

Monitoring of debt levels in the sector for USS employers

An introduction to the consultation and the consultation materials

Overview

The covenant provided to USS by its sponsoring employers is essential to its efficient management. In turn, a strong, secure long-term covenant can benefit all employers by potentially reducing scheme costs and therefore allowing employers to retain funds to run and invest in their business.

- The overall covenant rating for the Scheme for the 2018 actuarial valuation was ‘**strong**’ but on ‘**negative watch**’.
- This was partly due to the fact that there was no formal process in place for the Trustee to monitor and assess debt levels on an ongoing basis.
- The employer covenant can change materially over a short period of time and the Pensions Regulator expects trustees to monitor the covenant regularly between formal assessments for that reason.
- **Therefore, the Trustee is proposing a new Framework, under which it will work with employers to monitor debt and act if necessary, to protect the Scheme’s interests as a creditor and to help support the case for a strong covenant assessment for the 2020 valuation.** (Note, a strong covenant assessment is however dependent on other factors including the long-term rule change on employer exits also being implemented and a general monitoring of the Covid-19 impact.)

The proposed Framework has been drawn up through the Trustee working with its covenant advisers PwC and in discussion with Universities UK and a group of employers from the Scheme, who also took independent advice and made a number of very useful recommendations.

Employers are now being asked to review the proposed Framework and provide any comments they may have so that the Trustee may finalise the Framework and take it into account when assessing the covenant strength for the 2020 valuation and longer-term.

Employers may wish to consider taking their own advice or discussing the contents of this proposal with their lenders when collating their response.

There has been a healthy debate with employer representatives in the preparation of this Framework and the Trustee would like to thank them for their contributions. The Trustee has accommodated comments received from the employer representatives as far as it has felt able to do so in the proposed Framework which is now being shared for wider consultation.

Consultation documents

The consultation documents attached are structured as follows:

- *Part A - Policy*: this section sets out the Trustee’s approach to working with employers in relation to the Framework, particularly the *key principles* it intends to follow.
- *Part B - Requirements*: this sets out the detail of the Framework and the *metrics* used, and where further engagement between an employer and the Trustee might be needed. It also gives more information on the data the Framework will require;
- *Part C – Process Flow Charts*: this sets out diagrammatically the processes that the Trustee will use for: (i) collecting and reviewing information received from the Employers for debt monitoring purposes; and (ii) seeking *pari passu* security, where required;

- *Part D – Worked Examples*: this contains a set of example ‘case studies’ showing how the Framework could operate in practice and what further engagement between an employer and the Trustee (if needed) might look like; and
- *Part E – Defined Terms*: this contains a glossary of key terms used in the documents.

Please note that the engagement examples provided in the Part D – Worked Examples are for illustrative purposes only. The Trustee cannot fetter any of its powers and will need to consider each case individually at the relevant time, having regard to matters including, but not limited to (i) its legal duties, (ii) the circumstances surrounding the breach, (iii) the severity of the breach, (iv) the prevailing economic conditions and (v) its available powers. The Trustee may therefore take different action to that set out in the examples provided if considered appropriate at the relevant time – which may also include taking no action at all. No decisions should therefore be taken, in part or in full, by UUK or a USS sponsoring employer based on the examples provided and no reliance should be placed on them accordingly. UUK and the USS sponsoring employers will also need to take their own advice on the potential implications of any decisions they take, now or in the future, and how the proposed Framework might apply to those decisions.

The consultation

Employers are asked to review the proposed Framework and provide any comments they may have to Universities UK (copied to USS by email to debtmonitoring@uss.co.uk) by 5pm on 3 August. The Trustee will then finalise the Framework and take it into account when assessing the covenant strength for the 2020 valuation and longer-term.

It is important to emphasise that the Trustee is seeking to implement an approach which, whilst addressing the identified covenant needs, can be supported and operated by the employers but avoiding any additional financial management processes as far as possible. Therefore any and all consultation feedback received will be considered by the Trustee before finalising the Framework. However some particular areas on which employers may wish to comment are:

- **The effective date of the Framework**: this Framework will be effective from **1 August 2020**. However employers will be aware that the need for the Framework has been under discussion with UUK and sponsoring employers since mid-2019. Any employer who is likely to negotiate new secured debt before 1 August 2020, which would have been reportable under this Framework if it had been granted after 1 August 2020, should already be engaging with the Trustee about this in line with existing employer obligations given the potential impact this can have on the Scheme’s covenant without appropriate mitigation also being granted to the Scheme.

The proposed trigger level for pari passu security: the Trustee is proposing that pari passu security for the Scheme will only be needed for new security which brings an employer’s total level of secured debt above 5% of that employer’s consolidated net assets (excluding pension provisions). There are further allowances for cumulative secured debts below a proposed aggregate de minimis level and a general carve-out for project finance which is demonstrably covenant-enhancing. In its discussions with employer representatives, their opinion has been expressed clearly that 5% may be too restrictive. The Trustee believes that with the exceptions provided, the thresholds proposed are fair, proportionate and necessary to manage the risks to the Scheme. The Trustee therefore welcomes further comments and

specific evidence from employers who believe a 5% limit may be challenging so this can be considered further by the Trustee before a final decision is taken.

- **The definition of secured debt:** at present the Framework looks primarily at new secured debt in its traditional form. However, the Trustee appreciates that employers could potentially raise funds in a number of other ways, for example secured against future income streams via the sale and leaseback of assets, and so has included these types of “Quasi-Security” in its proposals.

Once the Framework is finalised the Trustee will keep the contents of the Framework under periodic review and may consider making changes in light of experience or employer feedback received in the future. However, before it makes any changes it will again discuss these with Universities UK.

Webinars and support materials

A webinar hosted by PwC and delivered by PwC and USS will be held early in the consultation period – an invitation with full details will be issued by USS shortly. The webinar will explain more about the reasons for the Framework and how it will operate – if you have a question in advance that you’d like addressing then please email debtmonitoring@uss.co.uk.

You can also ask questions throughout the consultation period by sending them to debtmonitoring@uss.co.uk. The trustee will monitor these and will run a second webinar to address those questions that are raised most frequently – again details of this webinar will follow.

Next steps

As mentioned above, the consultation runs until 5pm on 3 August and any comments should be provided to Universities UK (copied to USS by email to debtmonitoring@uss.co.uk) by that date. The Trustee Board will then consider all feedback received before it finalises the Framework and its assessment of the covenant for the 2020 valuation.