

Document C3

Please note this consultation document sets out the provisions of the Framework under either Scenario 2 or Scenario 3. For **Scenario 2** the relevant items have been highlighted in **YELLOW**.

Employer exits

As explained in document **C1**, one key component of the package of covenant support measures is a rule change on employer exits.

This document details the key practical elements of a rule change on employer exits, the policy and process which the Trustee would apply when considering whether to exercise its discretion to consent to an employer becoming a Withdrawing Institution, and some of the scenarios in which an employer which is not a Withdrawing Institution and has paid its section 75 debt could be called upon to support the Scheme in the future.

The information here is reflective of the covenant support measures under ‘Scenario 2’ and ‘Scenario 3’ of the Trustee’s covenant support scenarios used in the [Trustee update on the 2020 valuation](#). In terms of a rule change on employer exits, this means:

- For Scenario 2, a rolling six-year moratorium with an initial term of nine years, effective on termination of the moratorium for the 2018 valuation and renewing at each valuation by default with any change subject to consultation with all employers.
- For Scenario 3, a rolling 12-year moratorium with an initial term of 15 years and at least as long as the Recovery Plan to be put in place for the current valuation, effective on the termination of the moratorium for the 2018 valuation. This would ensure that at the next valuation, if the moratorium were to be revoked and there was a resulting impact on the covenant strength, the Trustee would still have more than three full valuation cycles to make necessary changes to Scheme funding.

The outcomes in both scenarios 2 and 3 assume the new moratorium would apply to all current employers and would become effective on termination of the moratorium for the 2018 valuation. UUK has noted that this remains subject to legal advice.

References to elements under Scenarios 2 and 3 are shown throughout this document in the format ‘Scenario 2 / Scenario 3’, and for further ease of reference the position under **Scenario 2** is highlighted in **YELLOW**.

Capitalised words and phrases are defined in Section E.

A. Technical details

Withdrawing Institutions

Becoming a Withdrawing Institution – or, put another way, exiting the Scheme - under the Scheme Rules means that an employer is discharged from any future liability to the Scheme.

Under Scenarios 2 and 3, a new moratorium on employer exits would be put in place via an amendment to the Scheme Rules, and the current moratorium arrangements would fall away as of the effective date of those amendments (or the date of signing of the 2020 valuation, if sooner). The amendment would mean that no employer will become a Withdrawing Institution without the written consent of the Trustee, including where there is a breach of Exclusivity by that employer, for the period

of the moratorium.

Payment of a Section 75 Debt under the statutory regime will not automatically trigger an employer to become a Withdrawing Institution under the Scheme Rules. Unless and until the Trustee consents in writing to an employer becoming a Withdrawing Institution, that employer remains subject to the Scheme Rules and therefore the Trustee is able to rely on its ongoing covenant support.

Termination notice period for the moratorium

The moratorium would remain until the expiry of a period commenced by written notice from UUK (the formal representative of the participating employers for funding purposes), withdrawing the effect of the moratorium.

- The notice period will be 6 / 12 years from the signing date of the actuarial valuation following the date notice is given.
- Notice can be given at any time, up to 6 months after the effective date of any valuation (subsequent to the 2020 valuation).
- If served outside that 6 month period, any notice will remain in force and will take effect following the next formal valuation date (meaning that it will run for 6 / 12 years from that point), unless previously revoked.
- If notice is not served within 6 months of a valuation date the moratorium will remain in force.

For example, if the next valuation were as at 31 March 2023¹, then notice of termination must be received by 30 September 2023 in order for the moratorium to expire by June 2030 / 2036 (for Scenario 3, this is assuming the recovery plan agreed for the 2020 valuation ended prior to that date – if this was not the case then the moratorium would expire at the end of that recovery plan).

If notice were not received by 30 September 2023, the moratorium would remain in force. Notice could be served prior to or at the next valuation (31 March 2026), when notice received by 30 September 2026 could take effect from signing that valuation on, say, June 2027 and hence the moratorium would end in June 2033 / 2039.

