Private & Confidential
Dame Kate Barker
Trustee Chair
Universities Superannuation Scheme

By email only: kbarker@uss.co.uk

The Pensions Regulator
Making workplace pensions work

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Dear Dame Kate

Universities Superannuation Scheme (the Scheme)
Actuarial valuation as at 31 March 2020 (the 2020 Valuation)

We are writing further to the comments made in our letters on the 2020 Valuation during 2021, following the submission of the final scheme funding valuation summary and supporting documents. This letter is intended to supplement the previous letters and as such we will not reiterate all our previous comments but will focus on the final changes to the 2020 Valuation submission.

We have reviewed the 2020 Valuation for the Scheme in relation to the requirements of Part 3 of the Pensions Act 2004 (the Act) and set out our final observations below:

1. Covenant and affordability

We acknowledge the covenant support measures which we reviewed as part of Leg 1 were all agreed as part of the package. As such, we have no further comments in addition to what we have said in our previous correspondence.

2. Funding

Our previous letters, in particular those of 24 September 2021, 11 June 2021 and 26 February 2021, set out our views on the contribution rates and approach to determining Technical Provisions (TPs), based on what we knew at the time of those letters.

The final agreed contribution rates and approach to determining TPs, reflecting the final agreed new benefit structure, are set out in the Schedule of Contributions (SOC), Recovery Plan (RP) and Statement of Funding Principles (SFP) dated 28 March 2022.

Technical Provisions

The actuarial assumptions set out in the SFP used to determine the TPs appear unchanged from those we reviewed previously under Leg 1, therefore our views remain as previously stated.

In summary, given the covenant and steps taken to enhance it and the benefit changes from 1 April 2022, we had no major concerns about the TPs in the round. This was despite our view that, taken in combination with the asset outperformance built into the RP, the discount rates were at the limit of what we considered to be appropriate.

The TPs assumptions will need to be reviewed at the upcoming 31 March 2023 Valuation (the 2023 Valuation). If the Fundamental Building Block (FBB) model is again used as a tool in setting the discount rate or assessing the prudence incorporated in it, we will wish to understand the underlying assumptions and the rationale for them. Other assumptions will also need to be reviewed too, in particular, the inflation risk premium and approaches to setting retail and consumer price inflation.

<u>Contributions and recovery plan</u>

We do not consider the short extension of the RP from 18 years to 18 years and 1 month (with no asset outperformance being required in the final month, according to the SFP) to be a material matter. The contribution rates, reflecting the new benefit structure, set out in the SOC and RP appear unchanged from those we reviewed previously under Leg 1. Therefore, our views remain as previously communicated.

If there is a deficit at the upcoming 2023 Valuation we would expect the RP to be shorter and consistent with the covenant.

If contributions are determined in a similar way to the 2020 Valuation they would probably fall short of what we consider would be appropriate. However, given there has been improvement in funding subsequently which will impact on the need for and level of contributions to be determined at the 2023 Valuation.

3. Investment Strategy

We note the proposed investment strategy of retaining c.60% exposure to growth assets and increasing the liability hedging from 34% (interest rates) and 28% (inflation) hedging of the self-sufficiency (SS) liabilities to 40% of the SS liabilities. This is a move that will modestly reduce the mismatch risk of the assets to the liabilities and will be supported by more leverage of the matching assets.

However, noting the investment strategy review, recent market movements and the improved funding position, we would like to further engage with your investment team during and in advance of the 2023 Valuation. We would like to suggest holding a quarterly call between the USS investment team and our team to better understand the position of the Scheme, covering:

- Potential future investment strategy options.
- How financial assumptions will be set and ultimately reviewed by the Trustee.
- Understanding, implementing, reporting of ESG. We note that you have submitted your TCFD report to TPR and this is being reviewed by the relevant team.
- Understanding, implementing, reporting of Liability Driven Investments, in particular, the liability hedging strategy, how it is monitored, holdings of collateral assets and illiquid asset positions that may impact the strategy.
- We note that Universities UK is embarking on a governance review and as part of the review aims to look at the relationship between USSIM and the Trustee. We would be interested in this process including the recommendations and outcomes.

We understand that the Trustee has/is setting up an investment forum and that this is going to be used to understand the Employers' positions in relation to risk and to discuss the investment strategy further. We would like to understand more around how the forum will work and how this will feed into the investment strategy approach going forwards.

Review conclusion

Notwithstanding our comments above, on the basis of all the information provided to us and in the circumstances of this scheme, we do not propose to exercise any of our powers under section 231(2) of the Act in relation to the 2020 Valuation.

Status of this letter

This letter confirms only that, having had regard to the Pensions Regulator's objectives and priorities, we do not intend to carry out further investigations in relation to the 2020 Valuation. If there is a material change in circumstances and / or we receive information which is materially different from that which has been provided we may use our powers under section 231(2) of the Act in relation to the 2020 Valuation.

This letter does not provide any confirmation as to whether the 2020 Valuation complies with any or all of the requirements of Part 3 of the Act (which is the responsibility of the Trustee). We may still use this submission as part of any current or future investigation or action.

For further details of the formal position in respect of scheme funding requirements, you should refer to Part 3 of the Act, the Code of Practice 03: Funding Defined Benefits, and the related documents available on our website.

Next steps

We recommend that you discuss the content of this letter with the scheme actuary and other advisers as appropriate.

Yours sincerely

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