University of Cambridge
Responses to questions from the UUK survey on the 2017 USS valuation

The following questions are taken from Section 3 of the UUK Universities UK (UUK) papers titled "UUK papers to accompany the USS technical provisions consultation – September 2017"

Once answers have been agreed by the relevant groups, the survey will be completed on-line. The deadline for responses to the survey is **29 September 2017**.

This survey is accompanied by the following papers:-

- The consultation document itself, from USS, dated 1 September 2017. This documents sets out the proposed assumptions for the valuation and the associated rationale in some detail. It also comments on risk and reliance on the employers.
- A paper from UUK's adviser, Aon Hewitt, with comments on the consultation and proposed assumptions, dated 1 September 2017. This paper sets out the employers' objectives and comments on the proposed assumptions and contribution and benefit implications;
- The UUK papers referred to above, which sets out possible responses to the USS shortfall as well as views on the proposed technical provisions.

This paper provides a first draft of the University's potential answers to each question and, where appropriate, any additional comments.

Survey questions

<u>Identifiers</u>

1. (a) Name of respondent
   (b) Position of respondent
   (c) Email address of respondent
   (d) Name of USS employer

Comment – Sue Curryer will submit the response on behalf of the University

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
• No (comment)

No.

Comment - the short timescale for submission of responses does not provide sufficient time for all of the relevant groups and committees to consider the documents and provide the required approvals. As such, the response has been prepared by the Officers of the University having taken into account comments from the University's Pensions Advisory Group which has some member representation. The response has been reviewed by the University Finance Committee and will be considered by University Council at their next meeting.

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 (i.e. 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
• My institution wants less risk to be taken, acknowledging the implications this might have for benefits and/or costs

Answer - *• My institution wants less risk to be taken, acknowledging the implications this might have for benefits and/or costs*

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

Additional views and concerns on risk and covenant:-

- The University has reservations about the 2017 covenant assessment relative to the 2014 covenant assessment, given general pressures on HE funding and the potential impact of Brexit on the UK sector.
- Under the last man standing structure of USS, growth in reliance on the overall covenant means increased reliance on the University's covenant in a stressed scenario and therefore increased risk for the University. Following the triennial valuation of its Self-Administered Trust (SAT) the University has already seen the impact of this risk directly on its potential financial flexibility as a result of the intervention of tPR
- The University (and the other financially stronger institutions) continues to lend its balance sheet to the sector, which contains the cost of pension provision for all employers. In a competitive market for research and student places the University would be concerned if this appeared to be having an adverse effect on the University's competitiveness (by allowing competitor universities access to investment financing or reducing their PPF costs in a way that would not be possible on a stand-alone basis).
- The University does not support any real increase in the reliance on the overall sector covenant.
- The University's preference is that reliance on the overall sector covenant is reduced over time.
- We note that the level of risk, in absolute terms, under the proposed approach for the 2017 valuation is significantly higher than the level of risk under the 2014 valuation. In particular, the gap between the assets and the self sufficiency liabilities has increased from £14bn in 2014 to £23bn in 2017 (or £27bn without the change to self sufficiency target)
- The University has a strong preference for sectionalisation, if this can be arranged, of both past and future service benefits and associated assets, with individual employers responsible for funding individual deficit amounts and future service benefits.
- If sectionalisation is unacceptable, then the University would look for the covenant reliance to be reduced much more quickly through, for example, increased contributions.

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)[33]?

• Additional contributions to the scheme to alleviate risk (not towards benefits)
• Changes to future service benefits
• My institution's position would depend on the outcome of the 2017 valuation

[33] Please note that any action would be in addition to measures taken to meet the funding shortfall identified at the 2017 valuation

Answer - • My institution's position would depend on the outcome of the 2017 valuation

Cost

The questions on this page 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
• Moderately oppose – my institution might be willing to pay more than 18% in specific circumstances (please specify these circumstances in question 5(b) below).
• Strongly oppose – my institution would be willing to pay more than 18% to reduce impact on benefits (please specify the maximum your institution would be willing to pay in question 5(b))

Answer - • A decision on this would require more discussion internally. The extent to which DB benefits are valued by staff compared to other benefits available at the same cost would need to be evaluated.

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

Comments

- It is essential for the University's long term health to be able to control pension cost and risk more closely
- The University has other demands on uses of money in pursuit of its mission than to pay more into USS. In particular, the University wishes to protect the long term health of the University as a major asset to the UK economy
- A key element of the University's long term health is attracting and retaining its staff. The University would like to maximise the impact of the resources it has available to pay for staff. The University believes a large section of its staff values the pension highly, but it is not able to determine at present the trade-off in value to staff of the DB pension and other benefits that could be delivered at the same cost. However, the answer is likely to be different for different categories of staff. The University therefore strongly believes that flexibility of provision would allow it to maximise the value of the resources at its disposal for staff remuneration.

- The University notes that payment of regular contributions at a higher rate than 18% reduces the level of contingent contributions payable (meaning additional contributions do not have a £ for £ impact)

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

Answer – Yes, but it is unknown how material this is without further research

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

Comments

- The low take up rate (c20%) for the 1% matched DC contribution may be an indicator that the current contribution rate is at the level of affordability for many members.
- Anecdotal evidence from the University Pensions Office is that members ask if it is possible to pay a lower contribution than 8% to USS suggesting that for some even 8% is at or above the level of affordability
- The University also has a strong desire for flexibility to create its own benefit structure or structures to best match the needs of its staff. This would include benefit options with different employee contribution rates.
- The current position provides an opportunity to look at what sort of benefit structure(s)work(s) best for the University, especially for new staff

Benefits

The questions on this page relate to section 1, paragraphs 22 to 63, 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)?**

• Maintaining some DB
• Moving to DC

Answer – •

Note - we have not formed a view on this other than that the balance of benefits between DB and DC should move much more towards DC.

