility of the funding position we are wary of short term actions between valuations as they could be triggered by short term factors, e.g. a temporary fall in interest rates, that might not persist for very long and where interim action might prove unnecessary or could produce a disadvantageous result. We are also conscious of the practical difficulties in assessing and implementing interim measures in a scheme of the scale and complexity of USS. Our preference is therefore to rely on the triennial valuation process as the means by which the funding position is assessed and proportionate actions taken to address any funding issues thus identified. As an institution we can tolerate short term volatility in the context of the very long time horizon of USS.

<u>Cost</u>

The questions in this section relate to section 1, paragraphs 16 to 21, in the UUK paper.

5. **(a) Over recent months UUK has compiled a view from institutions that 18% is the maximum level of regular contributions that employers are willing to pay towards USS benefits. We need to affirm this view for the 2017 actuarial valuation. Please indicate your institution's view on the statement that regular employer contributions should be no more than 18% of salary.**

   - Support – 18% is the maximum my institution is willing to pay
   - **<u>Moderately oppose – my institution might be willing to pay more than 18% in specific circumstances (please specify these circumstances in 5 (b) below)</u> (UOB response)**
   - Strongly oppose – my institution would be willing to pay more than 18% to reduce impact in benefits (please specify the maximum your institution would be willing to pay in question 5(b)).

   (b) Please add any additional comments in support of your response to this question.

   Our strong preference is for an outcome to the valuation that maintains the existing employer contribution rate of 18%. However, we might support a small increase in employer contribution rates as part of a settlement including benefits re-structuring and modest employee contribution increases if this achieves a sustainable funding position, delivers greater flexibility for employers and employees, and enables agreement to be reached without extensive labour relations issues.

6. **(a) Does your institution believe that increasing member contributions beyond the current 8% of salary is likely to lead to more scheme members opting out?**

- Yes
- No

(b) We would welcome any further comments to support your answer above.

We do not have a specific view on question 6 (a) as the answer depends upon the extent to which the contribution level increases and the perceived attractiveness of the ongoing benefits provision, including the level of employer contributions.

We did not experience a significant rate of opt out among permanent employees when the most recent contribution rate increase was introduced. We would, however, anticipate that early career and more junior members of the scheme are more likely to consider opting out, due to affordability issues and having less cumulative accrued rights, if the member contribution rate rises significantly. For more senior members of staff, the diminishing value of the annual and lifetime tax allowances are likely to be more of a factor in any decision to opt out.

Benefits

The questions in this section relate to section 1, paragraphs 22 to63, in the UUK paper.

7. **(a) Does your institution prefer maintaining a level of DB accrual for future service at this valuation or moving to a DC-only solution (either temporarily or permanently)?**

- **<u>Maintaining some DB</u> (UOB response)**
- Moving to DC

(b) We would welcome any further comments to support your answer above.

It is clear from a funding and de-risking perspective that further changes to future benefit provision are necessary with a greater weighting towards defined contribution. However, we support continuation of some element of reduced DB provision in a hybrid benefits structure, if affordable, as part of a balanced response to the scheme funding position. This would provide a basic foundation platform of retirement income for employees who may not be best positioned to take financial investment decisions. Provision of some ongoing DB benefit may also reduce the perception of inter-generational inequality. Clearly, the reduced level of DB provision would need to be meaningful to the employee, and it is questionable whether a salary threshold of £15,000 as indicated in the consultation papers would be meaningful based upon 1/75 accrual rate.

We feel that any decision to eliminate future DB accrual benefits at this time would be difficult to reverse in the future. It is important to recognise this and that any such decision is heavily influenced by the current low interest rate environment. Although the USS trustee has allowed for some interest rate reversion to 2014 levels in its proposed valuation approach this could still prove overly prudent in the genuinely long term time horizon of USS.

8. If a level of reduced DB accrual is maintained in the future, do you have any initial thoughts on which of the following approaches would have your institution's preference?

- **Reducing the salary threshold (UoB response)**
- Reducing the accrual rate
- A combination of both
- No preference

We believe that reducing the salary threshold is the simplest and most transparent way to implement a reduced level of DB accrual. There appears little value in adjusting both the salary threshold and accrual rate in order to produce the same outcome. We also anticipate that the salary threshold may move over time in line with inflation and so may already need to be subject to periodic adjustment.

