**Dame Kate Barker**
**Trustee Chair**
Universities Superannuation Scheme

The Pensions Regulator
Making workplace pensions work

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**By email only**

24 September 2021

Dear Dame Kate,

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

1. We write further to our engagement with the Trustee in relation to the 2020 Valuation.

   We understand that, at its meeting on 31 August 2021 the Joint Negotiating Committee (JNC) reached a decision on how the funding challenges facing the Scheme should be addressed, including proposed changes to the way future benefits in the Scheme are built up. We note that the proposed changes to future benefits are subject to a statutory employer-led consultation with affected employees and their representatives, due to be launched later this year. In addition, the JNC at its meeting on 2 September 2021 conditionally approved the 'Dual-rate 2020 SoC[1]'.
2. You have confirmed to us that at its Board meeting on 3 September 2021, the Trustee approved:
   a. the overall contribution rate for the JNC benefit reform proposal (as approved at the JNC meeting on 31 August) as being 31.2% of salaries and confirmed the methodology and assumptions for calculating the Scheme's technical provisions;
   b. the draft recovery plan (RP), draft schedule of contributions (SoC) and the draft statement of funding principles (SFP) for consultation with Universities UK (UUK), who represent the Scheme's employers; and
   c. the use of the Dual-rate 2020 SoC.
3. Subject to the outcome of the consultation with UUK we understand that the Trustee hopes to be able to finalise the 2020 Valuation in the very near future. We therefore take this opportunity to provide our observations on the 2020 Valuation proposals. In the event that changes are made as a result of the consultation, we would need to consider whether they change our position.
4. Our observations are based on the Trustee's and/or its advisers' explanation, in writing and verbally, of the 2020 Valuation proposals as set out in the valuation papers for the 3 September 2021 Trustee Board meeting.

[1] Please see Appendix A which summarises our understanding of the Dual-rate 2020 SoC

**Observations**

5. We note the Trustee's support for the draft 2020 Valuation agreement and we recognise the significant effort of the Trustee and the extensive discussions involved in arriving at this point.
6. Although we continue to have concerns with some aspects of the approach, and we have outlined these to the Trustee during our engagement, we are encouraged by the progress to develop and implement a more sustainable long-term outcome for the Scheme.

**Our assessment of 'Leg 1' under the Dual-rate 2020 SoC**

7. 'Leg 1' will apply from 1 October 2021. This assumes the benefit change deed will be entered into on or before 28 February 2022 and overall contribution rates are set at 31.2% of salaries.
8. The proposal under Leg 1 and our view of it are essentially the same as the position we set out in our letter to the Trustee of 11 June 2021[2] in response to UUK's draft proposal for benefit reform, together with the Trustee's counter-proposal on the covenant support measures at that time.
9. In our letter we explained that, in relation to UUK's benefit reform proposal, if the covenant support measures were enhanced in line with the Trustee's counter proposal, we considered the appropriate overall contribution rate should be at least 1% to 2% of salaries higher than the Trustee's assessed cost of 31.2%.
10. In respect of Leg 1, although we are not comfortable with total contributions of 31.2% of salaries, we recognise that:
    a. from the information we have seen for post-valuation experience since the valuation date, the technical provisions deficit is likely to have reduced; and
    b. the revised package of covenant support measures which has now been agreed is considered by the Trustee's advisors to represent an enhancement relative to UUK's original proposals (as set out in its employer consultation dated 7 April 2021).
11. We take both of these factors into consideration when arriving at a pragmatic view on the 2020 Valuation outcome. This means that, although we are not comfortable with total contributions of 31.2% of salaries, we view this as a marginal situation and would not expect to take further action in relation to Leg 1.
12. We note that there remains uncertainty over whether the benefit change deed will be entered into on or before 28 February 2022, in which case Leg 1 would fall away and be replaced by Leg 2.

**Our assessment of 'Leg 2' under the Dual-rate 2020 SoC**

13. 'Leg 2' is a backstop schedule of higher contributions should the benefit change recommended by the JNC (or any equivalent replacement recommendation) fall away and the benefit change deed is not entered into on or before 28 February 2022.
14. We have provisionally assessed Leg 2 as being at the limit of compliance with Part 3 of the Pensions Act 2004. A key factor in reaching this assessment is the very low level of deficit repair contributions (DRCs) being paid in the early years following the valuation date, other factors are set out below.

