Queen Mary
University of London

USS Pension Scheme Update

Outcome requested:	Council is asked to **note** the attached update on recent developments in relation to the USS Pension Scheme.
Executive Summary:	Earlier in March the USS Trustee laid out the key issues and a timeline for the ongoing 2020 valuation of the USS Pension Scheme, on which 59% of Queen Mary staff are enrolled. This included the level of contributions required by members to support the scheme's existing benefit structure. This presents a range of contribution options, each of which is unaffordable for both Queen Mary and members. This paper provides Council with an overview of the current situation and likely next steps, including: i) Developments in relation to the USS Scheme since 2017 ii) The background to the current 2020 valuation, including key drivers for the unaffordable contribution scenarios iii) The response of the sector and Queen Mary to recent developments iv) Likely next steps in the valuation over the coming months As outlined in the paper, this is a challenging situation, with the financial implications of recent developments, and increasing intergenerational unfairness, making it increasingly clear that securing the best possible sustainable pension for our staff will involve benefit reform.
QMUL Strategy: strategic aim reference and sub-strategies [e.g., SA1.1]	The USS issue impacts across all areas of our Strategy, with a particular focus on financial sustainability, staff engagement and the student experience
Internal/External regulatory/statutory reference points:	n/a
Strategic Risks:	Risk 1: Greater student satisfaction Risk 2: Improving staff engagement Risk 12: Improved cash generation to enable investment Risk 13: Improved reputation Risk 17: External environment
Equality Impact Assessment:	N/a. Issues of inter-generational unfairness are addressed in the Paper

Subject to prior and onward consideration by:	The Report has been discussed by the Senior Executive Team and circulated to Heads of School for information.
Confidential paper under FOIA/DPA	No
Timing:	There are a number of milestone in relation to the 2020 Valuation which will take place over the coming months
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Date:	18 March 2021
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USS Pension Scheme Update

March 2021

A Paper by the President and Principal

Background

Queen Mary University of London (QMUL) offers three work-place pension schemes: the Universities Superannuation Scheme (USS); the Superannuation Arrangements of the University of London (SAUL) and the NHS scheme. USS is available to all staff on grade 4 and over, and has an exclusivity clause restricting employers offering an alternative pension scheme to eligible staff on these grades. 59% of our staff are in the USS, 19.2% are in SAUL, 6.1% are in the NHS, and 15.7% of our staff are currently not in any of our work-place pension schemes. In terms of USS, a sixth of our staff (grades 4 and above) are not enrolled in any work-place scheme, with BAME staff more likely not to be enrolled. The number of staff opting out of our work-place schemes (and so not benefitting from employer contributions) is a significant concern. This also aligns with the sector wide opt-out of the USS scheme of 1 in 6, with evidence from across the sector that the opt-out is mainly by younger members of staff due to the affordability of member contributions. This suggests that there is intergenerational unfairness within the current scheme which needs to be addressed.

The USS Scheme

The governance structure of USS is shown in Appendix A. The USS Trustee Board is made up of five independent directors (including the Chair), four directors appointed by Universities UK (UUK) and three directors appointed by Universities and College Union (UCU). The USS Trustee has clear legal and financial responsibilities and must manage and administer the scheme to make sure members get the benefits they are due at the right time. In the latest valuation and communication, the Trustee has made it clear that their role is to solely price the current benefit structure and it is the Joint Negotiating Committee's (JNC) role to define any changes to the benefit structure. This is a questionable position since the Trustee's responsibility is to ensure a viable pension scheme. The JNC is a body comprising five members nominated by UUK (representing employers) and five members nominated by UCU (representing members), with an independent Chair. This creates a very difficult governance structure to ensure the best possible affordable pension scheme going forward.

QMUL's position is clear on the USS pension; as a work-place private pension we need to provide the best possible pension for our staff that is affordable and sustainable for the University and staff members, and will deliver the pension promised to staff as they retire.

The USS Trustee and The Pension Regulator currently highlights that the principal risk that the USS private scheme faces is that it will not have enough funds to pay the pensions already promised to its members, which are due to be paid out over the course of the next 70-plus years.

In essence there are three main components to a private pension scheme that can be 'flexed' to achieve the best possible pension for staff members that is affordable. These components are, i) the level, and nature, of the benefits provided; ii) the total contribution rate (employer and employee contributions); and iii) the covenant strength.

USS currently operates a hybrid benefit structure where members accrue defined (promised) benefits (DB) up to a £59,586 salary threshold at a 1/75 accrual rate. The current contribution rate is 30.7% (21.1% of salary from the employer and 9.6% from the staff member). Above the salary threshold, total contributions of 20% (12% from the employer and 8% from the member) are paid into an Investment Builder (the Defined Contribution section – DC). Indexation on the DB pension is paid in line with CPI up to 5% and half of CPI between 5% and 15%, which is very generous and expensive in terms of the cost to support. It is important to note that of three main components outlined above, the most significant driver of costs (in terms of contributions) is the level, and nature, of the benefits provided.