B. Policy and process for potential exits while a moratorium remains in place

Key principles

The Trustee aims to be clear and transparent with employers about how it will make a decision as to whether an employer can become a Withdrawing Institution. The approach set out here is not intended to:

- fetter the Trustee's discretion, which must remain unfettered;
- undermine the 'mutuality of covenant' principle, which the Trustee acknowledges is of key importance to employers and the Trustee;
- interfere in employment matters between employers and employees;
- require all employer exits to be prevented;
- impose future benefit accrual in the Scheme for an employer's employees where a Section 75 Debt has been triggered.

¹ Note that these examples all follow the current legislative periods but may not do so in practice: legislation could change and actuarial valuations could take longer or shorter to conclude.

Operation

When a potential employer exit arises, The Trustee will take advice as appropriate. This advice would typically include, but not be limited to:

- advice on the strength of that Employer's covenant;
- the resulting potential impact of the Employer's exit on the covenant of the Scheme (taking account of any required Section 75 Debt payment);
- the concurrent funding of the Scheme.

The Trustee will liaise with the Employer throughout the process, requesting any further information which may be relevant to its decision making as and when appropriate.

Each Trustee decision will apply to the individual circumstances of the employer, and no decision will set any binding precedent for future cases.

An employer will exit the Scheme by becoming a Withdrawing Institution if, and only if, the Trustee exercises its discretion to determine that an employer becomes a Withdrawing Institution by providing written notice to the relevant employer.

Where an employer finds it impracticable or inexpedient to continue in the scheme, but is not granted Withdrawing Institution status, the Trustee will normally grant consent to waive Exclusivity in relation to other pension arrangements for Eligible Employees.

The Trustee may exercise its discretion to determine that an employer may become a Withdrawing Institution at any point, including where it may have previously chosen not to exercise this discretion in respect of that same employer.

There could properly be circumstances in which the Trustee would be prepared to exercise its discretion for an employer to exit the Scheme. Some examples are provided in Part C of this document.

Becoming a Withdrawing Institution

If the Trustee decides, having taken advice as appropriate and considered any relevant factors (while disregarding irrelevant factors), to exercise its discretion to consent to an employer exiting the Scheme, then the relationship between the employer and the Trustee ends. Subject to payment of the Section 75 Debt and any other outstanding sums, there are no further obligations on the employer to the Scheme.

The Trustee will provide written notice to the employer to confirm:

- where appropriate, that a Section 75 Debt payment to the Scheme of [amount] has been received from the employer;
- the date of the employer's exit from the Scheme;
- where appropriate, that there are no outstanding member or employer contributions due under the Scheme Rules or statute;
- that the employer is discharged from any future liability to the Scheme.

Remaining subject to the Scheme Rules

If the Trustee decides, having taken advice as appropriate and considered any relevant factors (while disregarding irrelevant factors), not to exercise this discretion, it will provide written confirmation to the employer. In that written confirmation, the Trustee will:

- confirm its decision;
- summarise the reason(s) for its decision, such as the impact of the potential exit upon the covenant of the Scheme;
- reference any other relevant information.

Where the Trustee has decided that it would better protect the employer covenant for the employer to remain in the Scheme, that employer will remain subject to the Scheme Rules. The effect is that Rule 6 (Ordinary employer contributions) continues to apply to the employer. While it remains difficult to predict specific future scenarios, a description of the possible circumstances where an employer may be required to pay contributions is shown in Part D.

The Trustee would not normally require an employer that has paid (or otherwise satisfied, or entered into an arrangement in respect of) its Section 75 Debt in full to make any additional contributions to the Scheme, even where the deficit increases, unless and until (i) all remaining Employers have been assessed at Section 75 debt level and (ii) where the liability share of that Employer exceeds the Section 75 Debt amount it has already paid.

Exclusivity and future accrual

An Employer may, under Rule 45 (Exclusivity), request that the Trustee consent to waive Exclusivity for one or a group of Eligible Employees. Where a waiver is in place, the employer may use an alternative Scheme for employees who would otherwise be Eligible Employees.

