USSEmployers

RESPONSE FORM

A CONSULTATION
ON THE USS TRUSTEE'S PROPOSED ASSUMPTIONS FOR THE SCHEME'S TECHNICAL PROVISIONS IN RELATION TO THE 2023 VALUATION

CLOSING DATE: 22 SEPTEMBER 2023

REPLY TO: PENSIONS@UNIVERSITIESUK.AC.UK

MAKING YOUR RESPONSE TO THE CONSULTATION ON THE USS TRUSTEE'S PROPOSED ASSUMPTIONS FOR THE SCHEME'S TECHNICAL PROVISIONS

The USS Trustee is undertaking a valuation of USS as at 31 March 2023, and on 19 July 2023 the Trustee published its consultation on the scheme's technical provisions and on the draft Statement of Funding Principles (SFP).

Firstly, USS sponsoring employers are invited to give feedback on the technical provisions and the underlying assumptions which are proposed to be adopted by the USS Trustee, and the SFP.

As a reminder, the USS trustee has invited feedback on its eight core consultation elements:

1. Proposed discount rates, both for the purposes of valuing Technical Provisions and determining future service contributions.
2. Remaining proposed assumptions set out in the Statement of Funding Principles (covering inflation, mortality, and the other demographic assumptions).
3. Any other aspect of the assumptions and methodology underlying the Technical Provisions.
4. Any other matter included in the Statement of Funding Principles. Whether employers are willing to agree to debt monitoring and *pari passu* arrangements and the long-term rule change required to support a strong covenant.

In addition, comments are welcomed on:

5. The Trustee's overall assessment of employer covenant, including assumptions made about the level of financial support employers are collectively able and willing to give the Scheme and their Affordable Risk Capacity.
6. The assumed Valuation Investment Strategy (VIS) and strategic mix of return-seeking assets and matching assets.
   (Note that more extensive engagement with employers on the investment strategy will take place in the later stages of the valuation process.)
7. The balance and trade-offs between investment risk, the degree of prudence and stability (of benefits, contributions, and funding levels), both at this valuation and looking ahead.
8. Any other aspect of this consultation.

Secondly, Universities UK (UUK) has set out a broader plan for the development, and reform, of USS and invites USS sponsoring employers' views on the plan.

The consultation questions for USS sponsoring employers are shown below.

A. Do you have any specific comments on the individual assumptions for the scheme's technical provisions (and future service contribution rate) put forward by the USS Trustee, or indeed on their collective effect?

B. On the broader strategy, do you support the nine overall objectives set out in section 2 of the UUK briefing, and which do you consider the most / least important?

   [The nine objectives are stability, reduction in contributions, improvement to future benefits, commitment to covenant support, utilisation of surplus, conditional indexation, governance review, changes to long-term investment strategy, and lower cost / flexibility options.]

C. Given the valuation outcome proposed in these TPs, do you support the approach set out in the joint statements to improve benefits to pre-April 2022 levels from April 2024 (and do you agree that there is sufficient evidence of stability / affordability to do so)?

D. More generally, are you content to provide a supportive mandate to UUK's JNC negotiators to finalise the responses to the valuation in alignment with the joint statement?

We welcome responses to this consultation from each and every one of the scheme's participating employers.

We encourage employers to consult with their own decision-making bodies as considered appropriate, so that the responses provided can be considered to be the view of the employer. We ask that employers confirm whether the organisation's decision-making body has been consulted.

This template form is optional and can be used for the response from your institution (or alternatively please use the above structure in forming your responses where possible).

Please send the response from your institution to pensions@universitiesuk.ac.uk as soon as possible and no later than 5pm on Friday 22 September 2023.

