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(1) The ability of employers to make higher contributions

• The Trustee believes, based on advice given to it, that employers have the ability to increase their contributions to the USS to 21%

The USS Trustee, along with its covenant advisers PwC, has undertaken further work to assess the ability of employers to make higher contributions should they be required. It is emphasised that this is an assessment of absolute ***ability*** of employers to make contributions, rather than an assessment of what would be ***preferred***. In its provisional report, we understand that a small number of USS institutions, covering one-third of the scheme's liabilities, were engaged. This was a survey of their ability to make higher contributions, and on the decisions which they would need to take should such higher contributions be required. The exercise also included an examination of latest HESA data for approximately 125 employers, which covers 95.5% of the deficit.
In short, the USS Trustee – based on PwC's provisional advice – continues to believe the participating employers provide a "strong" covenant to the scheme, although the amount of risk to that covenant has increased since their initial review in 2016. On the affordability front, the Trustee's conclusion is that the vast majority of employers covered by the HESA data could increase contributions to 21%, and acknowledged that increasing to 24.9% is more challenging.
We understand that the USS Trustee board will consider the final report of the PwC covenant review in early July; UUK has not had sight of that report.

UUK's initial views
Making assessments of the covenant provided by employers to the scheme is complex and is ultimately a matter for the USS Trustee. UUK continues to impress to the USS Trustee the spread and diversity of the employers that support USS and to ensure that any assessment is sufficiently comprehensive.
We are concerned that this assessment of ability to make higher contributions does not address in detail to recognise the very difficult decisions employers would have to make when contributions increase to 21% – or even 24.9% rate. We believe there are very real consequences and may include an impact on institutions':

• headcount,
• recruitment,
• reward,
• existing and new capital investment, and/or
• a potential slowing down of existing business projects.

These, and other, points need to be recognised as having a harmful effect on the sustainable growth of institutions, which is fundamental to the support which underpins the scheme and the security of members' accrued rights.
We are also concerned that the duration of any such higher contributions is considered fully by the USS Trustee. Whilst some employers may have the ability to support contributions of the order of 21%, they may have this ability to do so for only a limited period and beyond this the decisions made (for example on headcount) may well lead to instability.
Finally, UUK is concerned that the broader population of USS employers is taken into account, beyond those covered (for example) by HESA data. UUK has impressed upon the USS Trustee the potential impact of higher contributions on medium to small employers that

participate in USS, and the events that could be triggered which could present a very real risk of destabilising the scheme.

Your views and comments
Whilst we recognise that the above represents only a very short summary of the USS Trustee's updated assessment of *ability* to pay higher contributions – and UUK itself awaits a fuller report – we would welcome your views on the emerging position of the USS Trustee views regarding 21% and 24.9% employer contribution levels, and on UUK's initial views.

University of Leeds : our position is unchanged in that 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, and put employment security at risk. Were contributions to increase to 24.9% we believe these negative impacts are likely to be material.

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(2) Approach to increasing contributions – 21% in 2019/20 then 24.9% from 2020 onwards

• The USS Trustee has advised that it requires employers and members to cover the cost of future service benefits (indicatively 21.0% for employers and 9.6% for members) for the year 2019/20.

• The USS Trustee would then require employers and members to cover the cost of future service benefits and deficit recovery contributions (indicatively 24.9% for employers and 11.7% for members) from the year 2020/21.

While UUK and UCU will, within the JNC, be working on any changes required to the scheme after the JEP has reported in September 2018, the Trustee has set out a plan under Rule 76 which requires higher contributions (more information on Rule 76, and the Trustee's obligations, is available in this factsheet). These contributions would be in place until any alternative outcome decided on by the JNC has been implemented.
It is not yet clear from the USS Trustee how the future service rate and deficit contribution components would be calculated, and how they would be split between employers and members, in its proposal. UUK is engaging with the USS Trustee on this and other questions, which we believe is particularly important to USS employers' FRS102 positions.

UUK's initial views
A staged increase in contributions is preferable to the imposition of the full amount of 24.9% employer contributions from April 2019, although we do want to understand some further detail from the USS Trustee.
In practice, a step up to 24.9% from April 2020 includes deficit recovery contributions of 6% (compared to 2.1% currently). The Trustee would need to consult formally with employers on the recovery plan.
The Trustee has offered further staging of contribution increases in the 2019/20 year which is considered in the next section.

University of Leeds : We agree that a staged increase in contributions is preferable.

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(3) Phasing the step to higher employer contributions of 21% over the 2019/20 year

• The USS Trustee has advised that it requires employers and members to cover the cost of future service benefits (21.0% for employers and 9.6% for members) for the year 2019/20.

