

Private and Confidential
Professor Sir David Eastwood
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11 September 2019

Dear Sir David

**Universities Superannuation Scheme
Actuarial Valuation as at 31 March 2018 (the 2018 Valuation)**

I am writing ahead of the Trustee board's meeting on 12 September when the board will be discussing the 2018 Valuation. This letter confirms the messages I passed onto Bill Galvin and Rene Poisson on our call of 10 September.

Concluding the 2018 Valuation

1. I understand that the board will be deciding whether it can approve the conclusion of the 2018 Valuation at this week's meeting and the Executive has shared the relevant board papers with us, which include updates on the development of the funding position up to 30 August 2019. We understand that further oral updates will be provided to the board in light of more recent market conditions and ongoing volatility.
2. In its paper, the Executive states that "Arguably what this analysis shows is that whilst the deficit has grown it is still broadly manageable within the framework envisaged under Option 3 for the completion of the 2018 valuation".¹
3. Should the Trustee board decide to implement Option 3, we would expect the Trustee to articulate to us why Option 3 has been chosen over the other alternatives. For example, the Trustee should be able to explain why it is not pushing for higher contributions sooner under Option 1, particularly in light of the funding deterioration since the valuation date.
4. We will look to ensure that the Trustee's written explanation of its rationale for its decision is appropriate, that the final valuation documentation reflects our current understanding of the proposed funding agreement, and that the approach to developing the monitoring and action framework is sufficiently robust. If this is the case, we would anticipate that the

¹ Board paper MC 303-2.2 paragraph 3.6

Scheme's post-valuation experience to the end of August would not alter the conclusion of my letter of 6 August that we do not anticipate carrying out further investigations in relation to the 2018 Valuation.

Monitoring and action framework

5. The volatility of the Scheme's funding position remains a concern and having a monitoring and action framework is something we have raised during previous valuations.
6. The Executive's analysis is that the current post-valuation increase in the deficit does not necessitate changing the valuation approach. However, it is important that the Trustee sets appropriate red lines for the point at which further action would be required and establishes what this action would be. On our call, Bill and Rene agreed that engagement with the JNC to build a monitoring framework, along with development of responses to take to downside outcomes, would be appropriate. Importantly, we also expect discussions on what actions the Trustee would take without needing the agreement from the JNC to be prioritised.
7. Over the course of September and October, we will continue to liaise with the Executive and the board, so we can understand how the Trustee develops and implements a meaningful framework to respond to the market conditions. Although the Executive has prepared an updated FMP Monitoring Report along with some responses to market conditions, we expect the final monitoring framework to have firm triggers set at appropriate levels, which result in meaningful actions in response to downside outcomes, and which are implemented on a timely basis.
8. In addition to working with the JNC to formulate a framework, it is important that the Trustee seeks to agree a more immediate set of parameters regarding at what level a deterioration in the Scheme's funding position would necessitate a response and what that response would be. As part of the board's discussions this week, we expect the Trustee to consider how it will look to fully define and develop the red lines that should apply, such that, if adverse funding conditions persist, there is clarity on the pre-agreed actions that will be taken. These actions should be both those which the Trustee can take unilaterally, as well as those which need to be taken with the agreement of other stakeholders. The speed at which these mitigating actions would be implemented should also be discussed. We would like to understand the timetable for developing these triggers and actions.
9. On yesterday's call, we agreed that Bill Galvin will arrange for further meetings to be coordinated with the case team. For our clarity, please could you share a timetable with us, so we can understand how and when the Trustee intends to progress these matters.

2020 Valuation methodology

10. We understand that work for the 2020 Valuation will commence shortly, including agreeing the methodology of the valuation with the stakeholders. During its discussions, we would expect the Trustee to review whether its assumption for gilt-yield reversion (above market implied rates) remains valid and to consider, for example, the extent to which the inputs into the Fundamental Building Blocks methodology remain appropriate. In this context we would expect the Trustee to also consider some of the issues raised by Roger Gray in his paper of 16 August 2019 which was submitted to the board (in particular for a "paradigm change" to impact key inputs to the methodology). As discussed on the call with Bill and Rene, and as per previous correspondence, we are not implying that the Trustee should take a "gilts-plus"

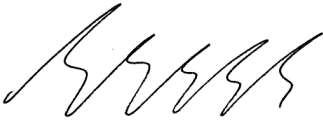
approach to setting discount rates. However, starting a new valuation provides the opportunity for the Trustee to review its approach to setting the valuation assumptions, particularly the discount rates.

Next steps

11. As with previous correspondence, we consider it would be appropriate for this letter to be shared with the JNC and with UUK as formal consultee. Please can you confirm if you are comfortable with this.

12. I look forward to receiving your response to the points made in this letter after your board meeting.

Yours sincerely

A handwritten signature in black ink, appearing to read 'MB', written in a cursive style.

Mike Birch
Director of Supervision
The Pensions Regulator