USS response: PPF Levy Rules 2025/26 consultation
October 2024

The Universities Superannuation Scheme (USS) welcomes the opportunity to respond to the PPF's consultation on the Levy Rules 2025/26. Our responses to the consultation questions are set out below.

Universities Superannuation Scheme (USS) 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 554,000 members and their families. We are one of the largest pension schemes in the UK, with total assets of around £77.9bn (at 31 March 2024).

Q1: Do you agree with our proposal to update the levy factors (A11 and asset & liability factors)?

No.

We do not support the levy being retained at £100m and, by extension, the proposal to change the stress factors. Our reasons, in summary, are as follows:

- With no policy changes, the overall levy quantum would fall by nearly half. Changes which bring the levy back up might reasonably be argued to be designed to retain current levels of levy and cannot be considered 'risk-reflective' particularly in light of the materially changed funding environment and the opportunities that this presents for strengthening the resilience of the PPF in a more effective manner than the current proposals represent.

- Concern about the long-standing legislative restrictions are noted, however, that legislation was drawn up when DB pension schemes' funding positions were very different and the PPF was much younger and thus had much lower reserves. In fact, the evolution of PPF funding compared to risk in the universe has been so pronounced that the entire "deficit of schemes in deficit" (as reported by the PPF) would now be comfortably covered by reserves. And over that time, schemes have by and large embarked on a one-way de-risking journey
- Therefore, we believe that there is now no reason to continue collecting levy - or at the very least, the levy should be allowed to fall in line with risk, under the existing levy rules.

- We further note that in the highly unlikely scenario that additional funding is considered necessary, within the confines of the existing legislation, a levy of circa £50m could be brought back up to £100m in three years. That does not seem imprudent against the backdrop of a benefit liability profile which reaches many decades into the future.

Therefore our view is that the effective doubling of the stress factors appears to be an artificial change, with a primary goal to support the calculation of a £100m levy, rather than reflecting risk in a consistent, persuasive manner.

The proposed change would also particularly impact schemes which continue to invest in growth

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assets, potentially increasing the levies payable by this group. Assuming the PPF invests additional funds raised through levy in line with its current investment strategy, this would be counter to the Government's aim to encourage investment from pension schemes into UK growth assets through its productive finance agenda. We do not believe that this challenge by the PPF to wider Government policy is justifiable, appropriate or reasonable given that PPF does not require a levy quantum of £100 million.

Q2: Do you agree with our proposal on how to maintain the levy at £100 million? (Moving to a two standard deviation asset and liability stress, reducing the levy scaling factor and increasing the scheme-based levy multiplier to ensure that the scheme-based levy reflects 20 per cent of the total levy).

No.

We have already commented on the asset and liability stress factors in our response to Q1. We also do not agree with the proposals in relation to the LSF and SLM. However, if the PPF decides to set the 2025/26 Levy Estimate at £100m, we would have a preference for the PPF achieving that via a change to the stress factors (as proposed) rather than through the other ways suggested (higher LSF or introduction of a liability factor).

The LSF and SLM are tools for further adjusting the RBL and SBL to appropriate levels to support the overall levy strategy and satisfy any legislative requirements. As explained elsewhere the PPF should not be looking to collect £100m in 2025/26 given the strength of its resources and the far. diminished risk to those resources.

The proposed change to the SLM will increase the SBL (regardless of the risk posed by a scheme), further penalising larger schemes. These schemes have already played a major part in the PPF achieving a positive funding position through payment of large levies (even though in many cases these will be the structurally stronger schemes, and thus less likely to fall into the PPF). Larger schemes with low insolvency probabilities, which represent less risk to the PPF, should not be required to take on a greater proportion of the overall funding burden: increasing the SLM simply to allocate more requirements. As explained elsewhere the PPF should not be looking to collect £100m in 2025/26 given the strength of its resources and the far-diminished risk to those resources.

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Where the PPF continues to collect levy, the LSF and SLM should be set such that the allocation between the scheme and risk-based elements is broadly maintained, with the levy allowed to fall to the level it would otherwise without the offsetting impact of the proposed policy changes - thereby, continuing to be risk-reflective in a consistent way.

Q3: Do you agree with our proposal on deficit reduction contributions to expand Option Beta to all schemes?

No opinion.

