17 March 2017

Dear Mary

RE: Comments on USS Technical Discussion Document for Sponsoring Employers (17/02/17)

Further to the publication of the above document and considering a range of other supporting information may I outline below the feedback and commentary from the University of Sheffield to feed into the UUK sector-wide response to the USS trustee board.

The University has sought the views of key stakeholders within the organisation which has influenced this response. The stakeholder group comprised UCU branch representatives, academic colleagues and senior staff from Finance and HR. Their contribution to this work is welcomed as we understand that the long-term viability of USS is a shared aim for sponsoring employers and members alike.

The University notes the projected deficit position of c£14bn based on a valuation which uses the same assumptions as in 2014. The inference in this scenario as provided by USS is that combined employer and member contributions of 48% of pensionable salaries would be required to avoid any reduction in benefit provision. Whilst the regulatory framework which is in operation requires trustees and sponsoring employers to respond to the short term issues arising from valuations based on a snapshot in time and a set of assumptions, the University wishes to ensure that collectively USS the HE sector do not lose sight of the long-term position for USS. Underlying the views expressed in this response is a desire to ensure USS remains sustainable in the long-term, affordable and strikes the right balance between flexibility, stability and predictability.

The USS trustee is inviting comments from employers on the relevant trends and drivers that impact on the trustee’s initial assessment of the methodology and inputs. The key drivers on which views are particularly sought are:
1. The approach to determining the maximum reliance which can be placed on the employer covenant in future when funding the scheme, and in particular the inputs that are used to determine the reliance. The trustee has assessed that contingent contributions, paid over a time horizon of 20–40 years from now, of 7% of pensionable pay (being the difference between 25% maximum contribution and the regular contribution of 18%), consistent with the 2014 view is still reasonable;

ii. The view on future investment returns, and in particular whether employers prefer to rely on the current market view for long term interest rates, or whether they prefer the view that long term interest rates will revert to higher levels than markets currently predict;

iii. The degree of confidence required that the assumed pension costs will prove a reliable forecast, and how much risk the employers prefer to take out of the maximum risk possible. Specifically, is the risk appetite different for funding benefits earned to date versus the benefits the sector wishes to promise in future?

Note: bold highlighting added by University of Sheffield

Our feedback centres around these three issues and provides additional commentary on some specific technical elements.

**Employer covenant**

The University would like to note that, whilst it welcomes the recognition that the horizon over which the strength of the collective covenant is appropriately distant, the trustee should be cautioned against seeing the *in extremis* position of contingent contributions outlined in the covenant review as being either palatable or welcomed by the sponsoring employers.

Alongside pension cost pressures there are unprecedented challenges and levels of uncertainty impacting on the sector which affect that ability and willingness to increase costs. The need for agility and flexibility to weather whatever those challenges may bring our way and to ensure we are able to invest and seize opportunities to support our long term success is of utmost importance to this University. As noted above our desire is for USS to be sustainable in the long-term, however to support it in the long-term it has to be affordable.

**Investment returns**

The trustee seeks views in relation to sponsoring employer’s opinions around the future of interest rates. Whilst such future forecasting is most appropriately reserved for those suitably skilled in undertaking such analysis (and noting that even those who are deemed suitably skilled will not be able to predict the future with a strong sense of certainty), the University would encourage the USS trustee to think more about the fundamental design of the discount rate to apply to the scheme’s assets.

The University would welcome more exploration of the validity and potential impact of using alternatives to the currently favoured “Gilts +” methodology to determine the discount rate. Whilst this approach does meet the need for prudence, given the asset classes in which USS is primarily invested, it is an unrealistic assessment of the potential returns to be expected, even allowing for prudence. In particular the University would urge the trustee to present more views on how it might determine a discount rate based on a “Best Estimate – ” approach (this being an estimate of the actual USS investment portfolio with a 50/50 chance of achieving a particular return minus an allowance for prudence) or other methodologies and their impact on the reported deficit position.
Appetite for risk

The University’s position on the amount of risk sponsoring employers could bear is tempered by both points above. Whilst there is merit in ensuring that predicted returns on assets realistically reflect the probable levels based on the actual asset classes held, there is an acknowledgement that inherent in this is a risk that those levels of return will not be achieved. The impact of that would normally be increased cost to the employer which we have stated above would not be welcomed by this University. The degree of prudence adopted in the predictions therefore becomes key in balancing the level of risk. Our steer would be to ensure that greater reliance on the sponsoring employers by way of additional contributions should be avoided for reasons already outlined.

The University also wishes to comment on the trustee’s adoption of “Test 1” and its impact on the scheme. The USS trustees have proposed revised wording for “Test 1” as follows:

“Test 1 aims to ensure that the scheme’s promised benefits can always be funded, with a high degree of confidence using a low risk investment portfolio from within a level of future contributions which could be credibly paid in extremis from the sector’s operating cash flows. Thus the security of the promised pension payments is ensured by providing the sector or the trustee with an option to reduce the level of risk taken in providing pensions without the need to sell or mortgage assets to fund the scheme. The test is applied over a suitable control period, projecting forward the agreed benefit levels. It takes a low-risk portfolio of assets as its reference point for “self-sufficiency” consistent with the aim of giving a high confidence that the scheme’s planned funding plus future contingent contributions in extremis would provide the accrued benefits in full.”

The University is unconvinced that such an approach to funding the scheme is needed or appropriate. In an open scheme with a long term horizon and good covenant (such as USS), the important thing is the ability to produce income or available asset growth to support any gap between incoming contributions and outgoing benefits. Whilst it’s true we would wish for slightly less volatility and that some de-risking over time is to be encouraged, until the scheme is completely closed and in its last decade of benefit payments, we cannot see the rationale for the scheme to be de-risked and invested in just gilts. This is a scenario which, given the reported strength of the employer covenant, appears unlikely within a lengthy time horizon.

I trust these comments will support the collective UUK feedback to USS. Please do contact me should you require further detail or clarification.

Yours sincerely

[Signature]

Ian Wright
Associate Director of HR
On behalf of the University of Sheffield.