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

Comments

- The University is already exposed to a significant level of risk in respect of DB benefits already built up in USS and wishes to significantly reduce or remove risk associated with future pension provision
- We note that £9bn of new self sufficiency liabilities will build up over the next 3 years if no changes are made to benefits. This level of new risk is not affordable or acceptable.
- The University has a strong desire for flexibility to create its own benefit structure or structures to best match the needs of its staff.

- The University's own scheme for Assistant Staff provides an alternative risk-sharing model which would be worth investigating for USS.
- The USS structure (salary threshold and CRB accrual rate) provides a practical framework for future benefit change, but the employee contribution rate may be unattractive for employees and might be unaffordable for some
- We note that the cost of DB provision has risen sharply since 2014 so that the (DB) benefits that can be provided for a given level of contribution have reduced very significantly. From the members' perspective, the necessary reduction in DB benefits may look like poor value for money reinforcing our desire for flexibility.

The term "regular" contributions means those contributions payable by employers on an ongoing basis to maintain both the scheme's future service benefits and contributions to any deficit recovery plan contributions relating to the DB section. It also includes the employer's contribution to scheme running costs.

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
• Reducing the accrual rate
• A combination of both
• No preference

Answer - • A combination of both

Note – the DB threshold level and the DB accrual rate are the main moving parts of the benefit structure. Providing a pragmatic range of options on these would allow the university to tailor its own benefit structure, in particular the balance between DB and DC.

Comments (if they can be entered here, but already included under 7b))

- The University has a strong desire for flexibility to create its own benefit structure or structures to best match the needs of its staff.
- The University's own scheme for Assistant Staff provides an alternative risk-sharing model which would be worth investigating for USS.

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?**

For example, you may wish to comment on whether the move to DC should be permanent, what the minimum employer contribution should be, whether there should be greater flexibility in terms of member contributions and which ancillary benefits should be offered.

- It is not possible to provide comments on detailed design at this stage. However, we would like to provide input at the appropriate time if it is decided to move to DC-only
- Our high level comments below relate to protection, flexibility and interaction between DB and DC benefits
- Protection benefits should be a key consideration (i.e. death in service, ill health, incapacity) as these are highly valued by most employees

- Greater flexibility both in terms of level of contributions paid by employees and how employees are able to access their benefits
- Greater flexibility for employers to decide how pensions fit in with other benefits in a total reward environment
- Design considerations should look at how the DC benefits interact with accrued DB benefits, for example in terms of treatment of tax free cash at retirement and communication of benefits to members
- A fundamental question is how a DC arrangement of this scale would be provided (i.e. via USS or using external parties)

Final remarks

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

- Share information at the earliest opportunity to allow the University to consider and respond
- Continue to engage with the University and other institutions on developments in terms of the valuation and potential changes to benefits
- Consider related issues in more detail (i.e. sectionalisation and exclusivity)
- Assuming that changes to benefits will be made, provide information on what level of support will be offered to institutions in terms of consulting with affected members
- Confirm how institutions will be supported in terms of dealing with questions and concerns raised by employees

11. **Please add any further comments your institution has on the USS valuation, for example you may wish to comment further on the following pertinent to your exposure to USS.** For example, you may wish to comment on:

• The proposed valuation assumptions
• Any areas of concern related to cost or risk
• Any further comments on future benefit design (including core benefits, as well as ancillary benefits) or the consequences of benefit change
• Any wider views on scheme structure, including mutuality and exclusivity
• Issues relating to section 75 debt

Further comments

Assumptions

- We note that the proposed assumptions for the Technical Provisions are materially weaker than those adopted for the 2014 valuation and are at the least prudent end of the range likely to be acceptable to the Regulator in respect of the HE sector as a whole
- The University notes that the combined impact of the proposed changes to the discount rate and the other assumptions is to reduce the Technical Provisions liabilities and deficit by £7.6bn on a like for like basis (page 22 of consultation document). As noted in other responses, this increases the level of risk associated with the Scheme by the same amount.
- More generally, we note that adoption of less prudent assumptions leads to an increased risk of assets being insufficient to meet accrued benefits and a greater risk of call on employers in the future

- The University does support some reduction in the level of prudence adopted in the funding assumptions but this should be limited to the change in the self sufficiency target, so that the gap between the funding liabilities and self sufficiency liabilities does not widen.
- The University is concerned to see any base case assessment of the March 2020 valuation which would anticipate, on professionally produced assumptions, a higher past service deficit than at March 2017

Risk

- The University is concerned that reliance on covenant is compared to the value of contingent contributions of 7% of pay over periods of up to 40 years (page 27 of consultation document). Allowance for payment of contingent contributions should be limited to 7% of pay over 20 years or equivalent

- Although the University can afford to bear more risk than the sector as a whole, the level of risk already built up in the Scheme, including the last man standing risk, is such that the University wishes to maintain or reduce current levels of overall risk beginning in the 2018-21 period

Design

- The University has taken action to reduce risk in its in-house pension arrangements for support staff by reducing accrual rates and introducing a hybrid structure for new entrants.
- The University wishes to reduce the risk associated with future benefit provision under USS in a similar way and notes that the proportion of benefits provided on a DC basis is currently only 10-15%, with 85% to 90% provided on a DB basis.
- The University notes that there are alternative ways to share risk between employers and employees and these should be considered alongside the salary threshold method currently used.

Other

- The University would expect to see proposals to sectionalise USS
- The University would like to understand what lessons can be learned from not hedging interest rate and inflation risks in previous years, noting that falls in real yields were a significant contributor to the increase in deficit on a like for like basis