9. If the outcome for employers at this valuation is a mandate to seek a DC-only solution to future service benefits, do you have any comments you wish to be taken into account as to how best to achieve a DC offer optimised and tailored to the needs of USS institutions?

The need to increase the proportion of overall retirement benefits delivered by defined contribution is clear, to reduce risk and achieve a sustainable funding position. However, we would still seek to provide a foundational level of DB benefits as part of a flexible remuneration package.

As previously mentioned, whilst mechanisms might be developed for theoretically reintroducing DB accrual in the future we believe that it will prove difficult to do so, given the judgements involved and the inherently prudent approach necessitated by the trustee and pensions advisers.

We believe that any DC only offer should have a minimum level of employer and employee contribution. There should also be an incentive for the employee to contribute further to their retirement savings in the form of additional employer matched contributions for additional employee contributions. As an example, the base offer might be a 5% employee contribution and a 10% employer contribution, with additional employer match funding of 1% for each additional 1% employee contribution, up to an employer total contribution cap of, say, 15% that would be broadly consistent with the current employer future service contribution level.

We strongly support greater flexibility in the provision of pension benefits, both for the employee and also the employer. It is our view that individual employers should have greater flexibility in future in respect of the retirement benefits they wish to offer employees as part of overall remuneration packages. Employees should also have flexibility on contribution levels, investment choices and options at retirement. In a DC only environment employee flexibility may also mean the option for contributions to be managed by a third party DC provider rather than via USS.

It is important that costs are kept low and suitable investment options made available to employees. This may mean allowing access to the best performing existing funds from third party managers rather than forcing employees to take a USS constructed investment product.

It is likely that the changes necessary to enable the desired greater flexibility of retirement benefits provision in the sector will have a significant impact on the role and approach of USS. We doubt whether any such changes could be identified, agreed and implemented within the timetable for this valuation but we encourage UUK to engage with USS on a timely basis to enable this issue to be fully addressed by the time of the 2020 valuation.

We support the continued provision of ancillary benefits to members (life and critical illness cover) as an option to be purchased by the member as part of their overall retirement benefit package.

Final Remarks

10. What additional support can UUK or the USS trustee offer to support your institution in the valuation process?

It is important that clear and regular communications are maintained by UUK and USS as the valuation process progresses.

It would be helpful to understand the approximate impact of the benefits changes implemented in 2014 on this valuation.

It would also be helpful to better understand the sensitivity of the valuation to interest rate changes, e.g. what impact a 0.25% increase in interest rates would have on liabilities, assets, and future service cost contribution levels, assuming that this 0.25% change flowed through to the assumptions and the currently proposed investment strategy.

11. Please add any further comments your institution has on the USS valuation.

We note and support the overall positioning of the valuation in respect of prudence and employer covenant reliance.

There is one aspect of the valuation that is unclear from the documents supporting the consultation, relating to the position in respect of the 2.1% deficit recovery contributions once the deficit has been eliminated. We understand that the trustee is yet to determine the recovery period, with the key outstanding assumption being the expected asset return in excess of the discount rate. However, we are unclear as to how the trustee is treating the 2.1% recovery plan contribution that will no longer be required once the deficit has been eliminated, and whether this represents an opportunity as part of the overall valuation result.

There appear to be two alternative options for the 2.1% employer contributions that are presently attributed to recovery plan contributions once the deficit has been eliminated:-

1) The contributions continue such that overall employer contributions remain at the 18% limit which has been indicated as the maximum that employers are willing to pay but that they are attributable to funding the future service benefit from the point at which the deficit is extinguished;

2) At the point that the deficit is extinguished employer contributions could reduce by the 2.1% deficit recovery payments so that the ongoing employer contributions become 15.9%. In this scenario, if the in extremis maximum capacity of employers to pay contingent contributions is viewed as 25% of pensionable salaries, then the maximum reliance that the scheme could place on the employer covenant could increase to 9.1% of pensionable salaries, resulting in a higher absolute employer reliance capacity.

It is unclear how the overall valuation has dealt with this issue and we would appreciate a better understanding of this and whether this provides an opportunity to partially address the funding challenge outlined in the papers supporting this consultation.