In terms of the covenant, employers are responsible for making sure that there is enough money in the scheme to pay the promised benefits to members. The covenant is a measure of the employers' financial ability and commitment to support the scheme. When the scheme takes investment risk, it is relying on the covenant for support if, for example, investment returns are lower than expected. The sector has worked with the Trustee to strengthen the covenant in recent years including debt monitoring, pari passu arrangements against loans, and a moratorium on leaving the scheme.

Queen Mary, together with other universities, remain concerned about financial constraints currently imposed, or suggested to further strengthen the covenant, by the USS Trustee, since this will erode the University's future financial autonomy which is critical to its long-term sustainability and success. Unless we hold firm on our position of ensuring that the University maintains full financial autonomy, the University will effectively hand control of its balance sheet to the USS Trustees. Notwithstanding our concern about these covenant measures, Queen Mary agrees with the position of UUK that both the USS Trustee and the Pensions Regulator continues to underestimate the current collective covenant strength of the 340 employers in the scheme. We will work with UUK to continue to challenge both the USS Trustee and The Pensions Regulator on its assessment of the current covenant strength, whilst fully recognising that benefit reform is urgently needed going forward. It is important that the employers through UUK challenge the assessment of the covenant strength to ensure that the scale of benefit reform is proportionate, justified and in the best interests of scheme members.

The contributions are defined based on the level and structure of the benefits, the deficit in terms of ensuring that current promised pensions are delivered, and the service costs of delivering pensions going forward. Benefits already earned by members cannot be changed by law and so deficit recovery contributions will be required. Therefore, the scope for benefit changes to reduce contributions needs to be focussed on the future service contribution rate. However, it should be noted that a failure to change the benefit structure previously (including in 2017) has resulted in a required increase in deficit recovery contributions to address the deficit.

Past, current, and scenario-based possible future contribution rates are summarised in Table 1. The section below gives an overview of how we arrived at the current benefit position, and more detail on the possible future scenarios. In terms of future scenarios the table also highlights the required deficit recovery contribution (DRC) and the future service costs (FSC) for each possible scenario.

		2017 Valuation	2018 Valuation		2020 Valuation		
	2017	April 2019	Oct. 2019 **Current Contribution Rates**	Oct 21 Increase	Scenario 3: Strong Covenant Support	Scenario 2: Some increase in Covenant Support	Scenario 1 Existing Covenant Support
Employer	18%	19.5%	21.1%	23.7%	28.6%	33.7%	38.2%
Employee	8%	8.8%	9.60%	11.00%	13.5%	15.9%	18.0%
Total Contributions	**26%**	**28.3%**	**30.7%**	**34.7%**	**42.1%**	**49.6%**	**56.2%**
DRC					8.5%	14.9%	19.2%
FRS					33.6%	34.7%	37%
Employer Cost 20/21 £m			30.7	34.5	41.6	49.0	55.6
Increase v 2018 Schedule of Contributions £m pa				+3.8	+10.9	+18.3	+24.9

Table 1: Contribution rates as a percentage of salary

<u>Developments since 2017</u>

In March 2017 the USS Trustee announced that the scheme had a large deficit (£7.5bn) that needed to be addressed, alongside an increase in the costs of providing new defined benefits going forward. At that time UUK proposed changes to the scheme with the aim of making it sustainable and keeping future contributions affordable (at the 2017 rates) for members and employers.

In response to this, disputing the basis of the valuation and arguing that the there was no deficit, the UCU on behalf of members commenced industrial action which resulted in strikes taking place across 61 universities. The strike action was suspended when UUK and UCU agreed to set up a Joint Expert Panel (JEP) to independently review the valuation to enable all stakeholders to gain a common understanding of the valuation of the scheme. The JEP had a clear remit not to consider benefit reform to allow all stakeholders to come to the table.

It is important to note that the JEP has no official standing, responsibility, or accountability, in contrast to the statutory roles of the USS Trustee and The Pensions Regulator. The USS Trustee has clear legal and financial responsibilities and must manage and administer the scheme to make sure members get the benefits they are due at the right time. The Pensions Regulator protects UK's workplace pensions, by making sure employers, trustees, pension specialists and business advisers can fulfil their duties to scheme members.

To allow the JEP to finish its work a new valuation was announced in 2018, with the level, and nature, of the benefits remaining in place. The 2018 valuation was concluded with a total contribution rate of 30.7% of salary, with employers paying 21.1% and members 9.6%. Under this valuation (still currently in place) contributions will rise again in October 2021 to 34.7%. Although at the time of the 2018 valuation it was agreed that this contribution increase should be avoided by completing a 2020 valuation, since it was considered unaffordable, the current position is that these contributions are highly likely to come into force, due to the delay in the 2020 valuation and lack of decisive action.