THE USS TRUSTEE'S EIGHT QUESTIONS

Please set out your comments and views on the USS Trustee's eight questions as set out on page two (and on page six of the USS consultation document)

In addressing the USS Trustee's eight core consultation elements and the consultation questions for USS sponsoring employers the University would like to note the following matters that it sees as material in framing the specific answers below:

- The swing from the deficit at the last valuation to the surplus at this valuation reflects the significant rise in interest rates and consequent impact of this on discount rates. At the last valuation the lack of regulatory and Trustee focus on the long-term nature of USS as an open scheme contributed to significant decisions about reductions to benefits, which are now being reversed. The shorter term 'technical provisions' approach to valuations, alongside a regulatory regime that is designed to mitigate the risk of smaller, shorter term, less solvent employers, can be seen to have created an unnecessarily greater degree of prudence and an over-cautious investment strategy that exacerbated this turbulence, with the resulting damage to industrial relations, a loss of trust in the scheme, and materially worse retirement prospects for members. We recognise that volatility is an inherent feature of growth assets and that, over the short term, stability comes at a cost, however, the USS scheme operates in a stable, long-term sector, with a strong covenant and receiving steady contributions. We believe that the USS scheme should be able to achieve a steady state when viewed over the long term. We would like to see the Stability Working Group explore all dimensions of how the long-term stability of the scheme can be achieved, including appropriately challenging the regulatory framework and the three-year valuation cycle in the context of the Scheme's long-term open nature;
- In this process of consultation for the 2023 Valuation we are being asked to comment on the technical provisions and other assumptions in advance of and separately to consideration of the Investment Strategy. We note with some frustration that this means that the consultation on the Investment Strategy will be constrained by the technical provisions rather than being able to consider the articulation of alternative investment strategies with the key assumptions, and longer-term options identified or debated;
- Within this framework the University supports the accelerated timetable and is keen to ensure that the improvements to benefits are implemented as outlined in that timetable, particularly to ensure that the cost of augmenting benefits does not continue to increase;
- The University also supports, in terms of the overall prudence of the valuation assumptions, a 70% confidence level.

ASSUMPTIONS FOR THE TECHNICAL PROVISIONS

A. Do you have any specific comments on the individual assumptions for the scheme's technical provisions (and future service contribution rate) put forward by the USS Trustee, or indeed on their collective effect?

[It would be helpful to refer here to the eight specific questions proposed by the USS Trustee, and which can be found on page six of the USS consultation document.]

1. **Proposed discount rates, both for the purposes of valuing Technical Provisions and determining future service contributions.**

   We welcome the reduced level of prudence in both the pre- and post-retirement discount rates, noting that these are now similar to the rates used in the 2017/18 valuations. These are acceptable levels of prudence and preferable to the higher levels of prudence that were applied in the 2020 valuation.

   The planned exploration of ways to improve the stability of the scheme will be vital to ensure that future valuations do not fluctuate to the same degree as over recent years.

   We note that one of the major contributors to the improved funding position is the significant increase in gilt yields. To reduce this volatility we continue to advocate for a method of setting discount rates that better reflects the long-term nature of USS as an investor, and the long-term nature of USS' liabilities.

2. **Remaining proposed assumptions set out in the Statement of Funding Principles (covering inflation, mortality, and the other demographic assumptions).**

   There is a risk that short term inflation exceeds the long-term assumption of 3%, and (all other things being equal) this would lead to a lower level of funding at the next valuation, though we note that inflation rates are reducing in some countries.

   The longevity assumption could be less prudent but set alongside other assumption changes that reduce the level of prudence we would not advocate a higher level of adjustment.

   We broadly support the other actuarial assumptions.

3. **Any other aspect of the assumptions and methodology underlying the Technical Provisions.**

   We would like to see further detail about the rationale for the increase in the expense allowance from 0.4% to 0.5% of pensionable payroll.

   We would like also to reiterate the point made in previous consultations about the approach to Self-Sufficiency, which added unnecessarily to the volatility of contributions at the last valuation through assigning undue weight to a test assuming that the scheme would close immediately and the assets transition in short order to essentially matching liabilities. In future valuations the test should be revised to assign an appropriate, low probability to the likelihood of the scheme closing, and a more realistic assumption of a longer asset transition period of 20-30 years.

4. **Any other matter included in the Statement of Funding Principles.**

We have no comment on any other matters included in the Statement of Funding Principles.

5. **The Trustee's overall assessment of employer covenant, including assumptions made about the level of financial support employers are collectively able and willing to give the Scheme and their Affordable Risk Capacity.**

   We support the assessment of the sector's covenant as strong, and strengthened since the last valuation, as demonstrated by the resilience through the Covid pandemic, in absorbing real term reductions in regulated fees, and, from a quantitative perspective, the self-sufficiency deficit of £5.1bn is now more than 5x covered by the affordable risk capacity of £28.1bn..

