Dame Kate Barker
Universities Superannuation Scheme

By email only

The Pensions Regulator
Making workplace pensions work

Napier House
Trafalgar Place
Brighton
BN1 4DW

www.tpr.gov.uk
www.trusteetoolkit.com

11 June 2021

Dear Dame Kate,

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

1. Following the Trustee board meeting on 8 June 2021 and the outcomes from this meeting which you have communicated to us, we are writing to confirm our feedback to you.
2. At this stage our feedback is preliminary, recognising that we have not been asked to evaluate a final draft proposal and that there remains a live negotiation and an evolving position. However, USS and Universities UK (UUK) have both indicated it would be helpful to receive confirmation of our position at this point in time.

Our feedback:

3. We consider that the UUK proposal[1], meaning the combination of the proposed covenant support measures and funding strategy set out in UUK's employer consultation dated 7 April 2021 (which UUK estimated would lead to a proposed contribution rate of 30.7%), is not acceptable in its current form. In our letter of 26 February 2021, we assessed Scenario 3 in the Rule 76.1 report as being at the limit of compliance and, in our view, the UUK proposal is likely to be non-compliant with Part 3 of the Pensions Act 2004.
4. UUK's consultation sets out a range of proposed covenant support measures. We understand the Trustee considers that UUK's proposed measures would, overall, provide a lower level of covenant support than was envisaged under Scenario 3. As such, we have been informed that the Trustee has now put forward a counter-proposal to UUK on the support measures that, if agreed, the Trustee would consider provide a level of support greater than that under Scenario 3. We understand this would enable the Trustee to arrive at an overall employer covenant rating of 'Strong'. We also understand that, based on the covenant counter-proposals being accepted, the Trustee could accept UUK's proposals on the valuation assumptions and recovery plan structure, resulting in an assessed cost of 31.2% of salaries.
5. In line with the views we have previously expressed to you, we continue to view the covenant support measures as protective – they give greater comfort that the covenant could not be wilfully or accidentally diminished (either by the introduction of material debt, or, assuming there is no gap between the current and new moratoria, by strong/numerous employers departing the Scheme).

[1] See Appendix for our understanding of the UUK proposals and total contributions that would be required.

6. Although we welcome the covenant support measures and believe that they do have value (please see our comments below), there is nothing about these measures that materially improves the covenant. In that sense, our view remains that the covenant is still at (the upper end of) 'Tending to Strong' – in either the UUK proposal, or our understanding of the counter-proposal which has been put forward by the Trustee.
7. Therefore, on account of the remaining differences in our views on covenant, we would have concerns with UUK's proposed valuation assumptions and recovery plan structure (which leads to an assessed cost of 31.2% of salaries) even if the covenant support measures were enhanced in line with the Trustee's counter-proposal.
8. As we have explained in the past, when assessing any funding proposal we look at everything in the round. We are ultimately more interested in the outcome, the total level of contributions and the proportion of those which are deficit repair contributions (DRCs), than the individual elements of the strategy. That said, we can see the merit in the argument that lower DB accrual and lower future DB risk can allow for a higher pre-retirement discount rate to be used. We remain less convinced that the recovery plan should be extended from 15 to 18 years and the level of investment outperformance maintained at 0.5% a year over that longer period.
9. If the covenant support measures were enhanced in line with the Trustee's counter-proposal, we consider the appropriate overall contribution rate should be at least 1% to 2% of salaries higher than your assessed cost of 31.2%.
10. However, we are mindful of post-valuation experience since the valuation date and its implications, and this is important to our overall consideration and assessment of the 31 March 2020 valuation. From the information we have seen, the technical provisions and self-sufficiency deficits are both likely to be smaller as at 31 March 2021. We also recognise that the covenant support measures within the counter-proposal would be an enhancement against UUK's proposals
11. We take both of these factors into consideration when arriving at a pragmatic view on the valuation outcome. This means that, although we would not be comfortable with total contributions of 31.2% of salaries (calculated using UUK's proposals for valuation assumptions and recovery plan structure), we would probably see this as a marginal situation which would not trigger further action on our part.

Future expectations

12. Although the 2020 Valuation remains ongoing, it is worthwhile commenting on future expectations at this point. Our assessment of these funding proposals should not be taken to imply that we would arrive at the same views if future valuations were developed on similar terms. For example, an 18-year recovery plan is highly unusual (for either a 'Tending to Strong' covenant or a 'Strong' covenant) and each valuation is assessed on its own terms and in light of circumstances at the time. We would not expect such a long recovery plan at the next valuation unless there were very strong reasons for doing so.

Covenant support measures

13. Please note that our assessment of the value provided by the proposed covenant support measures in the Trustee's counter-proposal, and in turn our overall assessment of covenant strength, is particularly dependent on the assumptions that:
    - there is no 'window' between existing and proposed moratoria, as the UUK proposal has the potential to allow a damaging level of departures; and
    - any 'covenant enhancing debt' provisions do not create a material loophole in the pari passu security provisions. We understand that the Trustee intends to address

this risk through the development and agreement of a ‘Code of Practice’. We would appreciate the opportunity to comment on any such document as it evolves.

Next steps

14. I have provided a copy of this letter to Alistair Jarvis, Chief Executive, UUK.

15. The feedback provided in this letter relates to an evolving position and, as far as we are aware at the time of writing, includes information which is not currently in the public domain. Therefore, in our view it is appropriate that our letter is not shared beyond the USS and UUK teams until the information to which it refers has been provided to wider stakeholders.

16. Please let me know if you would like to discuss the content of this letter. We look forward to our continuing engagement with you and key stakeholders as a sustainable outcome is sought for the 2020 Valuation.

Yours sincerely

Mike Birch
Director of Supervision

CC Alistair Jarvis, CEO, UUK

Appendix – UUK Proposals

The table below shows our understanding of the funding proposals put forward by UUK, reflecting the benefit reform it has proposed.

Pre-retirement discount rate	Gilts + 2.75%
Post-retirement discount rates	Gilts + 1.0%
Technical Provisions deficit (calculated by USS)	£14.1bn
Recovery plan (RP) length	18 years
Additional investment outperformance over RP	0.5% p.a.
Total estimated contributions proposed by UUK	30.7%
Accurate assessed cost calculated by USS	31.2%

Our understanding of the main elements of the UUK proposals on covenant support measures are:

- 20-year rolling moratorium (23-year initial period)
- Potential for a window between the existing moratorium ending and the new one starting
- 15% threshold for pari passu debt security
- Debt monitoring carve-out “to limit metric testing to material employers”.