USS

Options for DB Schemes Consultation Team
Department of Work and Pensions

Your ref	
Our ref	CY/JMR
Date	16 April 2024

By email to: pensions.consultations@dwp.gov.uk

Dear consultation team

Please find attached below our submission to the consultation *Options for Defined Benefit schemes*, launched on 23 February 2024 and closing 19 April 2024. As we set out in our response to the Call for Evidence in September, we'd like to reiterate that USS is very different to most pension schemes, given its open status, size, resources and hybrid nature. With that in mind, we have offered broader thoughts on chapters 1 and 2 of the proposals, followed by responses to individual questions relating to chapter 3.

About USS

Universities Superannuation Scheme (USS, the Scheme) was established in 1974 as the principal pension scheme for universities and higher education institutions in the UK. We work with around 330 employers to help build a secure financial future for more than 500,000 members and their families. We are one of the largest pension schemes in the UK, with a hybrid structure and total assets of around £75.5bn (at 31 March 2023) of which £73.1bn related to the defined benefit section of the Scheme.

USS is open to future accrual of hybrid benefits. The latest actuarial valuation of USS showed that as at 31 March 2023, on a Technical Provisions basis, the DB liabilities of the Scheme were around £65.7bn and therefore a funding surplus of £7.4bn existed as at the valuation date.

Chapter 1: Treatment of scheme surplus (paragraphs 23 to 39)

Statutory override (paragraphs 23 to 26)
Firstly, the USS Scheme Rules do not permit a return of surplus in an ongoing scenario, and our amendment powers are such that we would not foresee that position changing. However, in summary, we believe the treatment of any valuation outcome or surplus should be a scheme specific matter, decided on by the trustees, sponsor(s) and any other relevant stakeholders, reflecting the statutory funding regime, trustee fiduciary duties and the scheme rules. Schemes and their stakeholders may wish to evolve these frameworks in a scheme specific manner over time. We would therefore encourage the avoidance of prescriptive regulatory approaches or blanket statutory overrides.

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We are mindful that while ongoing scheme valuation outcomes provide important information for scheme decision making, surpluses are only crystallised once the assets of the scheme have been properly applied in accordance with the scheme rules and member benefits have been fully discharged or secured. The position of open schemes is therefore fundamentally different to that of closed schemes in that, although a periodic valuation may indicate the scheme is in a Technical Provisions surplus, it is a snapshot in time only and crystallisation will not arise. In addition, for open schemes some risk is shared across generations and any surplus identified can be a useful stabilising tool for managing the impacts of financial market volatility between valuations.

USS has been considering these very issues recently. After more than a decade of deficits, addressed by increasing contribution rates and/or modifying benefits, the 2023 actuarial valuation revealed USS held a surplus when liabilities were measured on a Technical Provisions basis: its funding level was 111% equivalent to a surplus of c£7.4bn.

USS was very likely one of the first open schemes to complete its valuation in respect of the 2023 valuation cycle, with the formal valuation report and the Schedule of Contributions being signed off on 20 December 2023, less than nine months after the valuation date. It is also therefore probably one of the first to have addressed the issue of a new Technical Provisions funding surplus, arising out of the financial conditions (particularly increased UK gilt yields) at that date. When doing this it was clear that the issue of surplus raised two key and interlinked questions for the Trustee and our stakeholders: how should the Scheme react to its surplus position; and how could the Scheme best protect itself against future fluctuations in the funding position and valuation outcomes, which might include deficits which require increasing contributions/reducing benefits?

In relation to the application of surplus, it has been agreed to date that no specific actions will be taken in respect of the £7.4bn Technical Provisions surplus revealed at 31 March 2023. The Trustee and stakeholders are now working to address the future stability of funding (and benefits/ contributions) for USS and the buffer that a current Technical Provisions surplus gives may well be of significant value in that context.

Alternative Safeguard: 100% PPF underpin (paragraphs 35 to 39)

The consultation also asks for views in relation to an option for trustees to secure a 100% PPF compensation level in return for payment of an annual “super levy” (expected to be at least 0.6% of the paying scheme’s buy-out liabilities). From USS’s perspective, we have responded in the context of the question in paragraph 36 which asks about the potential interest from large schemes which will run on over the long term.

Firstly, for USS the 2023 actuarial valuation estimated the Scheme’s total buy-out liabilities at c£99.4bn, which would mean a super-levy payment of c£596m per annum would be required to secure the 100% compensation level. This would have been c0.8% of the Scheme’s total asset value at 31 March 2023, and would be payable every year – clearly a significant and material cost for the Scheme.

