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 4, as the means to achieve a solution which might be acceptable in the round (see also question 15)?

Scenario	Effective debt monitoring	Effective *pari passu*	Length of rolling moratorium	Initial moratorium to support Recovery Plan length*
1: No additional covenant support	No	No	Zero	None
2: UUK package of covenant support	Yes	No	6 years	9 years
3: Adequate to fund on a strong basis	Yes	Yes	12 years	15 years

The above table refers to the additional measures suggested in the three scenarios by USS.

The UUK suggestion:

Alternative Approach (UUK proposal, March 2021)	
Debt monitoring	De minimis to limit metric testing to material employers.
Pari-Passu (equal) security on new secured debt	Metric E threshold for Gross Secured Debt: c15% of Net Assets and c15% of Gross Assets, (all subject to an appropriate de minimis provision)
Rule change on employer exits	20 year rolling moratorium on employer exits without USS Trustee consent (applying to all employers)

Response:

The University of Edinburgh considers the strengthening of covenant support as a component of the overall solution to the current challenges facing the Scheme. We currently perform regular debt monitoring in support of our own debt arrangements and consider this good practice in diligent financial management. The University of Edinburgh is content to share debt-testing metrics with the Trustee in support of future arrangements. We would support collaborative agreement on form to ensure that existing protocols are employed (as appropriate) to avoid unnecessary duplication.

We consider that the University of Edinburgh is unlikely to pursue new secured debt so the proposal here will not affect us directly. We do acknowledge that this measure could potentially impact other employers in the scheme disproportionately, and may result in an increase in the cost of debt and a change in behaviour and expectations amongst lenders to the sector. Sufficient care and consideration is required to ensure the consequences of this measure are equitable across the employers within the Scheme.

We recognise that a rolling 20-year moratorium is effectively a semi-permanent commitment to the Scheme. In reality, a crystallised Section 75 debt would be unaffordable to almost all employers in any event. The University of Edinburgh would support this commitment as an element of the overall package of measures to be agreed, with consideration of benefits, flexibility and optionality as further aspects requiring consideration, provided that the agreed outcome remains affordable to members and employers. Further, this support would only be agreed were it to form part of a longer-term financially sustainable outcome which does not require revision at each subsequent valuation.

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?

Scenario	Effective debt monitoring	Effective *pari passu*	Length of rolling moratorium	Initial moratorium to support Recovery Plan length*
1: No additional covenant support	No	No	Zero	None
2: UUK package of covenant support	Yes	No	6 years	9 years
3: Adequate to fund on a strong basis	Yes	Yes	12 years	15 years

Response:

The University of Edinburgh would support scenario three, but only as part of an overall agreement which considers all aspects of the scheme and the choices members have. We would not agree to enhanced covenant support measures to maintain the status quo (in terms of scheme characteristics).

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.

Response:

It is important that any proposed measures to strengthen covenant support do not result in unintended consequences. To this end it is crucial that the extent and implications of Pari Passu are considered alongside the sector's existing debt arrangements. Equally, debt monitoring should not be more cumbersome or restrictive than market-standard (in the HE sector) measures for existing arrangements. An appreciation of the existing lender and financial covenant landscape is important so that Institutions are not encumbered further with existing lenders (for example through 'Most Favoured Lender' clauses).

COVENANT SUPPORT MEASURES

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

Response:

The University of Edinburgh would not consider other areas of covenant support unless such concessions formed part of a more fundamental reform of the Scheme, contributing to a long-term, stable and affordable design which provides the benefits in retirement sought by members at rates consistent with the employers'

and members' ability and willingness to pay.

Asset pledges may be problematic with regard to existing debt arrangements (where, for example permitted securities form part of finance contracts). Further, there will be significant variability between Institutions in terms of their balance sheet capacity (and value) to make meaningful pledges. In many cases the 'market value' of assets may be hard to realise (due to their location or proximity to other University facilities) and may therefore be less attractive to the Trustee.

Contingent contributions should not be triggered by short-term or immaterial events and any decision to introduce them subject to agreement between the employer and USS. That said, they must be sufficiently responsive when necessary but must also reverse when conditions improve. Defining these parameters and triggers is fraught and the uncertainties which result from this approach further complicate Institutions' planning for financial sustainability. It is important to remember that in line with the Scheme's mutual characteristics, such contingent contributions would need to apply uniformly to all employers (and members) and the issue of affordability vs equity resurfaces.

We believe the scheme would have to be managed and presented quite differently (on an employer by employer basis) should asset pledges and contingent contributions feature as part of the overall solution.

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.