A request to waive Exclusivity:

- remains subject to the consent of the Trustee, and the Trustee's decision will take into account any relevant factors which may include the impact on the Scheme's covenant, plus other relevant funding, financial, and reputational impacts including the effect of the loss of active member contributions (in particular any deficit recovery contributions element);
- can be granted on such terms and conditions as the Trustee may require in order to protect the Scheme. It may, for example, be appropriate to require ongoing deficit reduction contributions under Rule 6.1 (Ordinary employer contributions) in respect of those removed from the Scheme under any waiver of Exclusivity, mainly in cases where there has been no Section 75 Debt payment;
- will result in a Cessation Event if the Trustee consents to the request and the employer has no active members remaining in the Scheme. Payment of the resulting Section 75 Debt will be due immediately and in full;
- will normally receive the consent of the Trustee in cases where:
 - an employer requests to exit the Scheme upon considering it impracticable or inexpedient to continue to participate and/or otherwise ceases to have active members in the Scheme, thereby triggering a Section 75 Debt which it shall pay in full; and,
 - the Trustee decides not to exercise its discretion for the employer to become a Withdrawing Institution, meaning that the employer remains subject to the Scheme Rules; and,

- the employer requests to waive Exclusivity for all of its Eligible Employees.
- does not trigger an employer to exit the Scheme, including where a waiver is granted and where all future accrual ceases at that employer. The employer will not exit the Scheme unless and until the Trustee so determines by providing written notice to the employer.

It remains inappropriate for the Trustee to be involved in, or express opinion on, any employment matters related to an employer request to waive Exclusivity (such as in relation to contracts of employment).

C. Potential exit scenarios

Below are some examples of potential scenarios where an employer requests to exit the Scheme. Please note that the examples presented are illustrative and are not intended to cover all possible scenarios. Each potential employer exit will be considered on a case-by-case basis, and the decision made by the Trustee will be specific to the circumstances of the case and will not set a binding precedent for any future cases. Any actions taken will be to protect the Scheme's Covenant.

Scenario 1 - Employer A supports 0.002% of the Scheme deficit. It requests to leave the Scheme and reports the following information:

Key financial line items	£,000
Total income	400
Net cash from operations	5
USS contributions	10
Fixed assets	400
Cash and cash equivalents and investments	200
Net assets excluding pension provisions	300
Section 75 deficit	600

The Trustee considers that Employer A provides a relatively weak covenant to the Scheme as it:

- Generates low levels of cash relative to the size of its contributions;
- Has a small asset base relative to its share of the deficit.

Employer A also supports a relatively immaterial share of the Scheme deficit.

Outcome: Trustee permits Employer A to exit the Scheme and provides written consent. Employer A pays its Section 75 Debt and exits the Scheme.

Scenario 2 - Employer B supports 4% of the Scheme deficit. It requests to leave the Scheme and reports the following information:

Key financial line items	£,m
Total income	1,000
Net cash from operations	100
USS contributions	50
Fixed assets	1,500
Cash and cash equivalents and investments	1,000
Net assets excluding pension provisions	2,000
Section 75 deficit	2,000

The Trustee considers that Employer B provides a relatively strong covenant to the Scheme as it:

- Generates high levels of cash relative to the size of its contributions;
- Has a relatively large asset base relative to its share of the deficit;
- Has grown its operations materially in the past and has the potential to do so in the future.

Employer B also supports a material share of the Scheme deficit.

Outcome: Given Employer B's covenant strength and growth potential, Trustee does not permit Employer B to exit the Scheme.

Scenario 3 - Employer C supports 0.03% of the Scheme deficit. It requests to leave the Scheme and reports the following information:

Key financial line items	£,m
Total income	10
Adjusted net cash from operations*	1
USS contributions	0.5
Fixed assets	20
Cash and cash equivalents and investments	250
Net assets excluding pension provisions	200
Section 75 deficit	15

*adjusted for endowment income

The Trustee considers that Employer C provides a relatively strong covenant to the Scheme as it:

- Has a large asset base relative to its share of the deficit.

Outcome: Given Employer C's covenant strength, Trustee does not permit Employer C to exit the Scheme.