[2] Our letter to the Trustee dated 11 June 2021 is published on the Scheme website.

15. In addition, we have not seen sufficient evidence or professional advice to support Trustee decision-making that the higher contribution rates required by Leg 2 are affordable – particularly in the later years of the recovery plan, when total contributions rise to 57% of salaries from October 2025. Similarly, we have also not seen sufficient evidence or advice to justify the length of time over which contributions step-up (being in 6-monthly increments over 4 years).
16. We understand that further analysis on these points may only be carried out by the Trustee and its advisers in the event that Leg 2 was implemented. Therefore, as the Trustee has currently not been able to demonstrate that Leg 2 would be implementable in practice, we can only provide a provisional view at this time and reserve our position generally should Leg 2 come into play.

**More detailed observations on the pattern and structure of the contribution schedules:**

17. In addition to our overall assessment of the two legs under the Dual-rate 2020 SoC, we would make the following more detailed observations:
    a. In relation to Leg 2, we have no comments on the assumptions used for the technical provisions or the assumptions for investment outperformance used for the first 10 years of the recovery plan. Our concerns only relate to the level and structure of the contributions.
    b. Because the cost of providing the current level of benefits is significantly higher at the 2020 Valuation than at the previous valuation, the Scheme has effectively been receiving no DRCs since the valuation date. Under both legs of the Dual-rate 2020 SoC, this continues from 1 October 2021 when the new SoC comes into force, until 1 April 2022 under Leg 1 and 1 October 2022 under Leg 2. This is despite the significantly worse deficit position at the 2020 Valuation date versus the 2018 valuation. We would also note that, even allowing for post-valuation experience, the likely deficit if the Scheme carried out an actuarial valuation today, would still be more than the £3.6bn reported at the 2018 valuation.
    c. Under both legs of the Dual-rate 2020 SoC, the initial contribution rate is 31.2% of salaries, which is below the cost of accrual of current benefits (which is, for instance, 37.0% of salaries using the Leg 2 assumptions). Furthermore, the Scheme is expected to lose out on around £150m in contributions compared to the contribution rate being 34.7% over the period 1 October 2021 to 31 March 2022. We note the Trustee's view that £150m is immaterial in the context of the Scheme, but nevertheless our preference in the Leg 2 scenario, where the envisaged benefit change does not happen as planned, would be for inclusion of a clawback mechanism for these missed contributions to be paid as soon as possible.

**Governance**

18. We note the requests by stakeholders to review valuation governance arrangements, and that the Trustee has indicated to us recently that it will be considering how it can most effectively engage with such a review.
19. From our perspective we would like to understand what changes may be desirable to support a more streamlined process, and what changes may be required to be made to existing governance arrangements and the valuation process to ensure legislative compliance in the future, including from a timing perspective. As we have previously indicated to the Trustee, we look forward to engaging with the Trustee and key stakeholders in this area.

**Our view of the 2020 Valuation and our position**

20. Notwithstanding the above comments and observations, we confirm that from our review of the information provided, and on the basis that the final documentation in relation to the 2020 Valuation reflects our current understanding of the proposed funding agreement, we do not anticipate that we would carry out any further investigations or raise further queries, beyond those noted at paragraph 16 above, in relation to the 2020 Valuation following its submission.
21. If there is a material change in circumstances and / or we receive information which is materially different from that which has been provided, then we may undertake a further assessment of the 2020 Valuation which could result in the use our powers under section 231(2) of the Pensions Act 2004 (the Act) in relation to them. References to ‘compliance’ in this letter relate only to the requirements of Part 3 of the Act and this letter does not relate to (or provide any comment on) the exercise (or potential exercise) of any of our other powers.
22. Please let us know if you would like to discuss any of the feedback contained within this letter.