Response:

The University of Edinburgh has responded in previous consultations that it felt that the earlier employer contribution rate of 18% was at the top end of affordability. Both employers and members have since been stretched further by increased contribution rates which for employers have impacted operating plans and for members has affected take-home pay considerably. When the 2018 valuation was agreed it was not anticipated that the increases to contribution rates (those already implemented and the increases we expect to see implemented in October 2021) would persist. This level has significant consequences on other areas of expenditure. We recognise that for many employers in the scheme the current levels are not affordable and the impact of sustained contributions at this rate may materially impact the longer-term sustainability of some. We firmly consider that further increases to contribution rates are not financially sustainable.

It is worth noting that 12% of eligible respondents answered our survey, of those responding, some 68% (12% of members responded to the survey) find the current contribution rates either 'readily' or 'somewhat' affordable, however, 85% indicated that they would be either 'very' or 'somewhat' concerned were contribution rates to increase. This suggests that recent increases appear bearable to the majority but that further increases beyond the 9.6% level may be problematic. The University of Edinburgh received very few responses to our survey from eligible staff who are not currently members of USS as such we may not have a robust response regarding affordability and the potential impact on other areas of the University from increased funding of the USS from those who have elected not to be members.

BENEFITS

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

Response:

The University of Edinburgh wishes to see greater flexibility and choice for members, the hybrid benefit structure could be one of the options available, provided it can be designed in an affordable, sustainable and stable way. We consider that the proposal put forward by UUK may provide the basis for a discussion on the core scheme offering, provided that it addresses the key concerns of members and employers, but we also believe that members should be able to choose a more affordable option should their circumstances and needs require that.

Our member survey responses show that 46% of responders would support a more flexible pension option which would allow lower contributions to be paid for reduced benefit (for a period of time). As a reminder we received a response rate of just 12% to our survey.

63% of our members also indicated that the promises provided by the DB part of the scheme are worth retaining, 'regardless of cost'. This response demonstrates the value members attach to the DB element of the scheme, but responses around increases to contribution rates do indicate that cost of contributions is an important factor (see response 5).

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?

Scenario	DC contribution rate above threshold	Salary Threshold	Accrual rate for indexation:		Estimated DIS / Ill-health element % pay
			Current	Capped at 2.5% p.a.	
2	12%	£40k	1/170	1/155	1.6%
		£30k	1/165	1/145	1.7%
3	16%	£40k	1/115	1/100	2.1%
		£30k	1/110	1/95	2.2%

Comment

The USS Trustee knows that the contributions for Scenario 1 are unaffordable, so it has reached the conclusion that without covenant support the scheme must close.

Response:

The University of Edinburgh does not consider the illustrative benefits presented as viable, the benefits defined do not represent value for money for the considerable contribution rates required. There would be greater benefit in exploring alternative structures and options available with varying degrees of choice and flexibility for members. Choice around benefits, contribution rates and flexibilities around use of pension should feature in the consideration.

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?)

Response:

We believe a suite of options is the best way forward, with a range of benefits and correlated contribution rates. These may cover, at one end of the spectrum, a DB/DC hybrid – along the lines of the UUK suggestion – attracting a relatively higher contribution rate, with a full DC option at the other end of the scale. The DC option may be designed in such a way to allow lower contribution rates depending on member choice. We would expect that in such a model the employer contribution could be developed to encourage greater level of member saving without penalising those who felt unable to save at higher levels. Tiered contributions for members should be considered and absolute clarity is required regarding the deployment of contributions for deficit repair and future accrual.

Providing members with choice and being clear on the relative value of each option is key to finding a sustainable way forward. This approach can deal with inter-generational fairness, but employers and the Scheme would have a continuing role to play in advocating for increased saving for retirement and the value and benefits this can bring.

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)?

Response:

The University of Edinburgh believes that every option should be considered in designing the most appropriate long-term scheme for both employers and members. Worked examples of how conditional indexation should be provided for an illustrative cross-section of the membership. Any agreed solution must be financially sustainable in the long-term and must have at its core the principles of mutuality and equity to all members.

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?

Response:

The University of Edinburgh believes the scheme should offer greater choice for members as their circumstances and requirements change throughout their careers. The current binary approach (in or out) is unhelpful when contribution rates rise and an alternative cannot be offered. If employers are unable to offer staff alternative vehicles to help save for retirement, reflecting their status and needs, we consider our opt-out rates would rise and we would be failing in one of our primary roles as a responsible employer.

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).