Q4: Do you agree with our proposal on deficit reduction contributions to widen the definitions of contributions that can be certified to include special contributions without a recovery plan (but with actuarial certification) for Option Beta?

No opinion.

Q5: Do you agree with our proposals to update the credit rating mapping to take account two credit rating providers rather than three?

No opinion.

Q6: What are your views in relation to how the existing criteria (Rule E3.1(11)(a)(i) and (ii)) on the special category employer rules operate in practice? What, if any, aspects of the criteria in E3.1 (11)(a)(i) and (ii) do you consider should be amended or updated?

We have no comments on the consultation question as posed.

However, we would propose that consideration be given to easing the levy burden for schemes which might be assessed to present only a remote insolvency risk to the PPF, for example, as a result of structural or economic reasons (for example USS is a last man standing non-associated multi-employer scheme with a diverse covenant across a strategically important sector). Very large schemes in such positions, by virtue of their size, still find themselves paying substantial levies in monetary terms which is unfair given the remote risk they present. We would be happy to discuss this further if it would help, but an example identifier for such schemes could be whether the assessed probability of insolvency is significantly smaller than that for the highest rated conventional sponsoring employers.

Q7: Do you have any further comments on our proposed levy rules for 2025/26?

PPF should not be seeking to hold the levy at £100m in 2025/26, and therefore the changes to the levy rules proposed here are inappropriate as they appear to in part be being motivated by a wish to support the E100m calculation (the consultation document shows that in the absence of these changes the levy would fall by almost half, to c£55m).

The costs and expenses of running USS, including the payment of the various levies, are drawn from the fund that is used to pay members' benefits, so it is central to its role in managing the scheme that the USS trustee keeps tight control of costs. It also has a legal duty to consider and report on the value achieved for the money it spends. Levy-paying pension schemes accept they are an important part of the pensions community and should provide appropriate support, but that does not extend to further overfunding bodies like PPF when not necessary.

In terms of the justification for this proposal, we understand that unexpected 'funding challenges' could arise in future, for example due to large claims. However, in our view the need to continue to collect this level of funds is simply not justifiable:

- the PPF now has very significant reserves (c£12bn compared to total deficits across all DB schemes of c£3.5bn) and so can clearly cover additional cashflows falling due for some time, even in extreme downside scenarios. This in turn would allow PPF the time to increase a lower levy up towards the required levels over the available time;

- and because of the size of the fund's assets, PPF'S investment strategy has become a far more powerful lever than the levy. So if additional funding needs to be raised in the future, it may well be more feasible and more effective to review the investment or funding strategy than to seek to ratchet up levies again (especially across a declining scheme base).

If the PPF feels it does still need to be able to collect levies to address future funding challenges, it should seek to address the legislation restricting it from being able to make immediate significant levy increases in the future, rather than collect levies which appear unnecessary at the current time. However, to be clear, we do not believe that a reduction in the levy quantum, regardless of the risks faced by the PPF, should be dependent on legislative change - the levy can be reduced now with legislative change following in due course. Finally, we are aware that the PPF Administration Levy (collected by TPR) is currently suspended. Given the very healthy funding position of PPF we would suggest an extension of the suspension be seriously considered.

Q8: What are your views on the ACS methodology? What aspects of our approach, if any, do you consider should be changed/ updated for future levy year?

No comments.

Q9: Do you agree with our proposed approach to maintain the asset and liability stresses and the risk factor stresses at a calibration of one standard deviation for ACSs?

No opinion.

Q10: Do you agree with our proposal to update the asset and liability factors to take account of market data up to 23 December 2023 for ACSs?

No opinion.

Q11: Do you have any other comments?

We would reiterate our key points and urge PPF to reconsider its proposals accordingly:

- PPF is in an extremely strong position, with a very large surplus meaning it is well able to deal with all but the most extreme high-exposure events and so no levy payment should be required at all.

- If PPF feel ongoing collection of a levy is important, then it should be set at the minimum possible level.

- If PPF is concerned about the restrictive legislation applying to future levy increases it should seek to deal with that issue, but this should not stop levy reductions being made now.

We have also sought to bring these views to the attention of PPF in other discussions and forums. We are happy to discuss this submission with you and Government if it would help (for example with the formulation of alternative proposals and legislative change).