   As we have noted in previous consultations, the higher education sector has a number of characteristics that differentiate it from other sectors: visibility of long-term demand and supply, the flexibility of institutions in how surpluses are generated and applied, charitable status and objects with regulation, a sector-wide scheme, and the reinvestment of surpluses. These all strengthen the covenant of the higher education sector.

   With such a strong covenant, one wouldn't normally expect to see or need such a range of covenant support measures. The Trustee has stated that contributions would need to be materially higher (1.7% for the current benefits and 3.2% for the pre- April 22 benefits) without the covenant support measures based on an increase of 100bps in the discount rate used to calculate the affordable risk capacity. Could the Trustees please provide the supporting analysis for this including the impact on the overall covenant strength rating of not having the covenant support measures in place (with and without the exit moratorium) and why that is consistent with the suggested discount rate of gilts +1.7%?

   We recognise the importance of these measures in supplementing the employer covenant when needed to address a potential scheme deficit, and the practical implications of removing these measures and then seeking to reinstate them if needed in the future. With the scheme in surplus, however, the technical provision assumptions seem not to reflect the strengthened employer covenant with the continuing employer support measures nor provide a payback (or rationale) to employers for keeping the covenant support measures in place. The most obvious area is the affordable risk capacity. The Trustees need to understand and explain why the increased covenant strength hasn't led to an increase in the affordable risk capacity of the employers, and why keeping the support measures in place hasn't increased the visibility beyond 30 years.

   An increase in the affordable risk capacity would support the more growth, less hedging illustrative alternative pre-retirement investment strategy that we feel would be more appropriate for an open scheme (see comments below).

6. **The assumed Valuation Investment Strategy (VIS) and strategic mix of return-seeking assets and matching assets.**
   (Note that more extensive engagement with employers on the investment strategy will

take place in the later stages of the valuation process.)

We look forward to a more detailed engagement with USS on the investment strategy and have noted above our frustration that this is not being considered alongside the technical provisions and other assumptions.

We note that the assumed VIS for the 2023 valuation is consistent with the VIS that was consulted on as part of the 2020 actuarial valuation. We previously communicated our views around investment strategy and against increasing the allocation to LDI assets in our letter to Bill Galvin dated 21 February 2022 (jointly issued with the University of Cambridge and Imperial College London). Our overall views around investment strategy remain as set out in that letter.

We accept that there is a complicated tension between expected return and risk.

Well-performing investment funds can, over the long term, achieve higher levels of distribution, linked to inflation, than those achieved by USS without employing matching assets. USS is an open scheme with sponsors with a strong covenant and a long-term future where the inflows are likely to match the outflows of benefit payments, and could adopt a valuation approach that reflects this. Short term fluctuations in equity values should not result in a loss of value in the longer term.

However, the valuation approach taken by the Trustee and more generally accepted by the Pensions Regulator seeks to address the balance between expected return and risk by effectively linking discount rates to the yield on long-term index-linked gilts, but exposes the scheme to large deficits when there is a negative real rate on index-linked gilts.

We would like to see a higher equity rated pre-retirement investment strategy, commensurate with a very long-term view of this open scheme and reflecting how the strengthened covenant can allow more risk in the strategy.

The alternative investment strategies modelled in the consultation paper show only a small degree of deviation in the probabilities of exceeding the defined contribution levels and the stress testing only considers one stress scenario. In the future consultation on a prospective Valuation Investment Strategy the modelling needs to explore the loss of benefits with less growth alongside the level of risk reduction with more hedging, and across a range of stressed scenarios.

The prospective Valuation Investment Strategy should also explicitly incorporate the risks inherent in matching assets (concentration risk, availability of leverage), and the implications for the strategy of future scheme changes, for example moving to a Conditional Indexation structure.

7. **The balance and trade-offs between investment risk, the degree of prudence and stability (of benefits, contributions, and funding levels), both at this valuation and looking ahead.**

We strongly support the work of the Stability Working Group in exploring ways in which the stability of the contributions and benefits in the scheme may be increased. The scale of change over the last few valuations has been destabilising and costly in terms of time, effort, relationships and confidence in the value of the USS scheme to members.

