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Private and Confidential
Professor Sir David Eastwood
Chair, Universities
Superannuation Scheme Ltd

Sent via email only:
d.eastwood@bham.ac.uk

Our ref: C134794663

15 May 2019

Dear Sir David

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

Trustee meeting on 16 May 2019

1. I am writing in relation to the "Trustee's reply to UUK's feedback and questions on the Consultation on the 2018 Technical Provisions" sent to UUK on 7 May, and subsequently shared with me on 10 May.
2. I understand the trustee board is meeting on 16 May ahead of the JNC's 17 May meeting. We wish to provide you and the other trustee directors with our thoughts prior to your meeting tomorrow. Ideally, we would have provided our thoughts in good time to your Executive; however, this was not possible with the tight timetable. Hence, this late submission.
3. We are taking this extraordinary step of making a late submission as we have several issues with the three Options being submitted to you for discussion. Mainly these concern **Option 3**. Given the gravity of these concerns please can you ensure this letter is distributed to your fellow trustee directors before these Options are considered.
4. Before the trustee makes any decision on the Options, we are more than happy to provide further explanation or, preferably, come and discuss these issues with the trustee board or a trustee sub-committee.
5. Later in this letter, I return to the issue of how we could improve communications between TPR and the trustee board in the future.

Comments on the Options

6. I will start by giving our views on **Option 3**, as this is the most concerning from our perspective. This option is new to us and one that we have not had the opportunity to fully understand or discuss with you before it was shared with UUK. Our understanding is this option has been given a favourable report by UUK's actuarial advisers, and, we expect, will also be looked on favourably by UCU. Therefore, given the momentum of support behind it, we can see how the trustee could be attracted to it.
7. **Option 3**, as we understand it, is predicated on the current affordability crunch being dealt with (in part) under a future valuation. We would have grave concerns if this was used to justify

delaying taking an action that otherwise the trustee would have taken in relation to the 2018 Valuation. In addition, the trustee's assessment of covenant, especially in relation to affordability, must properly reflect the duration of the recovery plan which the trustee is seeking.

8. It is a fundamental principle of the statutory funding regime that where a valuation discloses a funding deficit, the trustees must adopt a Recovery Plan which can ensure that the statutory funding objective is met. As the trustee will be aware the Recovery Plan "must set out the steps to be taken to meet the statutory funding objective"¹. We expand on this requirement in our guidance, Code of Practice 3: Funding Defined Benefits². This guidance was designed to help trustees put in place "concrete and realisable" Recovery Plans³. This clearly suggests issues should be dealt with when completing the valuation, and not deferred.
9. A Recovery Plan or any other material funding decision based upon the premise of future valuations addressing the issues revealed by a current valuation would be inimical to the purpose and effect of the legislation – as well as our guidance on this point.
10. Should there be any doubt, **Option 3** is not analogous to the approach the trustee took on finalisation of the 2017 Valuation: the 2017 Valuation was (immediately) followed by a 2018 Valuation but it was not *predicated* on it.
11. We also want to understand more about how this option arose and the rationale for it. How long has the trustee been discussing it? Had you recognised the issue we identified? Where do you stand on it? We would make the point that, based on our current understanding, we would be very concerned if the trustee proceeded with **Option 3**.
12. Turning to the other options, we have the following comments:

Option 1: Upper Bookend. Phased increases agreed as part of the 2017 Valuation continue, with total contributions of 33.7% implemented from 1 April 2021. Whilst we have not completed any detailed analysis, this appears similar to the approach taken for the 2017 Valuation.

Option 2: Lower Bookend with contingent contribution agreement. We understand that as a rule change would be required, this means a new schedule of contributions would apply from 1 October 2021 at the earliest. Should this option be chosen, we would expect that any contingent contribution arrangement would be sufficiently robust so that it would adequately cover any additional risk being run, as we discussed in previous meetings with the Executive. My 11 December 2018 letter states, "any further movement away from the 2017 Valuation proposal which involves additional risk will need to be fully backed by additional, tangible and realisable contingent support from the employers".

Timeline

13. We note that for all options, there is a likelihood that the statutory deadline of 30 June 2019 will be missed. After the trustee board and JNC meetings this week, we would like to understand the implications of the trustee's and the JNC's decisions.
14. Bill Birdi already has a call arranged for 21 May when Jeff Rowney will update him on this week's meetings. He is also arranging a more substantive meeting with Jeremy Hill and Louise Howard to discuss the various timelines and potential rule changes.

¹ Under section 226(2)(a) of the Pensions Act 2004.

² See paragraphs 140 to 150 of this Code where we outline how trustees should approach putting in place a Recovery Plan.

³ See Article 14 of EU Directive IORP II (2016/2341) which replicated similar provisions from an earlier EU Directive IORP I (2003/41), which the Recovery Plan provision in section 226 of the Pensions Act 2004 must be read together with.

Trustee Minutes

15. Bill Galvin has hopefully indicated that we seek more visibility over the reasons for the trustee's decisions generally. You, after all, are our regulated entity. So, we hope it is unsurprising that we would like to fully understand how you consider decisions as well as the rationale and reasons for the decisions you take. We are asking so that we can understand the type of debate that the trustee board is having. It is for this reason we will be asking to see more about the trustee's decision making in the future.
16. With that in mind we would like to see the minutes, when they are agreed, for your discussion from tomorrow's meeting on all the options.

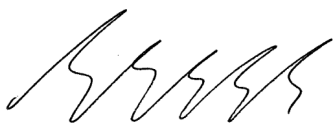
TPR interaction with the USS Board and Executive

17. We appreciate the frequent and informative interactions we have with your Executive. Nevertheless, we are also keen to engage more frequently with the trustee board. This will enable us to stay up to date with the trustee's discussions in real time and be able to provide our feedback more quickly.
18. We initially see this as being a meeting with the full trustee board, so we can agree how this interaction can take place.
19. This board interaction would not be a replacement for our ongoing interaction with your Executive. As discussed on a call with Bill Galvin yesterday, we see the need for even more regular TPR and Executive meetings than we have previously had. We found it extremely useful to have Rene Poisson as a trustee director attend those too, and when we meet the trustee board, we would like to agree how we may open this up to more trustee directors so that we receive a broad representation from the board.

Ongoing work

20. In your letter of 18 January to me you committed to carry out further analysis to enable all stakeholders to better understand the risks in USS and the employers' ability to support those risks. We see this as an extremely important piece of work and we continue to liaise with the Executive on these matters. We would expect the Trustee to have the outcome of this work available before making any final decisions on the 2018 Valuation.

Yours sincerely



Mike Birch
Director of Supervision
The Pensions Regulator