



## USS Valuation 2017 Working Group

### Outputs & recommendations for input to USS consultation on proposed assumptions for the scheme's technical provisions and Statement of Funding Principles Sept 2017

Date: 12 September 2017  
From: USS Valuation Working Group Members  
To: Professor Sir Keith Burnett, President & Vice-Chancellor, & UEB

#### For consideration.

#### Executive Summary

1. The USS Valuation Working Group was convened earlier in 2017 to consider the initial assessment of technical methodology and inputs for the USS 2017 valuation. The purpose of the group was to collectively inform a University response to the 2017 valuation that is knowledge-based and representative of both members and the University.
2. The views in this document represent a summary of the collective views of the Group rather than one particular constituency.
3. The Group welcomes the USS Trustee changing its position in respect of the level of prudence in its assumptions.
4. The Group however is unable to recommend either acceptance or rejection of the assumptions as presented by the USS Trustee in its consultation documentation. This is on the basis that:
  - a. There are a number of key pieces of information which are not available to fully understand the position
  - b. The USS Trustee's Test 1 is too complex to fully understand and its impact on the funding position of the scheme and the behaviours it appears to drive are not well explained and may be counter-productive
5. The Group acknowledge the cost pressures on the University and that it is likely to see its current levels of contribution (18%) as the maximum acceptable.
6. The Group understands the University's likely position in terms of seeking to contain and limit the reliance placed on the employers by the scheme in future.
7. This report is intended to inform the University's formal response to the USS consultation, taking advantage of the considered opinions of a range of internal stakeholders. The University's final response will be determined by the President & Vice-Chancellor following discussion by UEB.

## **Working Group Input/Response**

The Working Group comprises stakeholders from different perspectives – the employer (HR and Finance), trade unions (UCU) and wider staff group. Despite this there is a shared objective in relation to pension provision at the University. That is to ensure the best possible benefits for members available in a long-term sustainable fashion and in a manner that is affordable for both members and the employer. It is with this shared aim in mind that the following points are made.

It is assumed that the Vice-Chancellor and UEB have had access to the USS consultation document on which this commentary is based.

### **Technical Provisions assumptions (excluding Test 1 – see below)**

The technical provisions are a prudent estimate of the assets needed to pay the pensions earned up to the valuation date (accrued pensions) and the cost of providing those benefits in future. This requires the trustee to make a number of demographic and financial assumptions and to apply an appropriate level of prudence.

The Group welcomes the trustee's approach to rely more on a "best estimate" approach to the majority of these factors. The Group considers this, along with reliance on actual scheme experience gives a more realistic view of likely outcomes without an excessive level of prudence. The Group acknowledges that a certain degree of prudence is required under law in undertaking a valuation of this kind.

The Group notes the commentary (p12) in the consultation document regarding the scheme actuary's view that the level of prudence being close to the upper end (i.e. most optimistic end) of the range which he considers acceptable. The Group considers that this is probably appropriate given the multi-employer nature of USS and the collective strength of covenant.

The Group is unclear however whether this view on the level of prudence being at the most optimistic end of the scale includes or excludes the change to investment strategy caused by Test 1. In other words, would the level of prudence still be acceptable to the scheme's actuary were Test 1 to be removed?

The Group notes that under a "best estimate" basis of assumptions the USS Trustee would expect to see an £8.3bn surplus and yet, with under the proposed prudent levels of assumptions (including Test 1) this position becomes a £5.1bn deficit. The spread of possible outcomes is large. The extent to which this is as a result of Test 1 is unclear (see below for a commentary on Test 1).

### **Test 1**

Test 1 is used by the USS Trustee to assess the level of planned funding of the scheme so that the reliance on the employer is no more than the "risk budget" available (see p5 of the USS consultation document).

The aim of Test 1 is to ensure that moving the scheme to the relative security of a self-sufficient portfolio is within affordable reach at the end of a 20-year horizon. It defines 'affordable reach'

(elsewhere articulated as 'reliance') to be the total of 7% of payroll paid over a 20-year period. It notes that this is an *in-extremis* scenario.

The effect of Test 1 is to steadily remove investment risk from the scheme. The group understands why the University may feel this aim is sensible. However, this comes with an associated cost of lower forecast investment returns, which in turn can lead to decreased benefits or increased contributions. Further, it is not clear whether Test 1 and the resulting de-risking of investments would result in an increase or decrease of the risks above, and whether there are better ways to achieve this.

The Group notes that Test 1 is not a statutory requirement but a construct of the USS Trustee as a means to achieving the two objectives above.

In determining the value of 7% of payroll over a 20-year period (the figure used in the articulation of Test 1), USS appears to have added a further £3bn of prudence in reducing the actual figure from £13bn to £10bn. The reason for this is unclear in the documentation.

The Group remains unclear as to the way in which Test 1 seeks to achieve its aims, its interplay with the other assumptions being proposed and the linkages to the de-risking strategy. In particular, there is a concern, based on the information provided, that application of Test 1 may drive a level of de-risking that harms the long term performance of the scheme and is therefore counterproductive.