• The USS Trustee has said it is willing to phase this increase for employers so that contributions of 19.5% are paid from 1 April 2019 and contributions of 22.5% are paid from 1 October 2019.

The USS Trustee has said it is willing to phase contribution increases over 2019/20 by increasing employer contribution to 19.5% on 1 April 2019 and to 22.5% on 1 October 2019, so that employer contributions over the 2019/20-year total 21% overall.

UUK's initial views

This flexibility on the part of the USS Trustee is welcomed, however, even the initial level of contributions is above the level which employers have told UUK in March 2018 they would pay which is 19.3%. There is also some detail which UUK needs to understand, particularly around deficit recovery contributions. UUK is engaging with the USS Trustee on this and other questions.

Given the JEP is due to report in September 2018, and the Trustee has indicated it require up to 12 months to implement any reforms to the scheme, UUK has been engaging with the Trustee both to try to delay contribution increases to maximise the amount of time available for the JEP to report and the JNC to decide on reforms, and to question the Trustee on the time period they say is required to implement changes to the scheme (see area 7 below). UUK believes that reforms can be implemented in less than 12 months, and should replace the subsequent contribution increases.

Your views and comments

We would welcome views, comments and preferences from employers on the information outlined above in advance of 20 July.

University of Leeds : a phased approach is preferable.

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(4) The impact of higher contributions on members

• Cost sharing rule 76 requires higher contributions on members as well as employers

• There is a risk that materially higher contributions will cause some existing members to opt-out, or for those eligible to join the USS choosing not to join

The USS Trustee has confirmed the aggregate contributions required to fund the current future service benefits – and to support the funding deficit – would be 36.6%. This assumes that the matching contribution by employers is removed, an automatic step which has been confirmed by the USS Trustee (this lowered the aggregate contribution rate from 37.4%). Under the USS cost-sharing formula, increases to contributions are shared on a 65:35 basis by employers and members respectively. The USS Trustee has advised that the cost-sharing formula, absent any other changes, would produce higher contributions for members of 11.7% from April 2020 (up from 8%). A phased approach to contributions for members is also expected over 2019/20 with members required to pay 8.8% from 1 April 2019 and 10.4% from 1 October 2019.

UUK's initial views

UUK is concerned that increasing member contributions to the extent described above – and even allowing for any phasing envisaged by the USS Trustee – would cause members to choose to leave the scheme on affordability grounds, or indeed not to join the scheme. UUK understands that initial work has been undertaken by the USS Trustee on the absolute and relative affordability of member contribution increases to assess this risk, and clearly the phasing of contribution increases is helpful. However, opting-out by members is, in UUK's view, potentially significant and UUK is engaging with USS further on this point.

Your views and comments

UUK would welcome the views of employers as to whether they share the same concerns that we will see a potentially material increase in members opting-out of USS, or choosing not to join. UUK believes this would be harmful to the overall scheme, to the contributions payable to the scheme deficit, and to the extent that it is able to meet its fundamental purpose of providing good workplace pensions (particularly given the exclusivity provisions present in USS).

University of Leeds : we are concerned that increases in member contributions to this scale could materially increase members opting out or choosing not to join but we don't have any evidence to support this. However, the USS benefits are valuable and costly, and therefore if a defined benefit scheme is to be provided in the future the current cost sharing approach is essential.

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(5) Potential removal of the employer contribution on salary above the threshold (Rule 76.5)

• The USS Trustee is seeking a decision from the JNC as to whether to reduce or remove the contributions payable by employers to the USS Investment Builder

Employers' current contributions are 12% of salary above the salary threshold (currently £57,216.50), to members' USS Investment Builder funds.
As part of the provisions of rule 76, the JNC must consider whether *to reduce or remove* the level of contributions payable by employers on salary above the salary threshold.
This would potentially mean that members with salaries above £57,216.50 would receive no employer contributions on their earnings above this salary threshold, and therefore would receive lower overall benefits compared with those provided presently. Removing these contributions would reduce the overall contribution rate required by 1.2% (36.6% less 1.2% = 35.4%).
The USS Trustee has advised the JNC that it has until 20 July to decide whether or not to reduce or remove this element of the employer contribution. UUK has already strongly asked for further time, particularly given the full detail of the Trustee's proposal was not received until after 3 July Trustee Board meeting, however the Trustee has continued to insist on a deadline of 20 July.

