Dear Mr Field

Universities Superannuation Scheme (the “USS”)

Thank you for your letter of 14 August 2017 regarding the USS.

Before answering your specific questions, we thought it would be worth setting out some general points on our role and approach to the regulation of defined-benefit (DB) schemes and the background to our ongoing engagement with the USS.

We have statutory objectives to protect members’ benefits and reduce the risk of calls on the Pension Protect Fund (PPF), as well as to promote good governance and administration. Our funding and PPF objectives are balanced against our objective to minimise any adverse impact upon sustainable employer growth – as a strong employer is the best support for any scheme. However, this also relies on the risks being recognised, measured and appropriately managed relative to the employer covenant and affordability.

Early engagement with particularly large schemes is part of our risk-based, proactive approach. We talk to the trustees and employers in advance of them agreeing the three yearly valuation and any recovery plan. In practice, we have been continuously engaged with USS since 2010. This has ensured that we have been kept informed in the run up to strategic funding decisions and could provide comments when appropriate, as matters progressed.

Whilst it is difficult to measure the impact of our engagement on any scheme with certainty, we believe we made a significant contribution to the development of USS’ approach in the context of the 2011 and 2014 valuations. Our interventions on risk
management and risk allocation helped lead to an overarching set of risk and funding principles for the USS. These principles include:

- the principle that the pension risk within the USS should be proportionate to the amount of financial support available from its sponsoring employers, and specifically that there should be no increase in the reliance placed on that support over time; and,
- an express intention to take opportunities for long term, gradual risk reduction given the right economic conditions and following appropriate dialogue.

Turning to your specific questions:

1. **Adequacy of recovery plans for 2011 and 2014**

When reviewing and commenting on valuation assumptions we reach a view that we believe to be reasonable at the time. As USS’ position shows, there is always uncertainty arising from the assumptions that are made in relation to how a scheme’s assets will perform relative to the scheme’s liabilities.

Both the 2011 and 2014 triennial valuations of the USS revealed a significant deficit. This resulted in the implementation of a package of reforms under the 2014 valuation designed to address both the future service cost and the scheme’s deficit within the risk and funding principles set out above, so that the risks were kept within the tolerance levels set by the overarching framework. The 2014 valuation included reforms to future benefit accrual which reduced the deficit by £5.2bn.

Throughout our engagement, we have seen a number of positive changes, including: a significant improvement in the trustees’ ability to understand the scheme dynamics and risk; improvement in communication to all the scheme’s stakeholders; the covenant analysis is more sophisticated and more appropriate for a scheme of this size; and a risk management framework has been developed and implemented by the trustees. We believe that it is important that further positive developments in each of these areas continue as part of the current valuation.

2. **2017 valuation**

Due to the scheme’s size, importance and the large membership, as well as the ongoing funding challenges, we are engaging proactively with the USS as the pension trustees progress through the 2017 Valuation exercise, prior to the formal submission of the valuation to TPR.
The deficit figures reported in the media for the 2017 valuation reflect the fact that, as we expected and have discussed with the USS, more work still needs to be done to ensure that the full extent of the USS deficit is managed so that an appropriate balance of risk and cost is maintained.

It is worth noting that:

- although the deficit figure is large, the amount of assets held by the scheme is also large (i.e. £12.6bn deficit vs some £60bn in assets);
- the USS has experienced a large increase in the rate of new joiners, some 27,000 since March 2013, partly as a result of auto-enrolment; and
- there is a great deal of flexibility within the scheme funding regime – see our comments on the degree to which the PPF is shielded below.

Our case team is actively and extensively engaging with the USS (and Universities UK) to seek to influence the outcome of the valuation negotiations to meet our aim for an appropriate funding agreement to be reached. Our proactive process allows us to understand how schemes and employers are incorporating our messages and guidance into their funding plans and influence the specific issues and challenges faced by them, while being clear about our expectations.

3. Bill Galvin’s role

Mr Galvin’s employment at TPR was prior to my appointment and that of the Chairman but, having undertaken appropriate enquiries and as far as we can ascertain, during his time as Chief Executive Mr Galvin did not have any direct involvement in regulatory casework relating to USS. Mr Galvin’s departure to take up his new role at USS was announced in a TPR press release dated 27 March 2013 which stated:

‘For his remaining time at the regulator, to avoid any potential conflict of interest arising from his future role, Mr Galvin will have no further involvement with any matters related to the regulation of defined benefit (DB) schemes, including regulatory strategy and policy, and discussions with external stakeholders and European regulatory authorities. Until a new chief executive is appointed, the regulator’s work on DB schemes will be directly overseen by the regulator’s chair Mr O’Higgins, and managed by the regulator’s executive director for DB regulation Stephen Soper.’

Mr Galvin took up his role at USS in August 2013 and leads the USS Executive which along with other representatives of the scheme’s Group Executive meets with TPR on a regular basis, as for any scheme of this size and complexity.

4. Capacity of the employer covenant to meet the deficit
How the sponsoring employers propose to adhere to the funding principles formalised in the 2014 valuation (to ensure that the USS continues to sit within its overarching risk and funding principles) is key to our engagement on the 2017 valuation. To achieve this, the trustees and employers are undertaking further work to ensure that all options are properly explored. We are ensuring that the focus of this work is on the affordable level of contributions to the scheme to inform an assessment of the employers’ ability to support the scheme and underwrite its investment risks on a sustainable basis.

We cannot pre-judge - and nor is it our place to comment on - whether costs will be passed on to students or taxpayers, although we recognise the challenge represented by the source of contributions and its wider sensitivity. It may be that there are sufficient flexibilities within the scheme funding regime to offer an alternative solution to increased deficit repair contributions.

5. Impact of any covenant failure on the PPF

We recognise the scale of the risk that the USS potentially poses to the PPF, due to the quantum of its deficit. That is another reason for our engagement with the USS since 2010. We also recognise that, since the USS is a “last man standing” scheme, access to the PPF would not arise until the last employer became insolvent, and all assets were realised and distributed to creditors, including the scheme. However, this is an outcome which would be entirely unacceptable on a wider basis. Our focus is therefore on ensuring that the trustee manages the scheme in a manner which ensures that, by taking appropriate action to address the deficit now, they ensure that the deficit is contained within a level that does not pose a threat to the health of the university sector.

Factors such as changes to tuition fees, student loans, the promotion of vocational training and apprenticeships impact on the whole higher education market and could affect the strength of every employer in the Scheme. This is another reason why we stress the importance of an integrated risk management approach.

In our ongoing engagement with the USS we continue to be guided by our statutory objective of reducing the risk to the PPF but, as we indicated at the outset, we have to balance this against the objective of minimising adverse impact on the sustainable growth of the employer. In the same way, employers must strike a balance between the needs of the scheme and those of their business, while being realistic about the strength of their covenant, likely returns on their investments and the benefits that the scheme can offer. We will continue to engage with the trustees and the employers with a view to securing the best possible resolution of these issues.
I hope that this helps to answer your questions but please get in touch if you require further information.

Yours sincerely

Lesley Titcomb
Chief Executive