The Group wishes to more fully understand the logic behind Test 1, the behaviour it drives and the likely future impact on investments, funding levels and moves towards de-risking. The Group would also welcome clarification regarding under what circumstances the scheme would be in a position to need to seek a move towards self-sufficiency. In summary, the Group considers that Test 1 is not well enough understood by stakeholders to determine whether its approach to achieving its stated objectives is sensible or not and as such feels unable to make a reasonable recommendation.

The Group recommends the University seeks this clarification from USS via UUK before it commits a response which accepts the assumptions as presented.

### **Request for further information**

Throughout the Group's discussions it has been difficult to make informed decisions or observations on the basis of the information presented. Further information from USS would help to clarify points, answer queries and provide a greater level of transparency to help stakeholders understand the position more clearly.

The Group would welcome the University requesting further information from USS via UUK as the employers' representative on the following matters:

- The USS projected cash flow position over the coming 20 year horizon. It is acknowledged that increased membership creates not just increased inward cash flow but also additional liabilities in the scheme, however understanding the expected cash flow position in this time horizon will give an indication of the pressures on the scheme to

“cash in” its investments to pay benefits or ability to take a longer term view of its investments.

- The actual impact of Test 1 on the deficit position – i.e. if Test 1 were removed (and any other assumptions had a level of prudence to be in line with the expectations of the Pensions Regulator) what would the valuation position of the scheme look like? This would help stakeholders see the “price” of using Test 1 to achieve the objectives outlined above.

### **Implications on benefits**

If the assumptions as proposed are accepted the scheme will report a £5.1bn deficit position which will require on-going deficit recovery contributions of 2.1% of payroll from participating employers. This represents contributions of c£4m per year from the University of Sheffield for a period as yet undetermined.

In addition the assumptions push the cost of future benefits (at their current levels) up to 30.5% (a total contribution of 32.6%). Given the clear position of the collective employers that 18% is the maximum level of affordable employer contributions, the only remaining lever to pull will be to amend scheme benefits for future members (or increase contribution levels for members).

Though not articulated in the USS consultation documentation this is likely to mean a reduction in the salary cap at which defined benefits are accrued by members, or a reduction in the 1/75<sup>th</sup> accrual rate and a greater proportion of benefits building up in the defined contribution section. The Group urges the University to consider the implications on benefit structure when considering whether or not to support the assumptions as proposed by the USS Trustee and whether a reduced defined benefit pensions offer would represent value for money for the University and continue to be an attractive proposition for current and prospective staff when compared to other sectors or pension scheme options within the HE sector (e.g. Teachers' Pension Scheme).

### **Conclusions**

The Group members and the University share a common aim of ensuring a pension scheme for University staff which is attractive, affordable for all and sustainable in the long term. The views put forward in this document are intended to support the University's decision making in forming its response to the consultation exercise via UUK.

The Group recognises the legal constraints on the USS Trustee in terms of their obligation to ensure that pensions promised can be paid and also the requirements of the valuation process and Pensions Regulator. As such the importance of being able to fulfil promises made and to ensure appropriate levels of prudence in determining the scheme's technical provisions is clearly key.

The Group also understands the University's desire to keep contribution rates at levels which do not have an adverse impact on its ability to deliver against its strategy and to continue to invest appropriately to support its ongoing success. The attraction to the University of the objectives of Test 1 is also noted.

The Group remains concerned however over the significant impact that the valuation may have on the future benefits offered in the short term and the long term sustainability of the scheme. The Group considers that it is important that all stakeholders have enough clear information on which to base their feedback and would welcome the University seeking this clarification before submitting its response to the consultation.

### **Next steps**

This report will be shared with the President & Vice-Chancellor and UEB for consideration in determining the University's formal response to the USS valuation consultation process on the proposed assumptions for the scheme's technical provisions which is due to be submitted by 29 September 2017.

## Appendix 1: Working Group Membership & Remit

Name	Role
Ian Wright	Deputy Director of HR
Suzanne Duke	Reward Manager
Robert Hebblethwaite	Assistant Director of Finance
Sam Marsh	University Teacher , School of Maths & Statistics, and UCU Communications Officer
Matthew Malek	Lecturer – Experimental Particle Physics, Dept of Physics & Astronomy and UCU Pensions Officer
Mark Bryan	Reader, Dept of Economics
Moty Katzman	Reader, School of Maths & Statistics

### Purpose and Remit of Group

A consultative group whose remit is to collectively inform a unified University response to the 2017 Valuation that is both knowledge-based and representative of both members and the University.

### Terms of Reference

- To review employer consultations as part of the 2017 valuation.
- To use its expertise to conduct an overview and evaluation of the valuation that is in scope of any employer consultation and will help inform a University response.
- To provide a collective view that is representative of scheme members but also considers and represents the short and long-term interests of the University.
- The group will input into and help inform the University response to any consultation as part of the 2017 Valuation, but will not determine the final response.
- Any final response will sit with the President and Vice-Chancellor (or their chosen nominee)
- The group will meet as required to provide timely consideration and responses to the USS 2017 Valuation consultation requirements.