pensions

From: pensions
Sent: 07 September 2023 15:05
To: pensions
Subject: Consultation on USS 2023 Valuation

Dear Colleague,

I am writing to invite your input to inform the University's response to the ongoing UUK consultation on the 2023 valuation of USS. Whilst legally speaking, the UUK consultation is of the 331 employers participating in the scheme, the University has traditionally sought the views of scheme members at each stage of the valuation process.

You will also shortly be receiving a separate communication directly from the USS Trustee giving notice the statutory consultation that they will be commencing with scheme members towards the end of this month. This is a separate, but complementary, consultation to the UUK one.

As you may have seen from media coverage over the summer, the financial situation of USS has improved dramatically since the controversial 2020 valuation. The Trustee's proposed technical provisions for the 2023 valuation turn the £12.5bn deficit estimated at the 2020 valuation into surplus of £7.4bn.

Contribution rates and future stability

Under the valuation, the cost of future service is projected to fall from 25.2% in the 2020 valuation to 16.2% for the current benefits package, or 20.6% for the pre-April 2022 benefits package. The cumulative impact under current USS cost-sharing rules is shown in the table below. For members, the proposed outcome would see benefits restored to the pre-April 2022 levels, and contribution rates fall to an historic low of 6.1%.

	Total	Employer	Member
2020 valuation contribution rates (25.2% for future cost of current benefits package +6.2% deficit contributions)	31.4%	21.6%	9.8%
Future cost of current benefits package under 2023 valuation	16.2%	9.88%	5.35%
Proposed outcome with improvement in benefits to pre-April 2022 level, surplus retained	20.6%	14.5%	6.1%
Improvement in benefits to pre-April 2022 level, surplus spent over 15 years as a partial contribution holiday	15.4%	11.1%	4.3%

Illustrative outcome of a 2026 valuation if future contributions increased to 25.2%	25.2%	17.5%	7.7%

UUK and UCU issued several joint statements as the valuation emerged over the spring committing to reinstating the pre-April 2022 benefits package where that could be done in a demonstrably sustainable manner. This would raise the DB threshold from £40k to around £60k (adjusted for inflation); increase the accrual rate from 1/80 to 1/75; and reinstate inflation protection (CPI up to 5%; half of CPI up to 15%).

A key decision will be whether to retain the £7.4bn surplus as a hedge against future instability, or to use it to reduce contribution rates still further. As shown in the table above a partial contribution holiday spreading the surplus over 15 years could enable the pre-April 2022 benefits package to be provided for only 15.4% of the salary bill, and could reduce members' contributions to as low as 4.3%. However, this would significantly increase the likelihood of contribution rates for the cost of future service increasing to above the current 25.2% level for future service at the next valuation, as well as presenting future problems and issues of intergenerational fairness when any contribution holiday came to an end.

It's also unclear to what extent the rosy picture presented by the 2023 valuation represented a combination of freak circumstances or a "new normality". The main driver of the improved circumstances has been the change in interest rates, although the covenant support package introduced as part of the 2020 valuation has also had a considerable impact. A significant reversal in interest rates could have an adverse impact on future valuations.

Retaining the surplus would create greater stability in the scheme – for example it would reduce the probability of contribution rates for future service exceeding the current 25.2% over the next two valuation cycles from a 60% likelihood if the surplus is spent to a 25% likelihood if it is retained. Although stability could further be improved if a higher contribution rate than 20.6% were to be agreed, for example by maintaining current levels of contributions for the cost of future service (25.2%), we understand that the impact of this on scheme stability is unlikely to be significant, particularly when weighed against affordability considerations for both scheme members and employers.

We would welcome your views on:

- **Whether the proposed 20.6% contribution rate strikes an appropriate balance between maintaining future stability and benefiting from the improved position;**
- **Whether the surplus should be retained as a hedge against future fluctuations;**
- **Whether USS should prioritise the delivery on the previously announced intentions to return to the pre-April 2022 benefits package.**

Timing of changes

The Trustee's current assumption is that benefit changes will be introduced from April 2024. However, it is apparent that earlier implementation – potentially from 1 January 2024 - would be possible, assuming swift agreement at the USS JNC between UUK and UCU. Under current contribution arrangements, employers are paying for a deficit that does not exist, and UUK's actuaries, Aon, calculate the level of overpayment to be around £125m a month. Even with an implementation date for new contribution rates of 1 January 2024, the surplus payments built up since the valuation date of 31 March 2023 could be used to provide an uplift to benefits in recognition of the lower benefits accrued since 1 April 2022, without touching the scheme surplus at the valuation date.

We'd welcome your views on

- **whether we should push for a 1 January 2024 implementation date for the new benefits package and contribution rates;**
- **whether we should lobby for the surplus payments made since 31 March 2023 to be used to offset the lower benefits accrued since 1 April 2022.**

Future developments

Whilst UUK's consultation focuses on securing agreement to a positive outcome from the 2023 valuation, this needs to be set in the context of ongoing work on the future stability of the scheme, including the review of governance and the development of more flexible and lower cost options. UUK have set out a journey plan of nine interlocking elements (stability, reduction in contributions, improvement to future benefits, commitment to covenant support, utilisation of surplus, conditional indexation, governance review, changes to long-term investment strategy, and lower cost / flexibility options). This provides a sensible and comprehensive route map to try to capitalise on the current beneficial situation to provide for sustainability in the longer term.

We intend to play as full a part as possible in supporting this work, and would welcome your involvement. During the 2018 and 2020 valuation processes, we established an informal Pensions Communications Group to help shape our consideration of strategic issues around USS and arrange communications to local scheme members. We'd welcome expressions of interests in participating in a resurrected Pensions Communications Group.

Next steps

We need to provide our response to UUK's consultation by 22 September. So that we can incorporate views expressed by members in our response, please let me have any thoughts on the issues highlighted above by close of business Monday 18 September.

The USS consultation material can be found on the USS webpage.

Yours sincerely,

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