Yours sincerely

**Nicola Parish**
Executive Director, Frontline Regulation

Copied to:
Mr Alistair Jarvis, CEO, UUK
Dr Jo Grady, General Secretary, UCU

**Appendix A – Dual-rate 2020 SoC**

A key component to the 2020 Valuation agreement and how this will be implemented is the Dual-rate 2020 SoC. Under this approach the 1 October 2021 step-up in contributions arising from the 2018 valuation agreement (from 30.7% to 34.7% of salaries) will not apply as the 2020 Valuation is accelerated so that it is concluded in September 2021 with a new schedule of contributions, the 'Dual-rate 2020 SoC'. The Dual-rate 2020 SoC will incorporate two contribution schedules:

- 'Leg 1' which will apply from 1 October 2021. This assumes the benefit change deed will be entered into on or before 28 February 2022 and overall contribution rates are set at 31.2% of salaries.
- 'Leg 2' is a backstop schedule of higher contributions should the benefit change recommended by the JNC (or any equivalent replacement recommendation) fall away and the benefit change deed is not entered into on or before 28 February 2022. Under 'Leg 2' overall contributions begin at 31.2%, rise to 34.7% from 1 April 2022 and then gradually step up to 57% over the period to October 2025.

**Appendix B – Funding proposals**

**The table below summarises our understanding of the key elements of the current benefits and the proposed benefits from 1 April 2022:**

| Benefits | Current | Proposed |
|---|---|---|
| DB Accrual Rate<br>• Pension<br>• Cash Lump Sum | <br>1/75th<br>3/75ths | <br>1/85th<br>3/85ths |
| Pension increases (pre and post retirement) | Pre-October 2011: CPI<br>Post-October 2011: CPI up to 5% pa, 50% of any increase in CPI between 5% and 15% pa[3] | CPI up to 2.5% pa |
| Salary threshold for DB | £59,883.65 pa[4] | £40,000 pa |
| DC contribution rates above salary threshold | Members – 8% of salaries<br>Employers – 12% of salaries | Members – 8% of salaries<br>Employers – 12% of salaries |

[3] https://www.uss.co.uk/glossary#Glossary_USSstandardpensionincrease
[4] https://www.uss.co.uk/glossary#Glossary_Salarythreshold

**The table below summarises our understanding of the covenant support measures for each leg of the Dual-rate 2020 SoC:**

| | **'Leg 1'** | **'Leg 2'** |
|---|---|---|
| Moratorium on employer exits | A rolling 20-year moratorium on employer exits without the consent of the Trustee (effective from the date of signing the 2020 Valuation) | Short term moratorium: which lasts until the earlier of (i) a replacement long term moratorium being agreed and (ii) the date of signing a valuation with effective date post 31/3/20. *(Equivalent to a maximum of 3 years)* |
| Debt monitoring | Yes | Yes |
| Pari Passu threshold | 10%, with exemptions available to 'de minimis' employers and to employers on Limited Participation terms | n/a |

**The table below summarises our understanding of the funding strategies for each leg of the Dual-rate 2020 SoC:**

| | **'Leg 1'** | **'Leg 2'** |
|---|---|---|
| Benefits accruing from 1 April 2022 | Proposed | Current |
| Pre-retirement discount rate | Gilts + 2.75% | Gilts + 2.0% |
| Post-retirement discount rate | Gilts + 1.0% | Gilts + 1.0% |
| Technical Provisions deficit[5] | £14.1bn | £18.4bn |
| Recovery plan (RP) length | 18 years | 12 years 4 months |
| Additional investment outperformance over RP | 0.5% p.a. | 0.5% p.a.[6] |
| Cost of future service benefits[5, 7] | 24.9% | 37.0% |
| Deficit repair contributions[5,7] | 6.3% | Until 30/09/22 - Nil<br>1/10/22 to 31/03/23 - 3.0%<br>1/04/23 to 31/09/23 – 6.0%<br>1/10/23 to 31/03/24 – 9.0%<br>1/04/24 to 31/09/24 – 12.0%<br>1/10/24 to 31/03/25 – 15.0%<br>1/04/25 to 31/09/25 – 18.0%<br>From 1/10/25 – 20.0% |
| Total contributions[5, 7] | 31.2% | 1/10/21 to 31/03/22 – 31.2%<br>1/04/22 to 30/09/22 – 34.7%<br>1/10/22 to 31/03/23 – 40.0%<br>1/04/23 to 31/09/23 – 43.0%<br>1/10/23 to 31/03/24 – 46.0%<br>1/04/24 to 31/09/24 – 49.0%<br>1/10/24 to 31/03/25 – 52.0%<br>1/04/25 to 31/09/25 – 55.0%<br>From 1/10/25 – 57.0% |

[5] Calculated by USS
[6] Outperformance only assumed over the first 10 years of the recovery plan
[7] All expressed as percentage of salaries