UUK's initial views
UUK believes that to reduce or remove the employer contribution on this tranche of salary would disproportionately affect a specific member group (namely those earning above the salary threshold). It would also set a potentially unhelpful precedent.
In practice, the removal of all DC contributions above the salary threshold would only reduce the required contribution rate by 1.2% of salaries. UUK believes that the benefit of reducing the future service cost by such a small amount is potentially outweighed by:
• the destabilising effect it is likely to have on scheme members
• the potential inequity of such a move; and
• the broader signals that might be sent as to which member groups are prioritised over others.

It would mean that all members above the current salary threshold (£57,216.50) would have no employer contribution above that amount. One potential outcome would be that those earning above the salary threshold may opt-out of the scheme, with the harmful disengagement of that member group.
UUK also does not wish to undermine the JEP by taking decisions now to change the benefits provided by USS.

Your views and comments
Reducing or removing the employer contribution could help to address the funding gap, but will adversely affect higher paid staff and may set an unhelpful precedent and undermine the JEP. We would welcome your thoughts and views on the UUK view above in advance of 20 July.

University of Leeds : we agree that a reduction or removal of the employer contribution on salary above the salary threshold disproportionately affects that population, and should not be considered until the JEP has reported.

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(6) Consideration of the broader implications of materially higher contributions

• Higher costs might disenfranchise employers with less ability to absorb such costs, and could undermine the collective structure and funding architecture of USS

• This could lead to actions and behaviours by employers which could undermine the collective support for, and confidence in, the scheme and in the core principles of fairness and equity under which the scheme's liabilities build up and are allocated

USS operates on a collective, non-sectionalised basis. This means that employers pay a single, uniform contribution rate to USS regardless of status, and the assets and liabilities are not segregated. It also means that if any institution were to fail, its liabilities in USS would be picked up by the remaining employers.
USS's rules include an "exclusivity clause" where institutions participating in USS must not offer another pension scheme to an employee who is eligible for USS membership. There is also a requirement to pay a "Section 75 debt", typically a very high cost, in order for an employer to exit USS.
In short, the materially higher contributions may cause employers to review the terms of their participation, to look seriously at ways to reduce their USS exposure, and potentially look at even more radical options which might bring participation in USS to an end.

UUK's initial views
Firstly, UUK recognises the risk in raising the profile of these issues by including them in this document, but the fact is that at least some of the options may legally exist and materially higher contributions may cause employers to pursue options which they would not otherwise consider.
UUK believes that a resolution to the funding challenges of USS is available and will provide longer term contribution requirements for employers which are affordable. UUK has asked the USS Trustee to undertake some level of assessment of the risks described in this area and to take them into account before finalising any contribution requirements. UUK is concerned about the potential damage to the scheme from actions employers may be forced to consider with high levels of contributions, even for a short period.

Your views and comments
UUK believes it is important to raise some of these potential consequences with employers and the USS Trustee. We would welcome the thoughts and comments of employers on their own sense of the risks that exist in this area.

University of Leeds : Increases in contributions of this scale will force some institutions to review the nature of their involvement in USS. Our focus should be on creating a scheme with valued benefits that is sustainable in the long-term.

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(7) The USS trustee's requirement for a 12-month implementation period

• The USS Trustee has asserted that it will most likely take 12 months following a decision of the JNC to implement reforms to the USS

• The USS Trustee does state that the precise implementation period is dependent upon the complexity of any changes proposed, and have outlined that they would seek to implement as soon as practically possible

The JNC is the formal body for considering and deciding upon changes to the USS rules. Once a decision has been made by the JNC, the USS Trustee has informed UUK that:

a) Reforms will most likely take around 12 months to implement

b) The USS Trustee would plan, for operational reasons, to implement reforms in line with the scheme's year end (i.e. 1 April)

UUK's initial views

UUK appreciates that the USS Trustee will have to carry out considerable work to update systems, processes and materials in order to implement any reforms that are decided upon. However, UUK has impressed on the USS Trustee the importance of an early implementation should the JNC decide on any changes, especially given the materially higher contributions which employers and members would otherwise face. UUK has emphasised to the USS Trustee the importance of implementing any reforms in as short a period as practicable, and has stated that it believes employers will take all reasonable steps to assure their readiness to implement changes, for example through their payroll systems.

Your views and comments

We would welcome any views on the potential timings of future reforms, and in particular if employers believe that UUK should continue to press the USS Trustee to ensure they understand that any proposed changes which arise from a JNC decision are implemented as soon as practicable. Also, UUK would welcome views on the willingness of institutions to take steps to ensure their readiness to implement changes.

University of Leeds : we believe any changes should be implemented as soon as practicable and are committed to making the local changes necessary.