As the JEP continued its work to find a mutually agreeable solution for the future of the scheme (as agreed following the 2018 strikes) further strike action commenced in November 2019 and continued through to March 2020 as the UK went into lockdown, in parallel to ongoing work by the JEP and 'tripartite' talks. Throughout this time UCU maintained its 'no detriment' position, meaning no reduction in benefits, and no employee contributions over 8% as it was before October 2019.

Amidst these developments the bigger picture, and current situation, is that since 2017:

i) Contribution rates for members and employers have steadily risen to unsustainable levels. Contribution rates for employers have risen by 50% over the last decade, and risen unsustainably for members as well, to the point where, as highlighted above, 1 in 6 members have left the Scheme.
ii) The funding position of the scheme has steadily deteriorated amidst ongoing low interest rates and volatile market conditions, meaning that an increasing level of deficit recovery payment is required.
iii) Four years of industrial action led by UCU has caused significant damage to the sector, and reputational and financial damage to Universities in the eyes of government and society.

There have been various attempts and extensive dialogue to attempt to find a solution to the dispute, and along with other universities we have responded to a number of different consultations covering different aspects of the scheme and its funding, all of which we have shared with Council and our staff community. Our position as an institution is essentially unchanged from 2018: that the pension scheme in its current form is unsustainable, and the benefits of the scheme need to be reviewed and reformed. Developments since 2018, in which the funding situation has deteriorated, and a large number colleagues continue to opt out of the scheme, have only reaffirmed this position.

2020 Valuation

March 2021 saw a significant development in relation to the ongoing 2020 valuation of the scheme, with the USS Trustee setting out the key issues and a timeline for the 2020 valuation. The Trustee published its actuarial report (known as the section 76.1 report), and the level of contributions required by members to support the scheme's existing benefit structure. The update is challenging, with the USS Trustee placing the Scheme's deficit at between £14.9bn and £17.9bn, meaning that under each of the scenarios outlined there is a significant element of deficit recovery required. Due to the benefit scheme adopted, by law the Trustee must adopt a cautious (or 'prudent') approach to the valuation rather than on a best estimate basis.

The USS Trustee sets out a range of pricing scenarios, alongside the level of covenant support required under each scenario. The scenarios (summarised in Table 1 above) increase the contribution rate from 30.7% to a range from 42.1% to 56.2%, as follows:

- **Scenario 1** – a total contribution rate of **56.2%** (including 19.2% deficit contributions) – based upon the current covenant support, in effect the status quo

- **Scenario 2** – a total contribution rate of **49.6%** (including 14.9% deficit contributions) – based upon the package of covenant support measures that UUK illustrated employers might be willing to collectively support based upon consultation feedback

- **Scenario 3** – a total contribution rate of **42.1%** (including 8.5% deficit contributions) – based upon a further strengthened package of covenant support measures identified by the Trustee.

The Pensions Regulator has stated that only Scenario 1 is compliant with its statutory requirements. A link to the letter from The Pensions Regulator to Dame Kate Barker, Chair of USS, can be found here.

It is clear that all these scenarios are unaffordable and benefit reform is required. However, it is also clear that, although reform is required to the future benefit structure, we need to ensure that any reform is based on a reasonable assessment of the covenant strength to obtain the best possible pension for members based on the current contribution rates.

Although benefit reform is required to maintain the current contribution rates we would also need to look at different approaches to contributions as part of a move away from a one-size-fits-all approach to address the current high opt out rate and growing intergenerational unfairness. With existing benefits accrued protected, any benefit reform disproportionately impacts early-career and younger staff.

UUK and UCU Response

UUK, on behalf of employers, has pushed back on the communication from USS, especially where blame seems to be shifted by USS towards employers, arguing that further justification is required from USS for the price of contributions outlined. A consistent position from UUK, as explained above, is that USS – which is influenced on this point by the Pensions Regulator - undervalues the current covenant support offered by employers.

UUK initially issued a strongly worded statement on the matter, which can be found here. This was followed with a letter which goes further in formally asking the USS Trustee to review the illustrative outcomes, stating that UUK has ‘not received strong or clear justification for the very high pricing decisions and, as such, although employers accept that reform is required they are very concerned that the scheme is facing an unnecessary and unjustified level of reform. Letters from UUK to the USS Trustee and The Pensions Regulator can be found here.

UCU so far has issued a more muted response, highlighting their previous assertion that the valuation methodology is flawed, and stating that it will shortly hold a special sector conference for higher education branches to decide next steps and ‘cannot rule anything out’, with the threat of industrial action clear.

