Mr Charles Counsell
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Our ref BG/JMR
Date 24 March 2023

By email : Charles.Counsell@tpr.gov.uk

Dear Charles

USS/Stakeholder response: Draft Funding Code of Practice for Defined Benefit (DB) pensions schemes

We are writing to raise some concerns regarding the draft Funding Code published by The Pensions Regulator ("TPR") for consultation in December 2022. We previously raised related concerns with the Minister for Pensions and Growth in October 2022 in respect of the draft DB funding and investment regulations which the Code will support.

We would like to emphasise that this letter is a collective view agreed by the Scheme's stakeholders – Universities UK, which represents the employers, and the University and College Union, on behalf of our members - who share similar views and have co-signed this letter.

We also believe that the concerns we outline below are shared more generally by other open DB schemes.

A unique structure

By way of introduction to us, the Universities Superannuation Scheme (the "Scheme") was established in 1974 as the principal pension scheme for universities and other higher education institutions in the UK. It has more than 500,000 members across 330 institutions and is one of the largest pension schemes in the UK, with total fund assets of £90.8 billion (as at 31 March 2022). It is a hybrid defined benefit (DB)/defined contribution (DC) scheme, with 212,000 active members as at 31 March 2022, and continues to grow. Indeed, it is one of the few remaining open DB schemes in the UK; USS members account for almost a quarter of the fewer than 1 million people in the UK who are still actively paying into a non-Government DB scheme.

We firmly believe that pension fund capital can play a critical role in accelerating growth, increasing long-term investment in infrastructure and supporting the transition to Net Zero. A DB funding regime which does not appropriately reflect USS's open status and long-term horizons, and which does not recognise the strength and nature of the higher education sector that supports it, may reduce its ability to support such objectives, place unnecessary demands on our sponsoring employers and be to the detriment of our members. Our stakeholders also have deep misgivings about the broader impacts the Code could have on the future prospects and retirement provision of those working in the higher education sector, and more broadly on the wider UK economy if the Code leads in the short-term to diverting university resources away from teaching and research activities because they are required to support lower risk pension scheme

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strategies than are required given the long-term nature of the scheme.

Our concerns

We are grateful for the helpful engagement that USS has had with TPR and Government on both the draft regulations and the draft Code, and for TPR's recent engagement with our stakeholders UCU and UUK through our Valuation Technical Forum. We note that the draft Code has developed significantly since it was last consulted on in March 2020. The willingness to engage makes us hopeful that our concerns are being heard and understood.

USS is very different to most defined benefit pension schemes in the UK. Most are now closed to new accrual and on their journey toward an 'end game'. We recognise that the regulatory regime needs to deal with a range of different schemes of different maturities with very different employer support and levels of member interest. The circumstances of USS do however need to be better reflected in the Code. Inappropriate prudence or an excessive drive to derisking is in no one's interests.

We would therefore call for **the content in the Code relating to open schemes to be drawn together into a single chapter**. This would both recognise the particular status of open schemes and provide a single point of reference to trustees, stakeholders, advisors, and TPR. We believe it would also allow greater clarity on the specific issues outlined below without creating tensions with the treatment of closed schemes. It will also ensure that the recognition of open schemes and their special circumstances has longevity within a Code that may guide regulatory behaviours and practice for many years to come and in doing so will help to build trust that Ministerial commitments previously made will be followed through. A shared view of both the letter and application of the Code for schemes such as USS is important; we believe a separate chapter would support this and is not an unreasonable ask.

We have concerns in respect of the detailed drafting of the Code in three areas:

- **We would like a clearer indication that when determining any time period over which a movement to low risk and low dependency for funding is required, open schemes (including USS) can take account of *both* future accrual and expected new entrants.** Without broad recognition of potential new entrants, the time horizon for the scheme to significant maturity will become artificially short which in turn, will mean an unnecessary pressure to de-risk toward a point in time that is known to be too early. We recognise that USS would have to show the evidence to support a view on new entrants but the evidence required should be less narrow than in the draft Code and should allow pragmatism to be applied.

- **We would like greater recognition that some schemes will have covenant reliability over much longer time horizons than most other DB schemes.** The nature of the higher education sector means the USS employer covenant is very different to that of most other schemes. The factors outlined in the draft Code including profitability and free cash generation, are helpful. They may though give too narrow a view of our covenant and its differentiating characteristics; these include the strategic importance and nature of the sector, and the manner in which operating surpluses are reinvested. The existing covenant support package and the last man standing nature of the scheme also offer a very different covenant. While we recognise the need to avoid employers overstating their covenant horizon, USS has at present a very long view of our covenant horizon, bolstered by additional covenant support measures, something which we think reasonable, particularly given the history and resilience of the sector. Pressure to significantly reduce our view of the horizon would potentially have consequences for the funding of the scheme.

- **We would welcome assurances that the scheme will not be artificially forced into a de-risking journey.** The consultation illustrates a de-risking journey for an open scheme that commences at the same point as a mature scheme that does not expect future accrual. We believe that to be inappropriate for a scheme like USS and would welcome assurances that, where the time horizons allow it, that current levels of risk could be continued.

We are mindful that the Code will likely be in place across a number of future USS valuations. We are committed to concluding our 31 March 2023 valuation promptly. Given decisions taken now will have implications for our approach to future valuations we'd welcome early reassurance that the final Code will take our concerns into account.

It is in the interest of DB schemes, sponsoring employers, members, the government and the wider UK economy that the Code does not take an overly restrictive approach that fails to take into account the unique structure of open, multi-employer DB schemes and the strength and nature of their employer covenants, therefore limiting the ability of such schemes to serve their members and not place undue demands on their sponsors.

USS will be submitting a full consultation response with more detailed responses to the questions. We hope that our concerns will be reflected in the final Code. We would be happy to discuss these with you further if that would be helpful.

Yours sincerely

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Dr Jo Grady
General Secretary
University and College Union

Stuart McLean
Director of Pensions
Universities UK

cc:
Sarah Smart, TPR Chair
Nausicaa Delfas, TPR Chief Executive (designate)
Laura Trott MP MBE, Minister for Pensions