D. Contribution scenarios

Where an employer has paid its Section 75 Debt and is not a Withdrawing Institution, the Trustee is able to rely on that employer for continued covenant support. Below are some examples of the scenarios in which the Trustee may need to seek additional contributions from an employer which has paid its Section 75 Debt. They are illustrative only, and the Trustee will consider all circumstances when deciding whether to seek additional contributions from an employer which has paid its Section 75 Debt.

Example 1

- Employer A has a deficit share of 0.1%.
- It triggers its Section 75 Debt (e.g. by ceasing to employ active members), which, at this time, is calculated to be £50m (total Scheme Section 75 Debt of £50bn).
- Employer A pays £50m, but remains liable to the Scheme in a downside event.
- Some years later, there is an extreme downside event that leads to the Scheme being wound up.
- At this time the Section 75 deficit has not increased and is still £50bn.

- All remaining employers become liable for their Section 75 Debt but there is a shortfall on recoveries from some employers, and 30% of the Section 75 Debt remains unpaid.
- As such the Trustee decides to seek further amounts from employers which have already paid their Section 75 Debt.
- The Trustee seeks to charge additional contributions to Employer A (and other employers which have already paid their Section 75 Debt) to fund the shortfall.

Example 2

- Employer B has a deficit share of 0.1%.
- It triggers its Section 75 Debt (e.g. by ceasing to employ active members), which, at this time, is calculated to be £50m (total Scheme Section 75 Debt of £50bn).
- Employer B pays £50m, but remains liable to the Scheme in a downside event.
- Some years later, there is an extreme downside event that leads to the Scheme being wound up.
- At this time the Section 75 deficit is measured to be £60bn.
- The employers who have not yet paid their Section 75 Debt are able to afford their liability, but the Trustee decides that it would be equitable for all employers, including those who have previously paid their Section 75 Debt, to fund the additional debt.
- The Trustee determines that Employer B would have a Section 75 liability of £60m if it had triggered its Section 75 Debt at this date.
- The Trustee seeks to charge additional contributions of the difference between this amount and the amount Employer B paid when it triggered its Section 75 Debt (i.e. £60m-£50m = £10m).

Example 3

- Employer C has a deficit share of 0.2%.
- It triggers its Section 75 Debt which, at this time, is calculated to be £60m (total Scheme Section 75 Debt of £30bn).
- Employer C pays £60m, but remains liable to the Scheme in a downside event.
- Some years later, there is an extreme downside funding event and poor sector performance. In this downside scenario, the Trustee decides to de-risk the Scheme and fund to self-sufficiency ('SS').
- At the next triennial valuation, the SS deficit is calculated to be £40bn.
- The Trustee consider it is equitable for all employers, including those who have previously paid their Section 75 liabilities, to contribute to this deficit.
- The Trustee determines that Employer C would have a SS liability of £80m if it hadn't triggered its Section 75 Debt previously.
- The Trustee seeks to charge additional contributions of the difference between this amount and the amount Employer C paid when it triggered its Section 75 Debt (i.e. £80m-£60m = £20m).

E. Defined terms

Cessation Event	Means when an Employer ceases to employ at least one active member when another employer continues to employ at least one active member, as defined in regulation 6ZA(1) of the Employer Debt Regulations and extended by regulation 9(4) in relation to frozen schemes.
Eligible Employees	Has the meaning given in Rule 4.1 (Terms of Entry: Eligible employees) of the Scheme Rules.
Exclusivity	Has the meaning given in Rule 45.1 (Exclusivity) of the Scheme Rules.
Scheme Rules	Means the Rules of the Scheme dated 19 November 2015, as amended from time to time.
Section 75 Debt	An Employer's share of the amount, over and above the value of the Scheme's assets, which the Scheme actuary estimates would be required to meet specified estimated expenses and fully buy out the Scheme benefits with annuities from a regulated insurer, as determined in accordance with Section 75 or 75A of the Pensions Act 1995 and accompanying regulations, both as amended from time to time.
Trustee	Means Universities Superannuation Scheme Limited.
Withdrawing Institution	Has the meaning given in Rule 1.1 (Definitions) of the Scheme Rules.