Queen Mary’s Position

There is much in common between our position on the recent developments and the UUK position, and I continue to work at a national level to influence the direction of travel. In particular we are in alignment with UUK that:

- The scheme is unsustainable in its current form and requires benefit reform, whilst preferably maintaining a hybrid model of DB and DC.
- That the USS Trustee has not provided sufficient justification for the high prices outlined above, each of which are clearly unaffordable for members and employers
- We also believe that the Trustee has not taken account of the Technical Provisions consultation which took place last year, with commitments made by the sector as part of this to strengthen the covenant. This includes commitments made in relation to debt monitoring, individual institutions leaving the scheme, and granting USS pari passu status.
- We are further concerned about the overly narrow view adopted by USS of its role in this process. The USS Trustee’s position is that its role is to price the benefits agreed

upon by the JNC, and that it has no material role in the valuation outcome. As outlined in the UUK letter, this ignores the role played by the USS Trustee's decisions – in particular in relation to covenant strength and relative importance attached to it – on the valuation and the overall viability of the scheme, which the Trustee must be responsible for.

Overall, it appears that the USS Trustee and Regulator has placed a disproportionate degree of significance in the withdrawal of Trinity College Cambridge from the USS Scheme in 2019. The USS is a 'Last Employer Standing Scheme', with sponsoring members liable for its commitments. Trinity leaving raised the prospect of other employers following this path, leaving a smaller number of employers less able to support the scheme. Trinity had less than 20 members of USS, however, and is unique in the sector in the strength of its endowment (assets). This combination of low membership and significant financial strength means that Trinity paid a sum totalling less than 2% of its assets to USS. The equivalent payment to USS from Queen Mary to leave we estimate would be in the region of £150m.

We have been consistent in our approach since 2018, as expressed repeatedly in consultations: that some form of benefit reform is inevitable to ensure a sustainable scheme and the best possible pension for our staff. The details of this would need to be worked through, but essentially this would potentially involve a reduction in the amount of defined benefit accrued while maintain the current hybrid structure, which would over time reduce the quantum of DB risk building up and less reliance on covenant, which could lead to more risk being taken by the Trustee and better returns to support pensions going forward.

As an institution we remain concerned about the impact of covenant support measures on the long-term autonomy of us as an institution. In particular, while we were content to accept enhanced debt monitoring provision, we are concerned about limiting our future ability to raise capital through USS commitments being granted pari passu status. While our strong financial position and robust gateway evaluation process meant we were able to make it through the previous financial year, having an external agency such as USS having such a degree of say over our financial activities may place the institution at risk. The last year has shown that it is essential to be able to act with agility.

We have repeatedly expressed concern with the governance of the USS Scheme, which makes it difficult for necessary long-term, but challenging decisions to be taken. The JNC, which currently define the benefit structure, is comprised of an equal number of UUK and UCU representatives, with an independent chair. This inevitably results in adversarial outcomes and paralysis of decision-making, particularly in discussions on overall reform. Further attempts at engaging a broad church of opinion through the JEP have also resulted in difficult decisions being deferred and benefit reform not being considered.

<u>Next Steps</u>

We are awaiting a response to the letter from UUK to USS. Meetings are ongoing between UUK, the USS Trustee and Pensions Regulator, with UUK encouraging them to further consider the value of the measures employers have illustrated to support a strong covenant and publish clear reasoning for the much higher level of contributions. UUK are also attempting to negotiate with USS and UCU to develop options for affordable benefit structures backed by appropriate covenant support measures. As highlighted above I continue to attempt to influence the conversation at a national level through the Russell Group and UUK. At the moment however there does not seem to be a way to stop the increase in October contributions coming into force.

Later in March UUK will consult universities on the way forward to address the scheme's high opt-out rate, and the sizeable deficit including covenant support measures, affordable benefit structures and contribution levels. At this point all staff members will be invited to contribute to the consultation. This is likely to bring the issues outlined above further to the fore, but unless there is meaningful engagement on the issue of benefit reform then at the present time industrial action is a distinct possibility. This would be incredibly damaging for the sector. It will mean some students will have faced industrial action during all of their years at University, with strike action occurring every year for the past 4 years. It is also likely to be very badly received by government, who are of the view that the sector should have resolved this issue in 2017/18. The government are also concerned that a significant amount of the student fees is being used to support the USS private pension scheme, which they see as being unfair to students (who are supporting the private pension scheme through their fees and long-term repayments), not value for money, and increasing intergenerational unfairness.

We have begun the process of engaging with staff. This is challenging on a topic as complex as this, but our messaging will be focussed on making it clear that we are working for the very best possible pension for our staff – one that is affordable, sustainable, will deliver promised pensions, and will be fair for staff of all levels and all stages of their career.

Professor Colin Bailey
14th March 2020

Appendix A: Governance Structure of USS