WARWICK
THE UNIVERSITY OF WARWICK

Universities UK
*Via email: pensions@Universitiesuk.ac.uk*

10 January 2019

**Reply to UUK on the USS 2017 valuation, Schedule of Contribution and Recovery Plan**

We understand why the USS Trustee is anxious to sign off the 2017 scheme valuation but believe that all parties would benefit from a less hasty approach.

We have the following observations and comments:

1. Deficit Recovery Contributions (DRCs)

It is not clear from the material why USS have not made provision for investment out performance in the recovery plan, an approach that has been adopted at previous valuations. This point has been made by Aon in their commentary and of course the JEP. Given that the pending 2018 valuation report is due to consider the JEP findings it would seem odd to have a "see-saw" approach with the resulting volatility in costs.

2. Future Service Costs (FSC)

The 2018 scheme valuation consultation material which was issued on 4 January 2019, makes clear that the future changes to Normal Pension Age have not been factored into the 2017 FSC with the effect that costs have been over estimated. This seems odd considering that these changes were a fundamental part of the 2011 scheme changes, i.e. why not correctly cost the true future service benefits? The fact that this has only now come to light does not help USS justify its claims of being transparent when this issue is raised by its critics, some of whom refer to layering on of unnecessary prudence. There are a number of different actuarial methods that could be used to capture the true cost.

3. References to recent market volatility

USS has referred to recent adverse market movements. Whilst such short term market movements cannot be ignored it remains the case that as USS is open to new entrants and has a positive cash flow, market volatility also provides an opportunity for the scheme to benefit from any over-reaction. After all USS liabilities are long term and backed by a strong covenant.

Taking all these points together, we believe that a case can be made for implementing an interim schedule to incorporate the April 2019 increases only whilst using the 2018 valuation to firm up the long term position for the future service cost and deficit contributions.

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4. Accounting for pension costs

We welcome the statement from the USS trustee regarding the provision of further information for employers on accounting for DRCs under FRS 102, and look forward to engaging with USS on this matter.

5. Wording on the Schedule of Contributions

Aon refer to new wording in the section entitled "Other Employer Contributions". We believe that USS are cross referring to rule 6.1 "Ordinary employer contributions"

"Each *employer* shall contribute to the *fund* while the *scheme* continues the amounts determined by the *trustee company*, acting on *actuarial advice*, to be required to satisfy the rights of *members* to benefit under the *scheme,* subject to the commitment contained in the letter dated 15 October 2015 from *UUK* to the *trustee company*."

This wording reinforces commentary made by USS personnel in the last consultation working group that USS are able to impose higher rates on employers and do not have to rely on the cost sharing provision. This wording is consistent with a contingent asset approach for claims on cash flows.

In conclusion we do not believe that the contingent asset approach is appropriate or valid because its approach is flawed for the following reasons:

i. It reflects a lack of understanding of the sector and by implication assumes agreement with the pensions regulator's (tPR) assessment of the covenant as "tending to strong" rather than strong.
ii. It would cause unnecessary complications for the sector because it would require institutions to review or even renegotiate banking covenants in place. It is unnecessary because USS already have the power to levy higher contributions.
iii. USS seem to be focussing on contingent assets and perceived increased risk from adopting some of the JEP recommendations rather than properly addressing the points raised by the JEP. For example in their article of 4 January 2019 entitled "A discussion on the future of USS" it claims *"It is important to note that, while it (JEP) passed high level comment on the methodology, the panel did not recommend any specific changes to it."* We do not agree with this assessment since the JEP made some pertinent criticisms of how the three tests were being carried out/used.
iv. We strongly recommend that UUK query the wording with USS as to their rationale for the additional wording in the schedule of contributions.

Your sincerely

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