We have previously noted the long-term nature of the higher education sector, and a longer-term approach to valuation could have buffered the impacts from 2020 to 2023, reducing the unsettling fluctuations in benefits.

In order to improve the stability of the scheme we support:

- Further consideration of the investment strategy as noted above;
- Exploration of longer-term structural change that can deliver higher pensions for a defined level of contributions with less volatility between valuations, for example Conditional Indexation;
- The retention of the surplus in the scheme, noting that this to some degree reflects the reduction in benefits at the last valuation that are now proposed to be restored. We support the use of part of the surplus to augment benefits in recognition of the lower accrual of benefits between April 2022 and April 2024, but only after applying excess contributions from the valuation date for this purpose. We support this one-off surplus being held against the risk of reducing benefits or increasing contributions in future valuations;
- Work to change the Self-Sufficiency Test to reduce volatility in valuation outcomes as noted above.

Depending on the progress made towards more stability in the Scheme we may consider the exploration of the mechanism of a ‘contributions corridor’ in future valuations, as proposed by Aon, with contributions held at 23% when a valuation calculates them to be somewhere in the range 20%-26%.

8. **Any other aspect of this consultation.**

We have no other comments.

2023 VALUATION OBJECTIVES

B. On the broader strategy, do you support the nine overall objectives set out in section 2 of the UUK briefing, and which do you consider the most / least important?

[The nine objectives are stability, reduction in contributions, improvement to future benefits, commitment to covenant support, utilisation of surplus, conditional indexation, governance review, changes to long-term investment strategy, and lower cost / flexibility options.]

We support all these objectives and see them all as important in ensuring that USS provides an appropriate level of pension provision for our staff, with a high degree of stability and value for money. Many of the objectives are inter-linked, so prioritising just a few will still inevitably mean progress needing to be made on many of the others.

The over-arching priority is for more stability in the scheme and we welcome the establishment of the Stability Working Group. This is important for the credibility of USS and the confidence of all stakeholders as well as enabling members and employers to plan for affordable contributions.

In order to achieve stability there will need to be exploration of contributing mechanisms, and a longer term approach to valuing and balancing the cost of benefit provision against the covenant and longevity of the HE sector. As part of this there needs to be consideration of long-term investment strategy, scheme design and conditional indexation, and governance review, all of which we support in the context of how they may contribute to achieving greater stability in contribution and benefit levels.

Our next priorities would be to explore further improvements in benefits and seeking reduction in contributions, but we recognise the need to consider these against the objective of scheme stability.

In the near term we still strongly support the development of lower cost/flexible options, particularly for our large workforce of early career researchers, where affordability and mobility of pension provision is a key concern.

APPROACH SET OUT IN THE JOINT STATEMENTS

C. Given the valuation outcome proposed in these TPs, do you support the approach set out in the joint statements to improve benefits to pre-April 2022 levels from April 2024 (and do you agree that there is sufficient evidence of stability / affordability to do so)?

As we have made clear in responses to previous consultations we would like to see benefits restored to pre-April 2022 levels. The consultation document notes the volatility of the valuation and as the stress testing shows, the scheme is vulnerable to changing economic conditions. Given this, we see the retention of the surplus in the scheme as providing a degree of resilience and view this as a higher priority than using the surplus to reduce contribution levels further. [Augmentation]

We have also made several points above about work that is needed to increase the stability of the scheme contributions and benefits, and to restore the confidence of employers and members. [NB acceptance of volatility inherent in growth assets, and 3-year valuations/regulator]

UUK MANDATE

D. More generally, are you content to provide a supportive mandate to UUK's JNC negotiators to finalise the responses to the valuation in alignment with the joint statement?

We are content to provide a supportive mandate to UUK's JNC negotiators.

PLEASE CONFIRM IF YOUR ORGANISATION'S DECISION-MAKING BODY HAS BEEN CONSULTED:

RESPONSE SUBMITTED BY:

NAME	**Kirsten Gillingham**
POSITION	**Director of Commercial Capital Finance**

ON BEHALF OF:

INSTITUTION	**University of Oxford**

Please send your completed form to:
pensions@universitiesuk.ac.uk as soon as possible and no later than 5pm on 22 September 2023

Thank you for taking the time to respond to this consultation.

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