**Vice-Chancellor**
Sir Alan Langlands FRSE HonFMedSci

University of Leeds
Leeds LS2 9JT

T +44(0)113 343 3000
E vice-chancellor@leeds.ac.uk

UNIVERSITY OF LEEDS

Alistair Jarvis,
Chief Executive,
Universities UK,

6 October 2017

Dear Alistair,

USS 2017 Valuation

Following a wide-ranging discussion in our Council last week, I am writing to add some explanatory context to the answers we are submitting today to your questionnaire on the 2017 valuation of USS.

In considering the issues raised by the consultation, the Council started from the position that it wants university staff to have access to a pension scheme which is both attractive and valuable and yet stable, secure and sustainable. It is not in the interests of employees – nor indeed in the interests of employers – for a pension scheme to carry disproportionate risk.

The fundamental question is, of course, whether USS in its present form is stable, secure and sustainable, given in particular

~ the challenge posed by rising life expectancy, which has greatly increased the costs of the scheme over the past two decades or so;

~ the current level of deficit in the scheme, which we note would be £5.1 billion on the USS trustee's proposed assumptions but would have been £12.7 billion had the 2014 assumptions been carried forward;

~ the increasing costs of future benefits, which we note have increased by a third (but the increase would have been twice as high if the 2014 assumptions had been maintained);

and taking into account the likely views of the Pension Regulator on these issues.

We recognise that what constitutes 'disproportionate' risk is a matter of judgement, requiring very careful thought and discussion by UUK, UCU and USS itself as the consultation and subsequent discussions unfold. But we do need to say that, as one of the largest employers in USS, the University of Leeds has significant concerns about the risks that currently seem to be embedded in the funding of USS. We are particularly concerned that the USS trustee appears to be attempting to manage down the level of deficits and costs at this valuation by reducing the prudence in its assumptions. Whilst it may be helpful to have some attempt to reduce costs by removing unnecessary prudence, and whilst some of the assumptions and methodology used by USS need careful scrutiny (perhaps Test 1 in particular), we fear that the degree of risk has now reached an unacceptable level. We need greater transparency and greater clarity about how risks are to be funded and how they will be controlled in future.

The USS has very little hedging and the trustee seems to be considering what in our view could be an enormous bet with the future of the scheme. A major assumption in this valuation is that long-term gilt yields will revert to their previous levels. There seems to be little planning for the contingency that gilt yields do not pan out as the trustee expects.

Instead, the trustee seems simply to be assuming that the employers (and indeed USS members) will be able to find much more money if the risks do materialise. We are not persuaded that this degree of reliance on the employer covenant is sensible. At Leeds, we do not consider that we can increase the employer contribution beyond 18 per cent. To do so would restrict academic and infrastructure development, place cost pressures on all areas of the University, and put employment security at risk. It could also give rise to student concerns about the use of fees they pay; and, ultimately, it could threaten the financial sustainability of the University.

Against this background, our view is that the only supportable way forward is to stop the risks in this scheme from building further by converting to a defined contribution (DC) arrangement for future accrual and for future members. We understand that this might not be welcome to many members, who might see a DC scheme as offering a less secure pension income than would a defined benefits (DB) scheme. But we consider that a DC scheme can be designed which will allow staff to make reasonable long-term plans for their retirement, and provide generous incapacity and life assurance cover. We have an opportunity now to produce a really good DC scheme, with employer contributions of 18 per cent or thereabouts. If the scheme is cleverly designed, with flexible options, it might be also possible, given the scale of the new scheme, to alleviate some of the risks typically transferred to members when moving to DC. If members of the new scheme choose to take the same degree of risk in their DC investments as the DB scheme is proposing to take, their returns over future years should be the same.

As we say in the questionnaire, we also think USS has an important role to play in supporting members in this long term planning and in any transition to a new scheme so that they are well equipped to make good decisions which will lead to good outcomes. More immediately, and whilst we consider that debate on the future of USS needs to be carried out through the agreed national mechanisms, we consider that USS has to be more open and transparent in its communications with members. It needs fully to explain and justify its (complex) valuation methodology and assumptions, and it needs to respond openly and directly to any issues, questions or concerns that are raised.

Please do not hesitate to come back to us if you would like any elaboration of our views.

Yours sincerely,

Alan Langlands
Vice-Chancellor

## USS Consultation Questions

*The options in the UUK survey are shown in full below; the Leeds response is highlighted in yellow.*

**Survey questions**

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

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)

## Risk and reliance

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

**(b) Do you have any additional views or concerns regarding the level of risk being proposed?**
The view of the University is that the risks being taken in the scheme are at an unacceptable level. Before the USS trustee has applied (what appear to be unjustified) adjustments to the levels of deficit, future cost and reliance compared to 2014, the increases that have developed since the last valuation demonstrate the huge risks embedded in the scheme and the University sector cannot allow these risks to continue to grow in future without threatening its future.

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)?**
• 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

## Cost

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))

(b) Please add any additional comments in support of your response to this question.
Increasing the total employer contribution above 18% of salary will restrict academic and infrastructure development plans, place cost pressure on all areas of University activity, put employment security at risk, and potentially raise concerns from students about this use of the fees that they pay. Ultimately it could threaten the financial sustainability of the University.

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
**(b) We would welcome any further comments to support your answer above.**
We do not have evidence to support this view but believe the implied increase to circa 10% will create affordability issues for some members.

Benefits

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

**(b) We would welcome any further comments to support your answer above.**
We seek a high quality stable scheme, that we are confident will not need major overhaul within the next 5-10 years, to build employee trust in this benefit and ensure as an employer we are being responsible in providing people with a secure, flexible and viable option to plan for their retirement.

The scale of the current scheme assets and liabilities, combined with uncertain longevity, investment returns, and inflation poses too great a financial risk. It risks the future financial sustainability of the University, including our strategic development initiatives, our ability to offer stable and attractive employee benefits for both existing and future staff, and risks severe cost pressure on all areas University activities. The DC option minimises the growth in liabilities, and gives the sector the greatest opportunity to securely fund the past benefits and offer attractive benefits in the long-term.

We are particularly concerned that costs related to the current scheme could escalate to the point that future benefits must be reduced, leading to intergenerational unfairness.

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

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.
Our view is that the move should be permanent.

We seek a high quality DC scheme where:

- employee contributions are flexible so provision for retirement can be made when there are affordability problems;
- the employer contribution is very attractive to members, is linked to the employee contribution and potentially higher than current level of DC contribution;
- incapacity and life assurance cover is generous;
- there are flexible and transferrable benefits that appeal to International staff;
- there is flexibility in how benefits are taken at retirement; and
- there is greater emphasis on USS providing education and support to members in their retirement planning.

Final remarks
10. **What additional support can UUK or the USS trustee offer to support your institution in the valuation process?**
We would like USS to be more open and transparent in its communication with members and employers, fully to explain its (complex) valuation methodology and assumptions, and to respond openly and directly to any issues, questions or concerns that are raised.

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