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Chief Executive
Universities UK
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Your ref
Our ref BG/JMR
Date 29 November 2019

By email only

Dear Alistair

Monitoring and Action Framework

Thank you for your letters of 13 and 19 November providing comments on the trustee's proposed monitoring and action framework and for working with employers to provide feedback ahead of the 20 November board.

In respect to your "particular comments" I can confirm that:

- The monitoring and action framework is specifically designed for the 2018 valuation and we will be reviewing it as part of the 2020 valuation. I would emphasise that the proposed monitoring and action framework is not greatly different from the monitoring the trustee put in place following the 2014 valuation. What is different is that the trustee has been more explicit on the thresholds for metrics which would lead to the trustee taking action, albeit noting the only automatic action being a meeting of the board within five days to consider what further analysis or action should be taken.
- The use of the framework does not assume that the underlying principles and assumptions would be acceptable to the employers as part of the 2020 valuation. The trustee approach to the methodology and underlying assumptions, together with the employers' risk appetite, will be subject to consultation as part of the 2020 valuation. We are writing to all stakeholders separately to confirm the timeline and key decision points for the 2020 valuation. The trustee is happy to engage with you and your advisors on how best to measure and present risk to stakeholders, we see this as an important part of developing the approach to the 2020 valuation.
- The trustee is happy to provide regular updates of the metrics and put in place a protocol for notifying employers when metrics are breached. I suggest our officials work together to establish the basis for regular updates and the protocol for notification to stakeholders if a metric threshold is breached.

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In addition to your comments at the meeting on 20 November, the board also considered views from UCU and the Pensions Regulator alongside the advice from the scheme actuary. Having considered all the views shared, the board approved the monitoring and action framework a copy of which is enclosed.

As ever, we are very happy to discuss these matters further, including the information sharing required to ensure all stakeholders feel sufficiently informed.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Bill Galvin'.

Bill Galvin
Group Chief Executive Officer

Enc.

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2018 Monitoring and Action Framework

The metrics to be monitored and their associated thresholds within the 2018 monitoring and action framework are as follows:

a) **Short term trigger metric: Self-sufficiency (SS) deficit affordability ratio**

- The ratio of the *SS deficit* to the present value of *affordable additional contributions* over a period of time.
- Where:
 - The SS liability is calculated using a discount rate of gilts +75bps.
 - Assets are taken at market value.
 - The value of future contributions is also discounted using gilts +75bps.
 - A contribution rate of 10% is used on the basis that *in extremis* this level of contribution could be provided to finance the accrued benefits, whilst allowing employers to provide their employees with a reasonable contribution towards the accrual of new retirement benefits within an overall cost envelope that is affordable.
 - Total pensionable salary payroll is assumed to increase in line with CPI + 2% pa.
 - The period of time is 30 years.
- The trigger level to consider mitigation is if the ratio is greater than the threshold of 85%.

b) **Long term trigger metric: Future service cost (FSC) coverage ratio**

- The ratio of the *future service contributions* being paid relative to *best estimate* FSC.
- Where:
 - The best estimate FSC is calculated based on the latest available FBB expected returns.
- The trigger level to consider mitigation is if the ratio is smaller than the threshold of 115%.

c) **Long term trigger metric: Deficit recovery contribution (DRC) adequacy**

- Adequacy of DRC to meet the TP deficit on the monitoring basis over the remaining life of the recovery period.
- Where:
 - The deficit contributions are those in the current SOC.
 - The deficit on the technical provisions monitoring basis is calculated using:
 - The latest FBB expected returns adjusted for prudence in line with the valuation.
 - Assets at market value.
 - The remaining recovery period is that set out in the SOC
- The trigger level to consider mitigation is if the existing DRC required a higher level of investment outperformance above the TP discount rate greater than the threshold of 50%.

d) **Covenant trigger metric: Covenant rating.**

- The rating of the covenant provided by the Trustee's covenant advisor.
- The trigger level to consider mitigation would be if the rating is below "Strong".

Should a metric breach its threshold, a meeting of the Board would be convened with five business days to consider the appropriate actions. The appropriate actions which would be considered are as follows:

- The commissioning of additional analysis.
- Revision of the 2018 Schedule of Contributions.
- Implementing a 31 December 2019 valuation (discussed above).
- Accelerating the 2020 valuation.
- Change the investment strategy.

In advance of such a Board meeting, the Scheme Actuary and the executive would undertake some initial analysis as set out in Annex A.

Annex A:**Actions and further analysis to be taken following a trigger breaching a threshold.****Following any metric breaching a threshold:**

- i) Prior to the board meeting:
 - Consult with the Scheme Actuary.
 - Understand what has led to the breach/breaches.
 - Consider what the other indicators show.
 - Initial assessment of whether breach is due to blip or persistent change:
 - Take preliminary investment advice.
 - Compare initial expectations with other providers if available (investment banks, Mercer etc) including path of real interest rates.
 - Consider trends in figures.
 - Consider high level impact on funding methodology / assumptions.
 - Consider the proximity of the next valuation.
 - Initial assessment of potential additional contributions to be received from the various mitigations available to the Trustee in the given circumstances.
 - Any other considerations relevant given the circumstances of the breach.

- ii) Potential further actions following the emergency board meeting:
 - Consult with the Scheme Actuary.
 - Further assessment of whether blip or persistent change:
 - Take further investment / economic advice.
 - Compare expectations with other providers (investment banks, Mercer etc) including path of real interest rates.
 - Detailed consideration of impact on funding methodology / assumptions.
 - Further assessment of the likely outcome in additional contributions to be received from the various mitigations available to the Trustee in the given circumstances.
 - Any other considerations relevant given the circumstances of the breach.

Following a self-sufficiency affordability breach:

- i) Prior to the board meeting:
 - Consult with the Scheme Actuary.
 - Comment on the impact on the severity of breach of current future service cost vs contributions being paid.
 - Consider impact of any expected changes in real interest rates.

- ii) Following the emergency board meeting:
 - Consult with the Scheme Actuary.
 - Potentially carry out additional affordability assessments (via covenant assessments and/or asking employers directly).

Following a future service cost breach:

- i) Prior to the board meeting:
 - Consult with the Scheme Actuary.
 - Consider implied level of prudence (percentile) of discount rate implied by current future service cost vs contribution being paid.

- Consider relative optimism of FBB discount rate relative to gilts+ compared with the position at the valuation date, and implied gilts + FSC.
- Consider size of deficit & implied deficit recovery contributions to see whether this potentially alleviates or adds to the situation.

Following a DRC breach:

- i) Prior to the board meeting:
 - Consult with the Scheme Actuary.
 - Consider FSC requirements vs contributions being paid in conjunction with DRC position.
 - Consider relative optimism of FBB discount rate relative to gilts+ compared with the position at the valuation date and implied gilts+ deficit.
 - Consider additional contribution rate that would be required in order to maintain original recovery plan.
 - What is the remaining length of the recovery plan?

Following a Covenant breach:

- i) Prior to the board meeting:
 - Consult with the Scheme Actuary.
 - Consider causes and high level implications of downgrade.
 - Any initial impact on the length of the visibility of the covenant.
- ii) Following the emergency board meeting:
 - Consult with the Scheme Actuary.
 - Potentially re-evaluate long term risk capacity and appetite of employers, and impact on assumptions and required prudence.