At the same time, it is only in the most extreme economic circumstances that one could envisage a scheme such as USS having to revert to the PPF to pay compensation for members, and the relative sizes of USS and the PPF would make the payment of compensation a challenging issue for the PPF. This context means that it is difficult to see how the 100% PPF underpin would be appropriate for USS – it would not on the face of it appear to be value for money and therefore difficult to justify the use of Scheme funds in this way.

However, our concern with such an option is that members may feel the Trustee should take every possible step to ensure their benefits are protected - making 100% PPF compensation generally available as an option for trustees could generate pressure from members to pay the super levy even where, on balance, those trustees consider it not to be in the best financial interests of Scheme beneficiaries to do so.

Finally, we are reassured to see that the consultation makes clear that any such super levy section would remain entirely separate to the current PPF fund. This would be an essential requirement in our view.

Chapter 2: Model for a public sector consolidator (paragraphs 40 to 69)

We have no particular views on the need for, or operation of, a public sector consolidator. In this section we have therefore restricted ourselves to again making clear the concerns we have around aspects of using the Pension Protection Fund (PPF) for this role.

As part of our response on the earlier Call for Evidence we gave our views on this proposal. We strongly believe that current Levy payers should bear none of the risks or costs if the role of the PPF is extended. However there still appears to be potential for that to occur. In particular:

- It is specifically discussed in paragraph 67 whether PPF's current reserves might be used to underwrite the consolidation fund. These funds have been built up over the years from Levy payers and even though there is now a surplus, these Levy payers are going to be required to continue to make Levy payments. Therefore, we feel strongly that the current PPF reserves should not be exposed to any such risks or costs or be used to underwrite a consolidator fund operated by PPF.

- PPF's costs would increase if it were to have to set up and operate a new consolidation fund – where these costs would be paid from is not covered in the consultation, unless it is the "running costs" referred to in paragraph 60 being dealt with as part of the entry price for schemes. It would not be appropriate for Levy payers to see increasing Levies, either through direct subsidisation of PPF's consolidator set-up/ongoing costs or through greater general PPF costs as a result of its work growing in size and complexity, or any under-resourcing of PPF's current work as a result. USS Levies are paid from Scheme funds, which ultimately exist to secure members' benefits.

We are reassured that the consultation confirms any consolidation fund would be legally ring-fenced from the PPF's existing funds which, as we understand it, means that no funding or cross-subsidy to the consolidation fund would be possible from the current PPF reserves. We ask for the same confirmation in respect of our two points above.

Chapter 3: Potential take-up and impacts (paragraphs 70 to 71)

In this section we have addressed each of the questions individually.
Question 41: Can you provide an overview of the size of your scheme (assets, liabilities (preferably on a buy-out basis), and number of members)?

As at 31 March 2023:

- Total number of members 528,074
- Value of assets £73.1bn
- Estimated buy-out liabilities £99.4bn

Question 42: Has your scheme previously had a surplus extracted? Was this accessed for a specific purpose?

No.

Question 43: To what extent do you think your scheme would extract a surplus under the changes discussed in this consultation?

USS is an open ongoing scheme. It is unlikely that USS would consider an extraction of surplus whilst that remains the case.

Question 44: Would your scheme be likely to change investment strategies as a result of being able to access a surplus easier? To what extent would this be dependent on the PPF 100% underpin?

No. The USS DB section's investment strategy is the approach considered to be appropriate for an open scheme with a long time horizon and reflects the benefits payable and the covenant provided by the Higher Education sector employers.

Question 45: As outlined in the consultation, the PPF previously conducted analysis suggesting a super levy of 0.6% of liabilities would be required to support a 100% PPF underpin. Do you consider this an appropriate cost? Is there a particular point which would make this more or less attractive to your scheme?

See above for our comments.

Question 46: To what extent would your scheme be interested in entering a Public Sector consolidator as outlined in the consultation?

Not at all at the present time. It would appear USS would not be the primary target audience for such a scheme.

Question 47: Has your scheme faced any challenges in trying to buy-out with an insurer?

No, this is not an exercise USS has undertaken.

Question 48: Were you to take part in the public sector consolidator, what would be the estimated savings of entering a public sector consolidator? Do you envisage any costs and if so, can you provide an estimate of what the costs are likely to be?

We have not performed any such assessments. As noted above it would appear USS would not be the primary target audience for such a scheme.

Question 49: Do you have any wider concerns about the impact a public sector consolidator could have on the insurance or superfund market?

We do not have any particular views on this. However, we would expect any public sector consolidator to be regulated in a similar manner to other consolidation vehicles and pension schemes.

I hope the above is helpful as you continue to consider these proposals. We would be happy to discuss any of these points in more detail with your officials.

Yours sincerely

Carol Young
Group Chief Executive Officer