Civil Service Partnership Scheme
• The Civil Service offers a DC alternative. It is fully separate from the main scheme (contract based) • It is non-contributory with an automatic age related employer contribution • Employee contributions are matched up to an additional 3% • Low uptake (<2%) but opt out also very low (<2%)

Civil Service Partnership Scheme Contributions	
Age at the last 6 April	Percentage of pensionable earnings
Under 31	8%
31 to 35	9%
36 to 40	11%
41 to 45	13.5%
46 or over	14.75%

NB the column on the right is employee contribution rates

LGBS 50-50 option
• The LGPS has reduced cost DB pension. • Employee contributions are half (2.75% - 6.25%) as are benefits. Ancillary beneftis provided in full. • Free movement in and out - and reenolment into the main scheme • Low uptake and used as tax management by some

Network Rail
• Offers a DC arrangement (trust-based) in addition to DB through RPS • Open to all but some employees may have this as their only option • Employee contributions 0-5%; employee contributions 3-7% • Includes death in service cover (insured but equivalent), and incapacity cover (insured)

Response:

The University of Edinburgh believes that every option should be explored so that Employers and Members are fully aware of the implications of revising (or retaining) the Scheme. We believe changes experienced in other Pension Schemes (public and Private sector) should be considered and modelled including tiered Member contribution rates (based on earnings or age). It is particularly important that inter-generational fairness be at the heart of any solution to be agreed for the Scheme.

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).

Response:

Consistent with our earlier responses – the University of Edinburgh would support the creation of a wholly DC vehicle as an option available to all members.

We believe that deficit recovery contributions should be made in accordance with liabilities associated with relevant past-service. Decisions around employer contribution levels to any flexible DC alternative should be agreed at an appropriate level without reference to the deficit in the DB section of the scheme.

We believe the combination of employer and member contributions to a DC alternative should be at a level to fulfil the objectives to create a scheme which is highly valued and provides a compelling and attractive option for saving for retirement (where a member feels unable to commit to the DB/DC hybrid).

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?

Response:

The University of Edinburgh believes there should be an array of options open to our staff which offer a range of choices around benefits and contribution rates – this would be the best way of ensuring the highest level of engagement from staff with regards to saving for retirement. The circumstances of our staff vary enormously, from early career academics to relatively short-term appointment of foreign nationals. Greater flexibilities around pension vehicles and how contributions can be invested, transferred or liquidated would be welcome to minimise opt-outs amongst our staff. We think it would be beneficial to consider all options and in particular look at options that have been developed by other (former) large DB schemes.

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?

Response:

The University of Edinburgh recognises the challenge the USS Trustee is facing given underlying economic conditions and the design of the scheme, we also note that fundamental difficulties and an enormous scheme deficit mean that agreement on next steps will be very difficult to achieve within prescribed timelines. However, scheme design is not the responsibility of the USS Trustee and it is our view that the Employers and the Members need to address this issue through the JNC now. A post valuation review should not only consider how the Trustee might expedite certain elements of the valuation process, it should also focus on the roles of the Employers' representative (UUK) and the Member's representative (UCU) on the JNC. Each of the representative bodies on the JNC should work towards greater engagement and seeking consensus on next steps and longer-term objectives. It is imperative that the JNC is not faced with these challenges after each subsequent valuation, as such we advocate long-term solutions being found during this process, which will inevitably require more fundamental change (such as the introduction of a DC alternative to sit alongside the UUK proposal).

In terms of governance review, we would encourage a fundamental review of the Investment strategy and performance of the fund. We would also be extremely keen to ensure that members' views are comprehensively represented both through employers (and UUK) and UCU. Whilst it remains the mandate of UCU to represent members in this forum we feel that UCU and the employers should actively encourage USS members who may not be members of the UCU to participate in surveys and consultations.

UUK ALTERNATIVE

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?

Response:

The University of Edinburgh supports the proposal that UUK are making, we are aware, though, that this proposal remains a challenge for the Trustee (who calculate the cost of the proposed benefits to be higher than UUK do). This is nevertheless a step in the right direction, but as reflected above, we believe it is part of the solution. It may be necessary to adjust some of the parameters in the proposal further to render the contribution rates more affordable to members (for example a further downward adjustment of the DB/DC threshold).

The provision of a lower cost alternative, possibly a DC only model should form part of the overall offering to members. The University of Edinburgh considers that choice and flexibility should be inherent in the new design with an affordable hybrid offering at one end of the scale and full DC options at the other. The options developed should be sufficiently robust and future-proof so as not to be 'tweaked' at each valuation and thus rebuild the confidence both of members and employers.

We firmly support an approach which will endure, rather than agreeing a short-term resolution designed to satisfy this valuation alone. The agreed design should therefore be financially sustainable, predictable, reliable and understandable in order to rebuild trust and value in the scheme.

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

Thank you for taking the time to respond to this consultation.

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